PROTECTION OF INVESTORS IN SECONDARY MARKET THROUGH SECURITIES CONTRACTS REGULATION ACT

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Abstract

The economic reforms of the early nineties created four new institutions: the Securities and Exchanges Board of India (SEBI), the National Stock Exchange, the National Securities Clearing Corporation, and the National Securities Depository. The National Stock Exchange (NSE) is a limited liability company owned by public sector financial institutions and now accounts for about two-thirds of the stock trading in India, as well as virtually all of its derivatives trading. The National Securities Clearing Corporation is the legal counter-party to net obligations of each brokerage firm, and thereby eliminates counter-party risk and the possibility of payments crises. It follows a rigorous 'risk containment' framework involving collateral and intra–day monitoring. The NSCC, duly assisted by the National Securities Depository, has an excellent record of reliable settlement schedules since its inception in the mid-1990s.

INTRODUCTION

India currently has two major stock exchanges--the National Stock Exchange, established in 1994, and the Bombay Stock Exchange (BSE), the oldest stock exchange in Asia, established in 1875. Until 1992 the BSE had a monopoly, marked with inefficiencies, high costs of intermediation, and manipulative practices, so external market users often found them disadvantaged. The Securities and Exchanges Board of India has introduced a rigorous regulatory regime to ensure fairness, transparency and good practice. For example, for greater transparency, the SEBI has mandated disclosure of all transactions where the total quantity of shares is more than 0.5% of the equity of the company. Brokers must disclose to the Stock Exchange, immediately after trade execution, the name of the client and other trade details, and the Exchange must then disseminate this information to the general public on the same day. The new environment of improved transparency, fairness, and efficient regulation led BSE to also become a transparent electronic limit order book market in 1996, with an efficient trading system similar to the NSE. Equity and equity derivatives trading in India has skyrocketed to record levels over the last ten years. Currently, about 5000 companies are listed and traded on NSE and/or BSE. While the dollar value of trading on the Indian stock exchanges is much lower than the dollar value of trading in Europe or the United States, it is important to note that the number of equity trades on BSE/NSE is about ten times greater than that of Euronext or the London Stock Exchange, and of the same order of magnitude as thatof NASDAQ and the New York Stock Exchange. Similarly, the number of derivatives trades on NSE is several times greater than that of Euronext or London, and is comparable to US derivatives exchanges. The number of trades is an important indicator of the extent of investor interest and participation in equities and equity trading, and provides important incentives for improving corporate governance practices in India.

Provisions of the Securities Contracts Regulation Act relating to Recognition of Stock Exchanges

Trading in secondary market is possible through recognised stock exchanges. These exchanges must have recognition from Central Government or from Securities and Exchange Board of India. The provisions of recognition are prescribed by the Securities Contracts (Regulation) Act 1956. The main provisions are as under:-

Object of the Act- The Securities Contracts (Regulation) Act, 1956 is enacted to prevent undesirable transactions in securities by regulating the business of dealing therein by providing for certain other matters connected therewith. It was enacted in the seventh year of the Republic Of India.

Important Definitions defined under the Act :-

a) Contract - "contract" means a contract for or relating to the purchase or sale of securities.
b) Corporatisation - "corporatisation" means the succession of a recognised stock exchange, being a body of individuals or a society registered under the Societies Registration Act, 1860 (21 of 1860), by another stock exchange, being a company incorporated for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities carried on by such individuals or society.
c) Demutulisation - "demutualisation" means the segregation of ownership and management from the trading rights of the members of a recognised stock exchange in accordance with a scheme approved by the Securities and Exchange Board of India;
d) Derivative**-** "derivative" includes—
   (a) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;
   (b) a contract which derives its value from the prices, or index of prices, of underlying securities;

e) Government Security - Government security means a security created and issued, whether before or after the commencement of this Act, by the Central Government or a State Government for the purpose of raising a public loan and having one of the forms specified in clause (*2*) of section 2 of the Public Debt Act, 1944.

f) Option in securities- "option in securities" means a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a *teji, a mandi, a teji mandi, a galli,* a put, a call or a put and call in securities.
g) Recognised Stock Exchange- "recognised stock exchange" means a stock exchange which is for the time being recognised by the Central Government under section 4.

h) Rules - "rules", with reference to the rules relating in general to the constitution and management of a stock exchange, includes, in the case of a stock exchange which is an incorporated association, its memorandum and articles of association.

