



STUDY NOTE - 2

CAPITAL & FINANCIAL MARKET REGULATIONS

This study Note includes

- **SEBI – Regulation of market and control**
- **Collective investment schemes, Depositories and Dematerialization of securities**
- **Regulation of banking and finance companies – Role of RBI and Banking ombudsmen;**
- **Regulation of insurance sectors by insurance regulation and development authority (IRDA)**
- **Cyber law and regulation of E Commerce and electronic financial transaction**
- **Contemporary issues and development**

2.1. SEBI – REGULATION OF MARKET AND CONTROL

Stock market Regulation

SECURITIES AND EXCHANGE BOARD OF INDIA

Securities and Exchange Board of India (SEBI)

U.K. and U.S.A. had long back created separate boards for the regulation of the securities market – In U.K it has **the Securities and Investment Board (SIB)** and U.S. has the **Securities and Exchange Commission (SEC)**. Indian Government's intention to set up a separate Board for the regulation and orderly functioning of the market was first declared in the Budget Speech by Shri Rajiv Gandhi, the then Prime Minister and Minister of Finance, while presenting the Budget for the year 1987-88. He stated, "The capital markets in India have exceeded Rs. 25,000 crores in 1986-87. They were only about Rs. 6750 Crores in 1980-81, for a healthy growth of capital markets, investors must be fully protected. Trading malpractice must be prevented. Government have decided to set up a separate board for the regulation and orderly function of Stock Exchange and the securities industry".

Origin

By a Notification issued on 1st April 1988, Securities and Exchange Board of India (SEBI), was constituted as an interim administrative body to function under the over all administrative control of the Ministry of Finance of the Central Government.

In July 1988, the SEBI, constituted as aforesaid, published an approach paper on 'Comprehensive legal issues for securities market'.



The SEBI was given a statutory status on 30th January, 1992 by an Ordinance to provide for establishing of SEBI. A Bill to replace the Ordinance was introduced in Parliament on 3rd march, 1992 and was passed by the President's assent. However, as provided for in section 1(3), this Act is to be deemed to have come into force on 30th January, 1992 i.e. the date on which the SEBI Ordinance was promulgated.

Powers and Functions of SEBI

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

- a) regulating the business in stock exchanges and any other securities markets;
- b) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;
- c) registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf;
- d) registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds;
- e) promoting and regulating self-regulatory organisations;
- f) prohibiting fraudulent and unfair trade practices relating to securities markets;
- g) promoting investors' education and training of intermediaries of securities markets;
- h) prohibiting insider trading in securities; (i) regulating substantial acquisition of shares and takeover of companies;
- j) calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organisations in the securities market;
- k) calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any central, state or provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Board;
- l) performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government;
- m) levying fees or other charges for carrying out the purposes of this section; (n) conducting research for the above purposes;



- o) calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions;
- p) performing such other functions as may be prescribed.

For carrying out the duties assigned to it under the Act, SEBI has been vested with the same powers as are available to a Civil Court under the Code of Civil Procedure, 1908 for trying a suit in respect of the following matters:

- (i) the discovery and production of books of account and other documents at the place and time indicated by SEBI.
- (ii) summoning and enforcing the attendance of persons and examining them on oath.
- (iii) inspection of any books, registers and other documents of any person listed in section 12 of the Act, namely stock brokers, sub brokers, share transfer agents, bankers to an issue, trustee of trust deed, registrar to an issue, merchant bankers, underwriters, portfolio managers, investment advisors and other such intermediaries associated with securities markets.
- (iv) inspection of any book or register or other document or record of the company referred to in Sub-section (2A);
- (v) issuing commissions for the examination of witnesses or documents.

Power to Issue Directions

Section 11B of the Act provides that if SEBI is satisfied after making due enquiries, that it is necessary:

- (i) in the interest of investors, or orderly development of securities market; or
- (ii) to prevent the affairs of any intermediary or other persons referred to in section 12 being conducted in a manner detrimental to the interests of investors or securities market; or
- (iii) to secure the proper management of any such intermediary or person, it may issue such directions, -
 - a) to any person or class of persons referred to in section 12, or associated with the securities market; or
 - b) to any company in respect of matters specified in section 11A, as may be appropriate in the interests of investors in securities and the securities market.

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



- a) suspend the trading of any security in a recognised stock exchange.
- b) restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities.
- c) suspend any office-bearer of any stock exchange or self regulatory organisation from holding such position.
- d) impound and retain the proceeds or securities in respect of any transaction which is under investigation.
- e) Attach for a period not exceeding one month, with prior approval of a magistrate, one or more bank accounts of any intermediary or any person associated with the securities market in any of the Act or rules or regulations made there under.
- f) direct any intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of any transaction which is under investigation.

Section 11A of SEBI Act provides that SEBI may prohibit for the protection of the investors, any company from issuing any offer document including a prospectus or advertisement soliciting money from the public for the issue of securities, and specify the conditions subject to which such offer documents can be issued. The Board may specify the matters relating to issue of capital, transfer of securities and other matters shall be disclosed by the companies. It may also by issuing prospectus, any offer document or advertisement soliciting money from public for issue of securities. SEBI may also specify the conditions subject to which the prospectus, such offer document or advertisement, if not prohibited, may be issued.

Organisation (Management Of SEBI)

The management of SEBI vests in the board which consists of the following members, namely

- a) A Chairman
- b) Two members from amongst the officials of the 'Ministers of the Central Government dealing with Finance or Law'
- c) One member from amongst the officials of the Reserve Bank of India.
- d) Two other members, to be appointed by the Central Government

The general superintendence, direction and management of the affairs of the SEBI vests in a Board of members, which may exercise all powers and do all acts and things which may be exercised or done by the Board which otherwise determined by regulations, the chairman shall also have powers of general superintendence and direction of the affairs of the Board and may also exercise all powers and do all acts and things which may be exercised done by the board.

The Chairman and members referred to at (a) and (b) above shall be appointed by the Central Government and the member referred to at (a) and (c) above shall be nominated by the Central Government and the Reserve Bank of India respectively.



For day to day functions the activities of SEBI have been divided into five operational departments viz. many markets-policy, intermediaries, investor grievances and guidance, etc.,

- Such Management & Intermediaries, investor grievances and guidance, etc.
- Secondary market-exchange administration, inspection and non-member intermediaries etc.,
- Secondary market-exchange administration, inspection and non-member intermediaries, etc.,
- Institutional investment-Mutual funds and Fills, mergers and acquisitions, research & publications and internal regulation.
- Each department is headed by an Executive Director. Besides these five departments, there are legal and investigation department.

Activities

The first major activity undertaken by SEBI was preparation of an Approach paper on comprehensive legislation for Securities markets. Since inception, SEBI has issued a number of guidelines, rules, drafts regular consultative papers etc. in order to regulate and develop the securities market and protect investors in some important guidelines etc. Issue by SEBI include.

- a) Rules regarding registration of intermediaries such as share transfer agents, bankers to the issue, trust deeds, registrars to an issue, underwriters, portfolio managers and investment advisors brokers and sub-brokers associated with the securities market.
- b) Guidelines for merchant bankers stating authorized activities of merchant bankers, the authorization and the terms of authorization.
- c) Code of Conduct for merchant bankers, the violation, intentional or otherwise, of which will make merchant bankers guilty of misconduct or unprofessional conduct.
- d) Categorizations of merchant bankers, under which merchant bankers have been categorized into categories. Category 1 merchant bankers are authorized to act in the capacity of lead management co-market advisor or consultant to an issue, portfolio manager and underwriter to an issue as mandatory required. ... II merchant bankers are authorized to act in the capacity of co-manager / advisor or consultant to an issue of portfolio manager.
- e) Guidelines on portfolio management services which cover such aspects as portfolio management act client relationship, investment tenure, fees to be paid to the portfolio manager, client's money account, investment of the client fund, periodical reports to clients and administrative powers of the SEBI regard.
- f) Guidelines for lead managers for inter se allocation of responsibilities which require that wherever the more than one lead manager to the issue inter se allocation of the pre-issue and post-issue activities/sub-act will be properly made and information in this regard sent to SEBI.



Regarding the number of lead managers in an issue, SEBI has prescribed that for a total issue aggregation less than Rs. 50 crore the number of lead managers will not exceed two ; for a total issue of Rs. 50 crore and above but less than Rs. 100 crore the number of lead managers may go upto maximum of three and for issues aggregate of Rs. 100 crore and above but less than Rs. 200 crores the number may go upto a maximum of five. For aggregating above Rs. 400 crore, the number of lead managers in excess of five will be prescribed by SEBI pertaining to each case.

- g) Guidelines regarding purchase of non-convertible part of debentures from the subscribers
- h) Regulation for registrars and share transfer agents
- i) Regulation on insider trading
- j) Guidelines for mutual funds and asset management companies
- k) Draft regulation for substantial acquisition of shares in listed companies
- l) Consultative paper on free market pricing of capital issue.
- m) Guidelines on capital issues / Guidelines for Disclosure and Investor Protection along with clarification as of March, 1993.
- n) Guidelines on issue of securities by Development Financial Institutions.
- o) Formation of two advisory committees ; one on primary market and the other on secondary market, company members from professional organisations , academic and investing public.

