

Securities Regulation and Investor Protection - A Legal Analysis in Financial Market

Adv. Rameshwari Phutane

Law, Saket Law College, Shahapur

Abstract - Generally, liberalized securities contribute to economic growth.

The level of economic growth is directly related to how liberalized a securities market is. The SEBI Act 1992 (Securities and Exchange Board of India) aims to protect the interests of investors in the securities market, promote development, and regulate the market. It was considered important to extend the jurisdiction of SEBI, increase its autonomy, and empower it to handle situations where the Act is violated. The investor forum and other authorities should have the authority to resolve cases quickly and provide compensation to affected investors. It is not sufficient to punish the guilty party. The guilty should be punished as an example, and investors must have the means to recover losses caused by them. The law should give authorities the power not only to impose penalties but also to provide compensation to investors.

Keywords - securities, depository, public issue.

Introduction - Investors are the foundation of the securities market.

Protecting their interests is crucial to maintaining their confidence and supporting market development. The main role of the Securities and Exchange Board of India under the SEBI Act 1992 is to safeguard investors' interests and ensure the healthy growth of the Indian financial markets. Considering the difficulty in regulating and monitoring all parts of the financial markets, it is a highly challenging and demanding task for regulators to prevent scams. This is also true for the Indian regulator. However, what are the responsibilities of regulators in correcting the system once a scam has occurred, particularly in addressing the concerns of investors to restore their trust? Resolving investor grievances after a scam is the most difficult challenge for regulators across the world, including in India. One of the tools available to regulators is collecting and distributing funds obtained from offenders to affected investors. SEBI issued guidelines to protect investors through the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000, which were introduced under Section 11 of the SEBI Act, 1992.

It is important to understand the context of key definitions provided in these guidelines.

1. Issuer Company - A company that has submitted offer documents to the Board for issuing securities in accordance with these guidelines.

2. Listed Company - A company whose securities have been listed on a recognized stock exchange, including Public Sector Undertakings with listed securities.

3. Merchant Banker - An entity registered under the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992.

4. Offer Document - Refers to a prospectus in the case of a public issue or offer for sale, and a letter of offer in the case of a rights issue.

5. Offer for Sale - Refers to the offer of securities by existing shareholders of a company to the public for subscription through an offer document.

SEBI guidelines for investor protection - SEBI has consistently issued guidelines for companies issuing securities to safeguard investor interests.

No company can issue securities unless a draft prospectus is submitted to the Board, through an eligible merchant banker, at least 21 days before the prospectus is filed with the Registrar of Companies (ROCs). Provided that, if the Board specifies changes in the draft prospectus within 21 days of submission (without being obliged to do so), the issuer or lead merchant banker must implement those changes before submitting the prospectus to ROCs. A listed company cannot issue securities through a rights issue where the aggregate value (including any premium) exceeds Rs.50 lakh, unless a letter of offer is submitted to the Board, through an eligible merchant banker, at least 21 days before the letter is filed. If the Board specifies changes in the draft letter of offer within 21 days of its filing (without being obliged to do so), the issuer or lead merchant banker must implement those changes before filing the draft letter. No company can issue securities if it is restricted from accessing the capital market under an order or direction from the Board.

A listed company whose equity shares are listed on a stock exchange can freely set the price of its equity shares and any security convertible into equity at a later date, offered through a public or rights issue.

An unlisted company that is eligible for a public issue and wishes to get its securities listed on a recognized stock exchange may also set the price of its equity shares or any securities convertible into equity at a later date. An eligible company is free to issue public or rights issues of equity shares in any denomination it chooses, as per Sub-section (4) of Section 13 of the Companies Act, 1956, and as long as it complies with SEBI's norms.

In the case of an initial public offer by an unlisted company, if the issue price is Rs. 500 or higher, the issuer has the flexibility to set the face value of shares below Rs. 10 per share, but it must not be less than Rs. 1 per share.

If the issue price is less than Rs. 500, the face value will be Rs. 10 per share. The disclosure of the face value of shares (including the statement that the issue price is "X" times the face value) must be made in the advertisement, offer documents, and application forms, using the same font size as the issue price or price band.

Pre-Issue Obligations - The pre-issue obligations are outlined in Chapter-V and include the following:

- The lead merchant banker must perform due diligence.
- The standard of due diligence should be such that the merchant banker is able to conduct a thorough and reliable assessment.

Consequence of Non-Observance of the Guidelines

- In case of non-observance of these guidelines (Section 11B) as it seems to be a bar from doing such things which may prejudice the interest of the investors the board can give the following directions: Direct the persons concerned to refund any money collected under an issue to the investors with or without requisite interest, as the case may be, direct the persons concerned not to access the capital market for a particular period, direct the stock exchange concerned not to list or permit trading in the securities, direct the stock exchange concerned to forfeit the security deposit deposited by the issuer company and any other direction which the Board may deem fit and proper in the circumstances of the case. Subject to condition that before issuing any directions the Board may give a reasonable opportunity to the person concerned. Provided further that if any interim direction is sought to be passed, the Board may give post decisional hearing to such person.

