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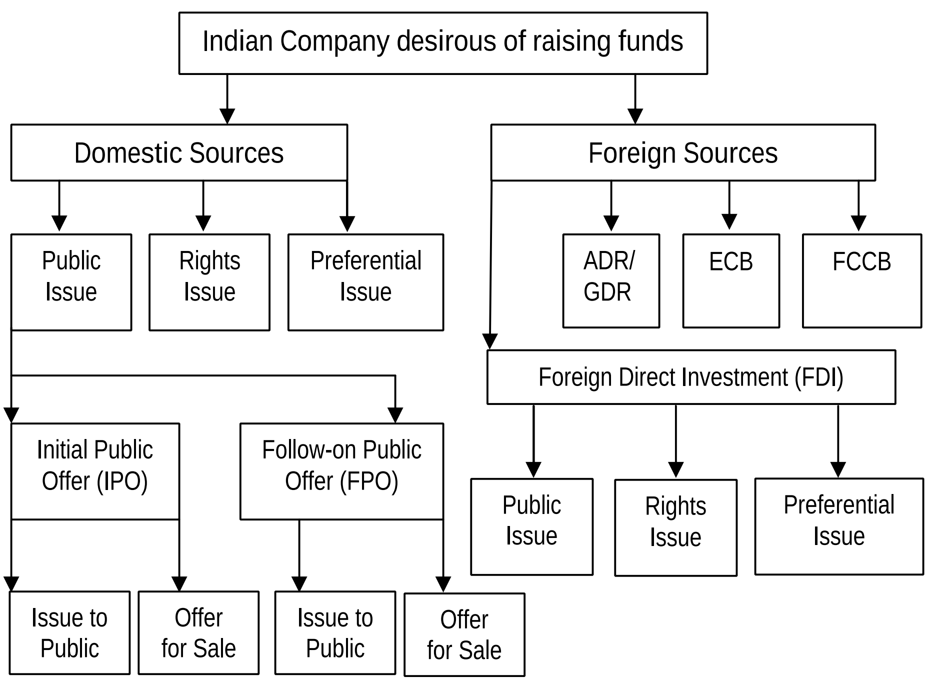
INDIAN CAPITAL MARKETS

1.1 Overview of Constituents

The Indian Capital Markets consist of the following constituents:

(a) Fund Raisers: Companies which raise funds from Domestic and Foreign Sources; Public and Private Sources. The various methods by which a company can raise funds are shown below by the help of a diagram:



(b) Fund Providers: Investors who invest in the capital market; Domestic and Foreign Investors; Institutional and Retail Investors. The list includes, subscribers to Primary market issues, investors who buy on the secondary market, traders, speculators, FIIs/ Sub-Accounts, Mutual Funds, Venture Capital Funds, NRIs, ADR/ GDR Investors, etc.

(c) Intermediaries: Service providers in the market, including Stock Brokers, Sub-brokers, Financiers, Merchant Bankers, Underwriters, Depository Participants, Registrar and Transfer Agents, FIIs/ Sub-Accounts, Mutual Funds, Venture Capital Funds, Portfolio Managers, Custodians, etc.

(d) Organisations: Stock Exchanges such as the BSE, the NSE and other regional exchanges, the 2 Depositories – National Securities Depository Ltd. (NSDL) and Central Securities Depository Ltd. (CSDL).

(e) Market Regulators: The Securities and Exchange Board of India (SEBI), the Reserve Bank of India (RBI), the Department of Company Affairs (DCA).

(f) Appellate Authority: The Securities Appellate Tribunal (SAT).

1.2 Introduction

The recent years have seen a sea change in the Indian capital market. Possibly, the greatest beneficiary of the reforms process has been the securities market segment. No other sector has seen the magnitude and quality of reforms, proactive legislation, stringent regulation, and results as the securities market. It is the result of these proactive steps which has seen India emerge as a favourite investment destination. Earlier India was popular only amongst US and West European investors but now even other countries such as Japan, Korea, etc., are equally interested in Indian securities. Some of the reforms introduced in India are not even present in western markets. For instance, several foreign stock exchanges yet use the open-cry system of dealing whereas India long back shifted to the online-trading system. Further, when India shifts to the T+1 settlement system (which is expected to be more sooner than later), it would probably be the only or part of a very elite group which would have introduced this system. The extent of development in the capital market can be judged by the following statistics which shows the number of SEBI registered market intermediaries:

Market Intermediary	As on 28th February, 2007
Stock Exchanges (Cash Market)	22
Stock Exchanges (Derivatives Market)	2
Brokers (Cash Segment)	9,440
Corporate Brokers (Cash Segment)	4,060
Sub-Brokers (Cash Segment)	26,274
Brokers (Derivative)	1,246
Foreign Institutional Investors	975
Custodians	11
Depositories	2
Depository Participants	583
Merchant Bankers	148
Bankers to Issues	47
Underwriters	47
Debenture Trustees	30
Credit Rating Agencies	4
Venture Capital Funds	89
Foreign Venture Capital Investors	71
Registrar to Issue & Share Transfer Agents	67
Portfolio Managers	156
Mutual Funds	40