Business India (March 1-14, 2006) noted what SEBI has done so far what it still needs to do as follows

WHAT IT HAS DONE SO FAR	WHAT IT STILL NEEDS TO DO
Registration of brokers	Appointment of nominees on exchange base
Inspection of stock exchange	Code of conduct for merchant bank
Investor protection rules	Penalizing erring companies
Protection for debenture holders	Bringing UTI under mutual fund rules
Stopping misuse of Promoter's quota	Rules for new instruments
Better disclosure norms	Corporate membership in stock exchange
RO status for merchant bankers	Postal ballot for company AGM's
Free pricing for public issues	Code for takeovers



WHAT IT HAS DONE SO FAR	WHAT IT STILL NEEDS TO DO
Insider trading norms Capital adequacy norms for brokers C... on kerb trading Fighter controls over mutual funds Comprehensive norms for underwriters Country rules for foreign intuitional Permission for private mutual funds Guidelines for asset management firms Rules for lead managers Rules for bankers to the issue Forms for issue of stock invests Guidelines for bonus share issues Rules for underwriters Advisory panels for primary, secondary market Investor education campaign	Norms for custodial, depository services Comprehensive legislation Penal powers over companies Uniform accounting standards Capital market development fund investorsInvestor protection funds

SECURITISATION

The concept SEBI in its short span of existence, has performed excellently as its developmental and national role is concerned. How far it would be able to carry out its enforcement role is yet to be seen.

Self – Regulation

If the foregone sections, we have discussed the regulatory framework applicable to primary and secondary market in India. The focus of discussion has been on what may be called legislative regulation of securities.

In addition to legislative regulation, self-regulation is equally important. Indeed in developed securities.. like U.K. self-regulations play an important role. There exist a number of self-regulatory organization in which they really complement for the legislative regulation.

The spirit of self-regulation had been prevalent in the Indian securities market as well. If one looks at the given to recognized stock exchanges in India to make and enforce bye-laws under the Securities Contracts (Regulation) Act, 1956, one tends to conclude that Indian stock exchanges have been envisaged as self-regulatory conditions. Just to elaborate the point let us look at section 9 of the Securities Contracts (Regulation) Act, which states as follows.



The recognized stock exchange may, subject to the previous approval of the Central Government (till 1991) securities and Exchange Board of India (since 1992) make bye-laws for the regulation and control of contracts. In particular, without prejudice generally of the foregoing power, such bye-laws may provide for.

- a) the opening and closing of markets and the regulation of the hours of trade
- b) The clearing house for the periodical settlement of contracts and difference there under, the delivery of the securities, the passing on of delivery orders and the regulation and maintenance of such a clearing settlement.
- c) The submission to the Central Government (till 1991) and Securities and Exchange Board of India (since by the cleaning house as soon as may be after each periodical settlement of all or any of the following, namely
 - a) The total number of each category of security carried over from one settlement period to another
 - b) The total number of each category of security contracts which have been squared up during the course of settlement period
- c) The total number of each category of security actually delivered at each clearing
- d) The number and classes of contracts in respect of which settlements shall be made or different through the clearing house.
- e) The regulation, or prohibition of badlas or carry-over facilities.
- f) The fixing, altering or postponing of days for settlements;
- g) The determinations and declaration of market rates, including the opening, closing, highest and lowest for securities.
- h) The terms, conditions and incidents of contracts, including the prescription of market requirement and conditions relating there to and the forms of contracts in writing.
- i) The regulation of the entering into, making, performance, recession and termination, of contracts between members or between a member and his constituent or between a member and a person not a member, and consequences of a breach by a seller buyer, and there responsibility of member not parities to such contracts.
- j) The regulation of taravani business including the placing of limitations thereon;
- k) The listing of securities on the stock exchange, the inclusion of any security for the purpose of listing and the suspension or withdrawal of any such securities, and the suspension or prohibition of trade specified securities.
- l) The method and procedure for the settlement parties to contracts in any capacity.
- m) The levy and recovery of fees, fines and penalties



- n) The regulation of the course of business between parties to contracts in any capacity.
- o) The fixing of a scale of brokerage and other charges;

Regulatory Frame work of Security Market

The four main legislations governing the securities market are: (a) the SEBI Act, 1992 which establishes SEBI to protect investors and develop and regulate securities market; (b) the Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges; and (d) the Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities.

Legislations

SEBI Act, 1992: The SEBI Act, 1992 establishes SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. It can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. It has powers to register and regulate all market intermediaries and also to penalise them in case of violations of the provisions of the Act, Rules and Regulations made there under. SEBI has full autonomy and authority to regulate and develop an orderly securities market. The details have been covered ahead in the next chapter.

Securities Contracts (Regulation) Act, 1956: It provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims to prevent undesirable transactions in securities. It gives central government/SEBI regulatory jurisdiction over (a) stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. As a condition of recognition, a stock exchange complies with prescribed conditions of Central Government. Organised trading activity in securities takes place on a specified recognised stock exchange. The stock exchanges determine their own listing regulations which have to conform to the minimum listing criteria set out in the Rules.

Depositories Act, 1996: The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by (a) making securities of public limited companies freely transferable subject to certain exceptions; (b) dematerialising the securities in the depository mode; and (c) providing for maintenance of ownership records in a book entry form. In order to streamline the settlement process, the Act envisages transfer of ownership of securities electronically by book entry without making the securities move from person to person. The Act has made the securities of all public limited companies freely transferable, restricting the company's right to use discretion in effecting the transfer of securities, and the transfer deed and other procedural requirements under the Companies Act have been dispensed with. The details have been dealt in the chapter on Depositories.



Regulators

The responsibility for regulating the securities market is shared by Department of Economic Affairs (DEA), Ministry of Company Affairs, Reserve Bank of India (RBI) and SEBI. The activities of these agencies are coordinated by a High Level Committee on Capital Markets. The orders of SEBI under the securities laws are appealable before a Securities Appellate Tribunal.

Most of the powers under the SCRA are exercisable by DEA while a few others by SEBI. The powers of the DEA under the SCRA are also con-currently exercised by SEBI. The powers in respect of the contracts for sale and purchase of securities, gold related securities, money market securities and securities derived from these securities and carry forward contracts in debt securities are exercised concurrently by RBI. The SEBI Act and the Depositories Act are mostly administered by SEBI. The powers under the Companies Act relating to issue and transfer of securities and non-payment of dividend are administered by SEBI in case of listed public companies.

Regulation of Secondary Market

As noted above Securities Contracts (Regulation) Act 1956 and the rules made there under, namely the securities Contracts (Regulation) Rules, 1957 are the main laws governing stock exchanges in India.

The preamble to the Securities Regulation Act states that is “an act to prevent undesirable transaction in Securities by regulating the business of dealing therein, by prohibiting options and by providing certain other matters connected therewith”. This Act provides for the direct and indirect control of virtually all aspects of securities leading and the running of the stock exchange. The Act makes every transaction in securities in any notified State area illegal and punishable by fine and / or imprisonment if it is not entered into between or with members of a recognized stock exchange in the state or area.

The Act thus prohibits the existence of other than recognized stock exchanges and provides the mechanism recognizing stock exchanges. Appendix 5.2 gives the list of recognized stock exchanges as of 1992. Application for the Central Government for recognition must include a copy of the rules relating in general to the constitution of the stock exchange and in particular to, among other things, the admission into the stock exchanges of various classes of members, the exclusion, expulsion and readmission of members, and the procedure for registration of a stock exchange. In determining whether to grant recognition, the Central Government may make whatever require is necessary and impose in the rules and bye-laws of the stock exchanges whatever conditions are required to ensure “fair dealing” and to “protect investors” These conditions concern, inter alia, the qualification for members, the manner in which contracts are to be entered into and enforced, the representation of not more than three Central Government nominees on the board of the stock exchange, and the maintenance of books and record by members and their audit by chartered accountants. The Central Government has the power to impose further conditions, other than in the rules and bye-laws, such as limiting the number of members. Finally, the Central Government has the power unilaterally to withdraw recognition.



After it recognizes a stock exchange, the Central Government exerts regulatory control over it, Per reports are furnished to the Central Government. Certain books and records are maintained for a period of years. The Central Government can make an inquiry itself, or through an appointment of third party, into the affairs of a stock exchange or any of its members. All officers, directors, members, and others who have had dealings matter under inquired are required to produce requested documents, statements, or information.

The Central Government retains control over the stock exchange's bye-laws and its rule amendment stock exchange, subject to previous Central Government approval, has the authority to make bye-laws for regulation and control of contracts and the regulation of trading. Similarly, no rule amendments have effect they are approved by the Central Government. The Central Government, furthermore, has the power to direct exchange to amend its rules ; and if it fails to do so, the Government may directly amend the such rules exchange. The suspension of business may be complete or subject to conditions. Suspensions may not may not more than seven days initially but may be extended form time to time. The Central Government may super the governing body of any exchange of declaration and then appoint any person of group of persons to exceed and perform all the power and duties of the governing body.

Other powers granted to the Central Government the ability to stop further trading in specified second for the purpose of preventing undesirable speculations, and the power to compel a public company "in the initial of the trade or in the public interest" to list its securities on any of the recognized exchanges.

The Securities Regulation Rules specifically provide for membership of an exchange. No person can eligible for membership if he is less than twenty-one years of age, is not a citizen of India, has been adjudged bankrupt, or has been convicted of an offence involving fraud or dishonesty. Under section 8, rules relative membership of stock exchanges are given which are reproduced bellows.

Regulation of OTCEI

The functioning and operations of the OTCEI is subject to the provision of the Securities Contracts (Regular Act, 1956, the Companies Act, 1956 and other relevant laws which are applicable to Indian stock exchanges of operations are supervised by SEBI and Government of India. The criteria for admission of members, licensed dealers and Companies on the OTCEI is prescribed as follows.

