



## REGULATION OF INVESTOR'S PROTECTION BY SEBI: A CRITICAL ANALYSIS\*

### Meaning of Investor Protection

An investor is an individual or a corporate entity investing his funds or capital in another business. Investors have a very limited role to play in the sense that they do not take part in the day to day management of the affairs of business and hence, cannot guide the destiny or fate of the money so invested. However, Investors are the backbone of the securities market. Hence, it is essential for the growth of the corporate sector that the confidence of the investors is maintained.<sup>1</sup>

Investor Protection is the act of protecting investors from being deceived or being put to loss by the companies. It mainly refers to the act of safeguarding the interest of investors and protecting them from dishonest brokers and advisers. The basic objective of setting up SEBI was to protect the interest of investors in the securities market and to ensure their welfare.

Few measures taken by SEBI to ensure investor protection include:

- It has been made mandatory for companies to undergo Secretarial Audit.
- Quoting of PAN has been made mandatory in all capital market transactions.
- Mutual fund businesses have been opened to the private sector.
- Depository Participants are required to get their internal audit done.
- Stock brokers are required to display rights and obligations of investors.<sup>2</sup>

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<sup>1</sup> Jain, Sankalp, Investors' Protection in India: Regulatory Framework and Investors' Rights, Obligations & Grievances (July 6, 2014). Available at SSRN: <https://ssrn.com/abstract=2462944> or <http://dx.doi.org/10.2139/ssrn.2462944>  
(Last accessed on 20.3.17)

<sup>2</sup> Tripathy, Rajashree Aryabala, Investor Education and Protection Fund (IEPF) (August 12, 2013). Available at SSRN: <https://ssrn.com/abstract=2308987> or <http://dx.doi.org/10.2139/ssrn.2308987>  
(Last accessed on 20.3.17)

## Need and objective of Investor Protection

When investors finance companies, they take a risk that could land them in a situation in which the returns on their investments would not be forthcoming because the managers or those whom they appointed to represent them on the board may keep them or expropriate them either covertly or overtly. This kind of betrayal of the investors by the “insiders” as the managers or board of directors of the company may shake their confidence, which in the long run would have a negative impact on the overall investment climate with serious repercussions on the economic development of the country. The economic parameters of a nation such as output, employment, income, expenditure, and above all, overall economic growth will be stagnated due to declining investment. Therefore, there is a very strong reason to maintain the investors’ morale, protect their interests and restore their confidence as and when there is a tendency for investors to lose confidence in the system or when their investments are at stake.<sup>3</sup>

The objectives of investor protection include:

- Enhancing investor confidence
- Promoting orderly growth of securities market
- Providing free and fair market conditions
- Development of economy of the nation

## Investors’ Rights, Responsibilities and Grievance Redressal

With a view to ensure and enhance investor protection in the securities market, SEBI has established and laid down various rights and responsibilities of investors. Along with the rights and responsibilities, SEBI has also established a grievance redressal mechanism in order to entertain genuine complaints and grievances of the investors.

Rights of investors include:

- To receive the share certificates, on allotment or transfer as the case may be, in due time.

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<sup>3</sup> Cetin, Nusret, Investor Protection as the Objective of Securities Regulation: Goal v Instruments (January 4, 2010). Available at SSRN: <https://ssrn.com/abstract=2226778> or <http://dx.doi.org/10.2139/ssrn.2226778> ( Last accessed on 20.3.17)

- To receive copies of the Director's report, Balance Sheet and P&L A/c and the Auditor's report.
- To participate and vote in General Meeting either personally or through proxies.
- To receive dividend in due time once approved in General Meeting.
- To receive corporate benefits like rights, bonus, etc once approved.
- To proceed against the company by way of civil or criminal proceedings.

