

# DOES SEBI REQUIRE A SUPER REGULATOR FOR CAPITAL MARKET STABILITY? (AN APPRAISAL)

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## ABSTRACT

The Securities Exchange Board of India (SEBI) was established in 1992 with the objective of being a market regulator. It was to improve the transparency and standards of disclosure in public issues and to bring about a transformation in the stock exchanges in India. The ultimate aim of SEBI was to protect the investors from unfair and fraudulent practices by regulating the capital market and efficiently handling the investor's complaints. This paper is an attempt to determine the extent of coordination between the regulators such as Reserve Bank of India, Insurance Regulatory Authority of India, Pension Fund Regulatory Development of India and Securities Exchange Board of India and whether there is a need for a super regulator to stabilize the capital market. It seeks to answer some key questions. Has SEBI been able to bring reforms in the capital market? Has it fulfilled the objective of investor protection? Does SEBI need a super regulator for bringing about financial stability in the capital market in India?

## BACKGROUND

The Securities and Exchange Board of India (SEBI) was established in 1992 by an Act of Parliament. This was followed by the dissolution of the Controller of Capital Issues (CCI) that exercised its powers according to Capital Issue (Control) Act 1947<sup>1</sup>. The Controller of Capital Issues became an ineffective and dormant institution as it did not respond to changes in the stock market and issues relevant to the dynamic developing economy. SEBI was set up to take up these new challenges through promotional and regulatory measures. It was given regulatory powers over intermediaries like underwriters, registrars to issue, bankers entrusted with issue work, share transfer agents and debenture trustees. The organizational setup of SEBI was formed with the head office at Mumbai. It had a Chairman, two members of Government of India (GOI), Ministry of Law and Finance, one member from the RBI and two other members.

Two other important Acts which are constituent to the Indian financial system are Companies Act 1956 and Securities Contract Regulation Act (SCRA), 1956.

The Companies Act covers financial and non-financial aspects of corporate affairs and helps in integrated relationship between promoters, investors and management. The SCRA regulates stock exchanges to prevent undesirable transactions and speculations and stipulates laws for strong investment markets. The Companies Act is under Ministry of Law Department of Company Affairs and the SCRA is under the Ministry of Finance Department of Economic affairs, Government of India. (GoI) Certain powers of Company Acts and SCRA have been delegated to SEBI. However, as reforms were brought in the Indian Financial System the need for regulation was considered in banking sector, insurance and various service sectors. India now has several independent regulatory authorities. These are Reserve Bank of India (RBI), Insurance Regulatory Authority of India, (IRDA) Pension Fund Regulatory Development Authority of India (PFRDA) and Securities Exchange Board of India (SEBI).

SEBI was given the role of regulating the five important areas of primary market, secondary stock market, investor's protection mutual funds, and

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<sup>1</sup> The Controller of Capital Issues regulated the private sector companies in their activities concerning securities to be issued in the primary market, related to issues such as timing, composition, interest and dividend rates on debentures and preference shares, price of right issues and premium on securities.

foreign institutional agencies. The main objective of SEBI in the primary securities market was to improve the transparency and standards of disclosure in public issues. In the secondary stock market, SEBI was to help in the transformation process of stock exchanges through modernization, raising accounting standards of firms and intermediaries and professionalizing stock broking system and having uniform By-laws for stock exchanges. Amongst the promotional steps, SEBI was to promote investors education and training of intermediaries in the securities market, conduct research and regulate substantial acquisition of shares and takeover of companies and thereby curb unfair and fraudulent practices relating to securities market especially relating with insider trading practices. All mutual funds were to be registered with SEBI and were to provide portfolio disclosure and standardization of accounting policies and would provide guidelines for valuation norms and pricing of issues. It also had the role of getting FIIs registered with it and to issue guidelines about transactions that could be conducted by them in the Indian capital market.

The most important function of SEBI was to protect investors by acting as a regulatory mechanism enlightening and guiding them on various issues related to the securities market and providing an insight to them of their rights and limitations and remedies to the situation by handling investors' complaints through an efficient system<sup>2</sup>.

## **OBJECTIVES OF THE STUDY**

The objective of the SEBI was to protect the interest of the investors and to promote development in the securities market. This paper attempts to find out the performance of SEBI in its role as a regulatory mechanism. Has SEBI been able to exercise control in capital market? Has it fulfilled the objective of investor protection for which it was conceived? Is there a coordination between the regulators Reserve Bank of India (RBI), Insurance Regulatory Authority of India, (IRDA) Pension Fund Regulatory Development Authority of India (PFRDA) and Securities Exchange Board of India (SEBI)? Does SEBI require a super

regulator for bringing about financial stability in the capital market in India?

Is the role of SEBI promotional or merely one with a plethora of legislations and no follow up programs are some questions it seeks answers to. The role of SEBI has been analyzed in different sections. Section I discusses the reforms in the primary market and Section II discusses the secondary market reforms, Section III SEBI'S failure in investor protection, Section IV discusses coordination between the regulators, the need for super regulator and implications and Section V provides the conclusions.

## **I. SEBI AND REFORMS IN THE PRIMARY SECURITIES MARKET**

The developments in the primary securities market was as a result of the recommendations of the Malegam Committee Report which was implemented by SEBI in 1995.