Criteria for admission of members

The members would be Public Financial Institutions, Scheduled Banks, Mutual funds, Banking Subsidies SEBI – registered merchant Banks, Venture Capital Funds and Venture Capital Companies, Non-banking Final companies having a minimum financial net wroth as specified by OTCEI. The applicant should satisfy the elegant requirements of the Securities Contracts (Regulation) Rules, 1957.

The member should posses necessary skills, resources and capabilities to appraise project/ common establish its viability, analyze company's financial worth, evaluate company's management and determine more for company's products.



The member should have the necessary status and standing to be able to carry the confidence of the members and licensed dealers while recommending scrip to the market for investment.

The member should have sufficient financial reserves to 'sponsor' and trade in the scrip

The member should be authorized by SEBI for carrying out merchant banking activities.

The member should have adequate organizational infrastructure to establish and manage the OTC count (That is office space, computers, PTI scam, telephones, telex, fax and any other data communication equipped specified).

The net worth of the member should be minimum Rs. 2.50 crores.

Criteria for admission of licensed dealers

The licensed dealers would be a corporate body, partnership firms and individuals having minimum net worth of an amount to be decided by the OTCEI governing board from time to time. The corporate bond should satisfy the eligibility requirements of the Securities Contracts (Regulation) Rules, 1957. The licensed dealers should have minimum tangible liquid net worth which would be sufficient to carry investment, trading and market making in the scrips listed on the OTC Exchanges.

The licensed dealers should have adequate organizational infrastructure such as office space, compound PTI scan, telephones (minimum two), telex, fax and other data communications equipment specified.

Licensed dealers should at least be graduates. Additional weightage will be given for additional ratio professional qualification. Licensed dealers should have adequate knowledge of trading, stock valuation, share transfer rules and relation.

Apart from the above, the licensed dealers will be required to comply with the following terms and conditions

- a) If the applicant is a corporate body, the promoters should hold at least 40% of the equity capital.
- b) In case of change in dealership from individual / partnership firm to corporate body original individual dealers / shares of the partnership firm should hold at least 40% of the capital of the new corporate body.
- c) Partnership firms and corporate applicants must nominate one of the authorized signatories whose signification will be considered for eligibility and the same person will be required to take a written test and appear in interview.
- d) Dealership is not transferable.
- e) If there is a change in shareholding of a body corporate who is a dealer, resulting in change in ownership management, OTC Exchange of India reserves the right to review the status of dealership of that dealer.

**Criteria for admission (for listing) of companies**

The company should be sponsored by a member of the OTCEI

The sponsor to certify that all the scrips proposed to be offered for trading on OTC Exchange have already on subscribed to my members and licensed dealers of OTCEI.

The company to agree to abide by all statutory and OTCEI's provisions for listing.

The company to agree to entered into an agreement with the OTCEI in a prescribed format.

The company will comply with the provisions laid down in the Notification to be issued by the Government of factor subscribed to by member and licensed dealers of OTCEI.

The company to agree to abide by all statutory and OTCEI's provisions for listing.

The company will comply with the provisions laid down in the Notification to be issued by the Government of .. for listing on the OTC Exchange of India.

The issues of securities by companies and their listing on the OTCEI will be governed by the following defines.

- i. The minimum issued equity share of accompany for eligibility for listing on the OTCEI will be Rs. 30 lakh subject to a minimum public offer of equity shares worth Rs. 20 lakhs in face value.
- ii. For companies with an issued equity capital of more than Rs. 30 lakhs but less than Rs. 300 lakhs, the return public offer should be 40% of the issued capital or Rs. 20 lakh worth of shares in value, whichever higher in relaxation of rule 19(2)(b) of the Securities Contracts (Regulation) Rules, 1957.
- iii. Companies with an issued equity capital of more than Rs. 300 lakhs seeking listing on the OTCEI will be comply with the listing requirements and guidelines as are applicable to such companies for enlistment on other organized stock exchanges, for venture capital companies 20% of capital should be minimum issued to ...in OTCEI.
- iv. Companies covered under the MRTTO Act/FERA may be listed on the OTCEI only if they satisfy the ... for listing on other recognized stock exchanges, such as minimum issued equity capital of Rs. 300 ... such other limit as may be prescribed from time to time.
- v. A company with an issued equity share capital of more than Rs. 25 crore will be eligible for listing on the OTCEI.
- vi. Companies which are engaged in investments, leasing, finance, hire-purchase, amusement parks, etc. ... not be eligible for listing on the OTCEI.
- vii. In the minimum number of centers for collection of application forms in respect of issue of securities by companies, under the OTCEI shall be four, one each from the Northern, Western, Southern, Eastern regions of the ... However, OTCEI shall have power to increase the



number of centers depending upon the size and nature Of securities made by a company.

- viii. Securities and Exchange Board of India (SEBI) vide its letter dated July 16, 1992 has inter alia classified as regards issue of shares through OTC Exchange of India as follows.
- ix. Where a direct public issue is made through OTC without the sponsor taking any shares the normal underlines for disclosures and investor protection shall apply.
- x. Where the shares of a company have been taken by the sponsor, such shares may be offered to the public calculate date at such price as the sponsor may deem fit in accordance with the regulations of OTC subject to the following conditions.
- xi. The promoters after such offer retain at least 25% of the total issued capital with lock-in-period of five years from the date of the sponsor taking up the shares.
- xii. The sponsor agrees to act as market maker for the shares at least for a period of three years compulsory basis and also finds an additional market maker for such compulsory market making and
- xiii. The sponsor compulsorily gives two way quotes based on minimum or maximum trading prices as stipulated by OTC respect of the scrip.

With a view to making markets more competitive and compliant, SEBI has brought in the following new regulations:

- SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003
- SEBI (Ombudsman) Regulations, 2003
- SEBI (Central Listing Authority) Regulations, 2003
- SEBI (Central Database for Market Participants) Regulations, 2003
- SEBI (Self Regulatory Organizations) Regulations, 2004
- SEBI (Criteria For Fit and Proper Person) Regulations, 2004

As a measure of regulatory pro-activeness, the existing regulations were reviewed and the following amendment to regulations were notified:

- SEBI (Foreign Institutional Investors) (Amendment) Regulations, 2003
- SEBI (Mutual Funds) (Amendment) Regulations, 2003
- SEBI (Depositories and Participants)(Amendment) Regulations, 2003
- SEBI (Debenture Trustees) (Amendment) Regulations, 2003



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- SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2003
- SEBI (issue of Sweat Equity)(Amendment) Regulations, 2003
- SEBI (Stock Brokers and Sub-Brokers)(Amendment) Regulations, 2003
- SEBI (Stock Brokers and Sub-Brokers) (Second Amendment) Regulations, 2003
- SEBI (Procedure for Holding Enquiry and Imposing Penalty)(Amendment) Regulations, 2003
- SEBI (Ombudsman)(Amendment) Regulations, 2003
- SEBI (Foreign Institutional Investors) (Amendment) Regulations, 2004

REGULATION OF THE INVESTMENTS OF A MUTUAL FUND

The investments of a mutual fund are subject to a set of regulations prescribed by SEBI. The important ones are

1. A mutual fund, under all its schemes taken together, will not own more than 10 percent of any company's paid up capital carrying voting rights.
2. A scheme shall not invest more than 15 percent of its NAV in debt instruments issued by a single issuer which are rated not below investment grade by an authorised credit rating agency.
3. Barring certain exceptions, a scheme shall not invest more than 10 percent of its NAV in the equity shares or equity related instruments of any one company.
4. A scheme shall not invest more than 5 percent of its NAV in unlisted equity shares or equity related instruments in case of an open ended scheme and 10 percent of its NAV in case of a close ended scheme.
5. Mutual funds shall mark all investments to market.

Legal Framework of Indian Capital Markets

Various acts, rules, regulations, ordinances, guidelines, clarifications, press releases and bye laws of self regulatory organisations constitute the legal framework of Indian capital market. The Indian securities laws, rules and regulations enacted for its capital market include the following:

- The Companies Act, 1956
- The Securities Contracts (Regulation) Act, 1956
- The Securities Contracts (Regulation) Rules, 1957
- The Securities and Exchange Board of India Act, 1992



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- The SEBI (Insider Trading) Regulations, 1992
 - The SEBI (Merchant Bankers) Regulations, 1992
 - The SEBI (Stock Brokers and Sub Brokers) Rules, 1992
 - The SEBI (Debenture Trustees) Rules, 1993
 - The SEBI (Debenture Trustees) Regulations, 1993
 - The SEBI (Portfolio Managers) Rules, 1993
 - The SEBI (Portfolio' Managers) Regulations, 1993
 - The SEBI (Registrars to Issue and Share Transfer Agents) Rules, 1993
 - The SEBI (Registrars to Issue and Share Transfer Agents) Regulations, 1993
 - The SEBI (Underwriters) Rules, 1993
 - The SEBI (Underwriters) Regulations, 1993
 - The SEBI (Appeal to Central Government) Rules, 1993
 - The SEBI (Bankers to an Issue) Rules, 1994
 - The SEBI (Bankers to an Issue) Regulations, 1994
 - The SEBI Appellate Tribunal (Procedure) Rules, 1994
 - The SEBI (Foreign Institutional Investors) Regulations, 1995
 - The SEBI (Prohibition of fraudulent and unfair trade practices relating to securities market) Regulations, 1995
 - Depositories Act, 1996
 - The SEBI (Depositories and Participants) Regulations, 1996
 - The SEBI (Mutual Funds) Regulations, 1996
 - The SEBI (Venture Capital Funds) Regulations, 1996
 - The SEBI (Custodian) Regulations, 1994
 - The SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997
 - The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002



The primary capital market provides opportunity to Issuers of securities, Government well as corporate, to raise resources to meet their requirements of investment or discharge some obligation. The issuers create and issue fresh securities in exchange of funds through public issues and private placements.