Responsibilities of investors include:

- To remain informed.
- To be vigilant.
- To participate and vote in general meetings.
- To exercise his rights on his own or as a group<sup>4</sup>

In addition to the above mentioned rights and responsibilities, SEBI has established The SEBI Complaints Redress System (SCORES). It is a web based complaints redressal system launched in June, 2011. The purpose of SCORES is to provide a speedy and transparent platform for redressal of grievances of investors, whose grievances remain unresolved by the concerned listed company or registered market intermediary. It is however, advisable that the aggrieved investor shall approach the concerned listed company or the registered market intermediary before approaching SCORES. SCORES, by providing an online platform, also enables the investors to view the action taken with respect to their complaints and its current status thereof. Once, an investor moves his complaint to SCORES, it becomes a part of the centralized online database of investor grievances. Then SEBI initiates online movement of the investor complaint to the concerned listed company or registered intermediary and demands for timely Action Task Reports by the listed company. In addition to the establishment of SCORES, SEBI has also laid down SEBI (Informal Guidance Scheme), 2003 with a view to enhance investor education and empowerment by providing them with informal guidance on various aspects related to the capital market.<sup>5</sup>

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<sup>4</sup> Role of SEBI in Investor's Protection ,available at,<http://zakirhusainpgeve.in/study/Chapter%2011%20Role%20of%20SEBI%20in%20Investor%20Protection.pdf> ( Last accessed on 20.3.17)

<sup>5</sup> Tripathy, Rajashree Aryabala, Investor Education and Protection Fund (IEPF) (August 12, 2013). Available at SSRN: <https://ssrn.com/abstract=2308987> or <http://dx.doi.org/10.2139/ssrn.2308987> (Last accessed on 21.3.17)

### The Securities Contracts (Regulation) Act, 1956

This Act was passed with the objective of regulating transactions in securities and to prevent undesirable speculation in securities. It gives the Central Government regulatory jurisdiction over the stock exchanges through a process of granting recognition and continued supervision. The Act also empowers the Central Government to call for periodical returns of stock exchanges and to amend the rules of a stock exchange. It also empowers SEBI to amend the bye laws of a recognized stock exchange.<sup>6</sup>

### The Securities Exchange Board of India Act, 1992

This Act was passed with a view to empower SEBI in order to enable it to fulfill its following objectives:

- To protect and promote interests of investors
- To educate and guide the investors
- To prevent trading malpractices like price rigging, insider trading etc.
- To regulate stock exchanges in order to promote their orderly functioning
- To develop a code of conduct and fair disclosures
- To provide a market in which issuers can raise finance in an easy and fair manner<sup>7</sup>

This Act empowers SEBI to exercise regulatory jurisdiction over registered stock exchanges, market intermediaries and companies in issuance of capital and transfer of securities in the securities market. SEBI has full autonomy to develop and regulate an orderly securities market.

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<sup>6</sup> Jain, Sankalp, Investors' Protection in India: Regulatory Framework and Investors' Rights, Obligations & Grievances (July 6, 2014). Available at SSRN: <https://ssrn.com/abstract=2462944> or <http://dx.doi.org/10.2139/ssrn.2462944>  
(Last accessed on 21.3.17)

<sup>7</sup> Subhash Dey, Business Studies(Geeta Publishing House, 2013 edition), pg 287

The functions performed by SEBI include the development, protective and regulatory functions.<sup>8</sup>

The Companies Act ,2013

The companies Act, 2013 provides several new provisions to safeguard protect and promote interest of investors in the securities market.

- **Acceptance of Deposits:** Section 73 of The Act prohibits any company from accepting deposits from general public and its violation is a punishable offence.
- **Misstatement in Prospectus:** Section 34 of the Act deals with the criminal liability for miss statement in the prospectus issued by a company. The prospectus issued, circulated or distributed, shall not include any untrue or misleading statement which prompts any person to make an investment.
- **Non-Payment of Dividend:** The Section 125 of the Act provides for the establishment of investors education and protection fund by the central government. This fund is to be credited with the unpaid/unclaimed amount of application money/ matured money or mature deposits. Such accumulations of the fund are to be utilized for promotion of investor's awareness and protection of investor interest.
- **Right to Demand Financial Statements:** Section 136 of the Act gives to a member a right to obtain copies of Balance sheet and Auditors Reports. <sup>9</sup>

SEBI (Disclosure and Investor Protection Guidelines),2000

With a view to fulfill its objective of investor protection, SEBI issued the SEBI (Disclosure and Investor Protection) Guidelines, 2000. SEBI used these guidelines as a yardstick to ensure that investor interests are protected. The Disclosure and Investor Protection guidelines apply to