RECOGNITION STOCK EXCHANGES

Section 3 and 4 of the Securities Contract (Regulation) Act, 1956 contains the provisions relating to recognition of Stock Exchanges. The central Government has the power to grant recognition to stock exchanges. Simultaneously, the SEBI is also empowered to give recognition and such powers as Central Government can exercise in relation to grant of recognition etc. The procedure of application for recognition and grant of recognition is prescribed as under :-

Application for recognition of stock exchanges.- Any stock exchange, which is desirous of being recognised may make an application in the prescribed manner to the Central Government. Every application shall contain such particulars as may be prescribed, and shall be accompanied by a copy of the bye-laws of the stock exchange for the regulation and control of contracts and also a copy of the rules relating in general to the constitution of the stock exchange and in particular to -

(*a*) the governing body of such stock exchange, its constitution and powers of management and the manner in which its business is to be transacted;
(*b*) the powers and duties of the office bearers of the stock exchange;

(*c*) the admission into the stock exchange of various classes of members, the qualifications for membership, and the exclusion, suspension, expulsion and readmission of members.

(*d*) the procedure for the registration of partnerships as members of the stock exchange in cases where the rules provide for such membership; and the nomination and appointment of authorized representatives and clerks.

Grant of recognition to stock exchanges

If the Central Government is satisfied, after making such inquiry as may be necessary and after obtaining such further information and satisfied himself that the rules and bye-laws of a stock exchange applying for registration are in conformity with such conditions as may be prescribed with a view to ensure fair dealing and to protect investors. The central Government is satisfied that the stock exchange is willing to comply with any other conditions (including conditions as to the number of members) which the Central Government, after consultation with the governing body of the stock exchange and having regard to the area served by the stock exchange and its standing and the nature of the securities dealt with by it, may impose for the purpose of carrying out the objects of this Act; and the Central Government or SEBI, as the case may be, find that in the interest of the trade and also in the public interest to grant recognition to the stock exchange; it may grant recognition to the stock exchange subject to the conditions imposed upon it. The conditions which the Central Government may prescribe under may include, among other matters, conditions relating to the qualifications for membership of stock exchanges, the manner in which contracts shall be entered into and enforced as between members and the representation of the Central Government on each of the stock exchange by such number of persons not exceeding three as the Central Government may nominate in this behalf; and the maintenance of accounts of members and their audit by chartered accountants whenever such audit is required by the Central Government.

Withdrawal of recognition of Stock Exchange

If the Central Government/ SEBI is of opinion that the recognition granted to a stock exchange should, in the interest of the trade or in the public interest, be withdrawn, the Central Government may serve on the governing body of the stock exchange a written notice in this regard and after giving an opportunity to the governing body to be heard in the matter, the Central Government may withdraw, by notification in the Official Gazette, the recognition granted to the stock exchange. However, it will not have any effect on the validity of any contract entered into before the date of such notification.

Powers of Stock Exchanges

To make rules restricting voting rights, etc.- A recognised stock exchange may make rules or amend any rules made by it to provide for all or any of the following matters, namely:—

(*a*) the restriction of voting rights to members only in respect of any matter placed before the stock exchange at any meeting;

(*b*) the regulation of voting rights in respect of any matter placed before the stock exchange at any meeting so that each member may be entitled to have one vote only, irrespective of his share of the paid-up equity capital of the stock exchange;

(*c*) the restriction on the right of a member to appoint another person as his proxy to attend and vote at a meeting of the stock exchange;

(*d*) such incidental, consequential and supplementary matters as may be necessary to give effect to any of the matters specified in clauses (*a*), (*b*) and (*c*).

The rules of a recognised stock exchange made or amended in relation to any matter shall not have effect until they have been approved by the Central Government and published by that Government in the Official Gazette and, in approving the rules so made or amended, the Central Government may make such modifications therein as it thinks fit, and on such publication, the rules as approved by the Central Government shall be deemed to have been validly made, notwithstanding anything to the contrary contained in the Companies Act, 1956.

