

PART THREE: REGULATION OF SECURITIES MARKET

This part of the Report delineates the functions of SEBI as specified in Section 11 of the SEBI Act, 1992.

1. PRIMARY SECURITIES MARKET

There are different types of intermediaries operating in the capital market. They play a crucial role in the development of capital market by providing a variety of services. These intermediaries viz., merchant bankers, brokers, bankers to issues, debenture trustees, portfolio managers, registrars to issues and share transfer agents, etc., are regulated by SEBI.

During 2005-06, there was a marginal rise in the number of intermediaries belonging to the group of bankers to an issue and merchant bankers. As on March 31, 2006, the number of portfolio managers was 132 as against 84 a year ago, an increase of 57 per cent over the year (Table 3.1). The number of debenture trustees and underwriters, on the other hand, declined in 2005-06 over the previous year. Depository participants registered with NSDL and CDSL witnessed modest rise in 2005-06. The entry of certain new intermediaries in the market during 2005-06 could be attributed to good

business opportunities in the securities market and rise in investors' need for different types of services.

2. SECONDARY SECURITIES MARKET

I. Registration of Brokers

During 2005-06, 554 new brokers were registered with SEBI (Table 3.2). The number of reconciliations/ cancellations/ surrender of memberships during 2005-06 was 347, lower than that of 479 in the previous year. The total number of brokers registered with SEBI as on March 31, 2006 was 9,335, compared to 9,128 a year ago, a rise of 207 over the previous year. The share of corporate brokers was 42.4 per cent of the total brokers as on March 31, 2006 as against 41.3 per cent in the previous year (Table 3.3). Among the exchanges, National Stock Exchange (NSE) had the highest number of brokers at 1,014, followed by the Calcutta Stock Exchange (962) and BSE (840) as on March 31, 2006. In NSE, corporate brokers were 90.9 per cent

Table 3.1: Registered Intermediaries

Type of Intermediary	As on March 31		Absolute Variation	Percentage Variation
	2005	2006		
1	2	3	4	5
Registrar to an Issue and Share Transfer Agent (Category I and II)	83	83	0	0.00
Bankers to an Issue	59	60	1	1.69
Debenture Trustee	35	32	-3	-8.57
Merchant Banker	128	130	2	1.56
Portfolio Manager	84	132	48	57.14
Underwriter	59	57	-2	-3.39
DPs – NSDL	210	215	5	2.38
DPs – CDSL	267	311	44	16.48
Credit Rating Agency	4	4	0	0.00

Table 3.2: Registered Brokers

Registered Brokers as on March 31, 2005	Addition during the year 2005-06	Reconciliation/ Cancellation/ Surrender of Memberships	Registered Brokers as on March 31, 2006
1	2	3	4
9,128	554	347	9,335

Table 3.3: Exchange-wise Brokers Registered with SEBI

Stock Exchange	As on March 31, 2005			As on March 31, 2006		
	Total Brokers	Corporate Brokers	Corporate Brokers as a Percentage of Total Brokers	Total Brokers	Corporate Brokers	Corporate Brokers as a Percentage of Total Brokers
1	2	3	4	5	6	7
Ahmedabad	317	150	47.32	317	152	47.95
Bangalore	250	119	47.60	256	125	48.83
BSE	726	534	73.55	840	661	78.69
Bhubaneswar	221	18	8.14	219	19	8.68
Calcutta	962	204	21.21	962	204	21.21
Cochin	446	76	17.04	434	79	18.20
Coimbatore	135	49	36.30	135	48	35.56
Delhi	376	215	57.18	375	214	57.07
Gauhati	119	4	3.36	110	4	3.64
Hyderabad	288	118	40.97	304	122	40.13
ISE	654	250	38.23	788	283	35.91
Jaipur	522	19	3.64	507	19	3.75
Ludhiana	293	84	28.67	293	86	29.35
MPSE	174	35	20.11	174	35	20.11
Madras	178	69	38.76	182	71	39.01
Magadh	198	22	11.11	198	22	11.11
Mangalore*	66	9	13.64	66	9	13.64
NSE	976	877	89.86	1,014	922	90.93
OTCEI	801	616	76.90	769	588	76.46
Pune	186	55	29.57	192	57	29.69
SKSE	425	83	19.53	426	84	19.72
UPSE	504	103	20.44	463	93	20.09
Vadodara	311	64	20.58	311	64	20.58
Total	9,128	3,773	41.33	9,335	3,961	42.43

* Mangalore Stock Exchange has been refused renewal of recognition since August 31, 2004. The matter is sub-judice as on March 31, 2006.

of the total brokers. The shares of corporate brokers at BSE and OTCEI were 78.7 per cent and 76.5 per cent, respectively as on March 31, 2006.

Brokers are divided into five categories viz., proprietary, partnership, corporate, institution and composite corporate. However, as the registrations of broking entities under

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Bangalore	250	119	47.60	256	125	48.83
BSE	726	534	73.55	840	661	78.69
Bhubaneswar	221	18	8.14	219	19	8.68
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Brokers are divided into five categories viz., proprietary, partnership, corporate, institution and composite corporate. However, as the registrations of broking entities under

categories of institution and composite corporate are negligible during the recent years, these categories have been clubbed together under corporate brokers. The details of the exchange-wise stock brokers on the basis of ownership are provided in Table 3.4.