### **1. Criteria for Initial Public Offer**

SEBI made certain important reforms in the primary securities market to protect the investors from fraudulent dealings. An eligibility criterion for new issues was enforced by SEBI. A company was eligible for a new issue if it satisfied the following three conditions: The Company should have paid a dividend for at least three years prior to the public issue. It should have its project appraised by banks or financial institutions having a 10% stake in equity participation of the issuing company and the company should be listed with OTCEI (over the counter exchange of India). It has also been stated by M.T Raju (economic advisor to SEBI) that there should be transparency in new issues and for this reason it was necessary that prospectus of company was to be made available to public to give financial projections in their offer documents<sup>3</sup>.

### **2. Allotment of Shares**

SEBI made a reform relating to allotment of shares to investors 35% of the public offer was to be reserved for individual/retail investors applying for less than Rs. 1

<sup>2</sup> *Investor's complaints relating to delay in receiving shares or refund orders and to ensure that no malpractice take place in allotment of shares.*

<sup>3</sup> *M.T Raju Prospects of Indian Capital Markets, indepth information and reforms UTI Institute of Capital Markets & Birla Institute of Management and Technology. All India management convention 1997 papers, page 1.2. Convention held by BIMTECH AND UTI Capital Markets PHD House, Delhi 1997.*

lakh. SEBI reported in August 2010 that this amount should be doubled to Rs. 2 lakh to give preference to individuals for making investments in the capital market. SEBI also reformed the procedures of time period within which the closure of the allotment was to take place. The applicants of shares were to receive the number of shares allotted to them within 30 days of closure of the issue. After the stipulated time the company would have to pay 15% rate of interest.

### **3. Costs of Public Issue**

There were to be mandatory restrictions on costs of public issue on underwriting commission, brokerage, fee of managers of issue, fee to registrars to the issue, listing fees and advertisement cost. Merchant Bankers and bankers to the issue were to be compulsorily registered and only corporate bodies were to be allowed to function as merchant bankers, restriction was imposed upon them for carrying out fund based activities exclusively in the capital markets. They were prohibited from accepting deposits and leasing and bill discounting.

### **4. Book Building**

Book building facility was developed in the initial public offer to bring about the flexibility of price and quantity which would be decided on the basis of demand to aid price and demand discovery<sup>4</sup>. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional as well as the retail investors. The issue price is determined after the bid closure based on the demand generated in the process. It is a flexible pricing method based on feedback from investors and in the US it is called soft underwriting.

## **II. SEBI AND REFORMS IN THE SECONDARY SECURITIES MARKET**

There are twenty four recognized stock exchanges in India. The major reform made by SEBI has been to modernize and develop the stock exchanges. The stock exchanges have screen based trading. OTCEI was the first automated exchange in India in 1992. The G.S

Patel Committee, Dave Committee, recommendations have been accepted for improvement in the Stock market.

### **1. Screen Based Trading**

SEBI made the reform of bringing about screen based trading on stock exchanges in India where trade used to take place manually for matching or recording of trades. This was time consuming and inefficient. This imposed limits on trading volumes and efficiency. In order to provide efficiency, liquidity and transparency, NSE in 1992, introduced a nationwide, on-line, fully automated screen based trading system (SBTS) where a member can punch into the computer the quantities of a security and the price at which he would like to transact, and the transaction is executed as soon as a matching sale or buy order from a counter party is found. In March 1995, BSE online trading (BOLT) was started. It brought about the facility of trading with order book functioning as an ancillary jobber. BOLT brought about improvement in trading of volumes of transactions. The order book allows retention and matching of orders and improves the price competitive character. It provides investors to place orders at prices better than the quotes presently available<sup>5</sup>.

### **2. Depository or Paperless Trading**

The Depository Act was passed in 1996 to dematerialize and transfer securities through electronic book entry to help in reducing settlement risks and infrastructure bottlenecks. The dematerialized securities do have any identification numbers or distinctive numbers. Trading of new initial public offers were to be in dematerialized form upon listing. The National Securities Depository Ltd., (NSDL) was set up in Nov 1996 for clearing and transferring shares after trade. An exclusive feature of the Indian Capital Market is that multiple depository system has been encouraged. Hence there are two Depository Services. The other depository system is called Central Depository Service Ltd. (CDSL) was started in 1999. Debt instruments however, are not transferable by endorsement delivery.

Dematerialization of securities is one of the major steps for improving and modernizing market and enhancing the level of investor protection through elimination of

<sup>4</sup> For more information on Book Building read H.R Machiraju, 1998 Indian Financial System, Vikas Publishing House, New Delhi, pp 12.16-12-19.

<sup>5</sup> For further reference read M.Y. Khan (2006), Indian Financial System (5th Edition), Tata McgrawHill, India p. 2.27.

bad deliveries and forgery of shares and expediting the transfer of shares.

