Securities and Exchange Board of India and the Regulation of the Indian Securities Market

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ABSTRACT

Financial markets have an important relationship with economic development. Regulation has been acknowledged to enable the orderly functioning of the securities market. The Securities and Exchange Board of India (SEBI) is the regulator charged with the orderly functioning of the securities market in India, protect the interests of investors and ensure development of the securities market. Since the establishment of SEBI in 1992, the Indian securities market has grown enormously in terms of volumes, new products and financial services. The literature examining the role of SEBI in this growth and development is limited and somewhat dated. This paper supplements the existing literature by updating the developments in the securities markets over the years. It complements the extant literature by enhancing the framework for examining the adequacy of the institutional arrangements under SEBI and then by examining whether the statutory arrangements at SEBI's disposal are adequate ensure a well functioning securities market. This paper would be an important first step for a more systematic evaluation of the contribution of SEBI to the working of the Indian securities market. This paper is a substantial revision and updated version of an earlier paper on this subject.

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Securities and Exchange Board of India and the Regulatory Architecture of the Indian Capital Markets

Regulation and Securities Markets

The importance of financial markets for the development of an economy has been stressed in Goldsmith (1962) and in more contemporary work by Levine (1998), King and Levine (1993), and Rajan and Zingales (1998). The importance of regulation to the functioning of securities markets has been examined for some time now. The view led by Stigler (1956), supported in Benston (1973) argued that the disclosure norms of the Securities and Exchange Commission (SEC), the securities regulator of the USA did not enhance investor welfare. This was challenged in Jarrell (1981) and Simon (1989) which noted that the SEC regulations had a favourable impact on investor welfare. Beck, Demirguc-Kunt, Levine and Maksimovic (2001) found that firms are more likely to receive external finance in economies in which the legal system is conducive the development of large, active and efficient banks and stock markets. Black (2001) found a positive relationship between firm value and corporate governance practices. Country case studies of the securities markets in Peru in Glen and Madhavan (1998) and a comparison of the Polish and Czech markets in Shleifer and Johnson (1999), have corroborated the impact of regulation on activity and valuation levels in the securities markets. The picture that emerges is one of increasing evidence that law and regulation matter for the financial markets.

Broadly, financial markets may be considered to comprise the securities markets and financial institutions such as banks and non banking finance companies. This paper focuses on securities markets.

This paper has six sections. In the first section we present an overview of the working of the Indian securities market and the key categories of participants. The second part reviews relevant literature and proposes the methodology used in this study. An approach to analyzing and assessing the regulatory architecture of a securities market is presented in the third section. The key elements of the regulatory provisions that SEBI administers for the Indian securities market are presented in the fourth section. A few of the more important outcomes of SEBI's regulatory

activity are presented in the fifth section. The regulatory architecture is critically examined in the fifth section. The sixth section concludes.[1]

I. Overview of the Securities Market in India[2]

The impressive growth in the number of participants and the volume of activity on the exchanges starting 1992-93[3] to-date is evident from Tables I Also notable is the emergence of activities that were new to the Indian securities market such as derivatives, venture capital funds and mutual fund management entities in the private sector, as may be noted from Table II.

The National Stock Exchange (NSE), established in 1994, has a higher turnover in the cash segment in terms of value as well as trades than the Bombay Stock Exchange (BSE) established in 1875. Trading activity on the sixteen regional exchanges has nearly disappeared in nearly all but three of them where trading has dwindled to negligible levels. Barring taxes on transactions, Indian securities markets provide one of the least cost trading platforms.

The large number of trades on the two exchanges points out to the importance of the securities trade to the Indian economy.

As per NSE (2009) about 68.8% of the primary issuance of debt of Rs 6125 billion during 2008-09 and 99.3 % of the secondary debt market turnover of Rs 62,713 billion was government paper indicating that both in terms of resource mobilization as well as in terms of trading activity the market for corporate debt remained insignificant. The corporate bond market in India, comprising mostly commercial paper and bonds of maturity ranging from one to twelve years is small by international standards in spite of various policy initiatives such as mandated a price / order matching of trades in and dematerialisation.

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[1]This paper essentially focuses on the economic aspects of securities regulation. The approach to research as well as certain constructs in the language follow the general usage in finance and economic literature. For eg., the idea of an agent or agency is as used in economics, which is somewhat different from the legal usage of the term as pointed out in Cheffin (1999). References to provisions of relevant laws usually are to the main section unless the context of the discussion requires specific reference to a sub-section, clause or proviso thereto.

[2]Based on Allen et al (2007)

[3]To develop a picture of the securities market that SEBI helped evolve we track data on the Indian securities market from 1992-3, the year in which the SEBI Act came into effect, establishing the currently empowered incarnation of SEBI.

Purchases of securities by foreign institutional investors (FIIs) have steadily grown from about Rs. 56 billions in 1993-94 to over Rs. 6146 billions in 2008-09, the cumulative FII flows accounting for nearly 8% of the Bombay Stock Exchange market capitalization as of March 2009. FIIs have emerged as an important class of investors for more reason than one, as we will note later in this paper.

Underlying this progress in the securities market have been several noteworthy institutional developments. SEBI's role as a regulator in bringing about these developments is the topic of research in this paper.

The trade in securities in India takes place in a legal system that presents a somewhat mixed picture. India fares well on the formalism index of DLLS(2003), but poorly in terms of effectiveness in introducing and enforcing new laws as developed in Berkowitz, Pistor, and Richard (2003). The judicial infrastructure in India needs improvement with 23.2 million cases pending at the lower and the higher courts in India, 63% of civil cases being more than a year old and 31% more than three years old as pointed out in Hazra and Micevska (2004).

India scores well on the index of disclosure requirement in La Porta (2006), but that is offset by empirical evidence of earnings management practices. Similarly, SEBI fares well in terms of the powers of the supervisory authority and autonomy, but ranks way below the SEC in terms of enforcement powers as pointed out in Bose (2005).

Market Participants[4]

Issuers and Issuances: A whole range of organizations of Indian as well as foreign origin and ownership are allowed to issue securities in India. These include the central and the state governments, state owned and controlled bodies such as public sector undertakings, financial institutions and banks, private body corporates, mutual funds, collective investment schemes and special purpose vehicles established for securitization arrangements. A range of debt and equity

[4]The participants included here are those that are directly involved in the public securities market, the part of the Indian financial system that falls under the regulatory ambit of SEBI. The Indian securities market is home to a few more categories of players. A few of those categories are listed in Shah (2008).

instruments and hybrids are allowed to be issued in India. Securities that are permitted for trading and "dealing" in India are defined under law.[5]

Issuers are expected to ensure that the economic interests of investors are protected. Issuers may also be governed by pre-existing contractual obligations to those who could be affected by an issuance of securities. These obligations may be defined and enforced in a number of different ways.

Issuances may be public or private. Public issues are offered to all domestic investors subject to certain quotas where applicable. Private placements, by definition, are limited to a set of investors identified by the investor. Participation by foreign investors in private as well as public issuances is subject to regulatory restrictions.

Investors: A range of investors, of Indian as well as foreign origin and domicile, participate in the Indian market. Domestic investors are free to subscribe to all offerings of securities to the extent made available to them by the issuer.

Intermediaries: A brief description of the role of the more common among these intermediaries is in Table III. The involvement and role of some of these intermediaries is mandated under law as in the case of a merchant banker.

Stock Exchange: Trade in securities in India is permitted only on recognized stock exchanges and is allowed only through members of the stock exchange. Trades are executed and settled through the stock exchange.

Clearing Corporation: It is a part of the stock exchange system responsible for the settlement of trades. The Clearing Corporation is usually the legal counter-party to net obligations of each brokerage firm and is responsible for eliminating counter-party risk.

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[5] Sec 2(h) of the Securities Contracts Regulation Act, 1956: "securities" include shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate; derivative; units or any other instrument issued by any collective investment scheme to the investors in such schemes; security receipt as defined in clause (*zg*) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; units or any other such instrument issued to the investors under any mutual fund scheme; Government securities; such other instruments as may be declared by the Central Government to be securities; and rights or interest in securities;

Depository: Two depositories provide the service of maintaining the record for allotment and transfer of securities in an electronic format. The services of the two depositories are made available to investors through Depository Participants (DPs).

It may be seen from the brief discussion above that the Indian securities market is a complex network of a host of economic agents. When they come together to execute a transaction they are tied together through a web of regulations, in addition to their commercial interconnectedness. Even the conduct of those that are not directly governed by securities regulations is indirectly influenced through their contractual obligations to other regulated intermediaries and / or the regulation on the outcome of the service they provide.[6]

Literature Survey

Published academic research on the institutional aspects of Indian securities markets is scanty, in comparison to the literature on market efficiency. Some interest has emerged in recent times on certain specific aspects such as corporate governance[7], the impact of ownership structure[8] on corporate performance and so on.

Two sets of works are noteworthy in the area of institutional developments in the securities markets in India, namely, Gokarn (1996) and Shah (1999), Shah and Thomas (2000) and Shah and Thomas (2001). This paper builds on Gokarn (1996) and Shah (1999). An application of the public interest theory of regulation to securities regulation may be found in Goyal (2005).

Gokarn (1996) assesses the contribution of SEBI to the development of institutions in the securities markets in India during the 1992-96 period. It develops a theory of regulation which may be summarized as follows: Regulation is required to ensure that securities markets achieve the four dimensions of efficiency postulated by Tobin.[9] The functioning of the securities markets

[6]For example advertising agencies and printing agencies are not directly governed by securities regulations; but their output has to conform to regulatory standards. For example the merchant banker has to ensure that the presentation as well as the contents of the issue related publicity material conform to regulation under Chapter IX of DIPG.
[7]See for example Black and Khanna (2007), Lalita Som (2006),
[8]See for example Salarka (2006)
[9]The four dimensions are Information Arbitrage Efficiency, Fundamental Valuation Efficiency, Functional Efficiency and Full Insurance Efficiency.

in predicated on the activity of three broad sets of stakeholders, namely, investors, issuers and intermediaries. Gokarn argues that regulation is essential to address three potential sources of market failure, namely, information asymmetry, transaction costs and imperfect competition. The paper goes on to critically review the regulatory activity of SEBI during the period.

Shah (1999) focuses on how four key developments relating to trading have transformed the Indian securities markets into being one of the largest and the most competitive in the world in terms of costs and have improved the informational efficiency of the market. The institutional developments it focuses on are (i) the electronic limit order book order matching system (ii) rolling settlement (iii) dematerialised trading and (iv) novation through a clearing corporation. Shah takes the view that with these developments that the Indian securities market, in particular the equity market, has achieved nearly all the institutional development that is required and the scope for further development is the areas of investigation and enforcement.

Goyal (2005) identifies the sources of market failure that regulation has to address and provides instances of some of the key regulatory initiatives of SEBI that conform to these principles of regulation.

Methodology

In this paper we build an economic case for regulation. We then briefly examine whether the current regulatory oversight by SEBI meets the intended economic objectives. Towards this we survey the main regulatory initiatives and relate them to various market outcomes. As pointed out in Gokarn (1996) a methodology like event study would not be feasible in this case because of the numerous regulatory initiatives that have taken place in a limited amount of time, each of which impacts the working of the market in a number of different ways. This makes it difficult to link individual regulatory initiatives of SEBI to specific market outcomes.

This paper builds on the idea that the objective of regulation is to preempt market failures by anticipating sources of market failure and addressing them through appropriate institutions.