SEBI (Disclosure and Investor Protection) Guidelines, 2000

The primary capital issues are regulated by SEBI in terms of SEBI guidelines. SEBI has framed the guidelines in 1992, which were changed many a time keeping in view the inconsistencies, market development and changing needs of the capital market. New set guidelines were issued in the year 2000 called SEBI (Disclosure and Investor Protection) Guidelines, 2000, which are also amended subsequently. The said guidelines are issued by SEBI under section 11 of the Securities and Exchange Board of India Act, 1992. It provides a comprehensive framework for primary capital issues by the companies. The guidelines are applicable to:

- (i) all public issues by listed and unlisted companies,
- (ii) all offers for sale and rights issues exceeding Rs. 50 lakhs by listed companies whose equity share capital is listed.

The guidelines are not applicable to:

- (a) A banking company including local area bank
- (b) Public sector banks
- (c) Infrastructure companies
- (d) Rights issue by a listed company

The guidelines consist of framework of capital issuances as follows:

- Eligibility Norms for Companies Issuing Securities (Chapter n)
- Pricing by Companies Issuing Securities (Chapter HI)
- Promoters Contribution and Lock-in requirements (Chapter IV)
- Pre-Issue Obligations (Chapter V & VI)
- Post Issue Obligations (Chapter VII)

General Information - Capital Market Regulation

Several public sector undertakings have issued “debt instruments” commonly known as PSU bonds. These bonds are securities as defined under the SCR Act. Interest earned on some of these PSU bonds are not liable to income tax.

- Regulating the business in stock exchange and any other securities markets
- Registering and regulating the working of collective investment schemes, including mutual funds.



- Prohibiting fraudulent and unfair trade practices relating to securities markets.
- Promoting investor's education and training of intermediaries of securities markets.
- Prohibiting insider trading in securities, with the imposition of monetary penalties on guilty market intermediaries.
- Regulating substantial acquisition of shares and takeover of companies.
- Calling for information from, carrying out inspection, conducting inquiries and audits of the stock exchanges and intermediaries and self-regulatory organizations in the securities market.
- Carry forward deals permitted only on stock exchanges, which have screen, based trading system.
- Transactions carried forward cannot exceed 25% of a broker's total transactions on any one day.
- 90-day limit for carry forward and squaring off allowed only till the 75th day (or the end of the fifth settlement).
- Daily margins to rise progressively from 20% in the first settlement to 50% in the fifth.

2.2. COLLECTIVE INVESTMENT SCHEME, DEPOSITORIES, DEMATERIALISATION OF SECURITIES

Collective investment Scheme:

A **collective investment scheme** is a way of investing money with other people to participate in a wider range of investments than may be feasible for an individual investor, and to share the costs of doing so.

Terminology varies with country but collective investment schemes are often referred to as **managed funds**, **mutual funds** or simply **funds** (note: mutual fund has a specific meaning in the US). Around the world large markets have developed around collective investment and these account for a substantial portion of all trading on major stock exchange.

Collective investments are promoted with a wide range of investment aims either targeting specific geographic regions (*e.g.* Emerging Europe) or specified themes (*e.g.* Technology). Depending on the country there is normally a bias towards the domestic market to reflect national self-interest, familiarity and the lack of currency risk. Funds are often selected on the basis of these specified investment aims, their past investment performance and other factors such as fees.

As per the mandate given by the Government of India, the entities which issue agro bonds, plantation bonds etc. were to be treated as "Collective Investment Schemes" coming under the purview of the SEBI Act.



The committee has defined a Collective Investment Schemes by identifying 3 important characteristics, namely Pooling of Investments, Management by a separate entity and Absence of day to day control of the investors. While finalising the definition, the committee recognizes that it may be possible that some arrangements of this nature like time shares, club memberships etc. would also get covered in the definition. It is suggested that SEBI may be given appropriate powers to grant exemptions to any class of arrangements which are not desired to be regulated as Collective Investment Schemes. It has been also observed that many of the existing collective investment schemes resort to entering into multiple agreements with the investors whereby the investor is given the ownership of land and the company is given the right to develop this land. The amounts collected are treated as license fee by the company thereby trying to limit the liability of the scheme. The committee wishes to make it clear that the substance of such arrangements should be relied upon to determine whether the scheme is a collective investment scheme or not. The principle of no day to day control of the investor in management of the property should be the prime criterion in determining the status of such schemes.

Collective investment schemes-structure and constitution

The committee reviewed the information filed with SEBI by the existing collective investment schemes. It was noted that most of the schemes are being operated by companies registered under the provisions of the Companies Act, 1956. Some of the schemes were also launched by non corporate entities like Association of Persons. Though all of the existing schemes have been managing investors funds, there is no distinction between the management and trustee function. In most of the cases there is an intermingling of the schemes accounts with those of the company's accounts. Consequently, it has become difficult to ensure adequate investor protection measures in this structure of operations. Due to the inherent nature of collective investment schemes, where assets are managed for and on behalf of the investors, these schemes must declare a trust in favour of the members over the scheme properties.

Collective investment management companies- registration, constitution and obligations.

As the Collective Investment schemes, in general, accept monies from ordinary investors, the committee feels that these investments would be better protected if they are managed by persons who have the capability to ensure that the desired activities are carried out efficiently, honestly and fairly. Keeping in mind this underlying principle, the committee recommends that any entity seeking registration with SEBI, to operate collective investment schemes, must possess adequate organisational capacity to meet the current and future operational demands in addition to necessary skill and experience required to operate such schemes.

The following conditions must be satisfied before an entity is licensed to carry out the activities of a collective investment management company:

(A) Adequate Management structure

The Board of Directors of the CIMA should possess adequate professional experience in related fields. They should have high integrity and must not have been found guilty of moral turpitude or convicted of any economic offense or violation of any security laws. The composition of the Board should be such that at least 50% of the directors must be independent persons, who are either directly or indirectly not associated with the persons who are in control of the



collective investment management company. At least one of the directors would be representative of the trustee. The management team of the CIMA must also comprise of responsible officers who have not been found guilty of moral turpitude or convicted of any economic offense or violation of any securities laws.

(B) Financial Requirements

The committee recommends that the CIMA must have a minimum net worth of not less than Rs. 10 Crores. This is to ensure that the Collective Investment Management company has sufficient financial resources to ensure ongoing scheme related cash requirements. The minimum net worth requirement has also been specified in the mutual funds regulations and it acts as a filter and allows only the serious and committed players to enter the markets.

II. Depositories, Dematerialisation of Securities

A Depository is a securities “bank,” where dematerialised physical securities are held in custody, and from where they can be traded. This facilitates faster, risk-free and low cost settlement. A Depository is akin to a bank and performs activities similar in nature. At present, there are two Depositories in India, National Securities Depository Limited (NSDL) and Central Depository Services (CDS). NSDL was the first Indian Depository. It was inaugurated in November 1996. NSDL was set up with an initial capital of Rs 124 crore, promoted by Industrial Development Bank of India (IDBI), Unit Trust of India (UTI), National Stock Exchange of India Ltd. (NSEIL) and the State Bank of India (SBI).

NSDL carries out its activities through business partners - Depository Participants (DPs), Issuing Corporates and their Registrars and Transfer Agents, Clearing Corporations/ Clearing Houses. NSDL is electronically linked to each of these business partners via a satellite link through Very Small Aperture Terminals (VSATS). The entire integrated system (including the VSAT linkups and the software at NSDL and at each business partner’s end) has been named the “NEST” (National Electronic Settlement & Transfer) system. The investor interacts with the Depository through a Depository Participant of NSDL. A DP can be a bank, financial institution, a custodian or a broker.

A Depository Participant: DP is an agent of the depository and is authorised to offer depository services to investors. According to SEBI guidelines, financial institutions, banks, custodians, stockbrokers, etc. can become Depository Participants in a depository. You can open your securities account through a DP and start dematerialising your securities into your account and / or start trading in the electronic mode. The balances in your account are maintained with the depository and are available through the DP. Your DP will intimate you the status of your holdings or transactions from time to time.

Benefits of DP

As an investor you will enjoy many benefits if you buy and sell in the depository mode. Some of the benefits are :-

- No bad deliveries
- Reduced paper work



- No risk of loss, mutilation or theft of share certificates.
- Faster settlement
- No stamp duty for transfer of shares
- Low transaction cost for buying and selling in the dematerialised segment
- Low interest rates on loans granted against pledge of dematerialised securities by banks
- Low margin on securities pledged with banks
- Pay-In and pay-out of securities on the same day
- Increase in the liquidity of your securities because of faster transfer and registration of securities in your account.
- Instant disbursement of non-cash corporate action benefits like bonus and rights into your account. Regular account status updates available from the DP at any point of time

Various services offered by CDS

CDS offers the following services to the investors through its Depository Participants:

- Dematerialisation: i.e. converting physical securities into electronic form in your account.
- Rematerialisation: i.e. converting electronic securities balances in your account back into physical securities.
- Maintaining your holdings in the electronic form.
- Effecting settlement of securities traded on the stock exchanges.
- Effecting settlement of trades not done on the stock exchanges i.e. off-market trades.
- Enabling you to receive electronic credit in your account in case of public issues.
- Enabling you to receive your non-cash corporate action benefit such as bonus and rights in the electronic form.
- Enabling you to pledge your dematerialised securities.
- Facilitating Securities lending and borrowing

Dematerialisation

Dematerialisation is the process by which a client can get physical certificates converted into electronic balances. An investor intending to dematerialise its securities needs to have an account with a DP. The client has to deface and surrender the certificates registered in its name to the DP. After intimating NSDL electronically, the DP sends the securities to the concerned Issuer/ R&T agent. NSDL in turn informs the Issuer/ R&T agent electronically, using NSDL Depository system, about the request for dematerialisation. If the Issuer/ R&T agent finds the



certificates in order, it registers NSDL as the holder of the securities (the investor will be the beneficial owner) and communicates to NSDL the confirmation of request electronically. On receiving such confirmation, NSDL credits the securities in the depository account of the Investor with the DP.