### **3. Settlements and Clearing**

One of the major reforms in the secondary market by SEBI has been clearing and settlement of securities settlement involved netting of trades and drawing up of statements by members, amount of securities due, scrip-wise and member-wise. In a physical trade environment, trades were stuck on the floor statements had to be generated and confirmed by the members but in the computerized environment information the exchange can download the information to the member at the end of the day. There is a risk involved in the absence of a clearinghouse. The settlement cycle in India is T+2 days i.e. Trade + 2 days. T+2 means the transactions done on the Trade day, will be settled by exchange of money and securities on the second business day (excluding Saturday, Sundays, Bank and Exchange Trading Holidays). Pay-in and Pay-out for securities settlement is done on a T+2 basis. In 1996 after the M.S Shoes scam (1995) involving 18 crores of Rupees, a National Securities Clearing Corporation was started to guarantee all trades in NSE. Regional clearing facilities have also been provided.

### **4. Surveillance on Price Manipulation**

SEBI introduced surveillance and enforcement measures against intermediaries for violation of laws especially in price manipulations. All stock exchanges in India have surveillance departments which coordinate with SEBI and information has to be submitted by stock exchanges on daily settlement and monitoring reports. SEBI has also created a database for trading on National and Bombay Stock Exchanges. If price manipulation is detected auction proceeds may be impounded or frozen so that the manipulator cannot use it.

SEBI has introduced 'Stock Watch' an advances software for surveillance of market activities programmed to show movements from historical patterns through follow ups by analyst and trained investigators to act as a deterrent to trading and price rigging.

### **5. Insider Trading**

Insider Trading Regulations in 1992 notified by SEBI prohibited Insider trading, as it is unfair upon investors. Persons who possess price sensitive information because they have connections with a company take advantage of the situation to 'peg up' or 'down' prices of securities to their advantage. The TISCOs case is an example, whereby there was intense activity in trading volume of shares between October 22, 1992, and October 29, 1992, as there was insider information on poor performance of the companies working. Profits of the company had declined. After having brought trading under their control the prices of shares brought about a sharp fall in the prices from October 29 to Nov 6, 1992. Insiders had manipulated the market. When a probe took place the presence of insider information was considered to be the main problem area. As a result of this case, SEBI took precautions and enforced Insider Trading Regulation in November 1992, to protect the small investors from unfair advantage and fraudulent dealings.

### **6. Regulation of Stock Brokers**

SEBI passed Stock Broker and sub Brokers Regulation Act, in 1992. According to this Act brokers had to have a dual registration with SEBI and with the stock exchange in which it was dealing. Violation of laws by the broker would enforce penal action against him. Capital adequacy norms were introduced for individual brokers and for corporate brokers. Brokers had to maintain accounts for clients and brokers and disclosure of transaction price and brokerage separately in contract note was required. Audit was made compulsory of the brokers' books and filing of auditor's report with the SEBI was made mandatory<sup>6</sup>. SEBI also extended regulations to sub-brokers. Sub brokers had to be registered by entering into an agreement with the stock brokers from whom he got an affiliation. Sub brokers could transact business only through stock broker with whom he was registered.

### **7. Forward Trading and Badla**

Forward trading had been in practice in India as it was the main speculative activity in stock exchange. Futures and Options were absent in the Indian

<sup>6</sup> See information on SEBI in L M Bhole 1999, *Financial Institutions and Markets*, Tata McGraw Hill Publishing Co. Ltd., New Delhi, pp. 116-125.

Market and Forward Trading was called Contracts for Clearing. This system enabled a trader to play with price expectations, transfer outstanding buy or sell positions and delivery of securities<sup>7</sup>. In 1969, Contract trading was banned in India. However, a new system called Badla was developed which was used in Carry forward of trades to the settlement period. This system was regulated in 1983 by permitting trade through specified securities and carry forward facility up to 90 days<sup>8</sup>.

Controls were also set on margins and limits were placed on positions. In December 1993, badla was banned. In 1995, it was reviewed by Patel committee and SEBI reintroduced carry forward system with restrictions. 90-day limit was fixed for carry forward, trade settlements could be made in 75 days with delivery. For investor protection exchanges had to adopt a twin track trading system where transactions for delivery were separated from those that were carried forwards. Limits were also imposed on carry forwards positions and on scrip wise limits on brokers. Badla was again reviewed in 1997 by Varma Committee. SEBI increased carry forward limits of brokers to 20 crores and reduced margins from 15% to 10% and after the Ketan Parekh scam Badla was again banned from July 1, 2001. Trading in 246 scrips including all stocks that make of group A of Bombay Stock Exchange became cash down and day trade.

### **8. Options and Derivatives**

Options can be classified as call option or put options. The National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE) launched derivatives. They offer derivatives for three tenures one in the first instance each for subsequent 3 months. So in July Nifty call and put options can be purchased for July end,

August end and September end. The last day of the contract would be the expiration date<sup>9</sup>. In an options contract a premium has to be paid to enter a contract. Buyer's losses are limited to the extent of premium paid but his gains are unlimited. Seller's profits are limited to premiums received but losses are unlimited. These derivatives have been started by SEBI to bring about investor confidence to establish the market and to reduce risk. Initially options trading was allowed only in 14 stocks. Option will not allow a person to defer settlement of sale/purchase but they will enable placing of bets on Stock Markets.

### **9. Regulation of Mutual Funds**

SEBI regulated the mutual funds to provide portfolio disclosure and standardization of accounting procedures. The primary interest of SEBI to control mutual fund schemes was to protect investors from fraudulent deals.