LISTING OF SECURITIES AT RECOGNISED STOCK EXCHANGES

Meaning of Listing- Listing means admission of securities of any incorporated company, Central and state Governments, Quasi-Governmental and other financial institutions/ corporations, municipalities, electricity, housing boards, etc. to dealings on a recognised stock exchange. 'Listing' denotes the permission granted by a recognised stock exchange to a public company for the purpose of the company's particular securities being traded or dealt on the stock exchange, which has granted such permission. Listing means the admission of the securities of a company to trading privileges on a stock exchange. The Supreme Court held in the matter of the Raymond Synthetics Ltd. Vs Union of India[182] that the principal objectives of listing are to provide ready marketability and impart liquidity and free negotiability to stocks and shares. Ensure proper supervision and control of dealings therein; and protect the interest of shareholders and of the general investing public".

Advantages of listing- The stock exchange offers for listed securities an open trading platform where buyers and sellers from all over the country trade on terms of perfect equality and evolve a competitive market price. The following are some of the specific advantages of listing to its different beneficiaries

To the investors:

1. Since the securities are officially traded , liquidity of investment by the investors is well ensured;
2. rights entitlement in respect of further issues can be disposed of in the market;
3. investment in listed securities are well preferred by bankers for extending loan facility;
4. official quotations of the securities on the stock exchange corroborate the

valuation taken by the investors for purposes of tax assessments under Income Tax Act, Wealth tax Act etc.

5. since securities are quoted, there is no secrecy of the price realization of securities sold by the investors;
6. the rules of the stock exchange protect the interest of the investors in respect of their holdings;
7. listed companies are obligated to furnish unaudited/ audited financial results on a quarterly basis within a months of the expiry of the period. The said details enable the investing public to appreciate the financial results of the company in between the financial year;
8. Takeover offers concerning listed companies are to be announced to the public. This will enable the investing public to exercise their discretion on such matters.

To the company:

1. The company gains national and international importance by its share value quoted on the stock exchanges;
2. Financial institutions / bankers extend easy and liberal term loan facilities in the form of rupee currency and foreign currency loan;
3. It helps the company to mobilize resources from the shareholders through 'Right Issue' for programmes of expansion and modernization without depending on the financial institutions in line with the Government policies;
4. It ensures wide distribution of shareholding thus avoiding fears of easytake over of the organisation by others.

Conditions for listing- Where securities are listed on the application of any person in any recognised stock exchange, such person shall comply with the conditions of the listing agreement with that stock exchange.

Condition precedent for listing– The SCR Rules stipulated a condition of minimum public offer of securities to be listed. According to this rule, at least 10 per cent of each class or kind of securities issued by a company was offered to the public for subscription through advertisement in newspapers for a period not less than two days and that applications received in pursuance of such offer were allotted subject to the following conditions:

(a) Minimum 20 lakh securities (excluding reservations, firm allotment and promoters' contribution) was offered to the public;

(b) The size of the offer to the public, i.e., the offer price multiplied by the number of securities offered to the public was minimum Rs. 100 crores; and

(c) The issue was made only through book building method with allocation of 60 per cent of the issue size to the qualified institutional buyers.

The Obligations of a Listed Company under the Listing Agreement

Listing agreement is an agreement entered into between the issuer and the stock exchanges where the securities of the issuer are listed/ intended to be listed. Globally, stock exchanges set out various rules and regulations for issuers whose securities are listed at such stock exchanges. Compliance with the listing condition is mandatory by virtue of the relevant governing law of the land.

Delisting of securities- A recognised stock exchange may delist the securities, after recording the reasons therefore, from any recognised stock exchange on any of the ground or grounds as may be prescribed under this Act. That the securities of a company shall not be delisted unless the company concerned has been given a reasonable opportunity of being heard. A listed company or an aggrieved investor may file an appeal before the Securities Appellate Tribunal against the decision of the recognised stock exchange within fifteen days from the date of the decision.