In old exchanges, most of the brokers were proprietary in nature, whereas in the new exchanges, they were corporate members (Charts 3.1 and 3.2). As on March 31, 2006, the proprietary membership was the highest in Gauhati Stock Exchange at 95.5 per cent

**Table 3.4: Classification of Stock Brokers on the Basis of Ownership
(As on March 31 of the Respective Year)**

Stock Exchange	Proprietorship		Percentage of Total		Partnership		Percentage of Total		Corporate*		Percentage of Total		Total	
	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Ahmedabad	144	142	45.43	44.79	23	23	7.26	7.26	150	152	47.32	47.95	317	317
Bangalore	128	128	51.20	50.00	3	3	1.20	1.17	119	125	47.60	48.83	250	256
BSE	156	148	21.49	17.62	36	31	4.96	3.69	534	661	73.55	78.69	726	840
Bhubaneswar	203	200	91.86	91.32	0	0	0.00	0.00	18	19	8.14	8.68	221	219
Calcutta	712	712	74.01	74.01	46	46	4.78	4.78	204	204	21.21	21.21	962	962
Cochin	360	345	80.72	79.49	10	10	2.24	2.30	76	79	17.04	18.20	446	434
Coimbatore	86	87	63.70	64.44	0	0	0.00	0.00	49	48	36.30	35.56	135	135
Deihi	128	129	34.04	34.40	33	32	8.78	8.53	215	214	57.18	57.07	376	375
Gauhati	114	105	95.80	95.45	1	1	0.84	0.91	4	4	3.36	3.64	119	110
Hyderabad	165	176	57.29	57.89	5	6	1.74	1.97	118	122	40.97	40.13	288	304
ISE	403	496	61.62	62.94	1	9	0.15	1.14	250	283	38.23	35.91	654	788
Jaipur	497	482	95.21	95.07	6	6	1.15	1.18	19	19	3.64	3.75	522	507
Ludhiana	207	205	70.65	69.97	2	2	0.68	0.68	84	86	28.67	29.35	293	293
Madhya Pradesh (MPSE)	137	137	78.74	78.74	2	2	1.15	1.15	35	35	20.11	20.11	174	174
Madras	93	95	52.25	52.20	16	16	8.99	8.79	69	71	38.76	39.01	178	182
Magadh	175	175	88.38	88.38	1	1	0.51	0.51	22	22	11.11	11.11	198	198
Mangalore**	54	54	81.82	81.82	3	3	4.55	4.55	9	9	13.64	13.64	66	66
NSE	48	46	4.92	4.54	51	46	5.23	4.54	877	922	89.86	90.93	976	1014
OTCEI	166	162	20.72	21.07	19	19	2.37	2.47	616	588	76.90	76.46	801	769
Pune	124	128	66.67	66.67	7	7	3.76	3.65	55	57	29.57	29.69	186	192
Saurashtra Kutch (SKSE)	340	340	80.00	79.81	2	2	0.47	0.47	83	84	19.53	19.72	425	426
UPSE	395	364	78.37	78.62	6	6	1.19	1.30	103	93	20.44	20.09	504	463
Vadodara	244	244	78.46	78.46	3	3	0.96	0.96	64	64	20.58	20.58	311	311
Total	5,079	5,100	55.64	54.63	276	274	3.02	2.94	3,773	3,961	41.33	42.43	9,128	9,335

* The categories of Financial Institutions and Composite Corporate are clubbed within the category of corporate broker.

** Mangalore Stock Exchange has been refused renewal of recognition since August 31, 2004. The matter is sub-judice as on March 31, 2006.

Chart 3.1: Corporate Brokers and Total Brokers (As on March 31, 2006)