SEBI enforced that mutual funds should have a trustee company separate from the asset management company and the securities of the various schemes should be kept with a custodian independent of the mutual fund. SEBI created certain procedures of valuation norms and asset value and pricing for the mutual funds. All mutual funds were to be regulated with the SEBI. All schemes of UTI after 1994 were also brought under the control of SEBI.

### **10. Regulation of Foreign Institutional Investors (FIIs)**

FII's have a large volume of funds. By the nature of their trading volumes FII's can retain control over a stock market. SEBI had to keep these FII's under its control for protecting the investors. Hence, all FII's had to be registered with the SEBI. As per Regulation

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<sup>7</sup> In this Badla system off setting transaction when entered into on the last day of settlement with the intent of reversing the positions in the following accounting period. The make up price was called Havala & was fixed by the Stock Exchange, while interest on transaction was determined by borrowers and lenders.

<sup>8</sup> There are 3 groups of shares A or specified group "B1" and "B2" shares, on Bombay stock Exchange. A group with weekly settlement on which forward trading is allowed. B1 with weekly settlement without facility of carry forward and B2 with fortnightly settlement. In September 1996, all settlement duration were reduced to one week. Distinctions between B1 & B2 have therefore no meaning. F group includes debt securities.

<sup>9</sup> Expiration date is the last date of the contract. There are European options in which the Buyer can exercise option on expiration. There are American options also in which a buyer can exercise his options any day before or on the day of the expiration. The difference between index options and stock options is the mode of settlement. Index options are settled in cash, while Stock Options result in delivery. Indian Options are based on European style if they are indexed options and American style if they are Stock Options. They will be settled in cash for the first 6 months.

6 of SEBI (FII) Regulations, 1995 and it has to pay a registration fee of US \$ 5,000.00. Foreign Institutional Investors are required to fulfill certain conditions to qualify for grant of registration. They should have track record, professional competence, financial soundness, experience, general reputation of fairness and integrity. It should be regulated by an appropriate foreign regulatory authority. It should have the permission under the provision of Foreign Exchange Management Act, 1999 from the Reserve Bank of India and must be legally permitted to invest in securities outside its country. It should be a fit and proper person and have a local custodian and designated bank to route its transactions. The FII's under SEBI include Pension Funds, Mutual Funds, Asset Management Companies, Investment Trust and Charitable Institutions.

### III. SEBI'S FAILURE IN INVESTOR PROTECTION

SEBI had been formed in India as a regulatory mechanism. It was to bring reforms in the Indian capital market with the main aim that protective measures are taken towards the investors. While speculation is encouraged and the standard of transparency are maintained through the disclosures and audited financial statements of companies, underwriters, promoters and brokers in the market. It is time to make an appraisal of SEBI's contribution towards investor's protection and whether it requires a super regulator to bring about financial stability in the capital market.

This section discusses the investor protection measures and whether the legislations and protection measures have brought about discipline in the capital market and

protection for the investors from fraudulent dealings and manipulations. Some of the questions discussed are whether legislations have been useful in curbing malpractices.

#### 1. Legislations and Financial Scams

SEBI has a plethora of legislations. These legislations aim at investor protection there have been many committees on reforms of Primary New Issue Market and Stock Market in India. The numbers of legislations that have taken place are shown in table I. The number of rules, regulations, general orders, guidelines, master circulars and circulars and the number of committees, sub-committees are very confusing. Further, there are continuous amendments. L. C. Gupta has pointed out that there are many clarification and additions to legislations and guidelines, which makes them incomprehensible. According to him some of the rules are so 'difficult to comprehend that different interpretations of the rules are made and too often these rules are changed. SEBI is not fulfilling purpose of self regulation which is its objective. It may wield undue power with interpretation of its own rules and regulations<sup>10</sup>.

Hence laws and rules must be initiated but there should be clarity because these laws can actually be a deterrent towards investor protection if there are confusions. This can create many loops holes as it is interpreted differently by different people. This does not bring about the benefit of protection to the investor. It is important to bring about clarity for the understanding of the common investor. As the situation prevails, brokers have often taken advantages of the system.

Table I: Legislations in Primary & Secondary Market

Primary market	Secondary market
Merchant Banker 1992, 2010.	Stock brokers & sub brokers regulations 1992, 2010.
Debenture Trustee 1993.	Insider Trading 1992, 2008.
Portfolio Managers 1993.	Unfair Trade Practices 1995.
Registrar to Issue 1993.	Depositories Act 1996.
Underwriters Regulations 1993.	D&P Regulations 1996.

<sup>10</sup> Gupta L. C., (1996) "Challenges before Securities and Exchange Board of India" *Economic and Political weekly*, March 23 p 751 Vol. 31, No. 12.