Features:

- Holdings in only those securities that are admitted for dematerialisation by NSDL can be dematerialised.
- Only those holdings that are registered in the name of the account holder can be dematerialised.
- Names of the holders of the securities should match with the names given for the demat account.
- If the same set of joint holders held securities in different sequence of names, these joint holders by using 'Transposition cum Demat facility' can dematerialise the securities in the same account even though share certificates are in different sequence of names. e.g., If there are two share certificates one in the name of X first and Y second and another in the name of Y first and X second, then these shares can be dematerialised in the depository account which is in any name combination of X and Y i.e., either X first and Y second or Y first and X second. Separate accounts need not be opened to demat each share certificate. If shares are in the name combinations of X and Y, it cannot be dematerialised into the account of either X or Y alone.
- Check the demat performances of the companies whose shares are to be given for dematerialisation.
- Demat requests received from client (registered owner) with name not matching exactly with the name appearing on the certificates merely on account of initials not being spelt out fully or put after or prior to the surname, can be processed, provided the signature of the client on the Dematerialisation Request Form (DRF) tallies with the specimen signature available with the Issuers or its R & T agent.
- A client may, in the normal course, receive demat confirmation in about 30 days from the date of submission of demat request to the DP.
- There are special processes for Securities issued by Government of India and simultaneous transmission and demat.

Procedure:

- The client (registered owner) will submit a request to the DP in the Dematerialisation request form for dematerialisation, along with the certificates of securities to be dematerialised. Before submission, the client has to deface the certificates by writing "SUR-RENDERED FOR DEMATERIALISATION".



- The DP will verify that the form is duly filled in and the number of certificates, number of securities and the security type (equity, debenture etc.) are as given in the DRF. If the form and security count is in order, the DP will issue an acknowledgement slip duly signed and stamped, to the client.
- The DP will scrutinize the form and the certificates. This scrutiny involves the following :
- Verification of Client's signature on the dematerialisation request with the specimen signature (the signature on the account opening form). If the signature differs, the DP should ensure the identity of the client.
 - ◆ Compare the names on DRF and certificates with the client account.
 - ◆ Paid up status
 - ◆ ISIN (International Securities Identification Number)
 - ◆ Lock - in status
 - ◆ Distinctive numbers
- In case the securities are not in order they are returned to the client and acknowledgment is obtained. The DP will reject the request and return the DRF and certificates in case:
- A single DRF is used to dematerialise securities of more than one company.
- The certificates are mutilated, or they are defaced in such a way that the material information is not readable. It may advise the client to send the certificates to the Issuer/ R&T agent and get new securities issued in lieu thereof.
- Part of the certificates pertaining to a single DRF is partly paid-up; the DP will reject the request and return the DRF along with the certificates. The DP may advise the client to send separate requests for the fully paid-up and partly paid-up securities.
- Part of the certificates pertaining to a single DRF is locked-in, the DP will reject the request and return the DRF along with the certificates to the client. The DP may advise the client to send a separate request for the locked-in certificates. Also, certificates locked-in for different reasons should not be submitted together with a single DRF
- In case the securities are in order, the details of the request as mentioned in the form are entered in the DPM (software provided by NSDL to the DP) and a Dematerialisation Request Number (DRN) will be generated by the system.
- The DRN so generated is entered in the space provided for the purpose in the dematerialisation request form.
- A person other than the person who entered the data is expected to verify details recorded for the DRN. The request is then released by the DP which is forwarded electronically to DM (DM - Depository Module, NSDL's software system) by DPM.



- The DM forwards the request to the Issuer/ R&T agent electronically.
- The DP will fill the relevant portion viz., the authorisation portion of the demat request form.
- The DP will punch the certificate on the company name so that it does not destroy any material information on the certificate.
- The DP will then despatch the certificates along with the request form and a covering letter to the Issuer/ R&T agent.
- The Issuer/ R&T agent confirms acceptance of the request for dematerialisation in his system DPM (SHR) and the same will be forwarded to the DM, if the request is found in order.
- The DM will electronically authorise the creation of appropriate credit balances in the client's account.
- The DPM will credit the client's account automatically.
- The DP must inform the client of the changes in the client's account following the confirmation of the request.
- The issuer/ R&T may reject dematerialisation request in some cases. The issuer or its R&T Agent will send an objection memo to the DP, with or without DRF and security certificates depending upon the reason for rejection. The DP/Investor has to remove reasons for objection within 15 days of receiving the objection memo. If the DP fails to remove the objections within 15 days, the issuer or its R&T Agent may reject the request and return DRF and accompanying certificates to the DP. The DP, if the client so requires, may generate a new dematerialisation request and send the securities again to the issuer or its R&T Agent. No fresh request can be generated for the same securities until the issuer or its R&T Agent has rejected the earlier request and informed NSDL and the DP about it.

2.3. REGULATION OF BANKING & FINANCE COMPANIES – ROLE OF RBI AND BANKING OMBUDSMEN

The Reserve Bank of India (RBI) brought about crucial amendments to the Banking Ombudsman Scheme, 2006 which will now enable aggrieved customers to not only appeal against any Ombudsman's decision but also to appeal in case of complaints being rejected. The appeal could be made to the deputy governor's office of the RBI.

The Ombudsman, however, has the right to reject complaints if they are ; not on the grounds of complaint referred to in clause 8; beyond the pecuniary jurisdiction of Banking Ombudsman prescribed; frivolous, vexatious, malafide; without any sufficient cause; that it is not pursued by the complainant with reasonable diligence; in the opinion of the Banking Ombudsman there is no loss or damage or inconvenience caused to the complainant; or requiring consideration of elaborate documentary and oral evidence and the proceedings before the Banking Ombudsman.



In case of a complaint being aggrieved by the award under clause 12 or by rejection of a complaint, he may exercise the option of an appeal within 30 days, the RBI said in its notification.

Clause (8), is when an award lapses automatically in thirty days if the complainant does not furnish a letter of acceptance as full and final settlement of claims.

Under the scheme, the central bank has appointed 15 Banking Ombudsmen located mostly in state capitals.

The Banking Ombudsman tries to resolve customer complaints through conciliation or mediation and even passes an award if it is not resolved through such settlement.

Also, the bank shall, unless it has preferred an appeal, within one month from the date of receipt of the award, comply with the award and intimate compliance to the Banking Ombudsman, the RBI notification added.

Financial Supervision

The Reserve Bank of India performs this function under the guidance of the Board for Financial Supervision (BFS). The Board was constituted in November 1994 as a committee of the Central Board of Directors of the Reserve Bank of India.

Objective

Primary objective of BFS is to undertake consolidated supervision of the financial sector comprising commercial banks, financial institutions and non-banking finance companies.

Constitution

The Board is constituted by co-opting four Directors from the Central Board as members for a term of two years and is chaired by the Governor. The Deputy Governors of the Reserve Bank are ex-officio members. One Deputy Governor, usually, the Deputy Governor in charge of banking regulation and supervision, is nominated as the Vice-Chairman of the Board.

BFS meetings

The Board is required to meet normally once every month. It considers inspection reports and other supervisory issues placed before it by the supervisory departments.

BFS through the Audit Sub-Committee also aims at upgrading the quality of the statutory audit and internal audit functions in banks and financial institutions. The audit sub-committee includes Deputy Governor as the chairman and two Directors of the Central Board as members.

The BFS oversees the functioning of Department of Banking Supervision (DBS), Department of Non-Banking Supervision (DNBS) and Financial Institutions Division (FID) and gives directions on the regulatory and supervisory issues.



Functions

Some of the initiatives taken by BFS include:

- i. restructuring of the system of bank inspections
- ii. introduction of off-site surveillance,
- iii. strengthening of the role of statutory auditors and
- iv. strengthening of the internal defences of supervised institutions.

The Audit Sub-committee of BFS has reviewed the current system of concurrent audit, norms of empanelment and appointment of statutory auditors, the quality and coverage of statutory audit reports, and the important issue of greater transparency and disclosure in the published accounts of supervised institutions.

Current Focus

- supervision of financial institutions
- consolidated accounting
- legal issues in bank frauds
- divergence in assessments of non-performing assets and supervisory rating model for banks.

2.4. REGULATION OF INSURANCE SECTOR BY IRDA (INSURANCE REGULATION AND DEVELOPMENT AUTHORITY)

A contract of insurance is a contract by which one party in consideration of the price paid to him proportionate to the risk provides security to the other party that he would make good the loss by the happening of any event.

The insurer (insurance company) makes good the loss or compensates the insured against happening of a specified risk such as fire, theft or any other similar contingency. The property insured is the subject matter of insurance. The loss may arise from uncertain events or perils / hazards causing destruction or damage to the property or death/ disablement of a person.

Principles of Insurance:

The contract of insurance is required to fulfill the principles of insurance namely;

- Insurable Interest
- Indemnity
- Subrogation
- Proximate Cause
- Good Faith
- Consideration



Insurable Interest : The Insured must have the insurable interest in the subject matter of insurance i.e., benefit by its safety or prejudiced by its loss.

Indemnity : The insured person is placed financially, in the same position as he was before the loss.