The research methodology proposed in this paper is as follows. Having identified a set of key market participants we anticipate what each of this category of participants might expect from the market. Secondly, we identify a set of institutions that would be necessary to counter market

failure by augmenting the set of institutional prerequisites proposed in Black (2001). These augmented prerequisites serve as a reference point for a well designed set of institutions[10] for the securities market. We view regulation as part of institution as defined by Douglass North, "comprising formal rules (statute law, common law, regulations), informal constraints (conventions, norms of behavior, and self imposed codes of conduct), and the enforcement characteristics of both."

We then critically examine the provisions of two statutes that are central to the regulatory role discharged by SEBI in the Indian market, namely, The Securities Contract Regulation Act, 1956 and the Securities Contract Regulation Rules, 1957 and the Securities and Exchange Board of India Act, 1992. Additionally we examine a host of regulations enacted by SEBI under the authority bestowed on it. We also examine a key instrument of securities regulation in India, namely the listing agreement between stock exchanges and issuers, although it may not be part of the statutory framework. The provisions of the listing agreement have been covered as part of this research because it has traditionally one of the more important means of protecting the interests of the investor vis a vis the issuer. The listing agreement has continued to be an important instrument of regulation under SEBI's regime.

We examine the adequacy of these institutions based on a detailed analysis of the provisions of these statutes and arrive at some tentative inferences about the adequacy of the available institutional prerequisites. Such an understanding is essential to assess the effectiveness of the regulatory regime. Recent attempts to assess the extent and quality of protection to equity investors and creditors in La Porta et al (1998) and La Porta et al (2003) have involved an analysis of the details of the legal provisions. Gokarn (1996) also points out that the "abstract objective of market efficiency and the concrete regulatory outcome" may converge when the regulator has the "appropriate instruments to deal with the various sources of market failure and the enforcement power to make them effective." This paper assesses whether the existing regulations provide those instruments to SEBI.

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We also critically review some key developments in the securities markets that have resulted from SEBI's regulatory activity to examine whether over time the regulatory provisions have been able to address some of the sources of potential market failure.

This paper complements the extant literature in the following important ways. First, it updates some of the analyses of the earlier papers by reviewing regulatory and institutional developments upto 2009, which include some important developments such as the book building of primary issues, demutualization of stock exchanges and so on. Further, during this period the effect of SEBI's initiatives have begun to manifest in the growth in activity level and transformation of the market in many fundamental ways. Second, it elaborates the framework in Gokarn (1996) by analyzing other sources of market imperfection such as the agency issues in corporate governance and in the securities trading activity. It broadens the scope of the framework in Black (2001) by examining the sources of market failure that confront the primary market. Thirdly, and most importantly, it works on the essential premise that an assessment of the details of regulation and institutional arrangements are essential to a complete understanding the working of the securities market, an approach that the other papers have not adopted.

Role of Regulation : A Framework

There are multiple perspectives from which the rationale for regulation may be examined. The most fundamental and an obvious point of view to examine it from is what each of the participants identified in the previous section would expect from the securities market.

Issuers would expect the securities market to (i) help realize a fair price for the securities they issue and (ii) minimize the direct and indirect costs of issuance of securities. If mispricing persists issuers will take recourse to other means of financing or migrate to more efficient markets in other jurisdictions (Nayak (1999)). Direct costs at the time of issue include the cost of managing and distributing the issue. Indirect costs include the "discounts" that issuers will have to offer to ensure successful subscription to the issue. This issue in pricing has been examined in the huge body of literature on the underpricing of IPOs. Direct costs in the post issue phase are mainly by way of the costs of listing, complying with regulations specified by the stock exchange and / or the securities regulators in that market, including the cost of maintaining the mandated flow of information. Indirect costs might include the impact of disclosure on the competitive interests of the business.

Investors would expect (i) that their interests are not short changed by the opportunistic behavior of the managers of the issuer company (ii) a risk free and low cost mechanism for transaction in securities and achieving liquidity, and (iii) availability of risk management products.

Intermediaries would seek opportunities for designing and offering a whole host of products and services such as dealing in securities, mobilization of resources and advisory services for companies. In general intermediaries would seek the freedom to innovate to enhance efficiencies by minimizing costs and / or through exploiting arbitrage opportunities in the market.

Stock Exchanges would expect a stable, consistent and transparent policy regime that would enable them to engage in the activity of providing liquidity to investors by innovating, competing and responding to emerging developments in the financial sector.

The government and the community at large would expect that the securities market function as an important, stable and safe centerpiece of the financial system, coexisting in a symbiotic relationship with the rest of the financial system. The failure of the securities market could have a ripple effect on the rest of the financial system as a whole.

Some of the opportunities above conflict with each other. For example the existence of arbitrage provides an opportunity for profits for the intermediary but increases the cost of capital for the issuer or the investor or both. That creates an incentive for intermediaries to get together and engage in practices that increase costs for issuers and / or investors. One of the roles of regulation is in minimizing the conflicts inherent in these expectations.

To perform these roles a number of prerequisites have been identified in Black (2001). He identifies these as essential for ensuring that investors receive good quality information and minimize the risk of self dealing. Black defines self dealing as transactions between a company and its insiders or another firm that the insiders control. This paper proposes the view that the conditions in Black (2001), paraphrased below, are necessary but are not sufficient for the development of a vibrant securities market. [11]

[11] Professor Black goes on to say "If these two steps can be achieved, a country has the potential to develop a vibrant securities market that can provide capital to growing firms, though still no certainty of developing such a market." The two conditions in reference are that of addressing information asymmetry and addressing the problem of self dealing.

- Local Enforcement and Culture comprising an honest, sophisticated securities agency (and prosecutors for criminal cases), well functioning courts, good civil discovery rules and a class action or similar procedure and a culture of compliance with disclosure and self-dealing rules by insiders, reputational intermediaries and independent directors.
- Disclosure Rules relating to full disclosure of financial results and self-dealing transactions, accounting and auditing rules, auditing of financial statements and disclosure of ownership.
- Inclusion of independent directors on company boards and sophisticated reputational intermediaries accounting professionals, investment banking professionals, securities lawyers.
- A stock exchange with meaningful listing standards and an active insider trading surveillance operation.
- Civil liability for insiders who violate the disclosure and self-dealing rules, and for accountants, investment bankers and for independent directors who approve gross self-dealing and criminal liability for insiders who intentionally violate the disclosure and self-dealing rules.
- Market transparency in terms of trading prices and an enforced ban on market manipulation
- Self-Dealing Rules such as (i) procedural controls on self-dealing transactions (review by independent directors, non-interested shareholders, or both) (ii) Accountant review of the disclosure of self-dealing transactions and (iii) enforced securities or other rules banning insider trading
- Other Institutions such as an active financial press and security analysis profession and a good organization to write accounting rules.

Additionally, we identify the following additional requirements for the development of a healthy securities market.

Safe and efficient securities trading platforms: If trading platforms are not perceived to be safe, liquid and efficient in terms of costs investors are bound to avoid the platform for trading, leading to an eventual failure of the market. Trading platforms encompass the institution of the securities exchange, rules of engagement among traders, and between market intermediaries and their customers and between issuers and investors so as to minimize agency type conflicts among various participants, order processing and handling systems, settlement and clearing systems. The design of the trading platform has to provide for liquidity at low transaction costs of

transactions. Transaction costs comprise brokerage, stamp duties and so on and bid-ask spreads and impact costs.

Institutional Mechanism for Efficient Issuance of Securities: Issuance of securities is a complex and costly process involving flow of information, establishment of contracts between the issuer and the investor and the discovery of the price of an asset that may not have had a trading history and may often be dissimilar to other pre-existing assets that are traded on the exchange. An efficient process that assures investors of a fair and transparent process at minimum cost will attract high quality and serious investors to the market.

An Optimally Designed Set of Corporate Laws: The economic case for corporate laws, existing in addition to securities laws, has been challenged in recent times as in Romano (1998). Black (1998) extends a similar argument. However, the economic case for replacing a corporate law with a set of private contracts is not very well established. Further, a common corporate code may be an efficient contracting mechanism where there are a large number of privately held companies. These laws might cover the most basic aspects of the working of a company such as its formation, dissolution, closure, reorganization, internal governance, resolving basic agency issues between the owner or owner manager on the one hand and the shareholder who is not involved in the management of the firm on the other, mobilization and redemption of capital, resolving agency issues and so on. These laws need to dovetail functionally with the securities laws that govern the working of public companies so as to avoid regulatory duplication and conflicts.

Laws relating to transactions in securities: A high velocity of trade is important for a well functioning securities market. Tariffs and taxes can act as "sands in the wheels" of securities markets. Commercial laws governing transfer or trade in securities should at least endeavour to miminise the cost of transactions, if they cannot be eliminated altogether.

The prerequisites identified in our analysis in the previous section may be broadly classified into five categories: (i) an optimally designed corporate law (ii) the organization of the securities regulator (iii) provisions relating to the governance and conduct of the issuer (iv) provisions relating to intermediaries, their quality and incentives; and (v) provisions governing securities exchanges and the trading activity on exchanges.

Together, these provisions deal with the sources of potential market failure pointed out earlier: Information asymmetry, agency related issues, transaction costs and self dealing.

Our analysis is based on the two pieces of statute that SEBI draws upon to discharge its statutory roles, namely, the Securities and Exchange Board of India Act, 1992 (SEBI Act, hereafter) and the Securities Contract Regulation Act, 1956 (SCR Act) and the rules made thereunder and select provisions of the listing agreement between the stock exchanges and the issuer.[12]

Organisations Regulating Securities Markets in India

Five agencies have a significant regulatory influence, directly or indirectly, over the securities markets in India currently.[13] These are

- The Company Law Board (CLB for short) which is a quasi judicial body that exercises some of the quasi judicial and judicial powers under the Act previously exercised by the High Court and the Central Government[14]
- The Reserve Bank of India (RBI) which is primarily responsible, *inter alia*, for the supervision of banks and money markets
- Securities and Exchange Board of India (SEBI) which is responsible for the regulation of capital markets and the various participants and activities therein; and
- Department of Economic Affairs (DEA) which is responsible for the economic management of the country and is the arm of the government that is concerned with the orderly functioning of the financial markets as a whole
- Ministry of Corporate Affairs (MCA) which is at the apex of a three tier structure that has responsibility for the registration and oversight of incorporated entities which fall under the regulatory purview of the Companies Act.

[12]Although this work is not intended to be a part of the literature in securities laws, references to relevant provisions have been provided in footnotes. The references to section numbers and provisions are at the time of writing this paper.
[13]The legal community identifies a set of laws that impinge on the functioning of the securities market, in addition to the SEBI Act, 1992 and the Securities Contract Regulation Act, 1956. These are (i) The Foreign Exchange Regulations Act, 1973 (ii)Arbitration and Conciliation Act, 1996 (iii) Companies Act, 1956 (iv) Debt Recovery Act (Bank and Financial Institutions Recovery of Dues Act, 1993) (v) Banking Regulation Act (vi) Benami Prohibition Act (vii) Indian Penal Code (viii) Indian Evidence Act, 1872; and (ix) Indian Telegraph Act, 1885. (See for example http://www.sudhirlaw.com/chapter11.htm) Shah (2001) additionally identifies the Depositories Act, 1996.
[14] Constituted under Section 10E of the Companies Act, 1956

Of the above, the agency that is directly charged with the supervision of the capital markets in India is SEBI. The working of SEBI is the primary focus of this paper.