Bankers to an Issue 1994.	Credit Rating Agencies Regulations 1999, 2010.
Buyback of Securities Regulations 1998.	Procedure for Board Meetings 2001.
Foreign Venture Capital Investors Regulation 2000, 2010.	Securitization and reconstruction of financial assets and enforcement of security interest Act 2002
Sweat Equity Regulations 2002.	Prohibition of unfair trade practices 2003.
Listing Regulations 2002.	Database of market precipitant regulation 2003.
Self-Regulations 2004.	Holding enquiry and imposing penalty regulation 2004, 2005.
Criteria for fit and proper person Regulations 2004.	Guidelines for disclosure and investor protection 2000, amendment 2005.
Certification of Associated Persons in the Securities Markets Regulations 2007.	Foreign Institutional Investors 2008.
Acquisition of takeover of shares 2008, 2010.	Delisting of equity shares regulations, 2009
Credit rating agencies (amendment) regulations, 2010.	Issue of capital and disclosure requirements, 2009 amendment 2010.

Source: SEBI.

The following are the various financial scams which have had an impact on the Indian Capital Market in different spheres.

(i) **IPO Bubble:** The Controller of Capital Issues was abolished as there was a massive scam in the primary market. This scam had two parts, the first part was perpetrated by existing companies which inflated their prices in order to raise money at a great profit to fund Greenfield projects, most of which have failed to take off. The other half of the scam had a multitude of small traders, chartered accountants and businessmen, who joined hands with bankers and investment bankers to float new companies and raise public funds. The IPO bubble lasted three years from 1993 to 1996 was burst when prices of listed companies began to crash. As a result, there was huge investors' disappointment that the primary market remained dead for the next two years, till the beginning of the year 1999.

(ii) **UTI Scam:** One of the major scams of Indian financial market is with Unit Trust's US-64 scheme, which also brought about Information Technology (IT) bubble. The US-64 crisis is due to corporate mismanagement. US-64 scheme was considered to be a steady income scheme and this scheme should have been invested in low-risk fixed income government bonds. Instead, the managers invested in equities, with high-risk profile. It was found that equities far

exceeded debt in their portfolio. Apart from heavy investment in equity based portfolio, the scheme also invested in Ketan Parekh's K-10 portfolio which involves technology oriented investments like Global Tele and DSQ despite the fact that technology boom had ended. As a result, US-64 lost half of its portfolio value due to incorrect investments.

(iii) **Ketan Parekh Scam:** The example of the Ketan Parekh case shows loopholes in the inherent system of laws. SEBI has not been able to regulate the capital market agencies despite rules and regulations and committees for regulating the market mechanism. Companies, brokers, underwriters, promoters and investors have been able to take advantage due to the inherent weakness of the system. SEBI was formed after the Harshad Mehta scam in 1992 and in less than a decade a scam of a greater magnitude than the 1992 scam took place in India which shook the securities market and many investors lost their total personal belongings leading to many suicide cases. This shows that SEBI has failed as a regulatory mechanism. The Ketan Parekh scam has been as a result of broker-bank-corporate nexus, and it is the small investor which has had a magnitude of losses and the SEBI cannot be said to have fulfilled its role as a Watch Dog or as a surveillance institution which was one of the major reforms it was to undertake in the capital market.

(iv) **CRB Scam (1992-96):** Chain Roop Bhansali's (CRB) cardboard empire was built and disappeared. His empire comprised of a mutual fund, fixed deposit collection, a merchant bank and a provisional banking license. Many of these licenses required adequate scrutiny and approval by SEBI and the RBI, and that fact that they passed their responsibility reflects supervisory lethargy. Favourable credit ratings and audit reports and clearance from SEBI and RBI in favour of CRB created a pyramid based on high cost financing which finally collapsed. As a result, C. R. Bhansali, moved on to the dotcom business and the regulators who were never held accountable. On the other hand, millions of small investors lost their money through fixed deposits or the mutual fund, causing a huge systemic problem and losses to investors.

(v) **The 1998 collapse:** In 1998, Harshad Mehta after the scam of 1992 again made a return by floating a website to hand out stock tips and writing columns in several newspapers who were told that his column would push up their circulation figures. He rigged BPL, Sterlite and Videocon shares that ended in a complete collapse. The BSE President and Executive Director were both held morally responsible and had to quit from their responsible job positions.

(vi) **Badla Trade Scam:** The Badla or carry forward system is said to have encouraged malpractice in the stock market in India. According to Bhole "the regulatory ineffectiveness of SEBI in certain cases has been due to its concentration on symptoms rather than root causes. The present delivery system is highly conducive for manipulative operations and unhealthy speculation. SEBI has kept on tinkering with trading laws instead of doing away with such an outdated delivery system"<sup>11</sup>. According to him SEBI has been corporate friendly rather than investor friendly. L. C Gupta<sup>12</sup> has also stated that "the defect in the Indian Stock Exchange is the mixing of cash market with futures". He has time and again warned SEBI not to take adhoc decisions in Badla trade and to evolve a long term policy through the use of derivatives. From July 2, 2001, Badla has been banned and the introduction of derivatives like call and put options has been introduced with daily settlements. Rolling

settlement has been extended to all the scrips with effect from Dec-2001 and rolling settlement cycle has been made T+3 from 1st April 2002. The settlement cycle in India is now changed to T+2 days i.e. Trade + 2 days.

(vii) **IPO Scam (2004-05):** The corporate stock brokers such as Karvy and Indiabulls alongwith other stock brokers were involved in the IPO scam. The operators opened many fake accounts to purchase shares in IPOs for selling it at a later date at a high profit. The IPOs that were issued were oversubscribed even as much as 40 times due to this scam.