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<sup>8</sup> SEBI supervision of securities market, available at: <https://scholararticles.wordpress.com/2016/02/09/sebi-supervision-of-securities-market/>  
(last accessed on 21.3.17)

<sup>9</sup>Provisions for protection of The Investor under The Companies Act,2013,available at: <https://blog.iplayers.in/provisions-protection-investor-companies-act-2013/>  
(Last accessed on 21.3.17)

the securities market, and regulate public issues made by listed and unlisted companies, rights issues, and offers for sale by listed companies in certain cases. These guidelines prescribe instructions for eligibility standards for companies issuing securities, pricing of securities to be issued by companies, requirements relating to promoter contribution and more. The guidelines also provide for the information that should be included in offer documents to the public, like a prospectus, abridged prospectus, and letter of offer. The Merchant Bankers are responsible for ensuring that all the requirements of Disclosure and Investor Protection Guidelines are complied with at the time of submitting the draft offers documents to SEBI. SEBI on its part evaluates if the guidelines are being followed and all required disclosures are made in the offer documents. These guidelines ensure proper and timely disclosures which are important for protection of investor interest.<sup>10</sup>

SEBI(Issue of Capital and Disclosure Requirements)Regulations,2009

The SEBI(Disclosure and Investor Protection)Guidelines,2000 have been replaced by The SEBI(Issue of Capital and Disclosure Requirements)Regulations,2009. These regulations apply to:

- A public issue
- A preferential issue
- A rights issue , where the aggregate value of specified securities offered is fifty lakh rupees or more
- An issue of bonus shares by listed issuer
- An issue of Indian depository receipts

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<sup>10</sup> Tripathy, Rajashree Aryabala, Investor Education and Protection Fund (IEPF) (August 12, 2013). Available at SSRN: <https://ssrn.com/abstract=2308987> or <http://dx.doi.org/10.2139/ssrn.2308987> (Last accessed on 21.3.17)

- A qualified institutional placement by listed issuer<sup>11</sup>

The SEBI (ICDR) Regulations, 2009 attempt to streamline the framework for public issues by removing unnecessary stipulations and introducing market-driven procedures thereby, aiming to reduce and simplify clutter of illegality prevalent in the securities market.

Certain key improvements made by the SEBI (ICDR) Regulations, 2009 over the SEBI (DIP) Guidelines, 2000 include:

- The exemptions available under the SEBI (DIP) Guidelines, 2000 to certain banking and infrastructure companies from eligibility norms for making initial public offers (IPOs) have been removed under SEBI(ICDR) Regulations,2009 and thus, eligibility norms have now been made applicable uniformly to all types of issuers. This is a progressive move because these companies are now competitive and do not require such a privilege
- Under the SEBI (DIP) Guidelines, 2000 an “offer for sale” was permitted only for unlisted companies proposing IPOs. The SEBI (ICDR) Regulations, 2009 now permit an “offer for sale” even by listed companies. The SEBI (ICDR) Regulations,2009 s provide that such offer for sale can be made only if the shares are held by the seller for a period of at least one year prior to the filing of draft offer document with the SEBI.
- Under the SEBI (DIP) Guidelines, 2000 the minimum promoter’s contribution in a public issue could be brought in by promoters or persons belonging to promoter group or his friends or relatives or the associates of the promoters. Under the SEBI (ICDR) Regulations,2009 only the promoters are allowed to contribute to the minimum promoters’ contribution.
- Unlike the SEBI (DIP) Guidelines, 2000 in case of a fixed price public issue, the issuer was required to disclose price or price band for the shares, under the SEBI (ICDR) Regulations,2009 there is no requirement to disclose the price or price band in the draft

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<sup>11</sup> SEBI supervision of securities market, available at: <https://scholararticles.wordpress.com/2016/02/09/sebi-supervision-of-securities-market/> (last accessed on 1.4.17)

red herring prospectus (DRHP). This is an important change from the issuer's perspective as it will allow the issuer to take into account market dynamics in determining the price closer to the issue date.<sup>12</sup>



Steps taken by SEBI to make investors aware of their rights and obligations.

**Comprehensive Education Campaign:** It was launched by SEBI and was aimed at creating awareness among investors about securities market. The motto of the campaign was – ‘An Educated Investor is a Protected Investor.’