Subrogation: The legal right of one person, having indemnified the other in a contractual obligation to assume the place of another and avail all rights and remedies of the another, whether enforced or not . *Example:* The Insurer of an importer of electrical goods receives claims in respect of faulty toaster. The insurer pays the claim and takes over the insured's right to claim from the manufacturer.

Proximate Cause : (Causa Proxima)- The active and efficient cause that sets into motion a train of events, which bring about result/ loss with no other intervening cause. *Example:* During the war period, a bomb was dropped on a factory, which caused fire to the factory. The proximate cause was enemy action and not fire

GoodFaith : (Uberrima Fidae) the insured is duty bound to disclose all material facts relating to the risk to be covered. Both parties are expected to observe goodfaith on disclosing the information of the contract.

Consideration: (“quid pro quo”) Each policy holder is obliged to pay only a rateable portion to the insurer, under each separate policy.

Types of Insurance : includes (A) Life Insurance (B) General insurance

- A. Life Insurance is
- B. General Insurance
 - (i) Fire Insurance
 - (ii) Marine Insurance
 - (iii) Miscellaneous

The Insurance is a federal subject in India. The primary legislation that deals with insurance business in India is: Insurance Act, 1938, and Insurance Regulatory & Development Authority Act, 1999.

As per the section 4 of IRDA Act' 1999, Insurance Regulatory and Development Authority (IRDA, which was constituted by an act of parliament) specify the composition of Authority, all appointed by the Government of India, constituting a ten member team consisting of

- (a) a Chairman;
- (b) five whole-time members;
- (c) four part-time members,



The Insurance Regulatory and Development Authority was established under the provisions of section 3 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999).

According to the Act, “Insurance Cover” means an insurance contract whether in the form of a policy or a cover note or a Certificate of Insurance or any other form prevalent in the industry to evidence the existence of an insurance contract”

Duties, Powers and Functions of IRDA

Section 14 of IRDA Act, 1999 lays down the duties, powers and functions of IRDA..

Subject to the provisions of this Act and any other law for the time being in force, the Authority has the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business.

As per the provisions contained in sub-section (1), the powers and functions of the Authority shall include, -

- issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
- protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
- specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents
- specifying the code of conduct for surveyors and loss assessors;
- promoting efficiency in the conduct of insurance business;
- promoting and regulating professional organisations connected with the insurance and re-insurance business;
- levying fees and other charges for carrying out the purposes of this Act;
- calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the insurance business;
- control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);
- specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
- regulating investment of funds by insurance companies;
- regulating maintenance of margin of solvency;
- adjudication of disputes between insurers and intermediaries or insurance intermediaries;



- supervising the functioning of the Tariff Advisory Committee;
- specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause (f);
- specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and
- exercising such other powers as may be prescribed

Regulation on Unit – Linked Plans:

After being a witness to rampant misrepresentation of ULIPs (unit linked insurance plans), the regulator - Insurance Regulatory and Development Authority (IRDA) finally introduced some much-needed guidelines to lend an element of insurance to an otherwise investment product. ULIPs made an entry at a rather opportune time for insurance companies., From 3,000 points, the BSE Sensex surged furiously to over 12,000 points in an unprecedented manner leaving investors breathless. Unfortunately, even insurance companies were rather excited by the sharp rise in stockmarkets. The ULIPS product was more geared towards ‘offering a return’ than insuring lives. And this anomaly was put to good use by insurance agents by adopting the marketing gimmicks like tax benefit under sec 80 (c), paying premium for only 3 years were the premium for first three years are normally high so as to recover the entire cost of the policy. The IRDA, to their credit, did intervene at regular intervals to infuse some much-needed sanity.

On July 1, 2006, the IRDA introduced revised ULIP guidelines to correct “some” of these anomalies, but more to be achieved later.

IRDA has given the new ULIP a ‘face’, in insurance a face can be taken as the sum assured and the tenure. The old ULIP lacked both and individuals did not have an inkling about either even after taking the ULIP. The latest guidelines dictate that:

1. Term/Tenure

- The ULIP client must have the option to choose a term / tenure.
- If no term is defined, then the term will be defined as ‘70 minus the age of the client’. For example if the client is opting for ULIP at the age of 30 then the policy term would be 40 years.
- The ULIP must have a minimum tenure of 5 years.

2. Sum Assured

The minimum sum assured is calculated as:

$(\text{Term} / 2 * \text{Annual Premium})$ or $(5 * \text{Annual Premium})$ whichever is higher.

There is no clarity with regards to the maximum sum assured.



3. Premium payments

If less than first 3 years premiums are paid, the life cover will lapse and policy will be terminated by paying the surrender value. However, if at least first 3 years premiums have been paid, then the life cover would have to continue at the option of the client.

4. Surrender value

The surrender value would be payable only after completion of 3 policy years.

5. Top-ups

Insurance companies can accept top-ups only if the client has paid regular premiums till date. If the top-up amount exceeds 25% of total basic regular premiums paid till date, then the client has to be given a certain percentage of sum assured on the excess amount. Top-ups have a lock-in of 3 years (unless the top-up is made in the last 3 years of the policy).

6. Partial withdrawal

The client can make partial withdrawals only after 3 policy years.

7. Settlement

The client has the option to claim the amount accumulated in his account after maturity of the term of the policy upto a maximum of 5 years. For instance, if the ULIP matures on January 1, 2007, the client has the option to claim the ULIP monies till as late as December 31, 2012. However, life cover will not be available during the extended period.

8. Loans

No loans will be granted under the new ULIP.

9. Charges

The insurance company must state the ULIP charges explicitly. They must also give the method of deduction of charges.

10. Benefit Illustrations

The client must necessarily sign on the sales benefit illustrations. These illustrations are shown to the client by the agent to give him an idea about the returns on his policy. Agents are bound by guidelines to show illustrations based on an optimistic estimate of 10% and a conservative estimate of 6%. Now clients will have to sign on these illustrations, because agents were violating these guidelines and projecting higher returns.

While what the IRDA has done is commendable, a lot more needs to be done.

Regulations for Insurance Brokers:

An “insurance broker” according to the IRDA Act, means a person for the time-being licensed by the Authority under regulation 11, who for a remuneration arranges insurance contracts with insurance companies and / or reinsurance companies on behalf of his clients.”



- (a) obtaining detailed information of the client's business and risk management philosophy;
- (b) familiarising himself with the client's business and underwriting information so that this can be explained to an insurer and others;
- (c) rendering advice on appropriate insurance cover and terms;
- (d) maintaining detailed knowledge of available insurance markets, as may be applicable;
- (e) submitting quotation received from insurer /s for consideration of a client;
- (f) providing requisite underwriting information as required by an insurer in assessing the risk to decide pricing terms and conditions for cover;
- (g) acting promptly on instructions from a client and providing him written acknowledgements and progress reports;
- (h) assisting clients in paying premium under section 64VB of Insurance Act, 1938 (4 of 1938);
- (i) providing services related to insurance consultancy and risk management;
- (j) assisting in the negotiation of the claims; and
- (k) maintaining proper records of claims;

2.5. CYBER LAW AND REGULATION OF E COMMERCE AND ELECTRONIC FINANCIAL INSTRUMENTS:

Cyber laws are meant to set the definite pattern, some rules and guidelines that defined certain business activities going on through internet legal and certain illegal and hence punishable . **The IT Act 2000, the cyber law of India** , gives the legal framework so that information is not denied legal effect, validity or enforceability, solely on the ground that it is in the form of electronic records.

1. The E-commerce industry carries out its business via transactions and communications done through **electronic records** . It thus becomes essential that such transactions be made legal . Keeping this point in the consideration, the IT Act 2000 **empowers the government departments to accept filing, creating and retention of official documents in the digital format** . The Act also puts forward the proposal for setting up the legal framework essential for the authentication and origin of **electronic records / communications** through digital signature.
2. The Act **legalizes the e-mail** and gives it the status of being *valid form of carrying out communication in India* . This implies that e-mails can be duly produced and approved in a court of law , thus can be regarded as substantial document to carry out **legal proceedings**.



3. The act also talks about **digital signatures** and digital records . These have been also awarded the status of being legal and valid means that can form strong basis for launching litigation in a court of law. It invites the corporate companies in the business of being **Certifying Authorities** for issuing secure Digital Signatures Certificates.
4. The Act now allows Government to issue **notification on the web** thus heralding e-governance.
5. It eases the task of companies of the filing any form, **application** or document by laying down the guidelines to be submitted at any *appropriate office, authority, body or agency owned or controlled by the government*. This will help in **saving costs, time and manpower** for the corporates.
6. The act also provides **statutory remedy** to the coporates in case the crime against the accused for breaking into their computer systems or network and damaging and copying the data is proven. The remedy provided by the Act is in the form of monetary damages, not exceeding **Rs. 1 crore(\$200,000)**.
7. Also the law sets up the **Territorial Jurisdiction** of the Adjudicating Officers for cyber crimes and the Cyber Regulations Appellate Tribunal.
8. The law has also laid guidelines for providing **Internet Services** on a license on a non-exclusive basis.