Right of appeal to Securities Appellate Tribunal against refusal of stock exchange to list securities of public companies

Where a recognised stock exchange, acting in pursuance of any power given to it by its bye-laws, refuses to list the securities of any company, the company shall be entitled to be furnished with reasons for such refusal, and may,—

- **a)** Within fifteen days from the date on which the reasons for such refusal are furnished to it, or
- **b)** where the stock exchange has omitted or failed to dispose of, within the time specified, the application for permission for the shares or debentures to be dealt with on the stock exchange, within fifteen days from the date of expiry of the specified time or within such further period, not exceeding one month, as the Securities Appellate Tribunal may, on sufficient cause being shown, allow, appeal to the Securities Appellate Tribunal having jurisdiction in the matter against such refusal, omission or failure. There upon the Securities Appellate Tribunal may, after giving the stock exchange, an opportunity of being heard,—

(*i*) vary or set aside the decision of the stock exchange; or
(*ii*) where the stock exchange has omitted or failed to dispose of the application within the specified time, grant or refuse the permission, and where the Securities Appellate Tribunal sets aside the decision of the recognised stock exchange or grants the permission, the stock exchange shall act in conformity with the orders of the Securities Appellate Tribunal.

Penalties and Procedure for Imposing Them

Section 23- 23J contains the provisions regarding grounds of penalties and procedure for imposing them. In this part, the grounds and procedure is discussed as hereunder:

Grounds for imposing Penalties

Any person who—

(*a*) without reasonable excuse (the burden of proving which shall be on him) fails to comply with any requisition made under sub-section (4) of section 6; or

(*b*) enters into any contract in contravention of any of the provisions contained in section 13 or section 16; or

(*c*) contravenes the provisions contained in section 17, or section 19; or (*d*) enters into any contract in derivative in contravention of section 18A or the rules made under section 30;

(*e*) owns or keeps a place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act and knowingly permits such place to be used for such purposes; or

(*f*) manages, controls, or assists in keeping any place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act or at which contracts are recorded or adjusted or rights or liabilities arising out of contracts are adjusted, regulated or enforced in any manner whatsoever; or

(*g*) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17 willfully represents to or induces any person to believe that contracts can be entered into or performed under this Act through him; or

(*h*) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17, canvasses, advertises or touts in any manner either for himself or on behalf of any other persons for any business connected with contracts in contravention of any of the provisions of this Act;

Any person who enters into any contract in contravention of the provisions contained in section 15 or who fails to comply with the provisions of section 21 or section 21A or with the orders of or section 22 or with the orders of the Securities Appellate Tribunal shall, without prejudice to any award of penalty by the Adjudicating Officer under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees, or with both.

OTHER GROUNDS FOR IMPOSING PENALTIES

Penalty for failure to furnish information, return, etc.- Any person, who is required under this Act or rules-

(a) to furnish any information, document, books, returns or report to a recognised stock exchange, fails to furnish the same within the time specified therefore in the listing agreement or conditions or bye-laws of the recognised stock exchange, shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less for each such failure;
(b) to maintain books of account or records, as per the listing agreement or conditions, or bye-laws of a recognised stock exchange, fails to maintain the same, shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure by any person to enter into an agreement with clients- If any person, who is required under this Act or any bye-laws of a recognised stock exchange made there under, to enter into an agreement with his client, fails to enter into such an agreement, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less for every such failure.

Penalty for failure to comply with provision of listing conditions or delisting conditions or grounds-If a company or any person managing collective investment scheme or mutual fund, fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof, it or he shall be liable to a penalty not exceeding twenty-five crore rupees.

Penalty for excess dematerialisation or delivery of unlisted securities- If any issuer dematerializes securities more than the issued securities of a company or delivers in the stock exchanges the securities which are not listed in the recognised stock exchange or delivers securities where no trading permission has been given by the recognised stock exchange, he shall be liable to a penalty not exceeding twenty-five crore rupees.

Penalty for failure to furnish periodical returns, etc- If a recognised stock exchange fails or neglects to furnish periodical returns to the Securities and Exchange Board of India or fails or neglects to make or amend its rules or bye-laws as directed by the Securities and Exchange Board of India or fails to comply with directions issued by the Securities and Exchange Board of India, such recognized stock exchange shall be liable to a penalty which may extend to twenty-five crore rupees.

Penalty for contravention where no separate penalty has been provided-

Whoever fails to comply with any provision of this Act, the rules or articles or bye laws or the regulations of the recognised stock exchange or directions issued by the Securities and Exchange Board of India for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.