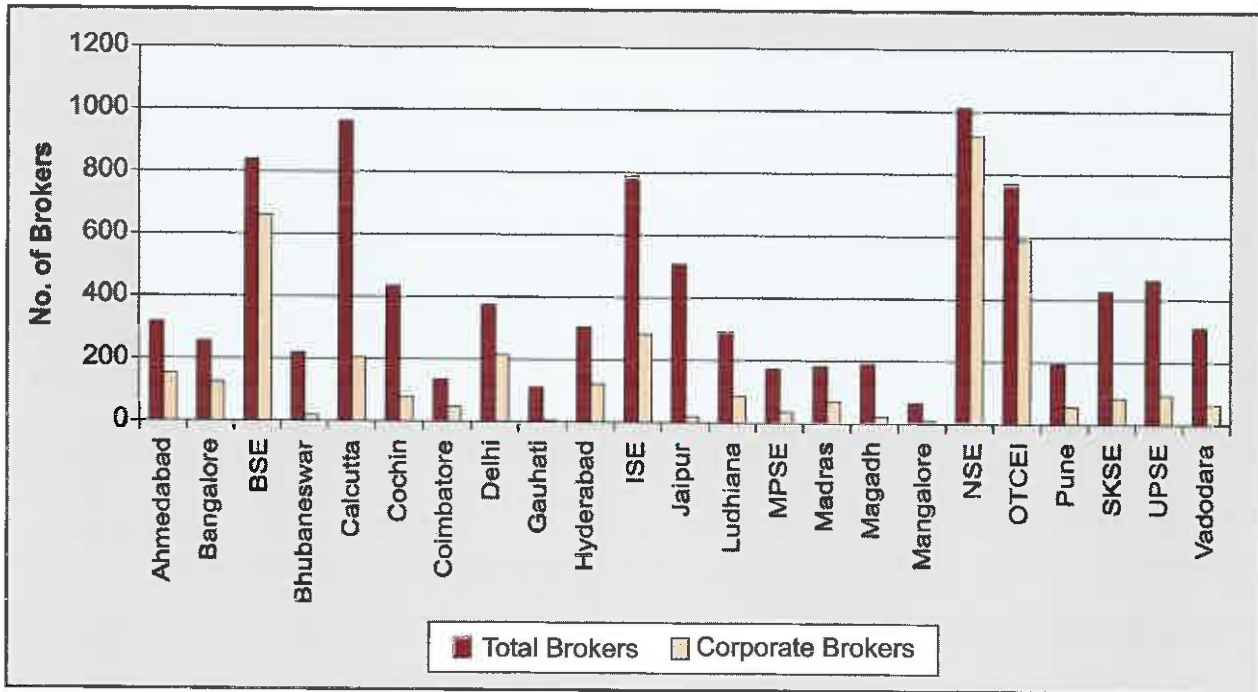
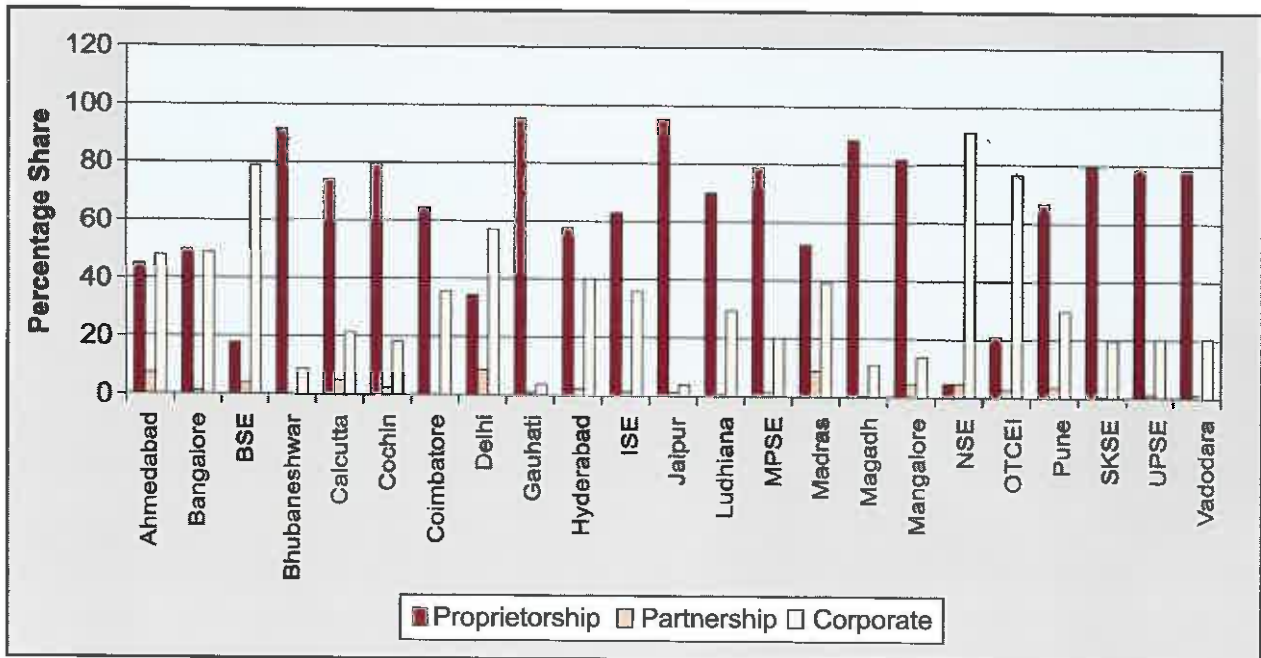


Chart 3.2: Percentage Share in the Classification of Brokers on the Basis of Ownership (As on March 31, 2006)



of the total brokers. It was the lowest for NSE wherein 4.5 per cent of the total brokers belonged to the proprietorship category. The percentage of brokers in the partnership category was the highest in Madras Stock

Exchange (8.8 per cent) as on March 31, 2006. There were no brokers in the partnership category in Bhubaneswar Stock Exchange and Coimbatore Stock Exchange.

II. Registration of Sub-brokers

There was a significant increase in the registration of sub-brokers in 2005-06 as compared to the previous year. As on March 31, 2006, the number of registered sub-brokers was 23,479 as against 13,684 a year ago, indicating a net addition of 9,795 during 2005-06 (Table 3.5). The two premier stock exchanges *viz.*, BSE and NSE together accounted for 93.9 per cent of the total sub-brokers in the country as on March 31, 2006 compared to 89.6 per cent a year ago.

III. Recognition of Stock Exchanges

The stock exchanges are granted recognition by SEBI under Section 4 of the Securities Contracts (Regulation) Act, 1956. Presently, there are twenty two¹ stock exchanges recognised under SC(R)A. Of the 22 stock exchanges, eight stock exchanges were granted permanent recognition. During 2005-06, SEBI had granted tenure period renewal to one stock exchange and yearly renewal to 10 stock exchanges. Details of the renewal of recognition granted to the stock exchanges are provided in Tables 3.6 and 3.7.