(viii) **Global Financial Crisis:** The subprime crisis that emerged in the US housing mortgage market in second-half of 2007 became a global financial crisis in 2008-09. The significant deterioration in global financial conditions since September 2008 led to severe problems of shortage in the short term funding markets, widening of risk spreads, sharp fall in equity prices and inactivity in the markets for asset-backed securities. The international developments had an impact into the Indian financial markets in September 2008. The strain on the accounts of financial institutions increased, creating the problem of viability of these institutions. A need was felt for greater co-ordination and co-operation amongst the policy making bodies to restore trust in markets. The BASEL Committee on banking supervision and the Financial Stability was to be known as financial stability board in its expanded version and it extended their membership to number of emerging markets including India. The RBI like other most central banks has taken various measures to improve the domestic and foreign exchange liquidity to make changes in supply constraints. However, the actions taken by them are different from central banks of other countries as they made reforms mainly through the banking channel.

(ix) **Satyam Scam:** In 2009, Ramalinga Raju, chairman of Satyam Computer Services stated that the company accounts had irregularities and faults statements. This scam was considered to be to the value of Rs. 12,000 crores and it was through a collusion of bankers, irresponsible authorities and the corporate organization. This had an effect on the outsourcing

<sup>11</sup> Bhole, 1999, *Financial Institutions and Markets*, Tata McGraw Hills Publishing Co. Ltd., New Delhi, p. 125.

<sup>12</sup> L.C.Gupta, is Director Society for Capital Market Research and former member of SEBI.



industry and the stock market. Government bailed out the corporate organization.

Problems of the small investors in relation to company matters or brokers dealings have been overlooked by SEBI despite legislations in this regard. There is a Brokers Act as well as Companies Act which is binding on these agencies and SEBI's objective of protecting the investor is a mere eyewash if these problems however small they appear are continuous. It clearly means that SEBI has not been able to use its control mechanism to the advantage of the investors in disciplining the brokers, companies, banks and other agencies. Such failings on the part of these agencies have not been given due consideration by SEBI.

SEBI has not been able to discipline UTI, which had a large number of shares of Ketan Parekh companies on its portfolios. SEBI's regulating mechanism through surveillance and watch dog operations should have seen unusual stock movements while UTI was purchasing shares of Ketan Parekh companies in large volumes. It is at that time it should have investigated into such purchases as the dividend of UTI 1964 Plan would be affected. Such shares are now worthless and affect the small share-holders as they will not be able to avail of dividends expected by them from UTI, which was supposed to be a stable mutual fund.

These problems have arisen because SEBI has a programme for investor awareness and education and guidelines for protection but no enforcement of guidelines are made

## **2. Insider Trading**

The random walk hypothesis states that in perfect competitive market conditions there should be equal information for all operators and there should be transparency in dealings and transactions. Hence there should not be any insider trading or rigging in the stock market. SEBI as a regulator has prohibited insider trading as per the Act. Insider trading takes place in other economies as well but it is illegal and the regulator has to be careful that insider trading does not take place. In the USA it is severely punished. One of the well known cases being SEC Vs Texas, Gulf Sulphur and in Shapiro Vs Merrilllynch, both the tipper and the tpee were prosecuted but in India Harshad Mehta who was responsible for a scam in

1992 was again in the price rigging scam through insider trading in 1998 in BPL, Sterlite and Videocon shares. There are further instances of Anand Rathi the Ex-president of Bombay Stock Exchange who gained insider information and used his official position for getting information into share prices and then was able to bring down the market through 'bear' operations. Finally Ketan Parekh manipulated the market through 10 software companies Table III. He purchased stocks of new software companies and in 6 months their prices reached at a very high level. In this way he cornered the market.

The question to be asked here is how did SEBI allow price rigging and not regulate the market at any time. How was Harshad Mehta allowed to operate again in the market after the scam of 1992? Why was his entry to the stock market not banned? 67 companies were under inspection and surveillance Table II. Why was timely action not taken against them? The Videocon International and Strelite Industries showed abnormal movements in April – May 1998 but investigation by SEBI was initiated only in the 3rd Week of June in 1998. In a stock market, which is highly volatile action should be taken at a fast pace. There were 18 brokers who were part of the scam and as SEBI had itself established that they had close links with Harshad Mehta. Table IV. How could a regulatory mechanism not adopt systems and steps before such a scam could take place? Lakshman Singhvi, Executive Director, SEBI pointed out that there should be integrity in the market and not artificial price rigging. In this market SEBI should take up the matter seriously.

**Table II: Inspection and surveillance under DCA\***

### **K P GROUP**

1. N H Securities Ltd.
2. Triumph Investment Finance Ltd.
3. Classic Share & Stock Broking Services Ltd.
4. K N P Securities Pvt. Ltd.
5. V N Parekh Securities Ltd.
6. Panther Fincap Management Services Ltd.
7. Panther Investrade Ltd.
8. Classic Credit Ltd.
9. Saimangal Investrade Ltd.
10. Classic Infin Ltd.

11. Panther Industrial Products Ltd.
12. Goldfish Computer Pvt. Ltd.
13. Nakshatra Software Pvt. Ltd.
14. Chitrakoot Computyard Ltd.
15. Luminant Investment Pvt. Ltd.
16. Triumph Securities Pvt. Ltd.