<u>Securities Market Regulation prior to SEBI</u>

Prior to the establishment of SEBI stock exchanges were under the administrative control of the Stock Exchange Division of DEA. The stock exchange division was responsible for the administration of the Securities Contract Regulation Act, 1956 (SCR Act, 1956 hereafter) which governed the business of buying, selling and dealing in securities. The mobilization or issuance of capital through the public securities market or otherwise was controlled by the Controller of Capital Issues (CCI). The CCI had to fulfill several social and economic objectives in the discharge of its functions such as (i) public investor protection (ii) alignment of corporate investments with plan priorities of the Government of India (iii) ensuring that the capital structure of companies was sound and in public interest (iv) ensuring that undue congestion of public issues did not occur in any part of the year; and (v) regulation of foreign investment. CCI's means of realizing these objectives included (i) micro-management of the securities issuance process (ii) centralised administration and cumbersome procedures and (iii) Tight controls on quantum of issue, terms (price and non -price) and even timing of issue. The CCI regime thus represented an extreme instance of "merit regulation".

The net result of the CCI regime was that it (i) impeded resource mobilization (ii) led to unhealthy administrative practices (iii) resulted in the inability of the system to cope with the increasing resource mobilisation load (iv) led to the development of a "grey" market and consequent unhealthy developments in the capital market and (v) paid little or no attention to development of market institutions.

While the CCI appears to have suffered from many drawbacks, with the benefit of hindsight the role of CCI would have to be seen in the context of the political economy that prevailed at that time, with the government assuming a large role in the allocation of resources so as to address an overarching concern with distributive goals and the relatively inadequate level of development of institutions that could have supported a market economy.

An optimal corporate law had been identified earlier as an important prerequisite. The law governing companies in India is the Indian Companies Act, 1956 (the Companies Act, hereafter).

The Companies Act is a comprehensive piece of statute covering nearly all aspects of the working of a body corporate in India. Modelled along and derived substantially from its British antecedents, The Companies Act and the rules made thereunder are an important element of the regulation of a company in India and are applicable to all body corporates in India. According to the MCA, it "enables a statutory platform for essential Corporate Governance requirements essential for functioning of the companies with transparency and accountability, recognizing and protecting the interests of various stakeholders." (MCA (2009)). The current Act was passed in 1956, has been amended twenty five times, including two major amendments. Companies in certain industries may be exempt from specific provisions of the Companies Act to address the business needs of that industry. Banking and electricity generation are two examples of such industries that enjoy specific exemptions.

The Companies Act is exhaustive in its coverage.[15] A "comprehensive review" has been on the cards for several years now. The review is intended to "enable a simplified compact law that would be able to address the changes in the national and international scenario, enable adoption of internationally accepted best practices while providing flexibility for evolution of new arrangements as warranted. " (MCA (2005)). The provisions and the amendments are too numerous and complex to warrant a meaningful elaboration here.[16] We merely note that India has a well established corporate law statute that has been acknowledged to be adequate to meet the needs of the corporate sector in India although it is sometimes criticized as being too laboriously detailed and therefore costly to comply with.

The provisions of the Act are administered by a three tiered structure with the MCA at the apex. Some of the provisions of the Companies Act, identified specifically later in this paper, are administered by SEBI insofar as they relate to listed companies.

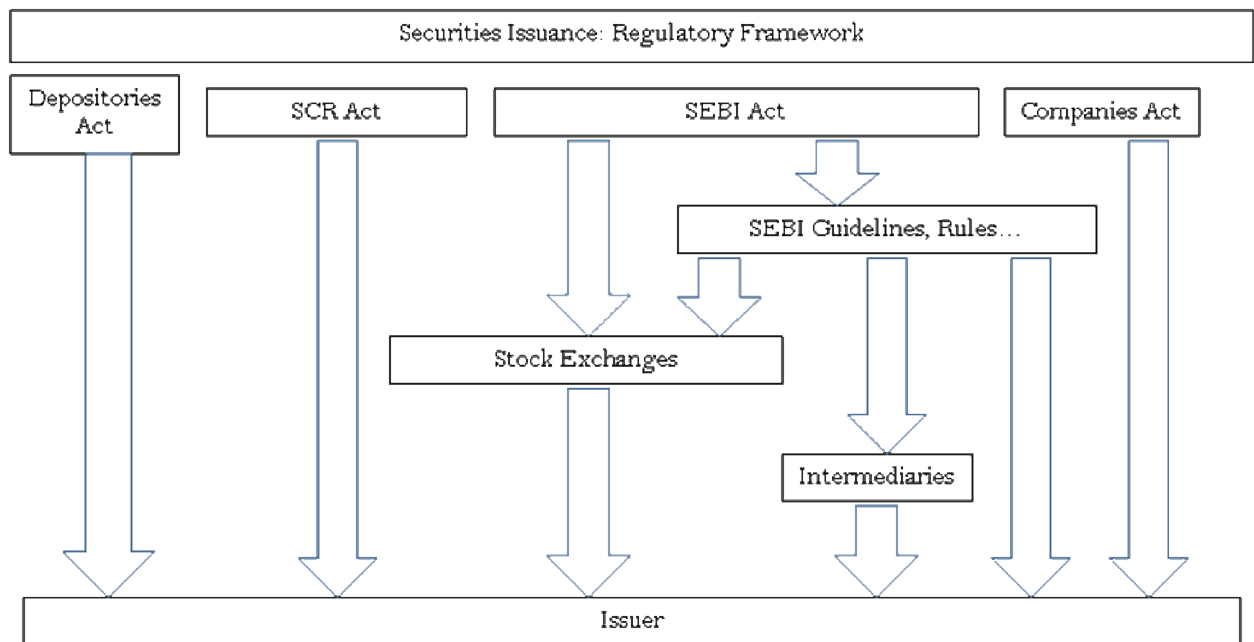
Similarly the Depositories Act is an important statute that governs dematerialization which is at the core of many of the developments on the securities trading front. While we discuss the

[15] It deals with formation of companies, various types of companies, issuance and types of share capital permitted, legal significance and contents in the prospectus, the rights and liabilities of various categories of shareholders, issuance of debt including debentures, creation of collateral, rights of creditors vis a vis shareholders, periodicity, contents and auditing of annual reports, conduct of board and shareholder meetings, conduct of poll or voting at shareholders' meetings, appointment, qualification / disqualification, duties and remuneration of directors, managerial remuneration, payment of dividends, maintenance of accounts and various other statutory books, intercorporate investments and shareholdings, prevention and oppression of mismanagement and various modes of restructuring and winding up of the company.

[16] The Companies Act has 658 sections and fifteen schedules.

benefits of materialization later, we do not analyse the legal provisions since they impact the efficiency of markets indirectly through the mechanisms of trading and book keeping for the securities.

The relationship between the various statutes may be represented by the graphic below:



Adapted from Sabarinathan (2008)

<u>The Statutory Sources of SEBI's Authority</u>

SEBI was brought into existence by the Securities and Exchange Board of India Act, 1992 (the SEBI Act, hereafter), which came into effect on January 30, 1992. The preamble to the act describes the purpose of the Act in broad terms as "an act to provide for the establishment of a Board 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". The provisions of the SEBI Act define its role in more specific terms.[17] These broadly relate to (i) Regulating the business in stock exchanges and any other securities markets (ii) Registration and regulation of a range of financial intermediaries and trade participants (iii) Prohibiting practices that are considered to be unhealthy for development of the securities market such as insider trading and fraudulent and unfair trade practices for promoting and regulating self regulatory

[17] S 11(2) of SEBI Act

organizations (iv) Promoting investors education and training of intermediaries of securities markets (v) Inspection and calling for information from various regulated entities referred to in (ii) above (vi) Conducting research (viii) Collecting fees or other charges for carrying out the purposes of this section and (ix) Performing such other functions as may be prescribed. The SEBI Act leaves open the room for SEBI to perform such other functions as may be prescribed.[18]

The SEBI Act empowers SEBI to make rules and regulations governing various aspects of the functioning of the securities market. [19] A wide range of powers has also been delegated by the Central Government to SEBI under the SCR Act.[20] SEBI pronounces regulations proactively and sometimes in response to developments that potentially challenge the functioning of the market mechanism.

Several of the functions that SEBI discharges are based on powers that it draws from the Securities Contract Regulation Act, 1956 (14 of 1956) (SCR Act, hereafter) and the rules made thereunder, the Securities Contract Regulation Rules, 1956 (SCR Rules, hereafter). The object of the SCR Act is to provide for the regulation of stock exchanges and of securities dealt in on them with a view to preventing undesirable speculation in them. It also seeks to regulate the buying and selling of securities outside stock exchanges through its various provisions. Two amendments in 1995 and 1999[21] brought about several important changes to the scope and the administration of the SCR Act, resulting in the current form of the law.

SEBI also draws some of its authority from the Companies Act,[22] which empowers SEBI to administer a number of provisions of the Companies Act[23]. These sections pretty much govern the capital mobilization process (issuance of capital), liquidity creation process (transfer) and the realization of return (dividend), the three important aspects of the issuer's relationship with investors.

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[18] S 11(m) of the SEBI Act

[19] S 11, S 11A and S 30 of the SEBI Act.

[20] S 29A of SCR Act

[21] Securities Laws (Amendment) Act 1995 and Securities Laws (Amendment) Act 1999 respectively

[22] S 55A of the Companies Act

[23] The sections identified are Sections 55 to 58, 59 to 84, 108, 109, 110, 112, 113, 116, 117, 118, 119, 120, 121, 122, 206, 206A and 207 of the Companies Act. The sections of the Companies Act broadly (not *in seriatim*) relate to issuance and contents of the prospectus and responsibility of those authorizing the issuance of the prospectus, procedure for issuance and allotment of shares and debentures, payment of brokerage and commission, buyback of shares, issue of shares at a premium or discount, further issue of capital (rights or otherwise), issue and redemption of preference share capital, administration of share capital, transfer of shares, provisions and payment of dividend.

Compliance Enforcement

SEBI has been armed with powers to enforce compliance with the rules and regulations that it makes as well as to administer the relevant parts of the Companies Act[24] and SCR Act. SEBI has the powers to enforce its regulatory ambit against stock exchanges. Under the SEBI Act, the Board has the power to call for periodic information and undertake routine or one-off inspections of the books of intermediaries, records, facilities, and premises and carry out audits and inquiries.[25,26] During the course of an investigation SEBI is empowered to call for information and record statements from any bank or any other institution established under a state, central or provincial statute insofar as it relates to a transaction in securities, which is under investigation.[27] SEBI's information gathering activities go beyond these formal and official channels as in the case of public issues for eg., where it gathers information from a variety of other non official sources.[28]

In case the information gathering, inquiry or inspection exercises reveal non-compliance with the regulation provisions of the SEBI Act, rules or, SEBI has powers to enforce compliance through a series of measures ranging from passing strictures and issuing warnings to imposition of fines, cancellation of an intermediary's licenses issuing "cease and desist orders" against a security that is about to be listed,[29] suspension of trading of a security, restrain persons from accessing the securities market, suspension of office bearer(s) of stock exchanges or SROs and levying penalties that could include disgorgement of profits that take away the economic incentives from these violations. To enforce these regulations SEBI has the powers of a Civil Court under the SEBI Act.

The summary nature of these powers enables speedy deterrence of market abuse and prevent panic in financial markets.