Table 3.5: Registered Sub-Brokers

Stock Exchange	Sub-brokers as on March 31			
	2005		2006	
	Number	Percentage of Total	Number	Percentage of Total
1	2	3	4	5
Ahmedabad	119	0.87	119	0.51
Bangalore	156	1.14	156	0.66
BSE	6,917	50.55	10,691	45.53
Bhubaneswar	17	0.12	17	0.07
Calcutta	88	0.64	88	0.37
Cochin	42	0.31	42	0.18
Coimbatore	22	0.16	22	0.09
Delhi	343	2.51	343	1.46
Gauhati	4	0.03	4	0.02
Hyderabad	199	1.45	199	0.85
ISE	3	0.02	3	0.01
Jaipur	34	0.25	34	0.14
Ludhiana	38	0.28	38	0.16
MPSE	5	0.04	5	0.02
Madras	115	0.84	115	0.49
Magadh	3	0.02	3	0.01
Mangalore ¹	1	0.00	1	0.004
NSE	5,338	39.01	11,359	48.38
OTCEI	19	0.14	19	0.08
Pune	161	1.18	161	0.69
SKSE	0	0.00	0	0.00
UPSE	19	0.14	19	0.08
Vadodara	41	0.30	41	0.17
Total	13,684	100.00	23,479	100.00

1. The renewal of recognition of Mangalore Stock Exchange was refused *vide* Order dated August 31, 2004 under Section 4(4) of the Securities Contracts (Regulation) Act, 1956. The matter is currently before the Securities Appellate Tribunal (SAT).

Table 3.6: Renewal of Recognition Granted to Stock Exchanges during 2005-06

Sr. No.	Exchange	Date of Notification	Period
1	2	3	4
1.	The Ludhiana Stock Exchange Association Ltd.	April 21, 2005	1 year, w.e.f. April 28, 2005 to April 27, 2006.
2.	The Gauhati Stock Exchange Ltd.	April 29, 2005	1 year, w.e.f. May 1, 2005 to April 30, 2006.
3.	Bhubaneswar Stock Exchange Ltd.	May 16, 2005	1 year, w.e.f. June 5, 2005 to June 4, 2006.
4.	The Uttar Pradesh Stock Exchange Association Ltd.	June 2, 2005	1 year, w.e.f. June 3, 2005 to June 2, 2006.
5.	Saurashtra Kutch Stock Exchange Ltd.	June 30, 2005	1 year, w.e.f. July 10, 2005 to July 9, 2006.
6.	Over the Counter Exchange of India	September 15, 2005	1 year, w.e.f. August 23, 2005 to August 22, 2006.
7.	The Pune Stock Exchange Ltd.	September 1, 2005	1 year, w.e.f. September 2, 2005 to September 1, 2006.
8.	Coimbatore Stock Exchange Ltd.	October 14, 2005	1 year, w.e.f. September 18, 2005 to September 17, 2006.
9.	The Cochin Stock Exchange Ltd.	November 2, 2005	1 year, w.e.f. November 8, 2005 to November 7, 2006.
10.	Magadh Stock Exchange Association	December 7, 2005	1 year, w.e.f. December 11, 2005 to December 10, 2006.

Table 3.7: Renewal of Recognition Granted to Other Stock Exchanges

Sr. No.	Exchange	Status
1	2	3
1.	National Stock Exchange of India Ltd.	5 years w.e.f. April 26, 2003 to April 25, 2008.
2.	Inter-connected Stock Exchange of India Ltd.	2 years, w.e.f. November 18, 2004 to November 17, 2006.
3.	Vadodara Stock Exchange Ltd.	2 years w.e.f. January 4, 2005 to January 3, 2007.
4.	Jaipur Stock Exchange Ltd.	3 years, w.e.f. January 9, 2006 to January 8, 2009.
5.	Bombay Stock Exchange Ltd.	Permanent
6.	Ahmedabad Stock Exchange Ltd.	Permanent
7.	Bangalore Stock Exchange Ltd.	Permanent
8.	The Calcutta Stock Exchange Association Ltd.	Permanent
9.	The Delhi Stock Exchange Association Ltd.	Permanent
10.	The Hyderabad Stock Exchange Ltd.	Permanent
11.	Madhya Pradesh Stock Exchange	Permanent
12.	Madras Stock Exchange Ltd.	Permanent

IV. Corporate Restructuring: Substantial Acquisition of Shares and Takeovers

During 2005-06, 104 public offers opened and 245 reports were filed under the category of transactions that qualify for exemption from open offer obligations. However, the transactions, which are not covered under the said category, were submitted to the Takeover Panel for exemption from open offer. During the financial year, 29 such applications were forwarded by SEBI to the Takeover Panel for their consideration, while exemptions from making open offers were granted in respect of 13 cases (Table 3.8).