### **NIRMAL BANG GROUP**

17. Bama Securities Ltd.
18. Nirmal Bang Securities Ltd.
19. Bang Equity Broking Ltd.
20. Bang Securities Pvt. Ltd.
21. Suresh Rathi Securities Ltd.
22. Nadi Finance & Investment Pvt. Ltd.

### **SHANKAR SHARMA & DEVINA MEHRA GROUP**

23. First Global Finance Pvt. Ltd.
24. First Global Stock Broking Pvt. Ltd.
25. Vruddhi Confinvest India Pvt. Ltd.

### **SHAILESH SHAH GROUP**

26. Dolat Capital Market Ltd.
27. Nirpan Securities Ltd.
28. Shailesh Shah Securities Ltd.

### **RADHA KRISHNAN DAMANI GROUP**

29. Damani Share & Stock Brokers Pvt. Ltd.
30. Maheshwari Equity Brokers Pvt. Ltd.
31. Pratik Stockvision Pvt. Ltd.
32. Pruthi Share and Broking Ltd.
33. Damani Estate and Finance Ltd.
34. Brightstar Investment Ltd.
35. Krishna Securities Ltd.
36. Avenue Stock Brokers Pvt. Ltd.

### **AJAY KEYAN GROUP**

37. Makertich Ltd.
38. SMIFS Securities Ltd.
39. Stewart Securities Ltd.

40. Maya Trade Link Ltd.
41. Powerflow Holdings Ltd.
42. Makertich Consultancy Services Ltd.
43. PNR Securities Ltd.

### **CONSORTIUM GROUP**

44. Consortium Securities Ltd.
45. CSL Securities Ltd.
46. CSL Stock Broking Pvt. Ltd.

### **BLB GROUP**

47. BLB Ltd.

### **RATHI GROUP**

48. Rathi Global Finance Ltd.

### **ZEE TELE GROUP**

49. Zee Telefilms Ltd.
50. Zee Gold Refinery Ltd.
51. Siticable Network Pvt. Ltd.

### **OTHERS**

52. Palombe Securities and Finance Ltd.
53. Global Tele Systems Ltd.
54. HFCL
55. Digital Superhighway.
56. Bulington Finance Ltd.
57. Briggs Trading Co.
58. Prajamata Trading co.
59. Gajan Trading Co.
60. Churu Trading Co.
61. Nirma Ltd.
62. Ranbaxy Lab Ltd.
63. Kopran Ltd.
64. Adani Export Ltd.
65. Lupin Laboratories.
66. Padmini Polymers.
67. Shonkh Technologies Ltd.

**\*Directorate of company affairs.**

**Source:** Economic Times, 23rd June, 2001

Table III : KP – 10 Stocks

	HIGH OF 2000	PRICE ON 11.4.01
HIMACHAL FUTURISTIC	2553	83
GLOBAL TELESYSTEM	3550	116
ZEE	1630	100
AFTEK INFOSYS	5000	98
SILVERLINE	1361	62
PENTAMEDIA	2272	60
DSQ	2372	67
RANBAXY	1240	468
SSI	6640	490
SATYAM COMPUTERS	1430	230

Source: Stock Exchange Information papers.

Table IV: Videocon Sterlite BPL Scam

1. GNH Global Securities Ltd. – BSE Broker
2. Satyanarayan Nangalia – BSE Broker
3. R. R. Mehta – BSE Broker
4. M/s. Sharukh N. Tara & Co. – BSE Broker.
5. PR Shah Share & Stock Brokers Pvt. Ltd. – BSE Broker.
6. M/s. Ramrakh R. Bohra – BSE Broker.
7. Mahico Pvt. Ltd. – BSE Broker.
8. M/s. Mefcon Securities Ltd. Broker BSE and Broker NSE.
9. Lalkar Securities Pvt. Ltd. – BSE Broker.
10. Harvest Deal securities Pvt. Ltd. – BSE Broker.
11. Bharat J. Patel – BSE Broker.
12. Sony Securities Ltd. – NSE Broker.
13. Digital Leasing & Finance Ltd. – NSE Broker.
14. Valfin Financial Services Pvt. Ltd. – NSE Broker.
15. Stenly Credit Capital Ltd. – NSE Broker.
16. Asian Securities & stocks Ltd. – NSE Broker.
17. Star Share & stock Brokers Ltd. – NSE Broker.
18. Malar Share Shopper Ltd. – NSE Broker.

\* Source : SEBI (18 Brokers)

Preventive measures should be taken by SEBI rather than corrective actions after the event and scams are over. In the interest of the shareholders SEBI should regulate the market in such a way that scams are avoided and the Primary New Issue Market and

Securities Market is controlled and small investors are protected from the fraudulent games played by brokers, bankers and corporate organizations. This requires a continuous watch over the market with inspection and effective policies, which are investor friendly.

The next Section IV discusses the need for super regulator to stabilize the capital market.