Review and Appeal Mechanism

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[24] S 209 A of Companies Act and S 621 of Companies Act
[25] S 11(2)(i) of SEBI Act
[26] Powers to inspect the books of a company under grounds of suspected insider trading or unfair trade practices is exercisable under section 11(2A) of SEBI Act.
[27] S 11(2)(ia) of SEBI Act
[28] SEBI's Annual Report 1993-94, p 14
[29] S 11D of SEBI Act and S 15A to S 15HB of the SEBI Act.

A person aggrieved by an order of SEBI may appeal to the Securities Appellate Tribunal.[30] The law establishing SAT envisages it as an independent agency which has an arm's length relationship with SEBI. An appeal against an order of the SAT would lie at the Supreme Court.

The SEBI Organisation

SEBI is managed by a Board comprising a Chairman and eight members including one nominee each from the Ministry of Finance, Ministry of Company Affairs and from RBI. The Board has three whole time directors the rest being part time members and persons of eminence drawn from the professions or industry. All appointments to the Board except that of the RBI's nominee, are made by the Government of India (GoI).[31] Since its inception the provisions relating to the Board have been amended to increase the number of whole time members and to permit nomination of persons who are associated with other companies as directors.

In general, successive amendments to the SEBI Act have not just enhanced SEBI's functional autonomy but also signaled the intention of the GoI to empower SEBI.[32]

Shah (2001) attributes SEBI's regulatory effectiveness to the Board structure, the demarcation of policy making to the members of the Board and its implementation to the executive directors. Further, he attributes its effectiveness in implementing market design reforms to the fact that it was "completely detached with respect to the rentiers". He notes that SEBI's track record in building internal competence appears to compare favourably with that of RBI.

A few areas of concern remain about the true autonomy of SEBI. The control of the GoI over the SEBI is one. That the term of the Chairman and that of members who are not officials of the GoI RBI can be terminated by the GoI with a three month notice is another. The power of the GoI to

[30] S 15T of SEBI Act
[31] The composition of the SEBI Board has been spelt out in S 4 of SEBI Act.
[32] These include scrapping the requirement of the approval of theGoI for SEBI to enact regulations, bringing grant of registration under the purview of SEBI's regulations, putting SEBI's actions and orders outside the jurisdiction of lower civil courts and providing immunity to the officials of SEBI from suits or other legal proceedings in respect of action taken in good faith, withdrawing the power of the GoI to exempt any person from the requirement of registration with SEBI, enhancement of its investigative and information gathering powers and authorizing SEBI to (i) issue directions to market participants to speedily address infractions (ii) to ensure compliance with disclosure and certain other essential requirements enshrined in the Companies Act and (iii) to file complaints in courts of law without the approval of the central government.

supercede the Board of SEBI under certain circumstances such as where the "Board has persistently made default in complying with the directives" of the GoI is a third area of concern.[33] The provision that the Board is bound by the directions of the GoI on issues of policy, with the decision of the GoI on what is a question of policy being final, raises the concern that SEBI may be potentially deployed as an instrument of policy, an aspect that is reminiscent of the days of the erstwhile of the CCI. The latent issue of regulatory overlap surfaced recently in a somewhat complicated standoff between the Insurance Regulatory and Development Authority and SEBI over the question of which of the two agencies has regulatory oversight over certain types of pension plans.[34] The related issue of split or joint responsibility for oversight of listed companies among the Ministry of Company Affairs, SEBI and stock exchanges through the listing agreement has been pointed out as an instance of "regulatory arbitrage" in the Report on Observance of Standards and Codes by the World Bank and IMF. (World Bank (2004)).[35] More recently, Patil (2010) warns that the proposal to constitute the Financial Stability Development Council (FSDC) might run the risk of undermining the role of SEBI.

Issuer related provisions

Issuer related regulations fall under three broad categories: (i) Access to market (ii) Obligations arising from listing, other than those relating to disclosure and (iii) Disclosure at the time of listing and after listing.

Regulation of Primary Market and Market Access[36]

There are twelve important aspects to SEBI's regulation of primary markets. These are (i) Criteria for issuance of securities to the public (ii) Disclosure requirements (iii) Alignment of economic interests of owner managers and outside shareholders (iv) Issuance process covering the pricing / price discovery mechanism, distribution of application forms, collection of subscriptions monies, allotment of securities and refunds in the case of applicants who did not receive allotments and timeline and procedure for allotment (v) Post issue servicing of investors and applicants (vi) Preferential allotments at or prior to the public issue to select groups of

[33] S 17 of SEBI Act.
[34] See Subramanian (2010) for a press coverage of this issue.
[35] A classic example of this is in the areas of issuance. The core of the issuance activity is legally governed by the Companies Act, although the issuance activity is regulated almost entirely in the case of a listed company by SEBI.
[36] The discussions here draw upon Sabarinathan (2007).

shareholders, if any, and allotment of shares to an employee share purchase plan or employee stock option plan (vii) Listing obligations and (viii) Minimum dilution to qualify for listing. (ix) Green shoe options (x) Issuance of debt (xi) Issuance of securities by foreign issuers in the form of Indian Depository Receipts or IDRs, for short; and (xii) Private placement of securities. (This list is not in the order of the relative importance of the aspects.)

SEBI's strengthening of the disclosure requirements for a public offering is reviewed under Disclosure related developments. The specifics of the other aspects are far too involved to be discussed in any detail in this paper. It is however necessary to point out the following: (i) SEBI restricts issuance of equity and convertible securities to certain companies who qualify in terms of criteria of size and profitability which are presumably intended as a proxy for firm quality. (ii) SEBI allows free pricing of securities except in the case of private placements by listed companies, where shares may be issued at a price that is linked to the market price according to the SEBI formulation, and in the case of pricing of preferential allotments to select categories of shareholders. (iii) There appear to be other instances of micro-management too as with the lock-in of owner-managers' equity and the extent of dilution, the impact of which has not been empirically tested.

An interesting feature of the regulation of the primary market is the regulatory strategy adopted by SEBI. Issuance activity is governed through the provisions in the DIPG. The incentives for compliance with the same are contained in the regulations governing the individual categories of intermediaries who participate in the primary market such as the merchant bankers, registrars to an issue, bankers to the issue and so on, who manage the issue process. The activity on the primary market is thus regulated through a web of contracts that are intended to mitigate the various sources of potential market failure in the primary market.

Listing of Securities – The Process

The stock exchange is free to establish rules for listing of securities as part of the bye-laws which govern their working.[37] A discussion on the bye laws follows later in this chapter. As such, companies or collective investment schemes which wish to get their securities or units respectively listed on a stock exchange have to apply to the stock exchange where they wish their

[37] S 9(1)(m) of the SCR Act

securities to be listed and comply with the necessary conditions specified in the bye-laws and the SCR Rules. However these conditions cannot be less stringent than those specified in the DIPG. The SCR Rules define the documents and information that a company or a collective investments scheme needs to provide to the stock exchange while seeking listing of its securities.[38] For example, the SCR Rules prescribe the minimum amount of equity that has to be offered for a company to qualify for listing its shares.[39] Stock exchanges have the right to relax the minimum issue rule with the prior approval of SEBI.[40] Further, the SCR Rules specify a detailed set of provisions that companies seeking to list need to comply. [41] The Rules leave an overarching authority in the hands of SEBI to waive or relax the enforcement of the listing requirements.[42] The exchange may stipulate additional conditions.[43]

A recognized stock exchange may suspend or withdraw the listing of the securities of a company in case of non-compliance with the conditions of the listing agreement, which can be contested by the company with the Securities Appellate Tribunal.[44]

<u>Listing of Shares – The Listing Agreement</u>

All securities exchanges presently have a listing agreement that has several common, standard provisions, a contract that securities exchanges enter into with issuers but effectively governing the relationship between the issuer and the investor. [45] SEBI has played a significant part in evolving this highly standardized agreement. The agreement covers certain requirements that are

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[38] Rule 19 of the SCR Act and Rule 20 of the SCR Rules. The information sought for typically includes copy of the memorandum and articles of association, prospectus, copies of key contracts with vendors, promoters, underwriters and top management, brief terms of key commercial agreements entered into by the company, historical financial statements of the company, copies of all documents and reports referred to in the prospectus, copies of acknowledgement card from SEBI, list of ten largest holders of each class of securities and so on.

[39] Under Rule 19(2)(b) SCR Rules companies may offer a minimum of 10% of each of the securities sought to be listed if they satisfy the following conditions : Minimum 20 lakh securities to be offered (excluding reservations, firm allotments and promoters' contribution), minimum offer size to public of Rs 100 crores and book built issue with 60% to be offered to Qualified Institutional Buyers (QIBs). A company that does not satisfy these criteria would need to offer a minimum of 25% of the securities instead of the 10%.

[40] Rule 19(6A) of SCR Rules.

[41] These rules govern the processes of allotment, splitting of share certificates and so on, commit the company to provide periodic information and updates on exceptional material events to the exchange, and intimate the exchange of "any other information necessary to enable shareholders to appraise the company and to avoid the establishment of a false market in the shares of the company".(Rule 19(3) of SCR Rules)

[42] Rule 19(7) of SCR Rules

[43] Rule 19 (2)(a) of the SCR Act

[44] Rule 19(5) of SCR Rules

[45] Rule 21 of SCR Act

considered essential for protecting the interests of traders, investors and brokers who avail of the services of the exchange.[46]

The value of the listing agreement as an alternative to regulation was demonstrated in Simon (1989). The listing agreement can be a means to address many of the sources of market failure and opportunistic behavior by corporate managements. The evolution of the listing agreement, in India suggests that it has clearly moved in this direction since the establishment of SEBI.

Mandating disclosure of information

We discuss the approach to disclosure in two separate categories, namely disclosure after the listing of the securities, also referred to as Continuing Disclosure in the Indian context and disclosure at the time of issuance of securities.

SEBI drives continuing disclosure from the issuer to the investor through the stock exchanges mainly. SEBI noted in its annual report of 1995 as follows. "Given that it is mainly in terms of the listing agreement that price sensitive information about the firm is required to be disclosed to the stock exchange and hence to investors, SEBI has been emphasizing the need to strengthen the provisions of the Listing Agreement, as well as its strict enforcement by the exchanges". [SEBI : 1995]. Three reasons may be advanced in favour of this approach to disclosure. For a long time prior to the advent of SEBI, issuers had provided information to investors through the stock exchanges. Second, stock exchanges are likely to be better equipped than SEBI to disseminate this information speedily and efficiently. Thirdly, given the centrality of information flow in the relationship between the issuer, the stock exchange and the investor it is a step towards preparing the stock exchanges to evolve into being SROs.

These disclosures[47] cover periodical interim statements of its workings,[48] notifications of Board meetings, details of share options granted,[49] any change in the general character or nature of the

[46]Some of the key issues that the standard agreement deals with are procedure and standards of servicing of investor application for transfer and issue of duplicate certificates, closure of books, disclosure of information relating to dividends, bonus shares, due process for new or further issue of shares, furnishing of periodic and annual financial and other reports, committing not to create a lien on shares, not to forfeit dividend earlier than required by law, agreeing to communicate material developments (such as change in any other information having a bearing on the operation or performance of the company as well as price sensitive information), furnishing unaudited quarterly results and half yearly results with a limited review and maintaining the non promoter holding at the minimum that is required as part of the conditions of listing.

business, change in directors, auditors, company secretary, treasurer or managing director,[50]copy of the annual financial statements,[51] statement showing shareholding pattern,[52] notification of events which will have a bearing on the performance / operations of the company as well as price sensitive information,[53]. Finally, the listing agreement spells out in considerable length the contents, the accounting standards to be followed and the format of presentation and with regard to the quarterly, year to date and annual financial results as prescribed and the announcement of the meeting of the board of directors that will consider the aforementioned results.[54]

Information to be produced at the time of a primary issue is governed by the Companies Act. The relevant sections of the Act are now administered by SEBI.[55] The disclosure mandated by SEBI[56] in the prospectus and offer documents relating to rights issues generally build on the requirements laid out in the Companies Act.