The campaign was launched at the national level by the then Prime Minister, Shri Atal Bihari Vajpayee, on January 17, 2003. The campaign was based upon the idea of conducting workshops across the country.

**Workshops:** These workshops are conducted by SEBI with the sole objective of educating the investors regarding their rights, responsibilities along with creating investor awareness. These also aim at educating the potential investors about the working of the securities market and risks associated with it.

**Advertisements:** SEBI has prepared simple “dos and don'ts” for investors relating to various aspects of the securities market. These advertisements are issued in various regional languages and newspapers thereby, upholding public interest.

**Educative Materials-**SEBI has prepared a standardized reading material and presentation material for the workshops.

**All India Radio-** With regard to educating investors through the medium of radio, SEBI

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<sup>12</sup> SEBI (ICDR) Regulations Demystified, available at: <https://www.vccircle.com/sebi-icdr-regulations-demystified/> (last accessed on 2.4.17)

Officials regularly participate in programmes aired by All India Radio.

Cautionary Message on television- With a view to uphold public interest , SEBI makes use of electronic media to give out cautionary messages on television with a view to educate investors with basic features of securities markets.<sup>13</sup>

Investor Protection measures taken by SEBI:

- **Simplification of share transfer and allotment procedure**

SEBI has attempted to simplify and expedite the share transfer and allotment procedure by following the recommendations of the R Chandrasekaran Committee. The aim is to ease the share transfer and allotment procedure and to expedite share transfer process by adoption of techniques such as online transfer of shares in dematerialized form. Online transactions ensure greater transparency and enable tracking of the transfer by the investors. The ultimate aim is to ease the procedure of share allotment in the securities market.

- **Unique order code number**

All stock exchanges are now required to ensure that each transaction is assigned a unique order code number which is intimated by the broker to his client. Once the order is executed, this number is to be printed on the contract note.

- **Time stamping of contracts**

Stock brokers are required to maintain a record of time when the client has placed the order and reflect the same in the contract note along with the time of the execution of the order. This will ensure that the broker gives due preference in execution of client's order and charges the correct price to his client without taking advantage of any intra-

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<sup>13</sup>Protection of the Interest of the investor, available at,<http://www.legalservicesindia.com/article/article/protection-of-the-interest-of-the-investor-1560-1.html>(Last accessed on 22.3.17)

day price fluctuation for himself. This will also enhance transparency and expedite the share allotment process.

- **Role of sub-brokers**

In an attempt to safeguard the interest of investors and bring sub-brokers under the regulatory framework of SEBI and the stock exchanges, the registration of sub brokers has been made mandatory. Thus a person cannot act as a sub broker unless he is registered with SEBI as sub-broker or is recognized by the stock exchange.<sup>14</sup>

- **Investor protection fund**

Section 125 of The Companies Act, 2013 coupled with The SEBI (Investor Protection and Education Fund) Regulations, 2009 provide for the creation and maintenance of Investor Protection and Education Fund by the Stock exchanges. The aim of creating and maintaining such a fund is to meet the legitimate investment claims of the clients of the defaulting members that are not of speculative nature.

The following amounts shall be credited to the Fund:- (a) contribution as may be made by the Board to the Fund; (b) grants and donations given to the Fund by the Central Government, State Government or any other entity approved by the Board for this purpose; (c) proceeds in accordance with the sub-clause (ii) of clause(e) of sub-regulation (12) and the sub- regulation (13)of regulation 28 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997; (d) security deposits, if any, held by stock exchanges in respect of public issues and rights issues, in the event of de-recognition of such stock exchanges; (e) amounts in the Investor Protection Fund and Investor Services Fund of a stock exchange, in the event of de-recognition of such stock exchange; (f) interest or other income received out of any investments made from the Fund; (g) such other amount as the Board may specify in the interest of investors.<sup>15</sup>

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<sup>14</sup> Investor protection measures, available at: <http://www.sebi.gov.in/annualreport/9697/pt1b2c.html> (last accessed on 2.4.17)

<sup>15</sup> Regulation 4 of The SEBI(Investor Protection and Education Fund)Regulation, 2009