#### IV. THE NEED FOR SUPER REGULATOR & ITS IMPLICATIONS

The past Indian experience states that despite the number of financial reforms that have taken place post-1991, there are several failures of SEBI in the control mechanism in the Indian capital market. Over of period of time, the country has established requisite mechanism to resolve differences amongst various regulators of financial market that is RBI, SEBI, IRDA and PFRDA to regulate money market, capital market, insurance sector and lastly the crucial pension sector too.

There is already a High-level Co-ordination Committee (HLCC) on financial and capital markets to discuss and determine the jurisdiction of various regulators in country. However, this committee has been found to be deficient in preventing territory wars between regulators. For example, there is a lack of clarity as to who will regulate ULIP's, whether IRDA or SEBI. Regulation of the debt market has had problems of coordination. Banks are the principal operators in the

debt segment and they are regulated by the RBI. SEBI, on the other hand, has to regulate financial markets. Coordination between the regulators is lacking and there is a need for inter coordination and demarcation of areas of control or joint control in areas where two or more regulators have to work in related areas. The creation of super regulation in such circumstances will not be necessary.

Creation of a Super Regulator by diluting SEBI powers for monitoring and regulating capital market will not serve the required purpose, rather, there is a need for intra regulatory co-ordination amongst various sub-committees of SEBI itself. Thus increasing the levels of hierarchy is not the correct solution but it is suggested that committees of timely surveillance is more suitable for growing and volatile stock markets of emerging developing countries like India.

A regulator is not there to see whether the market is going up or down but to ensure that whether market rises or falls, this reflects market sentiment, not market manipulation or other irregularities. The regulator must ensure that existing regulations are being strictly observed, and must be alert to any signals of regulations being subverted or by-passed so that corrective action is taken as quickly as possible.

There is a proposal to set up an apex level Financial Stability and Development Council. This council should be operative only to coordinate the activities of the existing financial sector regulators, including the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority (IRDA) and the Pension Fund Regulatory and Development Authority with full autonomy to the regulators. Therefore, SEBI should not be disturbed in its control mechanism because despite public criticism and many failures it has made many reforms to make the capital market more operational and investor friendly. It has also tried to provide investor education and awareness of the market.

In future there would be many more hybrid instruments that combine features of banking, insurance and the capital market. An apex body to supervise is not necessary because it will not be able to give full autonomy to the individual regulator but co-ordinating the operational aspects of the different regulators

should be the objective in setting up a new Council. It is possible that a single regulator may not have a clear focus on the objectives and rationale of regulation in the capital market and may not be able to adequately differentiate between different types of institutions. Therefore, coordination and not super regulation is the answer to the problem.

Before the financial crisis U.K. tried to work on a unified regulator and The Bank of England had to surrender prudential regulation to be merged into the regulator. This created a serious problem of control during the financial crisis period from 2007-09. In comparison, the RBI's role in insulating the Indian economy from the global financial crisis was useful. Therefore, the role of RBI should not be diluted by a super regulator. The creation of the inter-regulatory coordination body is proposed by creating the Financial Stability and Development Council (FSDC) and not a super regulator as it would undermine the work of SEBI as a capital market regulator.

United States of America and Australia still function with multiple regulators. They however, have a coordinating body which clears problems of demarcation of areas and bring about coordination in the complete financial system.

In India, most of the financial instruments do not have a combination of features of bank deposits, insurance policies and investment. Banks are not very participative in the equity market. Insurance companies are also not yet permitted to set up banks and Banking supervision has been done by the Reserve Bank of India. Due to these reasons a formal mechanism is necessary to coordinate their activities and to provide information to all the regulatory authorities through a coordinating council and not a super regulator.

It is suggested that besides the coordinating council each regulatory authority may become a lead regulator in the area of control required under it. SEBI may become a lead regulator in capital market stability, Reserve Bank in banking supervision and IRDA in all matters of insurance and discussions of these matters may be done through the coordinating committee.

The next section of this paper provides the conclusions with suggestions.

## V. CONCLUSIONS

1. There are a large number of reforms in the primary and secondary markets with a plethora of legislations, which are confusing and there are loopholes through which it is possible to perpetuate frauds in the Stock Market.
2. The reforms made by SEBI are useful but timely action and prosecution is not taken. It is more favourable towards the corporate sector than towards the investors.
3. SEBI as a regulatory mechanism failed to initiate discipline amongst the different stock market, agencies like Brokers, Corporate Entities, Mutual Funds and Banks.
4. SEBI is known to review situations rather than take preventive measures in regulating the market. Badla should have been discontinued as long back as in 1994.
5. SEBI has failed in protecting the small investor because it is not an effective controlling agency. The presence of RBI, Company Law Board, and Government of India weaken its position and bring about duplication of laws. SEBI should be made an autonomous institution for better control.
6. There should be a coordination committee between the regulators and there is no requirement for a super regulator. In India, each regulator has a different role to play. It is suggested that lead roles may be adopted and more coordination between the regulators should be brought about.
7. SEBI should not have a super regulator over it. It should be autonomous and have the powers to play a lead role in all activities of the capital market. However, it should coordinate and give information to the other regulators.
8. The practice of countries like USA and Australia may be followed where there are multiple regulators and a coordinating body for providing control.
9. SEBI should be a watch dog and should take greater interest in coordinating its own committees within SEBI, then control would be possible before frauds take a magnitude of volumes.

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