The current requirements of disclosure in the prospectus cover not just the substantive aspects of the content of disclosure but also various aspects of presentation. The requirements call upon the user to disclose many sources of intra group conflict among companies within the promoter group *per se* and self dealing between promoter and the issuer, assess the competence of the management and its attitude towards capital providers, develop a picture of the financial future of the company, identify sources of risk and value the business. Although the requirements leave room for improvement in many respects[57], it may be said that, on balance, the requirements significantly supplement the requirements mandated in the Companies Act. In the absence of regulatory compulsion on participants in the market there would be under-production of information.

Provisions relating to Intermediaries

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[47]This discussion is based on a paraphrasing of the listing agreement of the National Stock Exchange, downloaded from their website on May 8, 2010.
[48]Clause 18
[49]Clause 25
[50]Clause 30
[51] Clause 32
[52]Clause 35
[53]Clause 36 – examples of such events being disruption of operations due to natural calamity, commencement of commercial production / operations and litigations / disputes with a material impact.
[54]Clause 41
[55] The most relevant sections of the Companies Act are S 56, S 60A, S 60B and S 64.
[56]Spelt out in the Disclosure and Investor Protection Guidelines, 2000.
[57]as in the case of the justification of issue price for example

SEBI has evolved specific provisions relating to each category of intermediary. In this section we analyse the provisions that are commonly applicable to all intermediaries in general.

The SEBI Act provides that stockbrokers, sub-brokers and other intermediaries associated with the securities market may buy, sell or deal in securities only in accordance with the conditions of the certificate of registration.[58] SEBI has evolved regulations governing each one of these categories of intermediaries or participants.[59] Typically these regulations specify conditions relating to the size, capital adequacy, business conduct, record keeping and so on. The process of registration and licensing allow SEBI to ensure that those who are associated with the securities trade play by a set of rules governing the trade and have the organizational, financial capacity and, where appropriate, the infrastructure to be able to deliver their contractual obligations. It also allows for collection of valuable data. In addition, SEBI may also issue directions from time to time to intermediaries in the market as well as to issuers so as to protect investors or to ensure proper management of the intermediary's affairs.

Licensing of Stock Exchanges

Trade in securities in India may be conducted only a recognized stock exchange.[60] SEBI has been vested with the authority to grant recognition to a stock exchange if it is in the interests of the trade as well as the public.[61] In addition, SEBI may prohibit trading in certain geographical areas, limit them to a specified level or prohibit contracts in certain securities so as "to prevent undesirable speculation in specified securities in any State or area". By imposing appropriate conditions at the time of granting a license, SEBI can ensure that the exchange will promote the economic objectives that the regulator may wish to promote.

Controlling Exchanges

The application for recognition to stock exchanges has to be accompanied by documents relating to the bye-laws. The bye-laws are the basic contract that governs the conduct of the members of an exchange inter se as well as the conduct between the members and the management of the

[58]This requirement extends to depositories, depository participants, custodians, credit rating agencies, mutual funds, venture capital funds, foreign institutional investors and collective investment schemes. S 12 of the SEBI Act lists out those market participants who need to register under this section.
[59]These regulations have been put in place by SEBI under S 30 of SEBI Act, 1992
[60] S19 of the SCR Act
[61] S 3 of the SCR Act.

exchange and between issuers and the exchange. The bye-laws allow the exchange management to lay down the business rules on the exchange. [62]

The bye-laws provide the mandate to the stock exchange to frame appropriate rules, covering practically all facets of the working of the exchange: the type of order system that the exchange may adopt, rules for qualifications for brokers, the kind of trading systems that the exchange may adopt, clearing and settlement procedures, criteria for listing and so on, dealing with risk of defaults and counter-party risks at the level of individual traders as well as at the level of the exchange.

By requiring that the bye-laws require SEBI's approval and allowing SEBI draft rules *suo motu* and to amend the bye-laws through the management of the exchange or through fiat, the laws leave considerable degree of control over the functioning of stock exchanges in SEBI's hands.[63] Where SEBI perceives a problem with the governance and the administration of the stock exchange, it may supercede the governing body of the stock exchange and the governance of the exchange then passes over to the nominees of SEBI.[64] Finally, in the event of an "emergency" SEBI may direct that the business of the stock exchange be suspended[65] if it feels that it will be in the interests of the trade and the public to do so.[66]

Thus SEBI has a range of tools at its disposal to control the affairs of stock exchanges, from controlling the key levers of the management and administration of the business to halting the conduct of the business for such lengths of time as it finds necessary.

In order to ensure compliance with these provisions SEBI has the right to call for periodical returns[67] as well as annual reports,[68] the right to initiate an inquiry into the affairs of individual

[62]The bye-laws of the exchange typically deal with trading hours, establishing of clearing and settlement mechanisms, terms and conditions of contracts between members inter se, between members and non-members, consequences of default or insolvency, criteria for and conditions of listing of securities, brokerage terms, separation of functions of jobbers and brokers, dealings of brokers on their own accounts and providing of information by brokers to the governing body of the exchange as required.
[63] S 8 of SCR Act
[64] S 11 of SCR Act
[65] Business may be suspended for a period of seven days to begin with and for subsequent periods of seven days at a time.
[66] S 12 of SCR Act
[67] S 6 of the SCR Act
[68] S 7 of the SCR Act

members of the stock exchange or the stock exchange as a whole.[69] Finally, SEBI may withdraw recognition to the stock exchange, if it is convinced that it is necessary to do so in the interests of the trade or in public interest.[70]

SEBI's Performance as a Regulator – A Brief, Critical Review

A description of SEBI as a regulator of the securities market would be incomplete without at least a brief review of its accomplishments so far. This review is a thumbnail sketch of the regulator's more important contributions and is not meant to be exhaustive. SEBI's role has been reviewed along the following major areas (i) Primary market, market access and intermediaries (ii) Disclosure requirements (iii) Corporate Governance (iv) Market for corporate control (v) Trading Mechanisms (vi) Settlement systems (vii) Dematerialisation (viii) Institutionalisation of Trading and Ownership of Securities (ix) Market Integrity and Insider Trading (x) Ownership and Governance of stock exchanges; and (xi) Compliance Enforcement.[71]

Primary Markets

SEBI has regulated the primary market through (i) the regulation of issuers' access to market (ii) regulation of information production at the time of issue, and (iii) regulation of processes and procedures relating to issuance of securities. These aspects have been primarily governed through the Disclosure and Investor Protection Guidelines,2000 (DIPG).[72] All three aspects have evolved considerably over the years.

Access related regulations have, for example, evolved from a regime of unrestricted access[73] to equity markets to the current regime which uses a combination of size and profitability record as proxies for quality of the issuer to restrict market access. More recently a rating of all Initial Public Offerings by an accredited credit rating agency has also been mandated. The guidelines also prescribe criteria for issuance of debt that seek to ensure that the issuer's creditworthiness

[69] S 6(3) of the SCR Act
[70] S 5 of SCR Act
[71] This is not meant to be an exhaustive or deep coverage of the role played by SEBI. There are many other important constituents that have been brought under SEBI's control. Venture Capital Funds and Credit Rating Agencies are two such examples.
[72] The first version of the DIPG, released in 1992, was substantially rewritten in 1999, consolidating more than twenty six amendments that had been made to it over the years. The current version DIPG 2000 has also been amended a large number of times, making the DIPG one of the most dynamic pieces of SEBI's regulations.
[73] There were restrictions on access in the form of listing criteria that stock exchanges stipulated, but these restrictions were not imposed at the instance of SEBI.

has been certified by an independent rating agency and that the issuer is not in default to certain categories of creditors such as deposit holders and banks and financial institutions.

The disclosure related aspects of issuance of securities have been noted under our discussion on Disclosure.

The changes to the issue process have ranged from items of minutiae such as the number of centres for receiving applications to public offerings to measures that affect substantively affect investor welfare such as the basis of allotment. Of these various initiatives, the guidelines for book building issues was an initiative that truly transformed the primary market.

SEBI has relied on certification by the merchant banker to ensure compliance with the regulations. The provisions cast the responsibility for the accuracy of the prospectus on the issue manager as well as for ensuring that other intermediaries involved in an issue such as the banker and registrar had the required license and the underwriter had the financial capacity to provide the service. Incorrect certification would mean the risk of loss of license to carry on its business for the agency that did not qualify to provide the service as well as for the merchant banker that certified incorrectly. Over time this certification mechanism has been continuously strengthened. (SEBI (1995) and SEBI (1996))

The most significant initiative was the announcement of guidelines for book building public issues. The growing popularity of book building is evident from the data in Table III. The first book built issue appeared in 1998-99, even though the guidelines were announced as far back as 1996. One of the key institutional prerequisites for book building to work effectively was demateralisation, which was made mandatory for public issues in 2001. The bookbuilding mechanism was continually improved in 1997-98 and 1998-99. The number of book built issues started picking up from 2000-01, the year in which SEBI threw open book building to issues of all size and made some important amendments to the guidelines. The numerous institutional changes that accompanied the introduction of book building, such as the change in allotment patterns, may have made it attractive for international investors to participate in Indian public offerings. It is very tempting to infer as such that the growth in volume of issuances was the result of the various institutional changes. A more careful analysis would be necessary to see to what extent, if all, the growth in activity was the result of market forces.

Table II, referred to earlier, brings out an interesting aspect of the evolution of the primary markets and the network of intermediaries. The number of merchant bankers, registrars to issues and share transfer agents increased to begin with and then declined over time. This movement coincides with the increase in the number of public issues during the early and mid nineties and the decline in the number during the later part of that decade and thereafter, a trend that SEBI may have been keen on bringing about. A definitive comment on these movements would require a thorough investigation of the factors that influenced the prospects for these intermediaries. A cursory examination suggests that SEBI's regulatory interventions governing the activity of the various intermediaries may have played an important part in these developments.

Disclosure

The trigger for the strengthening of disclosures in the primary market that have been noted earlier[74] appears to have been the concern that "the quantitative growth of the market and the freedom to price issues had also raised questions about the quality of issues entering the market." (SEBI (1996)). Disclosure standards were not limited to accounting information but was extended to other issue related communications such as advertisements.

The continuing disclosure regime under the Companies Act that was in force prior to the establishment of SEBI suffered from three principal shortcomings (i) low frequency, at once a year (ii) insufficient and poorly administered deterrents against non compliance; and (iii) a common set of disclosure obligations for companies with limited as well as widely distributed ownership. In order to improve the frequency of disclosure, SEBI constituted a committee in--- under the chairmanship of Mr. C.B. Bhave to examine the question of continuing disclosure.

SEBI directed stock exchanges to implement most of the recommendations of a committee headed by Mr. C B Bhave which examined continuing disclosure requirements systematically for the first time in 1996.[75] Continuing disclosure requirements were further enhanced in 1999-2000.