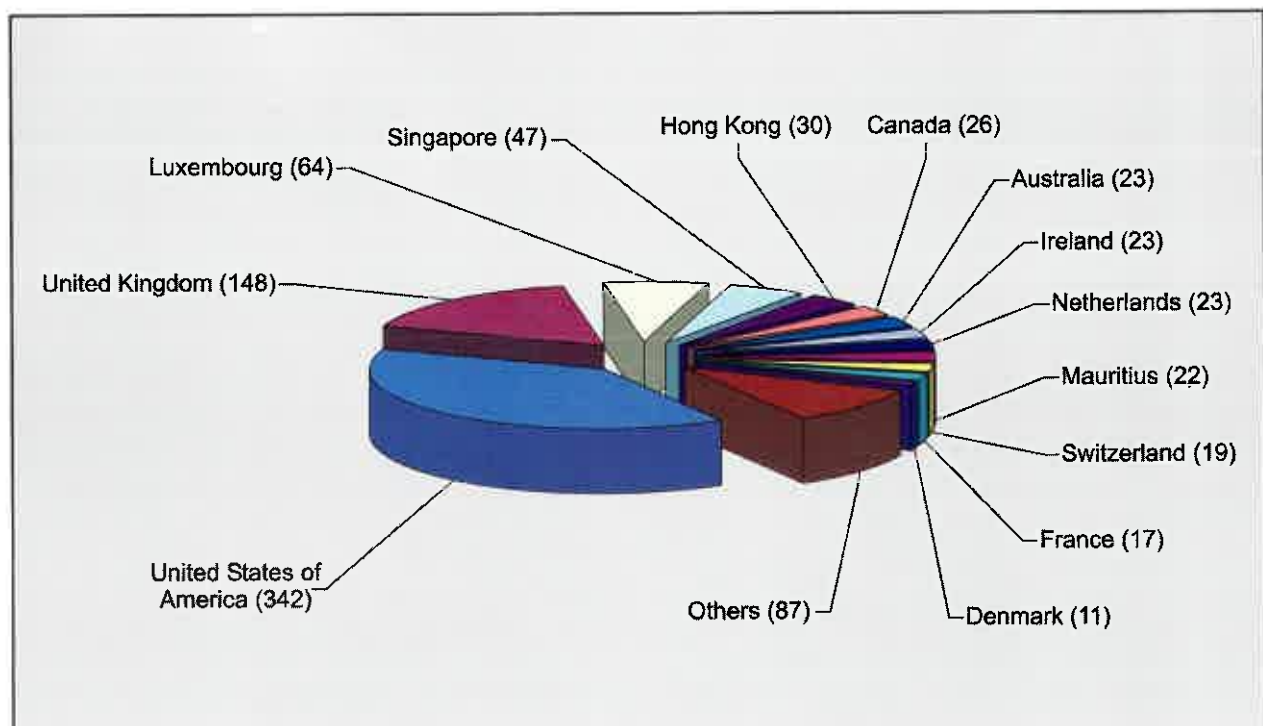
Table 3.8: Open Offers and Exemptions

Period	Open Offers Made	Exemptions Granted by Panel
1	2	3
2003-04	65	18
2004-05	60	17
2005-06	104	13

V. Registration of Foreign Institutional Investors

FII consider India as a preferred investment destination which is evident from rapid increase in their numbers during the recent years. During 2005-06, 224 new FIIs were registered with SEBI and a few were de-registered. As a result, the number of FIIs registered with SEBI as on March 31, 2006 stood at 882 compared to 685 as on March 31, 2005. Continuing the trend, institutions from across the globe channeled their funds to the Indian securities markets for investment. As on March 31, 2006, SEBI had registered FIIs from 37 countries. The highest number of FIIs, as on March 31, 2006, was from the USA (342), followed by the UK (148) (Chart 3.3). About 90 per cent FIIs come from the top 13 countries. There has been increase in the number of FII registrations from non-traditional countries like Malaysia, Australia, Saudi Arabia, Trinidad and Tobago, Denmark, Italy, Belgium, Canada, Sweden, Ireland etc.

Chart 3.3: Country-wise FIIs Registered with SEBI as on March 31, 2006



Classified on the basis of category, long-term institutional investors like foreign pension funds continued to show interest in Indian securities markets. Moreover, many foreign governmental agencies showed interest in the Indian capital market and many of them got registered as FIIs. Other categories of FIIs registered belonged to traditional institutions like mutual funds, investment trusts, managers of such funds, banks etc. The total number of sub-accounts registered with SEBI also increased from 1,889 as on March 31, 2005 to 2,488 by end-March 2006.

VI. Registration of Custodians of Securities

As on March 31, 2006, there were eleven custodians registered with SEBI under the SEBI (Custodian of Securities) Regulations, 1996. Nine of these custodians were banking entities, while the remaining two were non-banking institutions. SEBI received four applications for grant of registration as custodian during 2005-06. In January 2006, SEBI permitted mutual funds to launch Gold Exchange Traded Funds (GETFs). The existing custodians have shown significant interest to make available their custodial services for GETFs.

VII. Registration of Collective Investment Schemes

Subsequent to the notification of the SEBI (Collective Investment Schemes) Regulations, 1999, no CIS entity is registered with SEBI as on March 31, 2006.

VIII. Registration of Mutual Funds

Mutual funds are important institutional investors in the Indian capital market. They mobilised large amount of funds through various schemes from different categories of investors. During 2005-06, many innovative schemes were introduced by the mutual funds. Regulatory guidelines on mutual funds

were streamlined for the benefit of investors. As on March 31, 2006, 38 mutual funds were registered with SEBI, of which, 30 belonged to the private sector and 8 (including the UTI) were in the public sector (Table 3.9). Certificates of registration granted to Sun F&C Mutual Fund and Dundee Mutual Fund were cancelled by SEBI on their request, while Quantum Mutual Fund was registered with SEBI during 2005-06.