The IT Law 2000, though appears to be self sufficient, it takes mixed stand when it comes to many practical situations. It looses its certainty at many places like:

1. The law misses out completely the issue of **Intellectual Property Rights**, and makes no provisions whatsoever for *copyrighting, trade marking or patenting of electronic information and data*. The law even doesn't talk of the rights and liabilities of domain name holders , the first step of entering into the e-commerce.
2. The law even stays silent over the **regulation of electronic payments** gateway and segregates the negotiable instruments from the applicability of the IT Act , which may have major effect on the growth of e-commerce in India . It leads to make the banking and **financial sectors irresolute** in their stands .
3. The act empowers the Deputy Superintendent of Police to look up into the investigations and filling of charge sheet when any case related to cyber law is called. This approach is likely to result in **misuse** in the context of Corporate India as companies have public offices which would come within the ambit of "public place" under the Act. As a result, companies will not be able to escape potential **harassment** at the hands of the DSP.
4. Internet is a borderless medium ; it spreads to every corner of the world where life is possible and hence is the cyber criminal. Then how come is it possible to feel relaxed and secured once this law is enforced in the nation.

**Amendments to the Reserve Bank of India Act, 1934, E Commerce Act, 1998**

- (a) The Reserve Bank of India Act, 1934 is amended by inserting after Chapter IIIC, the following Chapter III D: “Chapter III D
- 1) If the Bank is satisfied that in the interest of development of efficient payment systems it is necessary to promote and establish multiple electronic funds transfer (EFT) systems, it may by order, allow banking companies, financial or other institutions, or any other person desirous of setting up an EFT System to apply for authorisation from the Bank to commence and operate an EFT System.
 - (2) An application for approval under sub-section (1) shall be submitted in the form specified by the Bank from time to time, along with a scheme of operations of the proposed system and the documents relating to rights, duties and liabilities of the person participating in such system.
 - (3) The Bank may, before granting approval for any such proposed system, require the applicant or the proposed participants in the system to submit such further information and particulars as considered necessary and the Bank may also cause such reasonable inspection of the premises, equipments, machineries, books or other documents, or accounts and transactions, relating to the proposed system as considered essential by the Bank, with permission of the applicant.
 - (4) The Bank may, subject to such modifications and alterations to the scheme and any contract and documents submitted therewith as are considered desirable, approve or reject any application submitted for approval under sub-section (2). Provided that while approving the scheme, the Bank may impose such terms, restrictions, limitations and conditions as it may deem fit, on the applicant or the proposed participant or any other person likely to be affected or benefited thereby. Provided further, that before rejecting any such application the Bank may serve notice on the applicant requiring it to show cause as to why the application should not be rejected and if so requested by the applicant, an opportunity for hearing should also be given.
 - (5) Any Regulation framed by the Bank for regulation of multiple payment systems shall be binding on the applicant, the proposed participants and any other person likely to be affected or benefited thereby.
 - (6) No person, other than a person whose application is approved by the Bank under sub-section (4) shall commence or operate any EFT System.

Explanation: For the purpose of this Section:

“EFT System” means the Electronic Fund Transfer System established by these Regulations for carrying out interbank and intrabank funds transfers within India, through EFT centres connected by a network, and providing for settlement of payment obligations arising out of such funds transfers, between participating banks or institutions. **“banking company”** means a company as defined in Section 5 of the Banking Regulation Act, 1949, and includes the State Bank of India, constituted by the State Bank of India Act, 1955, a Subsidiary Bank constituted



under the State Bank of India (Subsidiary Banks) Act, 1959, a Corresponding New Bank constituted under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, a cooperative bank, as defined in Section 56 of Part V of the Banking Regulation Act, 1949 and such other banks as may be specified from time to time. “Financial Institutions” shall bear the meaning assigned to it in Section 4A(1) of the Companies Act, 1956 and includes an institution notified under Sub-section (2) of that Section. “Institution” means a public financial institution and includes a department or agency of the Central or State Government or any other organisation approved by the Reserve Bank as eligible to open a settlement account with it.”

(b) Section 58(2) of the Reserve Bank of India Act, 1934, is amended by inserted after existing clause (P), the following new clause (PP):

“(PP) The regulation of multiple payment systems”

2.6. CONTEMPORARY ISSUES IN FINANCE

VENTURE CAPITAL

Concept of venture capital : The term “Venture capital” is understood in many ways. In a narrow sense, it refers to investment in new and tried enterprises that are lacking a stable record of growth.

In a broader sense, venture capital refers to the commitment of capital as shareholding, for the formulation and setting up of small firms specializing in new ideas or new technologies. It is not merely an injection of funds into a new firm; it is a simultaneous input of skill needed to set up the firm, design its marketing strategy and organize and manage it. It is an association with successive stages of firm’s development with distinctive types of financing appropriate to each stage of development.

Meaning of venture capital: Venture capital is long term risk capital to finance high technology project which involves risk but at the same time has strong potential for growth. Venture capitalist pools their resources including managerial abilities to assist new entrepreneurs in the early years of the project. Once the project reaches the stage of profitability, they sell their equity holdings at high premium.

Definition of a venture capital company: A venture capital company is defined as “a financing institution which joins an entrepreneur as a co-promoter in a project and shares the risks and rewards of the enterprise”.

Features of venture capital

Some of the features of venture capital financing are as under:

1. Venture capital is usually in the form of an equity participation. It may also take the form of convertible debt or long term loan.
2. Investment is made only in high risk but high growth potential projects.



3. Venture capital is available only for commercialization of new ideas or new technologies and not for enterprises which are engaged in trading, booking, financial services, agency, liaison work or research and development.
4. Venture capitalist joins the entrepreneurs as a co-promoter in project and shares the risks and rewards of the enterprise.
5. There is continuous involvement in business after making an investment by the investor.
6. Once the venture has reached the full potential the venture capitalist disinvests his holdings either to the promoters or in the market. The basic objective of investment is not profit but capital appreciation at the time of disinvestment.
7. Venture capital is not just injection of money but also an input needed to setup the firm, design its marketing strategy and organize and manage it.
8. Investment is usually made in small and medium scale enterprises.

Disinvest mechanism: The objective of venture capitalists to sell of the investment made by him at substantial capital gains. The disinvestment options available in development countries are:

1. Promoters buy back
2. Public issues
3. sale to other venture capital funds
4. sale in OTC market &
5. Management buy outs

In India, the most popular investment route is promoter's buy back. This permits the ownership and control of the promoter in tact.

The risk capital and technology finance corporation, CAN-VCF etc. in India allow promoters to buy back equity of their enterprise.

The public issue would be difficult and expensive since first generation entrepreneurs are not known in the capital market. The option involves high transaction cost and also less feasible for small venture on account of high listing requirements of the stock exchange.

The OTC exchange in India has been set up in 1992. It is hoped that OTCEI would provide disinvestment opportunity to venture capital firms.

The other investment options such as management buy out sale to other venture capital funds are not considering appropriate in India.

Scope of venture capital

1. Development of an idea – seed finance
2. Implementation stage – start up finance



3. Fledging stage – Additional fiancé
4. Establishment stage – Establishment finance

Importance of venture capital

1. Advantages to investing public: The investing public will be able to reduce risk significantly against unscrupulous management, if the public invest in venture fund who in turn will invest in equity of new business. With their expertise in the field and continuous involvement in the business they would be bale to stop malpractices by management.
2. Advantage of promoters: the entrepreneur for the success of public issues is required to convince tens of underwriters, brokers and thousands of investors but to obtain venture capital assistance; he will be required to sell his ideas to justify the officials of the venture funds.
3. General: A developed venture capital institutional set up reduces the time lag between a technological innovation and its commercial exploitation.

Securitisation is the process of conversion of existing assets or future cash flows into marketable securities. In other words, securitisation deals with the conversion of assets which are not marketable into marketable ones.

For the purpose of distinction, the conversion of existing assets into marketable securities is known as asset-backed securitisation and the conversion of future cash flows into marketable securities is known as future-flows securitisation.

Some of the assets that can be securitised are loans like car loans, housing loans, et cetera and future cash flows like ticket sales, credit card payments, car rentals or any other form of future receivables.

Suppose Mr X wants to open a multiplex and is in need of funds for the same. To raise funds, Mr X can sell his future cash flows (cash flows arising from sale of movie tickets and food items in the future) in the form of securities to raise money.

This will benefit investors as they will have a claim over the future cash flows generated from the multiplex. Mr X will also benefit as loan obligations will be met from cash flows generated from the multiplex itself.

The process and participants

Section 5 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, mandates that only banks and financial institutions can securitise their financial assets.

In the traditional lending process, a bank makes a loan, maintaining it as an asset on its balance sheet, collecting principal and interest, and monitoring whether there is any deterioration in borrower's creditworthiness.

This requires a bank to hold assets (loans given) till maturity. The funds of the bank are blocked in these loans and to meet its growing fund requirement a bank has to raise additional funds from the market. Securitisation is a way of unlocking these blocked funds.



Consider a bank, ABC Bank. The loans given out by this bank are its assets. Thus, the bank has a pool of these assets on its balance sheet and so the funds of the bank are locked up in these loans. The bank gives loans to its customers. The customers who have taken a loan from the ABC bank are known as obligors.

To free these blocked funds the assets are transferred by the originator (the person who holds the assets, ABC Bank in this case) to a special purpose vehicle (SPV).

The SPV is a separate entity formed exclusively for the facilitation of the securitisation process and providing funds to the originator. The assets being transferred to the SPV need to be homogenous in terms of the underlying asset, maturity and risk profile.

What this means is that only one type of asset (eg: auto loans) of similar maturity (eg: 20 to 24 months) will be bundled together for creating the securitised instrument. The SPV will act as an intermediary which divides the assets of the originator into marketable securities.

These securities issued by the SPV to the investors and are known as pass-through-certificates (PTCs). The cash flows (which will include principal repayment, interest and prepayments received) received from the obligors are passed onto the investors (investors who have invested in the PTCs) on a pro rata basis once the service fees have been deducted.

The difference between rate of interest payable by the obligor and return promised to the investor investing in PTCs is the servicing fee for the SPV.