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[74]Based on recommendations of two committees, in 1995-96 and 2000-01, under the Chairmanship of Mr. Y.H. Malegam.

[75] Prior to the constitution of the Bhave Committee SEBI had mandated some piecemeal changes such as disclosing comparison of actual profitability with projected profitability and so on. The requirements of the committee included quarterly disclosure of financial results, publishing details of deployment of proceeds of public and rights issues half yearly, that the quarterly and half yearly disclosures have to be on the same basis as the accounting principles of the previous year (failing which the previous year's figures have to be

With the introduction of the corporate governance requirements in 2000-01 disclosure of materially significant related party transactions with promoters, directors, management, subsidiaries, relatives and so on were added. In order to institutionalize the evolution of the continuing disclosure process, SEBI entered into a collaborative initiative with the Institute of Chartered Accountants of India (ICAI) and formed the National Committee on Accounting Standards (NACAS).[76] Over the years, having increased the frequency to quarterly reporting the disclosure requirements have started mandating a more fine-grained presentation of the performance of the company.

Following SEBI's directive, exchanges have improved the flow of trade related information by taking advantage of technology and minimizing instances of gaps in flow of information as in the case of off market transactions such as block trades which are now required to be routed through the electronic trading systems of the stock exchange. Exchanges have also been required to invest in market surveillance systems which could help detect insider trading or market manipulation transactions.

Corporate Governance

SEBI has led the effort in improving standards of corporate governance in India, although the matter of corporate governance should be relevant to all body corporates, listed or not. Some elements of the role of the Board of Directors of a company collectively and that of directors individually have been dealt with under the Companies Act, long before corporate governance emerged as the hot topic that it is currently. SEBI's initiatives starting with the committee headed by Mr Kumar Mangalam Birla and thereafter the two reports presented by the Committee headed Mr. N R Narayanamurthy, culminated in the introduction of Clause 49 in the listing agreement. The main items covered under Clause 49 are (i) ensuring independence of the Board and disclosure of their compensation (ii) ensuring correctness, sufficiency and credibility of disclosures (iii) requirement of financial literacy among members of the audit committee and expertise in accounting / financial management among one of them (iv) whistle blower policy (v) requirement of a formal risk management policy (vi) certification of financial and cash flow

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restated for comparability) and all other material events having a bearing on the operations or performance of the company as well as price sensitive information.

[76]The recommendations of NACAS so far have included Segmental Reporting, Related Party Transactions, Consolidation of Accounts, Deferred Taxes and Earnings Per Share, mandatory compliance with ICAI's accounting standards and addressing of previous quarter's audit qualifications.

statements by the CEO / CFO to the Board; and (vii) quarterly reporting on compliance with the requirements of every provision of Clause 49 to the stock exchanges. Compliance with Clause 49 was mandated for all listed companies by December 31, 2005. All companies making an IPO are required to comply with Clause 49 at the time of making an IPO. The provisions of Clause 49 are often compared with Sarbannes Oxley Act 2002 and are said to draw upon that legislation in the objectives as well as approach to regulating corporate governance.[77]

It is perhaps too early to assess the impact of Clause 49 on the governance standards of companies in India although some studies such as Black and Khanna (2007) have tried to estimate the impact of compliance with Clause 49 on the market valuation of companies. Some observers have also expressed doubts about whether mere enactment of regulation will suffice to ensure true independence of the Board and raise the standards of governance.[78]

Market for Corporate Control

Takeovers and acquisitions are regulated by the SEBI (Substantial Acquisition of Shares and Takeover) Regulations 1997, also known as the Takeover Code, itself a substantially modified version of the 1994 Code, modified again substantially in 2002 and now the subject of a major overhaul. (The Code does not cover mergers.) Although subject to numerous criticisms[79], the Code has enabled an active market for corporate control to evolve in India. Data on the level of activity under the Code is in Table IV. The data shows an overall increase in the number of corporate acquisition initiatives during the period. The Takeover Code is an initiative entirely attributable to SEBI. Other modes of acquisition such as acquisition of assets also appear to have been popular during the same period. To understand whether the takeover code played a benign role in the evolution of a market for corporate control, would require an understanding of all the modes of corporate acquisition.

Trading and Trading Mechanism

[77]See for example Singh et al (2007)
[78]For one such view see, for example, Sen (2004)
[79]Some of the criticisms are poor drafting leading to considerable ambiguity in interpretation, excessive discretion in SEBI's hands in the administration of the Code, favourable to incumbent managements, not favourable to hostile acquisitions which are held to be essential for a healthy market for corporate control that incentivizes corporate managements to put shareholder interests above all else, exemptions from applicability of the Code available to various types of acquisitions such as preferential offers, inter se transfers, rights issues and so on, and that the open offer of 20% does not allow all shareholders that wish to exit to be able to sell their shares to the acquirer.

SEBI played an important role in moving many Indian stock exchanges to adopt an electronic trading system.[80] The automation of trading and post trading systems on the major stock exchanges (i) reduced manipulation of prices and concealment of audit trails of such manipulation (ii) ensured investors received time based priority and correct prices for their (iii) fundamentally altered the economics of the business of stock exchanges as the operations of NSE and The Stock Exchange, Mumbai were allowed to be extended electronically to other cities from 1996-97. As a result the share of trade on regional stock exchanges dropped steadily from 57% in 1994-95 (SEBI (1995)) to 4% in 2002-03 (SEBI (2003)).

The fact that SEBI had to exert pressure on some of the exchanges to switch to electronic trading in spite of the signals from the market (from the success of NSE) that electronic trading was likely to be the way forward for stock exchanges in India suggests that this was an area that market forces may not have provided the required incentives for the incumbent players to choose what was in the best interests of the trade as a whole. (For a more detailed discussion on how the government has used crises to push reform through in the financial markets see Shah(2001).)

Settlement Systems

SEBI directed all SESs in 1992-93 to adopt a weekly settlement progressively for all categories of shares by 1994-95. With the introduction of dematerialisation of securities SEBI moved the stock exchanges gradually to a T+2 rolling settlement from April 2003. These developments were also accompanied by the discontinuation of several risk management products that were in use in disguised form such as the “badla”, a form of futures based trading. Alongwith the settlement SEBI also directed the stock exchanges to set up trade and settlement guarantee funds to assure investors that they would not face the risk of loss on account of a default by the counterparty. By 1999-2000 sixteen out of the twenty three exchanges that had any turnover had all set up trade guarantee funds.(SEBI (2000)).

The reduction of settlement cycles and the introduction of rolling settlement substantially eliminated the risks arising from the long settlement cycles combined with badla such as defaults, payment crises and temporary closure of the stock exchanges.

[80] SEBI pursued automation initiative with Mumbai, Pune and Delhi in 1995-96 (SEBI (1996)) and with Jaipur, Magadh and Inter-Connected Stock Exchanges India Ltd. in 1998-99

The combined result of these initiatives is the reduction in transaction costs that is presented in Table V. (Shah (1999) and Shah et al (2009)).

Dematerialisation

With the entry of FIIs starting 1992 and the setting up of mutual funds in the private sector in 1994, the institutionalization of stock trading and, concomitantly, trading volumes had increased considerably over the years. Various alternatives emerged such as consolidation of smaller trading lots into a single piece of paper known as a "jumbo certificate" and custodial services that specialized in handling the increased paper work relating to the trade. (SEBI (1994)). These initiatives did not meet the needs of the rapidly burgeoning trade. A committee headed by Mr.R. Chandrasekharan, appointed by SEBI, confirmed the need for an early introduction of dematerialisation. (SEBI (1998))]

Starting January 1998 dematerialisation was gradually made compulsory for all issuers and all IPOs in September 2001. Dematerialisation brought about several benefits: (i) Greater liquidity due to the withdrawal of the requirement of minimum trading lot sizes and reduced "no-delivery" period (ii) No loss or risk on account of mutilation or loss of scrips (iii) Shorter periods of book closure for corporate actions such as dividends payments, rights or bonus issues; and (iv) Eliminated delays in transfer that were intended to withhold transfers so as to create an artificial shortage of scrips in the market.

Table VI provides data that trace the progress in dematerialization since 2001-02. The table shows how dematerialization has maintained the momentum that was provided by the regulatory push from SEBI. The value of scrips dematerialized, the value of trades settled through the depositories, the number of companies which dematerialized their shares and the number of DPs have all shown an increase over the years. While the percentage of scrips dematerialized to the market capitalization may remain constant it must be borne in mind that during this period the market value of shares registered a steady increase during that period as may be noted from the data in Table I.

In theory, given the benefits of dematerialisation to the investor, it would be reasonable to expect that the drive for dematerialisation would have come from stock exchanges. The role for the

regulator should have been limited to putting the regulatory framework in place. In practice, given the scope for market manipulation that paper based trading offered, it is doubtful that dematerialization would have been possible without the "element of compulsion" that SEBI acknowledged in its annual report. (SEBI (1999)).

Institutionalisation of Trading and Ownership of Securities

A key feature of many of the better developed securities markets is the extent of institutional ownership of shares as well as the increasing share of institutions in securities trade. Table VII (a) and VII (b) provide an indication of the increase in institutional flow of capital into the securities market in India from two important institutional sources. A substantial part of these flows have been deployed into ownership of shares. This is in addition to a sizeable amount of shareholding in the hands of Indian institutions such as the insurance companies and former development financial institutions, acquired through a variety of mechanisms such as direct purchase of equity stakes in Indian companies as well as through conversion of their loans to Indian corporates. Apart from its value as a source of capital these flows are also said to be important for the impact they seem to have on market valuation. Allen et al estimate that the correlation between monthly net FII inflows and monthly Sensex returns is 0.49 from 1994 to 2005, suggesting a strong and increasing link between FII inflows and market returns, but of unsure causal direction. Even more importantly perhaps, some scholars such as Goswami (2000), have argued that these investors have exerted pressure on Indian corporate to raise their standards of governance. The point of distinction brought out in Patibandla (2005) is that the state owned or state controlled investors did not bring about comparable improvements in governance.

Market Integrity and Insider Trading

There has been an increasing recognition that in order to maintain the confidence of investors in the public securities market it is essential that some economic agents who possess an informational advantage over the others do not exploit the same to derive pecuniary gains for themselves. This view has been captured in a quote attributed to Mr. Arthur Levitt, a former Chairman of the Securities and Exchange Commission of the USA that insider trading "has utterly no place in any fair-minded law abiding economy". Further, there appears to be some empirical evidence that insider trading can increase volatility. SEBI's first enactment to curb insider trading, namely, SEBI (Prohibition of Insider Trading) Regulations, 1992 did not make

much progress due to poor enforcement. These regulations have been amended substantially over time. The current approach centres around prevention of insider trading by requiring listed companies, intermediaries and advisors to set up internal systems for preventing insider trading and reporting on compliance or otherwise to SEBI. There has been some concern that this approach imposes too much of a burden on the organizations and that this can be especially onerous in the case of smaller organizations. The general view however appears to be that given the difficulty in proving and prosecuting an offence of insider trading the approach of prevention is better.

An equally serious concern has been around manipulative practices in the Indian securities markets. Manipulative practices are usually resorted to by traders and brokers in the market. Often they involve the owner managers or promoters of companies who may stand to gain from these practices. These have typically been meant to create a false market in the securities or to push the price of the securities down to unwarrantedly low levels through circular trading and other means. Such practices have not been limited to the so-called "penny stocks" alone but have often been practiced in the shares of larger and well established companies as well. Thus manipulative practices can harm the interests of small and large investors alike as well as that of companies whose shares are subject to such practices. SEBI has addressed these through the SEBI (Fraudulent and Unfair Trade Practices) Regulation, 2003.