IX. Registration of Venture Capital Funds

Venture capital plays a pivotal role for technological progress and enhancing entrepreneurship in the country. These funds meet the capital requirements of various industries set up by new generation entrepreneurs who have limited access to the conventional sources of finance. Although the venture capital industry is in its nascent stage in India, considerable progress was made during the last four years. The number of indigenous venture capital funds increased substantially to 80 during 2005-06 from 50 in 2004-05, an increase of 30 over the previous year. There was also an addition of 25 foreign venture capital funds during 2005-06 (Table 3.10).

X. Fees and Other Charges

SEBI receives fees and certain other charges on both recurring and non-recurring basis from different market intermediaries as per various SEBI Regulations. Details of the

Table 3.9: Mutual Funds Registered with SEBI

Sector	March 31, 2005	March 31, 2006
1	2	3
Public Sector (including UTI)	8	8
Private Sector	31	30
Total	39	38

Table 3.10: Registration of Venture Capital Funds

	March 31, 2005	March 31, 2006
1	2	3
VCF	50	80
FVCI	14	39

amount of fees and other charges (unaudited) received by SEBI during 2005-06 are given in Table 3.11. During 2005-06, the amount of fees and other charges received was Rs. 57.6 crore as against Rs.169.9 crore in 2004-05, a decline of Rs.112.3 crore or 66.1 per cent. Incidentally, last year's fees were high due to one time collection of arrears from the brokers and sub-brokers under SEBI (Interest Liability Regularisation) Scheme, 2004. Among major heads, the largest amount of Rs.16.5 crore was collected from brokers and sub-brokers in 2005-06, followed by Rs.7.8 crore fees from FIs. Other major sources of fees received during 2005-06 were from derivatives members (Rs. 6.7 crore) and from sub-accounts of FIs (Rs. 5.8 crore).

3. SUPERVISION

Implementation of the regulations entails a multi-stage process of supervision through on-site and off-site inspections, enforcement through initiation of adjudication and enquiry against violations of rules and regulations, and prosecutions. Inspections of intermediaries are carried out directly by SEBI or through Self Regulatory Organisations (SROs) viz., stock exchanges or depositories. SEBI conducts inspections on a periodical basis to verify the compliance levels of intermediaries and also conducts specific/limited purpose inspections on the basis of complaints, references, surveillance reports, specific concerns etc. SEBI also directs stock exchanges and depositories to carry out periodic/specific purpose inspections of their members/participants.

I. Promotion and Regulation of Self Regulatory Organisations

SEBI (Self Regulatory Organisations) Regulations, 2004 were notified on February 19, 2004 with the objective to promote organisation of intermediaries representing a particular segment of the securities market as a self regulated entity / organisation. For recognition of organisation of intermediaries as SROs, SEBI held discussions with various bodies like Association of Merchant Bankers of India (AMBI), Association of NSE Members of India (ANMI) and Registrars Association of India (RAIN). Further response from these bodies is awaited.

II. Inspection of Market Intermediaries

According to the revised inspection policy, approved by the SEBI Board, SEBI would henceforth conduct risk based inspection and would not normally conduct routine inspections of brokers/sub-brokers and depository participants. Such inspection would be left to the stock exchanges and depositories concerned, which is in line with international practices. SEBI would oversee the quality of such inspections by calling for periodic reports on inspections conducted, violations observed and actions taken to check whether the quality, content and coverage of inspections are adequate.

a) Inspection of Brokers / Sub-brokers

During the current year, inspections of brokers, sub-brokers were carried out as per various regulations of SEBI. The number of inspections conducted on broking entities were lower at 7 during 2005-06 compared to 79 in the previous year (Table 3.12). However, there were no regular inspections conducted on sub-brokers during 2005-06. But, there was a rise in the number of surprise/limited purpose inspections carried out on 32 broking/

Table 3.11: Fees and Other Charges

(Rs. lakh)

Particulars	2004-05			2005-06		
	Recurring Fees	Non-recurring Fees	Total Fees Received	Recurring Fees	Non-recurring Fees	Total Fees Received (Unaudited)
1	2	3	4	5	6	7
Offer Documents and Prospectuses Filed	—	226.80	226.80	—	376.60	376.60
Merchant Bankers	45.00	36.25	81.25	170.00	53.50	223.50
Underwriters	18.00	35.00	53.00	32.00	40.00	72.00
Portfolio Managers	32.50	109.50	142.00	62.50	262.75	325.25
Registrars to an Issue and Share Transfer Agents	8.80	1.70	10.50	3.55	1.30	4.85
Bankers to an Issue	7.50	20.00	27.50	7.50	10.00	17.50
Debenture Trustees	20.00	5.00	25.00	10.00	0.00	10.00
Takeover Fees	—	66.50	66.50	—	92.60	92.60
Mutual Funds	165.00	50.50	215.50	159.50	26.25	185.75
Stock Brokers and Sub-Brokers	14,389.92	—	14,389.92	1,645.89	—	1,645.89
Foreign Institutional Investors	—	430.88	430.88	—	782.20	782.20
Sub Accounts – Foreign Institutional Investors	—	267.83	267.83	—	578.29	578.29
Depository	20.00	—	20.00	20.00	—	20.00
Depository Participants	5.37	163.05	168.42	5.47	195.85	201.32
Venture Capital Funds	—	49.00	49.00	—	157.75	157.75
Custodian of Securities	60.00	—	60.00	50.00	—	50.00
Approved Intermediaries under Securities Lending Scheme	12.55	5.20	17.75	6.00	0.00	6.00
Credit Rating Agencies	—	—	—	12.00	1.00	13.00
Listing Fees – Contribution from Stock Exchanges	166.04	—	166.04	188.79	—	188.79
Foreign Venture Capital Funds	—	29.56	29.56	—	130.08	130.08
Derivatives Members	523.66	—	523.66	670.93	—	670.93
Informal Guidance Scheme	—	15.50	15.50	—	8.65	8.65
Total	15,474.34	1,512.27	16,986.61	3,044.13	2,716.82	5,760.95