The way the PTCs are structured the cash flows are unpredictable as there will always be a certain percentage of obligors who won't pay up and this cannot be known in advance. Though various steps are taken to take care of this, some amount of risk still remains.

The investors can be banks, mutual funds, other financial institutions, government etc. In India only qualified institutional buyers (QIBs) who possess the expertise and the financial muscle to invest in securities market are allowed to invest in PTCs

Mutual funds, financial institutions (FIs), scheduled commercial banks, insurance companies, provident funds, pension funds, state industrial development corporations, et cetera fall under the definition of being a QIB. The reason for the same being that since PTCs are new to the Indian market only informed big players are capable of taking on the risk that comes with this type of investment.

In order to facilitate a wide distribution of securitised instruments, evaluation of their quality is of utmost importance. This is carried on by rating the securitised instrument which will acquaint the investor with the degree of risk involved.

The rating agency rates the securitised instruments on the basis of asset quality, and not on the basis of rating of the originator. So particular transaction of securitisation can enjoy a credit rating which is much better than that of the originator.

High rated securitised instruments can offer low risk and higher yields to investors. The low risk of securitised instruments is attributable to their backing by financial assets and some credit enhancement measures like insurance/underwriting, guarantee, etc used by the originator.



The administrator or the servicer is appointed to collect the payments from the obligors. The servicer follows up with the defaulters and uses legal remedies against them. In the case of ABC bank, the SPV can have a servicer to collect the loan repayment installments from the people who have taken loan from the bank. Normally the originator carries out this activity.

Once assets are securitised, these assets are removed from the bank's books and the money generated through securitisation can be used for other profitable uses, like for giving new loans.

For an originator (ABC bank in the example), securitisation is an alternative to corporate debt or equity for meeting its funding requirements. As the securitised instruments can have a better credit rating than the company, the originator can get funds from new investors and additional funds from existing investors at a lower cost than debt.

Impact on banking

Other than freeing up the blocked assets of banks, securitisation can transform banking in other ways as well.

The growth in credit off take of banks has been the second highest in the last 55 years. But at the same time the incremental credit deposit ratio for the past one-year has been greater than one.

What this means in simple terms is that for every Rs 100 worth of deposit coming into the system more than Rs 100 is being disbursed as credit. The growth of credit off take though has not been matched with a growth in deposits.

So the question that arises is, with the deposit inflow being less than the credit outflow, how are the banks funding this increased credit offtake?

Banks essentially have been selling their investments in government securities. By selling their investments and giving out that money as loans, the banks have been able to cater to the credit boom.

This form of funding credit growth cannot continue forever, primarily because banks have to maintain an investment to the tune of 25 per cent of the net bank deposits in statutory liquidity ratio (SLR) instruments (government and semi government securities).

The fact that they have been selling government paper to fund credit off take means that their investment in government paper has been declining. Once the banks reach this level of 25 per cent, they cannot sell any more government securities to generate **liquidity**.

And given the pace of credit off take, some banks could reach this level very fast. So banks, in order to keep giving credit, need to ensure that more deposits keep coming in.

One way is obviously to increase interest rates. Another way is Securitisation. Banks can securitise the loans they have given out and use the money brought in by this to give out more credit.



MERCHANT BANKING

The term merchant banking is used differently in different countries and so there is no precise definition for it. In London, merchant banker refers to those who are members of British Merchant Banking and Securities House Association who carry on consultation, leasing, Portfolio services, assets management, euro credit, loan syndication etc. In America, merchant banking is concerned with mobilizing saving of people and directing the funds to business enterprise.

Definition

There is no universal definition for merchant banking. It assumes diverse function in different countries. So merchant banking may be defined as, “an institution which covers a wide range of activities such as management of customer services, portfolio management, credit syndication, acceptance credit, counselling, insurance etc.

The notification of the Ministry of finance defines a merchant banker as. “any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to the securities as managers, consultant, adviser or rendering corporate advisory service in relation to such issue management”.

Origin

Merchant banking originated through the entering of London merchants in financing foreign trade through acceptance of bills. Later – the merchants assisted the government of under developed countries in raising long term funds through floatation of bonds in London money market. Over a period, they extended their activities to domestic business of syndication of long term and short term finance, underwriting of new issues, acting as registrars and share transfer agents, debentures trustees, portfolio managers, negotiating agents for mergers, take over etc. the post war period witnessed the rapid growth of merchant banking through the innovative instrument like Euro dollar and the growth of various financial centers like Singapore, Hong Kong, Bahrain, Kuwait, Dubai etc.

Merchant Banking in India

In India prior to the enactment of Indian companies Act 1956, managing agents acted as issue houses for securities, evaluated project reports, planned capital structure and to some extent provided venture capital for new firms. Few shares broking firms also function as merchant bankers.

The need for specialized merchant banking service was felt in India with the rapid growth in the number and size of the issues made in the primary market. The merchant banking services were started by foreign bankers, namely the National Grindlays banks in 1967 and city bank in 1970. The banking commission in its report in 1972 recommended the setting up of merchant banking institution by commercial banks and financial institutions. This marked the beginning of specialized merchant banking in India.



To begin with, merchant banking services were offered along with other traditional banking services. In the mid- eighties, the banking regulations act was amended permitting commercial banks to offer a wide range of financial services through the subsidiary rule. The state bank of India was the first Indian bank to set up merchant banking division in 1972. Later ICICI set up its Merchant Banking Division followed by bank of India, Bank of Baroda, Canara bank, Punjab National Bank and UCO bank. The merchant banking gained prominence during 1983-84 due to new issue boom.

Merchant banks and commercial banks

There are differences in approach, attitude and areas of operations between commercial banks and merchant banks. The differences between merchant banks and commercial banks are summarized below:

1. Commercial banks basically deal and debt related finance and their activities are appropriately arrayed around credit proposal, credit appraisal and loan sanctions. On the other hand, the area of activities of merchant bankers is “equity and equity related”. They deal with mainly funds raised through money market and capital market.
2. Commercial banks are asset oriented and their lending decisions are based on detailed credit analysis of loan proposals and the value of security offered against loans. They generally avoid risks. The merchant bankers are management oriented. They are willing to accept risk of business.
3. Commercial bankers are merely financiers. The activities of merchant bankers include project counselling, corporate counselling in areas of capital restructuring, amalgamations, mergers, takeover etc, discounting and rediscounting of short term paper in money markets, managing, underwriting and supporting public issues in new issue market and acting as brokers and advisers on portfolio management in stocks exchange. Merchant banking activities have impact on growth, stability and liquidity of money markets.

Services of merchant banks

The financial institutions in India could not meet the demands for long term funds required by the ever expanding industry and trade. The corporate sector enterprises, therefore, meet their requirements through issue of shares and debentures in capital market. To raise money from capital market, promoters bank upon merchant bankers who manage the whole show by rendering multifarious services. The merchant bankers also advice the investors of the incentives available in the form of tax relief's and other statutory obligation.

The services of merchant bankers are described in details in the following section.

1. Corporate counselling
2. Project counselling
3. Loan syndication



CAPITAL & FINANCIAL MARKET REGULATIONS

4. Issue management
 - Public issue through prospectus
 - Marketing
 - Pricing of issues
5. Post Issue management
6. Underwriting of public issue
7. Mangers, consultants or advisers to the issue
8. Portfolio management
9. Advisory services relating to mergers and takeovers
10. Off shore finance
11. Non – Resident investment

Scope for merchant banking in India

In the present day capital market scenario, the merchant banks play the role of an encouraging and supporting force to the entrepreneurs, corporate sector and the investors. There is vast scope for merchant bankers to enlarge their operations both in domestic and international market.

1. Growth of new issues market
2. Entry of foreign investors
3. Changing policy of financial institutions
4. Development of debt market
5. Innovation in financial instruments
6. corporate restructuring
7. Disinvestment

Key words

- OTCE
- Depositories
- Dematerialisation
- RBI
- IRDA



- Fund transfer
- Ecommerce
- Venture capital
- Securitisation
- Merchant banking
- Fund manger

Summary

In this Unit, we have discussed two segments of Indian securities market namely primary market on issues market and secondary market or stock market. We have highlighted recent trends in the primary discussed various types of securities traded, market players and trading arrangements which exists in the can stock market. Different aspects of the Indian stock market viz. origin and growth, role and functions. Membership, organization and management, trading systems, stock market information system, principal weakness of directions of reform have been explained so that you as a student of this course are able to clearly visualize environment in which investment and portfolio management decisions are made. A major development of 1992 the scene of Indian stock exchanges namely, the promotion of Over The Counter Exchanges of India (OTCEI), its true features, trading mechanism and expected benefits to companies, investors and general environment of finance is also discussed. In the following Unit we shall focus on the legal frame of Indian securities market. We also explained collective investment schemes . dematerialisation , RBI role in Banking and financial sector , role of IRDA in regulation insurance sector, cyber low special reference to fund transfer basics of venture capital, securitisation and merchant banking.

Questions to ponder:

1. Write on powers and Functions of SEBI
2. Briefly explain organisation management of SEBI.
3. Explain briefly Regulatory Frame work of Security Market.
4. Write a note on Securities Contracts (Regulation) Act, 1956
5. Explain about the Depositories Act, 1996: The Depositories Act, 1996
6. Write insight of Regulation of OTCEI
7. What are criteria for admission of licensed dealers
8. Write on the significance of venture capital
9. Explain briefly merchant banking and securitization
10. write on SEBI- regulation on Capital market and money market
11. Write a note on regulation of the investment of a mutual fund
12. Role of the RBI in regulating banking and financial sector
13. Explain the duties and powers of IRDA.