SEBI has backed up these regulatory measures with a substantial investment in surveillance of the markets. Over time much of the responsibility for surveillance has been handed over to the stock exchanges. SEBI has taken an active part in overseeing the level and nature of surveillance systems installed in the various exchanges. Protocols have been established for investigating unusual movements in the prices of securities as well as for the stock exchanges to report these incidents to SEBI. SEBI's effort at improving the integrity of securities markets also includes its attempts at improving governance that are discussed below. In particular, the separation of ownership and trading rights should enable the stock exchanges to effectively curtail the level of manipulative practices in the market.

SEBI's record in investigating these cases and taking action against these practices is provided in Table IX. The table suggests that SEBI has shown substantial progress in taking action against or disposing of such cases. However, the data should be interpreted with some caution. The quality of supervision depends on the number of instances that are identified and taken up for

investigation. That is a fairly difficult matter to comment upon. The general view remains that the Indian securities market is still subject to several manipulative practices and instances of insider trading.

Governance of Stock Exchanges

From its early days SEBI's approach towards governance of stock exchanges seems to have been influenced by the findings in the inspection completed in 1992-93. The principal finding of this inspection was that the exchanges were not functioning as effective SROs, not regulating their members through the enforcement of bye-laws, rules and regulations and paid minimal attention to redressal of investor grievances with long pending arbitration cases. (SEBI (1993)). In 1993-94 SEBI called for numerous amendments to the rules and articles of association of stock exchanges. These amendments mainly had to do with including public representatives on the governing bodies of stock exchanges and in the various statutory committees and a forced break before members could be reelected to the Board. The purpose of these amendments has been summed up neatly in SEBI's annual report: "It is expected that with this restructuring stock exchanges would move away from their "closed club character" and re-orient themselves to function as public institutions."

SEBI's most significant initiative to improve the governance of stock exchanges in India was the move to separate ownership and trading rights, referred to as corporatization and de-mutualisation (C&D, for short). The principal requirements of C&D was that all stock exchanges would be corporatized and not less than 51% of the ownership of the stock exchanges was to be held by public other than shareholders having trading rights.[81] As of 2008-09 sixteen of nineteen stock exchanges had completed the C&D requirement while three exchanges lost their recognition due to their inability to comply with the requirements.

Compliance Enforcement

Forming a robust view on compliance enforcement is tough because that would require that all instances of market abuse and infraction are detected and dealt with. However it may be tentatively inferred from the data on redressal of investor grievances in Table IX that the number

[81]The change in ownership is governed by Securities Contracts (Regulation) (Manner of Increasing and Maintaining Public Shareholding in Recognised Stock Exchanges) Regulations, 2006 (MIMPS Regulations for short), enacted in November 2006.

of unaddressed grievances is a declining fraction of the number of grievances filed. SEBI has been less effective in prosecutions and penalizing erring market participants or non-compliance. Some observers attribute it to its lack of authority to prosecute while others attribute the lack of effectiveness to its inability to make a convincing case with the Securities Appellate Tribunal and the Supreme Courts. The absence of specialized courts that have the capacity to deal with matters involving the financial markets is cited as a third reason for SEBI's lack of success in securing prosecution against various offences.

Conclusion

The reference point proposed in the paper for examining the regulatory role played by SEBI may be divided into two broad sets of aspects, namely, those aspects that fall within the purview of SEBI and those that fall outside. Aspects that fall outside the purview of SEBI include the court system, civil discovery rules, the taxation regime governing securities transactions and an active financial press. The rest of the aspects included in the reference point have been addressed in one of the following ways: Wherever, there was an enabling statute SEBI has been given the responsibility for administering those provisions as in the case of oversight of stock exchanges and certain provisions of the Companies Act. Many laws needed to be augmented, as in the case of the disclosure requirements or as in the case of the creation of the NACAS. Some aspects of the markets functioning had to be completely re-architected and new regulations or laws enacted for that purpose, as in the case of market access, governance of stock exchanges and the oversight of various intermediaries. Some others called for a radical redesign as in the case of the trading, clearing and settlement systems, which touched many other laws as well. This range of regulatory responses required a suitably empowered regulator and a law that provided the basis for such a regulator. The SEBI Act provides for the creation of such an organization in the form of SEBI.

This paper intends to deepen the understanding of the regulatory system that currently oversees the regulation of securities markets in India. The analysis of the structure that the GoI has followed provides some other interesting insights. First, the GoI created an agency that was empowered to merely administer the statutes that were already in place for regulating the securities markets, namely the SCR Act and SCR Rules and the Companies Act. The only major statutory change that accompanied the enactment of the SEBI Act, 1992 was the scrapping of the

Capital Issues Control Act, 1947, which in turn allowed considerable freedom in several aspects of issuance of securities and handed over the authority over the securities market to SEBI.

This strategy may have been prompted by the urgent need to strengthen the oversight of the securities market that had been necessitated by the stock market scam that was exposed in 1992. It may also have been guided by considerations of political economy, as an overhauling of extant securities laws would have met with stiff resistance from the powerful incumbents, as the subsequent experience of SEBI at every step of the reforming process has demonstrated. It may also have been influenced by considerations of administrative expediency, given that there was a large, existing body of jurisprudential wisdom and knowledge built around the existing statutes.

Notwithstanding these initial handicaps the analysis shows that compared to the benchmark developed in this paper SEBI seems to have fared well. It is an autonomous and suitably empowered agency with the requisite knowledge and human resources. It has managed to design a market that is operationally safe and among the most cost competitive, leaving aside taxes. There have been very few payment crises of the kind that prevailed in the early mid nineties. Risks in execution of trade and counterparty risks have been eliminated to a substantial degree. India has one of the better public offering mechanisms in the world that allows for reasonable price discovery and is capable of handling huge volumes of applications, although it has cracked a few times under the onslaught of deviant market participants. SEBI has put in place a comprehensive web of regulations that ensures a range of market participants and intermediaries and participants have the capacity and the incentives to function well in a coordinated fashion. The disclosure system at the time of listing as well as post listing compares with the best in the world. The accounting rule writing and administration system has been strengthened with the establishment of NACAS. Recent moves to converge to international financial reporting standards will improve the quality of disclosure even further. In spite of some initial push back and compromises SEBI has rolled out a corporate governance code that is often compared with the Sarbannes Oxley Act of the USA.

However the gradualist approach has not been without its consequences. First, as an institution SEBI had to struggle with a regulatory legacy that it inherited from a planned political economic paradigm, bestowed with neither the authority nor the legal framework necessary to discharge its role. It took more than a decade for SEBI to complete this redesign during which a considerable price had to be paid in terms of numerous scams.

The regulatory architecture still suffers from the lack of a holistically designed statutory framework. The current regulatory framework puts SEBI in charge of the capital market whereas the regulation of the money markets comes under the ambit of the Reserve Bank of India (RBI). For eg., money market mutual funds invest in securities that are regulated by the RBI but the AMC is itself regulated by SEBI[82]. These and other instances raise the question of whether it makes sense to one single regulator along the lines of the FSA. Yet another area that requires attention is that of investigation and enforcement.

In the final analysis the approach seems to have paid off as SEBI seems to have slowly worked its way into completely redesigning the securities market and transforming into a globally competitive and contemporary market. As noted in this paper it would appear that the process of designing is nearly complete. Much of the credit for that would go to SEBI entirely.

At a philosophical level it is possible to ask whether a regulator was necessary to accomplish these objectives. Or, could the same have been accomplished through market forces with an appropriate set of policy incentives? That is a difficult to question to answer empirically. However, we have noted that the serious competitive disadvantage that the Stock Exchange Mumbai suffered from did not seem to have persuaded its management or for that matter the management of any of the other exchanges to bring about any of the changes that were brought about later purportedly at the instance of SEBI's regulatory push. This is understandable because it has been seen in many other instances that the incumbents who extract rents from the status quo ante are bound to be happy with the status quo even if it should mean a lower level equilibrium overall. They are bound to resist changes to the status quo even if the change means a transition to a higher level equilibrium if they apprehend that the changes would affect their welfare adversely. As Shah (1999) points out the status quo on Indian securities markets based on the badla, unofficial bank financing of securities trade, manual trading system without price-time priority and based on paper scrips benefited a powerful set of incumbents. There is no research to assess whether the emergence of NSE spillovers and if so what the nature of such spillovers was. Whatever the nature of the spillovers, the resistance from the incumbents to the numerous reform efforts of SEBI and the apparent slowdown in maintaining the pace of the reforms for a while in the nineties suggest that pure reliance on market forces may not have brought about the changes that SEBI initiated.

[82] SEBI Mutual Fund Regulations

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Table I

Measures of Market Activity Volumes

All measures in billions of rupees, unless stated otherwise

	MC	MC / GDP	Turnover	Turnover Ratio
1995-96	5723	47.0%	2274	40%
1996-97	4883	34.6%	6461	132%
1997-98	5898	37.7%	9087	154%
1998-99	5741	34.1%	10234	178%
1999-00	11926	84.7%	20670	173%
2000-01	7689	54.5%	28810	375%
2001-02	7492	36.4%	8958	120%
2002-03	6319	28.5%	9689	153%
2003-04	13188	52.3%	16209	123%
2004-05	16984	54.4%	16669	98%
2005-06	30222	85.6%	23901	79%
2006-07	35488	86.0%	29015	82%
2007-08	51497	109.3%	51308	100%
2008-09	30930	58.1%	38521	125%

Source: Indian Securities Market Review, NSE (2009)

MC stands for Market Capitalisation.
MC / GDP is the ratio of MC to GDP
Turnover Ratio is the ratio of the turnover to the Market Capitalisation

Table II

Development of the Network of Intermediaries in Indian Securities Market

	SE Cash	SE Deriv	Brokers	Corp Brokers	Sub Brokers	MBs	RTI/STA	DTs	CRAs	Depo sitory	DPs	PMs	VCFs	FVCIs
1993	21	-	5290	0	0	74	0	0	0	0	0	28	0	0
1994	22	-	6413	143	202	422	100	0	0	0	0	40	0	0
1995	22	-	6711	616	876	790	264	20	0	0	0	61	0	0
1996	22	-	8476	1917		1012	334	23	0	0	0	13	0	0
1997	22	-	8867	2360	1798	1163	386	27	0	1	28	16	0	0
1998	22	-	9005	2976	3760	802	334	32	0	1	52	16	0	0
1999	22	-	9069	3173	4589	415	251	34	0	2	96	18	0	0
2000	23	2	9192	3316	5675	186	242	38	4	2	191	23	0	0
2001	23	2	9782	3808	9957	233	186	37	4	2	335	39	35	1
2002	23	2	9687	3862	12208	145	161	40	4	2	380	47	34	2
2003	23	2	9519	3835	13291	124	143	35	4	2	438	54	43	6
2004	23	2	9368	3746	12815	123	78	34	4	2	431	60	45	9
2005	22	2	9128	3733	13684	128	83	35	4	2	477	84	50	14
2006	22	2	9335	3961	23479	130	83	32	4	2	526	132	80	39
2007	21	2	8472	4110	27541	152	82	30	4	2	593	158	90	78
2008	19	2	8517	4190	44074	155	76	28	4	2	654	205	106	97
2009	19	2	8652	4308	62471	137	71	30	4	2		232	133	129