- Notes:**
1. **Recurring fees:** Fees which are received on annual/3-yearly/5-yearly basis. These include Renewal Fee/ Service Fee/ Annual Fee/ Listing Fees from exchanges.
 2. **Non-recurring fees:** Fees which are received on a one-time basis. These include fees for Offer Documents Filed/ Registration/ Application/ Takeover/ Informal Guidance Scheme/ FII Registration and FII Sub-Accounts.
 3. As all sums realised by way of penalties on or after 29.10.2002 have been credited to the Consolidated Fund of India, these are not included in the fees / income of SEBI.
 4. Brokers and Sub-Brokers registration fees include annual fees and turnover fees.

Table 3.12: Inspection of Brokers / Sub-brokers

Particulars	2004-05	2005-06
1	2	3
Regular Inspections Completed – Brokers	79	7
Regular Inspections Completed – Sub-brokers	78	Nil
Surprise / Limited Purpose Inspections – Brokers / Sub-brokers	22	32

sub-broking entities during 2005-06 as against 22 in 2004-05.

b) Inspection of Other Intermediaries

Section 11(2) of SEBI Act, 1992 provides that SEBI shall register and regulate the working of intermediaries. In fulfillment of the above, SEBI conducted inspection of 49 Depository Participants (DPs), seven Merchant Bankers and one Registrar to an Issue (RTI) and Share Transfer Agent (STA).

III. Inspection of Stock Exchanges

During 2005-06, SEBI inspected five stock exchanges, viz., The Stock Exchange, Mumbai, National Stock Exchange, Uttar Pradesh Stock Exchange, Calcutta Stock Exchange, and Gauhati Stock Exchange.

IV. Inspection of Subsidiaries of Stock Exchanges

A special inspection of the Subsidiary of Ludhiana Stock Exchange (LSE) was carried out by SEBI during 2005-06.

V. Inspection of Depositories

During 2005-06, inspections were carried out at National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL).

VI. Show Cause Notices Issued

Based on the investors' complaints, regarding delay in dematerialisation of shares

and also on the basis of reports submitted by both the depositories, show cause notices (SCNs) were issued to 60 companies as to why actions should not be initiated against them for violating provisions of Regulation 53 read with Regulation 54 (5) of SEBI (Depositories and Participants) Regulations, 1996 and the Depositories Act, 1996.

4. SURVEILLANCE

I. Mechanism of Market Surveillance

Market surveillance is an important function performed by SEBI in pursuance of its objectives to ensure investor protection and to safeguard the integrity of the market. The current surveillance system adopted by SEBI draws mostly on the feedback provided by the two premier stock exchanges, namely BSE and NSE which together account for almost the entire trading volume in the market.

The market surveillance is carried out at two levels. The stock exchanges are considered to be the primary regulator. They have been given the responsibility of carrying out day-to-day surveillance under the overall supervision of SEBI. SEBI also keeps constant vigil on the activities of stock exchanges to strengthen the surveillance system. The stock exchanges have their own systems in place to detect abnormal activities. In case of any detection of abnormality with regard to market manipulation, price rigging and other regulatory breaches, the stock exchanges take appropriate actions and the findings are communicated to SEBI wherever necessary.

The Integrated Surveillance Department of SEBI monitors market movements, analyses trading pattern in scrips and indices and initiates appropriate action, if necessary, in co-ordination with stock exchanges and the depositories. Towards this end, SEBI takes into account any unusual or suspicious market movements, formal or informal information

from the stock exchanges, the depositories, and specific complaints from any entities / persons. Based on an initial scrutiny of such information received, the matter is taken up for a preliminary enquiry. Subsequently, depending on the findings of the exchanges, depositories and concerned entities, the matter may be taken up for full-fledged investigation.

Integrated Surveillance Department of SEBI also organises weekly surveillance meetings with the stock exchanges. The scope of these meetings includes market movements, media reports, highlights of trading activity during the week and any other observation as communicated by the stock exchanges and initiate action as warranted. In the weekly meetings, inputs from SEBI and the stock exchanges are pooled for better co-ordination, sharing of information and co-ordinated actions. The meeting also provides a highly specialised and interactive forum to discuss prevailing surveillance issues and emerging concerns, if any, so as to expeditiously initiate appropriate surveillance action. During 2005-06, 47 such surveillance meetings were held. In addition, such meetings were also held as and when felt necessary depending on market exigencies.