Source: SEBI Bulletin

1.3 Segments

Broadly speaking, there are two market segments, the Primary and the Secondary. The primary market refers to that segment wherein a company makes an issue of securities to the investing public directly, i.e., the funds flow into the company. This would include, Initial Public Offers, Public Issues, Private Placements, Rights Issues, Foreign Direct Investment, etc. The primary market may further be bifurcated into the equity/ equity-linked segment and the debt segment. The primary market may also be bifurcated into domestic offerings and international offerings. While the domestic offerings would cover all issues made by Indian companies in India to local investors, the foreign offerings would cover issues of American Depository Receipts, Global Depository Receipts, Foreign Currency Convertible Bonds, External Commercial Borrowings, etc., made by Indian companies to foreign investors.

The following statistics about the number and amount of issues raised illustrate the rapid growth in the primary market:

Year/ Month	Total	
	No. of Issues	Amount (Rs. crores)
1999-00	93	7,817
2000-01	151	6,108
2001-02	35	7,543
2002-03	26	4,070
2003-04	57	23,272
2004-05	60	28,256
2005-06	139	27,382
2006-07 (till Feb 07)	117	32,854

The secondary market on the other hand, refers to that segment of the market wherein, the company is not directly involved and the trades are between buyers and sellers either on the stock exchange or by way of a private arrangement. Open offers, takeovers, acquisitions, delistings, etc., would also fall within the secondary market segment. The secondary market would also cover within its ambit the derivatives segment of futures and options. As of Feb, 2007, 4,816 companies were listed on the BSE and 1,208 companies were listed on the NSE. As of March, 2006, the total market capitalisation of all shares listed on the BSE was Rs. 34,89,213 crores and for the shares listed on the NSE it was Rs. 32,96,931 crores. The following table shows the turnover on the cash segments of the two major stock exchanges:

Rs. in crores

Year/ Month	BSE	NSE
1999-00	6,85,028	8,39,052
2000-01	10,00,032	13,39,511
2001-02	3,07,292	5,13,167
2002-03	3,14,073	6,17,989
2003-04	5,02,618	10,99,534
2004-05	5,18,715	11,40,072
2005-06	8,16,074	15,69,558
2006-07 (till Feb)	8,81,158	17,77,331

1.4 Legislative framework

The Indian Securities Market is regulated by 3 main regulators, the Department of Company Affairs (‘DCA’), the Securities and Exchange Board of India (‘SEBI’) and the Reserve Bank of India (‘RBI’). The 3 key legislations which are relevant to the securities market are as under:

(a) Companies Act, 1956
(b) Securities and Exchange Board of India Act, 1992
(c) Securities Contract (Regulations Act), 1956.

1.4.1 Companies Act

The Companies Act is the fundamental statute which deals with the issue of shares, types of shares, debentures, transfer of shares, premium on shares, bonus issues, rights issues, etc.

1.4.2 SEBI Act

The SEBI Act is the main Act from which several other Rules and Regulations have originated. The Act constitutes a Board (“the SEBI”) to protect the investors’ interest in securities and to promote the development and to regulate the securities market. The SEBI replaces the erstwhile Controller of Capital Issues. The SEBI has various powers under the Act including to issue various Regulations to better regulate the securities market and for better investor protection. It governs and regulates the market intermediaries. It has wide powers of investigation, survey, search and seizure, powers to impound documents, take statements on oath, etc. Thus, the powers enshrined in the SEBI are of a very wide amplitude. It also has powers to issue “directions, e.g., cease and desist” orders, by virtue of which, it can prohibit any person or intermediary from carrying out certain operations.

The Act provides for stringent penalties for different types of offences and violations. Some of the important penalty provisions include:

(a) Penalty for failure to furnish any information or returns to the SEBI, maintain certain books of account, records, etc., up to a maximum of Rs. 1 crore
(b) Penalty for failure to redress investors grievances: up to a maximum of Rs. 1 crore
(c) Penalty for insider trading in securities/ fraudulent and unfair trade practices in securities, ranging from Rs. 25 crores or thrice the amount of profits made from such trading/ practices, whichever is higher.

(d) In addition, any offender may be punished with imprisonment for a term which can extend up to 10 years and/ or a fine of up to Rs. 25 crores.

(e) The SEBI also has powers to issue directions or orders such as debarring people from accessing the capital markets for a certain period of time or debarring them from carrying out any transactions in securities for a certain period of time, etc.

The Act provides for a redressal mechanism in the form of the Securities Appellate Tribunal ("SAT"). Any person aggrieved by an order of the SEBI may appeal to the SAT. Orders of the SEBI which may be appealed against include, orders of the Chairman, Whole Time Member, Adjudicating Officer. The SAT is now a three-member bench instead of the earlier one-member bench. An appeal against the SAT order lies to the Supreme Court.