Future Overcast of the Investors - The Securities and Exchange Board of India (SEBI), as the apex regulatory authority in matters concerning securities, has undertaken substantial measures to safeguard investors against malpractices in the market. It has promulgated a comprehensive framework of guidelines with the stated objective of investor protection. Nevertheless, the

practical effect has been uneven: while larger market participants have often succeeded in eluding regulatory oversight, smaller investors have continued to face existential challenges.

As reported in Financial Daily [6], SEBI had previously received recommendations emphasizing the necessity of an exclusive legislative framework tailored to the protection of small investors. The Government accordingly contemplated the enactment of a separate statute, a view also reflected in the report of Mr. Mitra, who was appointed by the Ministry of Finance to formulate terms of reference for a new Bill.

The proposal generated considerable debate, owing to the multiplicity of regulatory authorities presently engaged in supervising entities that mobilize funds from the public—namely, SEBI for listed companies, the Reserve Bank of India (RBI) for non-banking financial companies, and the Department of Company Affairs (DCA) for unlisted companies. SEBI, however, has consistently advocated the establishment of a distinct regulatory mechanism for small investor protection and, in this regard, had earlier submitted a detailed proposal to the Finance Ministry underscoring the need for a separate enactment.

Mr. Mitra's report additionally recommended the creation of a comprehensive Investor Protection Fund. In practice, such a fund is already in existence today. The report further suggested that the extant Investor Protection Fund—financed by unclaimed dividends—be consolidated with the proposed fund, thereby creating a more robust corpus dedicated to investor welfare.

Conclusion - Through various guidelines, considerable effort has been made to ensure that no stone is left unturned in the mission of protecting investors. However, investor forums and regulatory authorities should be vested with the power to summarily dispose of cases and award compensation to affected investors. Punishing wrongdoers alone is not sufficient. While exemplary punishment is necessary, investors must also have effective means of recovering losses caused by such misconduct. Therefore, the law should empower authorities not only to impose penalties but also to grant compensation to investors.

At present, two major challenges stand out: scams relating to mutual funds and the issue of disgorge of money. With respect to mutual funds, SEBI has expressed concern over the quality of services provided to investors. The regulator has urged the industry to focus on hassle-free redemptions and to conduct investor surveys in their own interest. SEBI's then-Chairman, Mr. C.B. Bhavé, emphasized the importance of understanding investor preferences, remarking, "Take up investor survey to find out what they feel about your products, why they like certain products... Focus on what the client wants, as this will be in your interest." He further assured that SEBI

would establish an advisory committee for mutual fund institutions. Mr. Bhave also suggested the creation of a centralized depository to maintain a national database of mutual fund investors, similar to existing equity market depositories. In addition, SEBI planned to conduct workshops with trustees to gather feedback and launched a mutual fund advisory committee to address industry concerns.

The issue of disgorgement presents another area of challenge. In India, there remains ambiguity regarding the treatment of disgorged funds. Typically, penalties collected are credited to the Consolidated Fund of India. However, in its first disgorgement order dated 21 November 2006, in the Karvy case, SEBI directed NSDL, CDSL, and eight depository participants—including Karvy, HDFC Bank, Khandwala Securities, IDBI Bank, Jhaveri Securities, ING Vysya Bank, PR Stock Broking, and Pratik Stock Vision—to return ₹115.81 crore within six months. SEBI clarified that disgorgement is an equitable remedy rather than a penal or quasi-penal measure. Unlike damages, disgorgement compels a defendant to surrender the gains of unjust enrichment. The order was significant as it aimed to restore investor confidence, particularly among those deprived of IPO shares due to illegal cornering by financiers. The Wadhwa Committee Report (December 2007) further recommended compensating such deprived investors monetarily, a suggestion that SEBI appeared to endorse through its disgorgement order.

Investor protection mechanisms are also vital in cases of

systemic failures. For example, in the banking sector, depositors are insured up to ₹1 lakh in the event of a bank's liquidation or bankruptcy. This measure safeguards small depositors and contributes to overall financial stability. A comparable system could be introduced in the securities market, compensating investors up to ₹5 lakh for losses arising from systemic failures or misconduct by market participants. In the United States, a similar framework exists under the Securities Investor Protection Corporation (SIPC), which offers protection to investors in comparable situations. Finally, investor confidence can be further strengthened by institutionalizing professional intermediation services. Although regulators and industry participants have made initial efforts, they remain inadequate considering the scale of the securities market. A formal mechanism is required to ensure that intermediaries are equipped with the requisite knowledge and skills. Establishing a dedicated institute for securities markets, akin to the ICSI or ICAI, could play a pivotal role in professionalizing the sector and raising investor confidence.

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