Procedure for imposing penalties

SEBI's Power to adjudicate- For the purpose of adjudging under sections 23A, 23B, 23C, 23D, 23E, 23F, 23G and 23H, the Securities and Exchange Board of India shall appoint any officer not below the rank of a Division Chief of the Securities and Exchange Board of India to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty. While holding an inquiry, the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document, which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in sub-section (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections. All sums realized by way of penalties under this Act shall be credited to the Consolidated Fund of India.

Appeal to Securities Appellate Tribunal- Any person aggrieved, by the order or decision of the recognised stock exchange or the adjudicating officer or any order made by the Securities and Exchange Board of India under section 4B, may prefer an appeal before the Securities Appellate Tribunal and the provisions of sections 22B, 22C, 22D and 22E of this Act, shall apply, as far as may be, to such appeals.

Offences- if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations or bye-laws made there under, for which no punishment is provided elsewhere in this Act, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both. If any person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years, or with fine, which may extend to twenty-five crore rupees, or with both.

Cognizance of offences by courts- No court shall take cognizance of any offence punishable under this Act or any rules or regulations or bye-laws made thereunder, save on a complaint made by the Central Government or State Government or the Securities and Exchange Board of India or a recognised stock exchange or by any person. No court inferior to that of a Court of Session shall try any offence punishable under this Act.

Investor's Rights Relating to Dividends, Income from Collective Investment Scheme and Mutual Funds

Title to dividends- It shall be lawful for the holder of any security whose name appears on the books of the company issuing the said security to receive and retain any dividend declared by the company in respect thereof for any year, notwithstanding that the said security has already been transferred by him for consideration, unless the transferee who claims the dividend from the transferor has lodged the security and all other documents relating to the transfer which may be required by the company with the company for being registered in his name within fifteen days of the date on which the dividend became due.

Right to receive income from collective investment scheme- It shall be lawful for the holder of any securities, being units or other instruments issued by the collective investment scheme, whose name appears on the books of the collective investment scheme issuing the said security to receive and retain any income in respect of units or other instruments issued by the collective investment scheme declared by the collective investment scheme in respect thereof for any year, notwithstanding that the said security, being units or other instruments issued by the collective investment scheme, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units or other instruments issued by the collective investment scheme from the transfer or has lodged the security and all other documents relating to the transfer which may be required by the collective investment scheme with the collective investment scheme for being registered in his name within fifteen days of the date on which the income in respect of units or other instruments issued by the collective investment scheme became due.

Right to receive income from mutual fund-
It shall be lawful for the holder of any securities, being units or other instruments issued by any mutual fund, whose name appears on the books of the mutual fund issuing the said security to receive and retain any income in respect of units or other instruments issued by the mutual fund declared by the mutual fund in respect thereof for any year, notwithstanding that the said security, being units or other instruments issued by the mutual fund, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units or other instruments issued by the mutual fund from the transferor has lodged the security and all other documents relating to the transfer which may be required by the mutual fund with the mutual fund for being registered in his name within fifteen days of the date on which the income in respect of units or other instruments issued by the mutual fund became due.

Conclusion

The trading in secondary market is conducted by stock exchanges. It is primary duty of the Securities and Exchange Board of India to regulate these stock exchanges, so that investor's rights can be protected. The Securities Contracts (Regulation) Act, 1956 contains provision to regulate these stock exchanges. Under these provisions, the SEBI has been given powers to recognize these stock exchanges to conduct business in secondary market. While giving recognition to them, the SEBI can impose any conditions in the interest of investors. Under the SCR Act certain formalities has been prescribed to be followed by intending stock exchanges. If the SEBI is of the opinion that it is in the interest of investors to withdraw the recognition, then it can withdraw the recognition. The civil court has no jurisdiction in the matter of recognition of stock exchanges or withdrawal of recognitions. The aggrieved person can appeal to the Securities Appellate Tribunal. Moreover, any person aggrieved by the decision of the SAT may file an appeal to Supreme Court of India. The SCRA has also provides certain penalties who fails to comply with the provisions of it. Therefore, the Securities and Exchange Board of India is regulating the working of stock exchanges and company at Secondary market under the provisions of the Securities Contracts (Regulation) Act, 1956 and the Securities Contracts Regulation Rules 1957.

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