The Fund shall be utilized for the purpose of protection of investors and promotion of investor education and awareness. The Stock Exchanges have been permitted to fix suitable compensation limits. It has been provided that the amount of compensation available against a single claim of an investor arising out of default by a member broker of a Stock Exchange shall not be less than Rs. 1 lakh in case of major Stock Exchanges viz., BSE and NSE, and Rs. 50,000/- in case of other Stock Exchanges.<sup>16</sup> The Fund can also be utilized for funding investor education programs, aiding investor's association in undertaking legal proceedings in interest of investors and in enhancing investor awareness.<sup>17</sup>

## Lacuna in investor protection and Security Scams

### Lacunae in Investor Protection

Though there is a redressal mechanism in place in the country, investors could not get their complaints adequately addressed to, much less solved to their satisfaction by these public authorities. Multiplicity of authorities, overlapping functions, lack of knowledge and understanding by the common investor about these agencies and lack of enforcement have all acted against investor protection. Notwithstanding the existence of this seemingly comprehensive network of public institutions established for investor protection in India, a series of scams have taken place that has shaken the confidence of investors since 1991, the year of economic liberalisation. Loss of investor confidence due to these scandals that conveyed an image of fraud and manipulation was so great that for several years stock market remained moribund. To understand policy issues connected with the securities market, it is important to know how these scams burst out in the open due to misgovernance, greed, corruption, inefficiency and market manipulations.<sup>18</sup>

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<sup>16</sup> Investor Protection Fund, available at: [http://www.indiainfoline.com/article/news-business/what-is-investor-protection-fund-ipf-customer-protection-fund-cpf-at-stock-exchanges-113101910168\\_1.html](http://www.indiainfoline.com/article/news-business/what-is-investor-protection-fund-ipf-customer-protection-fund-cpf-at-stock-exchanges-113101910168_1.html) (last accessed on 3.4.17)

<sup>17</sup> Regulation 5, SEBI(Investor Protection and Education Fund) Regulations, 2009

<sup>18</sup> Cetin, Nusret, Investor Protection as the Objective of Securities Regulation: Goal v Instruments (January 4, 2010). Available at SSRN: <https://ssrn.com/abstract=2226778> or <http://dx.doi.org/10.2139/ssrn.2226778> (Last accessed on 22.3.17)

## Conclusion:

Since its inception in 1992, SEBI has registered substantial growth in its stature and reach. It has played a significant role in creating the country's capital market infrastructure. However, SEBI has also had its own share of failures such as

- Poor tackling of price manipulation and insider trading issues: Insider trading and price manipulation ahead of key corporate actions still continue to be prevalent. SEBI has to strengthen enforcement and surveillance and impose deterrent penalties to stop these wrongdoings.
- Poor conviction rate: A regulator's credibility relies on its ability to achieve a fairly high conviction rate against errant market players. SEBI's record is poor as without exception the Securities and Appellate Tribunal has overturned its decisions and penal measures in cases against prominent market players. To achieve more convictions, a focus on building a case that passes the test of stringent scrutiny is very much necessary along with establishment of procedure for the collection of relevant evidences necessary for framing charges and establishing prima facie case.
- Need to enhance its manpower skills: If SEBI is to make progress in its designated function, there has to be a vast improvement in the quality of its manpower skills at its disposal. It has to invest in developing skill-sets in areas such as finance and law by attracting professionals of quality and integrity.
- It should simplify and trim regulations: There is a need to simplify and trim the regulations, so that they are compact, easy to follow and comprehensible.. This would complement SEBI's efforts and enhance its effectiveness as a regulator.
- It should improve quality of disclosures: There is also a need to tone up the quality of disclosures in areas such as earnings, announcements, mergers/acquisitions to make them more meaningful for investors.

Thus, In order to ensure greater investor protection, SEBI needs to act in a proactive manner and it must move towards widespread implementation of the existing laws governing securities market. In this era of technological advancement, new laws also need to be framed to tackle issues infringing investor rights. Moreover, steps must be taken continuously to develop and create a securities market where investors can raise funds in a free, fair and efficient manner.<sup>19</sup>



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<sup>19</sup> Agenda for SEBI's New CEO, available at: <http://www.thehindubusinessline.com/todays-paper/tp-investmentworld/agenda-for-sebis-new-ceo/article2205468.ece> (last accessed on 4.4.17)