1.4.3 SCRA

The Securities Contracts (Regulation) Act or the SCRA is another important piece of legislation. This Act has been in force since 1956. It is an Act which regulates the stock exchanges and contracts in securities. It gives power to regulate and govern the stock exchanges and their working. This Act is also administered by the SEBI. If one were to point out the most important provision of this Act, then it would undoubtedly be s.2(h) which defines the term "securities".

The Act prohibits any contracts in securities unless they are of the following types:

(a) Contracts carried out through the members of a recognised stock exchange; or

(b) Spot Delivery Contracts.

The Act and its Rules also prescribe the conditions for listing of securities on the stock exchanges. It also provides for the amount of public holding required in every company seeking listing.

1.5 Settlement Cycle

The settlement cycle refers to the process of settling the trades executing on a stock exchange. The Settlement cycle is on T+2 rolling settlement basis from 1st April, 2003. In case of a Rolling Settlement trades executed during the day are settled based on the net obligations for the day. Earlier, the trades for a 5 day week (Monday to Friday in case of the BSE) were aggregated and then settled. Further, different exchanges had different settlement cycles. Now all exchanges have an uniform T+2 rolling settlement cycle.

A T+2 day basis means a settlement where T stands for the trade day. Hence, trades executed on Tuesday would be settled on Thursday (T + 2 working days).

The payment of funds and securities known as pay-in and pay-out would be done on the T+2 day. Thus, on this day, the broker for the buyer would pay the money to the exchange and the broker for the seller would give delivery of the shares to the exchange. The exchanges have to ensure that the pay out of funds and securities to the clients is done by the broker within 24 hours of the payout. The pay-in and pay-out days for funds and securities are prescribed as per the Settlement Cycle. A typical Settlement Cycle of Normal Settlement is given below:

	Activity	Day
Trading	Rolling Settlement Trading	T
Clearing	Custodial Confirmation	T+1 working days
	Delivery Generation	T+1 working days
Settlement	Securities and Funds pay in	T+2 working days
	Securities and Funds pay out	T+2 working days

1.6 SEBI's Structure

SEBI as the name suggests is a Board and hence, in all its Regulations it is referred to as the Board. The Board is constituted under s.3 of the SEBI Act, 1992. It is appointed by the Central Government and consists of 9 members - a Chairman, 2 members from the Finance Ministry, 1 member from the RBI and 5 other members of which includes the whole-time members. Each Whole Time Member heads a Functional Unit within which Executive Directors head the Departments. The current organisational structure of the SEBI is as follows:

SEBI Chairman		
Whole Time Member	Whole Time Member	Whole Time Member
Derivatives and New Products Department	Corporate Finance Department	Market Intermediaries Regulation and Supervision Department
Integrated Surveillance Department	Investment management Department	Office of Investor Assistance and Education
Investigations Department	Research & Training Department	Appeals under RTI Act
Enforcement Department	Regional Offices	General Services Department
Legal Affairs Department	Enquiries and Adjudication Department	
Market Regulation Department	Office of International Affairs	
Vigilance Cell		

1.7 Right to Information Act and SEBI

The Right to Information Act, 2005 provides for setting out the practical regime of right to information for citizens to secure access to information under the control of Public Authorities in order to promote transparency and accountability in the working of any public authority. SEBI is also covered within its purview. The right to information includes an access to the information which is held by or under the control of SEBI and includes the right to inspect the work, document, records, taking notes, extracts or certified copies of documents/ records and certified samples of the materials and obtaining information which is also stored in electronic form.

A request for obtaining information under the Act must be accompanied by an application fee of Rs.10. As per the Right to Information (Regulation of Fee and Cost) Rules, 2005, SEBI shall charge the prescribed nominal fees for obtaining copies, inspection, information provided on floppies, etc.

SEBI has designated Central Assistant Public Information Officers (CAPIO), who will receive the requests for information from the public and necessary number of Central Public Information Officers (CPIOs) in the 4 metros who will arrange for providing necessary information to the public as permitted under the law. SEBI will, within 30 days of receipt of the application for information communicate to the requestor whether it can or cannot provide the information.

1.8 Conclusion

Several capital market Regulations require the Auditor to certify that the requirements have been duly complied with. Besides, there is a lot of scope and opportunity for CAs in this field as an advisor, consultant, representation before the SEBI, Securities Appellate Tribunal, etc.

This book serves to provide an overview on several important aspects of capital market products, instruments, etc. The objective is to give a birds-eye view to a CA of these regulations so as to empower him in this field. This would also go a long way in a CA becoming a complete consultant. Further, with several CAs becoming Independent Directors, this would assist them in carrying out their duties to a more fuller extent. This publication would also be relevant to the industry and readers at large who want to enhance their knowledge in this field. Wherever relevant, Practice Pointers have been provided for Chartered Accountants.

To exhaustively deal with the Indian capital market and its myriad regulations would require a treatise by itself. This publication aims to provide an overview of the important provisions of the key regulations governing this market.