Source: Various Annual Reports of SEBI, Author's compilation

SE Cash: Stock Exchange with a Cash segment
SE Deriv: Stock exchange with a derivative segment
Corp Brokers: Corporate Brokers
MBs: Merchant Bankers
RTI/STA: Registrar to the Issue / Share Transfer Agent
DTs: Debenture Trustees
CRAs: Credit Rating Agencies
DPs: Depository Participants
PMs: Portfolio Managers
VCFs: Venture Capital Funds
FVCIs: Foreign Venture Capital Investors

Table III

(All amounts are in billions of rupees)

Panel A: Book built and Fixed Price Issues in Initial Public Offerings

	Book Built		Fixed Price		Book Built		Fixed Price	
	Nos	Sum	Nos	Sum	Nos	Sum	Nos	Sum
1998-99	0	0	18	379	0%	0%	100%	100%
1999-00	5	1,711	46	939	10%	65%	90%	35%
2000-01	13	1,035	99	1427	`12%	42%	88%	58%
2001-02	1	834	5	248	17%	77%	83%	23%
2002-03	2	255	4	784	33%	25%	67%	75%
2003-04	9	2641	10	550	47%	83%	53%	17%
2004-05	15	14,507	8	155	65%	99%	35%	1%
2005-06	54	10,260	21	504	72%	95%	28%	5%
2006-07	66	23,203	9	209	88%	99%	12%	1%
2007-08	83	42,262	2	68	98%	100%	2%	0%
2008-09	17	1,816	4	183	81%	91%	19%	9%

Panel B: Book built and Fixed Price Issues in Follow on Public Offerings

	Book Built		Fixed Price		Book Built		Fixed Price	
	Nos	Sum	Nos	Sum	Nos	Sum	Nos	Sum
1998-99			1	20	0%	0%	100%	100%
1999-00			2	1,986	0%	0%	100%	100%
2000-01			1	5	0%	0%	100%	100%
2001-02	*	*	*	*	*	*	*	*
2002-03	*	*	*	*	*	*	*	*
2003-04	6	14,135	4	4,95	60%	97%	40%	3%
2004-05	4	5,911	2	2,24	67%	96%	33%	4%
2005-06	18	12,643	7	1,86	72%	99%	28%	1%
2006-07	7	12,47	2	41	78%	97%	22%	3%
2007-08	5	10,856	2	39	71%	100%	29%	0%
2008-09								

Source: Prime Annual Report on Primary Market, various issues, Author's Analysis

*: No follow on public offerings during these years

Tables show (i) the number of book built and fixed price issues (ii) the sum of capital mobilized through each of these issues and (iii) the proportion of number of issues and the amount of capital raised through each category as a percentage of total issuance in each of Initial Public Offering (IPO) and Follow-on Public Offering (FPO) category. IPOs would correspond to Unseasoned Public Offerings while FPO would correspond to Seasoned Public Offerings in the North American trade parlance.

Table IV

Acquisitions and Takeover under the SEBI Takeover Code

	Offers	Exemptions	Total
	Nos	Nos	Nos
1992-93	8	10	18
1993-94	14	6	20
1994-95	30	11	41
1995-96			
1996-97	43	32	75
1997-98	41	5	46
1998-99	63	4	67
1999-00	83	11	94
2000-01	77	21	98
2001-02	81	16	97
2002-03	88	17	105
2003-04	65	18	83
2004-05	60	17	77
2005-06	104	13	117
2006-07	104	15	119
2007-08	116	31	147
2008-09	86	15	101

Source: Various annual reports of SEBI, compilation by author

Table V

Indicators of Trading Efficiency on Indian Securities Markets

	1994	1999		Standard
		Physical	Demat	
Trading				
Fees to Intermediaries	3.00%	0.50%	0.25%	0.25%
Market Impact Cost	0.75%	0.25%	0.25%	0.20%
Clearing				
Counterparty Risk	Present	0.00	0.00	0.00
Settlement				
Paperwork	0.75%	75.00%	0.10%	0.05%
Bad paper risk	0.50%	50.00%	0.00%	0.00%
Stamp Duty	0.25%	25.00%	0.00%	0.00%
	>5.25%			

Source: Shah (1999)

1. Standard represents Best in International Standards in terms of lowest cost.
2. Demat represents electronic settlement through depository.
3. Bad Paper Risk is the chance that the trade may not go through defects in physical securities that the issuer of the security is allowed to refuse transfer of legally. These risks disappear in depository based settlement and hence the cost in that case is zero.

Estimate of Impact Cost in Indian Securities Market

Impact Cost	
Year	Cost
1996	0.25%
2001	0.20%
2002	0.12%
2003	0.10%
2004	0.09%
2005	0.08%
2006	0.08%
2007	0.08%

Source: Shah (2009)

Note: These estimates are for a transaction of Rs 5 million on the Nifty, the broad market index of National Stock Exchange.

Table VI

Progress in Dematerialisation

	NSDL						CDSL					
	Companies		DPs	MC (Rs billion)	MC %	Value Settled (Rs billion)	Companies		DPs	MC (Rs billion)	MC %	Value Settled (Rs billion)
	Signed	Live					Signed	Live				
2001-02	4210	4172	226	6,150	49%	1,088	4293	4284	350	NA		314
2002-03	4803	4761	241	6,005	54%	1,269	4628	4628	397	5,921	53%	331
2003-04	5216	5212	242	11,071	48%	2,784	4810	4810	108	11,923	51%	837
2004-05	5537	5536	340	16,383	50%	3,970	5068	5068	243	16,712	51%	894
2005-06	6022	6022	364	30,051	51%	6,477	5479	5479	438	29,527	51%	1,371
2006-07	6483	6483	707	35,988	52%	8,305	5589	5589	529	33,894	49%	1,971
2007-08	7354	7354	803	52,197	52%	14,207	5943	5943	740	51,626	52%	3,832
2008-09	7801	7801	946	31,103	52%	10,889	6213	6213	815	31,437	53%	2,240

Source: Various annual reports of SEBI and author's compilation

NSDL is National Securities Depository Ltd
CDSL is Central Depository Services Ltd.
DP is Depository Participants
MC is Market Capitalisation is the market value of scrips dematerialized upto the end of that year
MC% is the % of the market capitalization of scrips dematerialized to the sum of market capitalization of the National Stock Exchange and The Stock Exchange Mumbai

Data for the analysis above is available in the SEBI annual report starting 2001-02. However, dematerialization started in 1997 and was mandated in phases

Table VII (a)

All amounts in billions of rupees

Institutional Resource Mobilisation of Funds

	Mutual Funds				FIIs	
	Gross	Redemption	Net	AUM	Net	Cumulative
1993-94	621				51	51
1994-95	137				48	99
1995-96	65				69	169
1996-97	48				86	255
1997-98	114				60	314
1998-99	227	237	-950	689	-16	298
1999-00	612	423	190	1079	101	399
2000-01	930	838	91	906	99	499
2001-02	1645	1573	72	1006	88	586
2002-03	3147	3105	42	1093	27	613
2003-04	5902	5434	468	1396	458	1071
2004-05	8397	8375	22	1496	459	1530
2005-06	10981	10454	528	2319	415	1944
2006-07	19385	18445	940	3263	308	2253
2007-08	44644	43106	1538	5052	662	2915
2008-09	54264	54547	-283	4173	-458	2456

Source: Various annual reports of SEBI and author's compilation

Note: FIIs stands for Foreign Institutional Investors
MF stands for Mutual Funds
AUM is Assets Under Management
NSE is National Stock Exchange and BSE is The Stock Exchange, Mumbai

Table VII (b)

Break up of Funds Mobilised by Mutual Funds

All amounts in billions of rupees

	Public Sector	Private Sector	Public Sector	Private Sector
	1	2	3	4
1990-91	75	0	100%	0%
1991-92	113	0	100%	0%
1992-93	130	0	100%	0%
1993-94	97	16	86%	14%
1994-95	100	13	88%	12%
1995-96	-60	13	100%	0%
1996-97	-30	9	0%	100%
1997-98	33	7	82%	18%
1998-99	6	21	23%	77%
1999-00	52	169	23%	77%
2000-01	18	93	17%	83%
2001-02	-60	161	0%	100%
2002-03	-75	121	0%	100%
2003-04	64	415	13%	87%
2004-05	-51	79	0%	100%
2005-06	109	416	21%	79%
2006-07	146	795	16%	84%
2007-08	206	1634	11%	89%
2008-09	104	-287	100%	0%

Source: http://rbidocs.rbi.org.in/rdocs/Publications/DOCs/78T_HB150909.xls, accessed on June 7, 2010.

Public Sector includes mutual funds owned and established by banks, financial institutions and insurance companies who are partly or entirely controlled owned and by the provincial governments or GoI. It includes the former Unit Trust of India.

Private sector includes mutual funds which are not in the public sector.

Columns 1 and 2 represent funds, net of redemptions, mobilized by mutual funds in that category during that year. Column 3 is the % of net funds raised by mutual funds in the Public Sector to the total funds raised during the year. Column 4 provides a similar percentage for funds raised by the private sector to the total funds raised.

In the case of negative amount of net funds raised in a particular year the proportion for that category has been shown as 0% while that of the other category that has a positive figure is shown as 100%.

SEBI enacted the SEBI (Mutual Funds) Regulations, 1993 during 1993-94 paving the way for mutual fund organizations in the private sector.

Table VIII

Record of Action Against Insider Trading and Market Manipulation

Year	Insider Trading		Market Manipulation	
	Taken Up	Completed	Taken Up	Completed
1996-97	4	0	67	0
1997-98	5	0	29	0
1998-99	4	4	40	31
1999-00	3	5	47	37
2000-01	6	4	47	27
2001-02	16	6	86	11
2002-03	13	14	95	72
2003-04	14	9	96	122
2004-05	7	10	110	148
2005-06	6	8	137	62
2006-07	18	10	95	77
2007-08	7	28	12	115
2008-09	14	14	52	86

Source: SEBI Handbook of Statistics 2009

Table IX

Compliance Enforcement Record of SEBI

	Complaints			Investigations	
	Received	Redressed	Redressal Rate	Taken Up	Complete
1991-92	18,794.00	4,061.00	22%		
1992-93	129,111.00	27,007.00	21%	2	2
1993-94	713,773.00	366,524.00	51%	3	3
1994-95	1,229,853.00	718,366.00	58%	2	2
1995-96	1,606,331.00	1,034,018.00	64%	60	18
1996-97	1,823,725.00	1,465,883.00	80%	122	55
1997-98	2,335,232.00	2,142,438.00	92%	53	46
1998-99	2,434,364.00	2,269,665.00	93%	55	60
1999-00	2,532,969.00	2,416,218.00	95%	56	57
2000-01	2,629,882.00	2,501,801.00	95%	68	46
2001-02	2,711,482.00	2,572,129.00	95%	111	21
2002-03	2,748,916.00	2,611,101.00	95%	125	106
2003-04	2,785,660.00	2,632,632.00	95%	121	152
2004-05	2,840,095.00	2,685,993.00	95%	130	179
2005-06	2,880,580.00	2,723,060.00	95%	165	81
2006-07	2,907,053.00	2,740,959.00	94%	120	102
2007-08	2,961,986.00	2,772,577.00	94%	25	169
2008-09	2,674,560.00	2,503,560.00	94%	76	116