II. Surveillance Measures during 2005-06

In order to protect the interests of investors and to safeguard market integrity, SEBI *suo motu* took the following measures:

- a) On scrips in Trade-for-Trade segment, 100 per cent VaR margin was levied. Moreover, BSE also levied 100 per cent VaR margin on scrips which were under "Z" Group over and above the scrips which were in Trade-for-Trade segment. Further, all scrips having price band above 5 per cent in Trade-for-Trade segment attracted a uniform circuit filter of 5 per cent.
- b) Exchanges were advised to keep a vigil on the trading pattern of institutional investors in scrips having negative price-earnings ratio, loss making companies and low capital base.
- c) A time patch analysis is being carried out by the stock exchanges whenever the Sensex and Nifty falls/rises beyond 0.5 per cent (instead of 1 per cent as followed earlier).
- d) The stock exchanges were advised to issue a subtle cautionary indication to the investing community at large, highlighting the risks associated with investing in scrips without having due regard to the fundamentals of the company and its volatility.
- e) The stock exchanges have been advised to initiate expeditious and demonstrative actions, wherever warranted, so as to protect investors' interests and to ensure orderly functioning of the stock markets.
- f) The stock exchanges have been advised to introduce toll free services for gathering market intelligence. This would be highly beneficial in obtaining leads and getting a general feel of the market in addition to indications of potential breaches. Accordingly, BSE and NSE have introduced toll free services since August 2005.
- g) It has been noticed that several companies deny news reports published by various media in respect of their activities/plans when the stock exchanges seek clarification from the companies. The stock exchanges have been advised to write to the companies advising them to take up the matter with the editor of the concerned newspaper if the factual position as given by the companies was at variance with the newspaper report. The stock exchanges have also been told to put up the

clarification of the companies on their websites.

- h) The stock exchanges have been advised to initiate action against those companies which have been non-compliant with the Listing Agreement. Several such companies were penny stocks or were trading on BSE in 'T' or 'Z' groups.
- i) The exchanges have also been advised to take action against those scrips where the companies do not have any license to do their business.
- j) The threshold limit for client concentration in the Futures & Options segment was reduced.
- k) The criteria for shifting scrips from Rolling Settlement to Trade-for-Trade segment and *vice versa* were reviewed. Several scrips have been shifted to the Trade-for-Trade segment. In this segment, each trade has to be backed by delivery. This discourages day trading and speculation.
- l) SEBI stipulated that at least 50 per cent of the non-promoter holdings of a company should be in dematerialised form before shifting trading in securities of company from Trade-for-Trade segment to Rolling Settlement, provided there are no other grounds for continuation in Trade-for-Trade segment. This is applicable for those companies which had earlier not established connectivity with the two depositories (and hence trading was shifted to Trade-for-Trade segment) and which have since then established the connectivity.
- m) Stock exchanges have been advised to separately disseminate the trades of DFIs, FIIs and other clients on their website. This has been done to have greater transparency and information dissemination.

- n) Additionally, from time to time, the stock exchanges are also issuing list of 'dos' and 'don'ts' for investors with regard to dealing in securities in the leading English and Hindi newspapers. SEBI also emphasises the same through its periodic investor education programmes.

III. Irregularities in Trading of Penny Stocks

In India, stocks with a face value of Rs. 10 or less and market capitalisation of less than or equal to Rs. 200 crore, quoting at less than the face value, are generally referred to as "penny stocks" or "small cap stocks". In the recent times, SEBI has been keeping a close watch on the trading of such stocks. Following suspicion, SEBI initiated quick and rapid investigation into several such scrips and entities that were active in the trading of such scrips. In these companies, generally a common *modus operandi* was noticed. It was observed that these companies have been making a flurry of seemingly price sensitive announcements detailing proposed corporate developments, status of business, projects and status thereof, corporate actions such as dividend, bonus, stock split etc., which were not mandated under the law. It was also noticed that the promoter shareholding in several such companies decreased following such announcements. This indicates that promoters took advantage of the price rise and benefited from it. Based on the preliminary examination, expeditious/demonstrative actions were taken wherever warranted, so as to protect the investors' interests and ensure the orderly functioning of the stock markets. SEBI passed interim *ex parte* orders, pending investigation in respect of transactions in such scrips against Minal Engineering Ltd., Interlink Financial Services Ltd., Konkan Tyres, Prime Property Development Corp. Ltd., Ind Tra Deco Ltd., Mega Corporation Ltd., Eltrol Ltd.,

Karuna Cables Ltd. and Millennium Cybertech Industries Ltd. Moreover, several clients and brokers have also been prohibited from buying, selling or dealing in the company's shares till further orders. Quasi judicial proceedings are under way against these entities. The depositories viz., NSDL and CDSL were also directed to ensure that all the above directions are strictly enforced. Further, detailed investigation has also commenced in this regard. In order to ascertain the veracity of the publicly reported financial statements of these companies, the matter has been taken up with the Institute of Chartered Accountants of India. Following initiation of actions by SEBI, there was a sharp decrease in the trading volume of penny stocks.

It was found that a debarred entity was dealing in shares of Interlink Financial Services Ltd. during the period of SEBI's prohibition through another broker. Therefore, prohibitory orders were passed against the broker. Adjudication proceedings were also initiated against the debarred entity. Moreover, the broker has been debarred from dealing in any other security till further orders.

IV. Detection of Fake Shares in the Market

It has been brought to the notice of SEBI about the fake shares being introduced in the market. Based on the preliminary examination, SEBI passed interim *ex parte* order in the matter of Consortex Karl Doelitzxh (India) Ltd. (formerly Andhra Pradesh Power Tools Ltd.). SEBI prohibited the company and its directors from issuing further shares or alter its share capital in any manner till further directions. The directors were debarred from accessing the capital market or dealing in securities, in any manner, directly or indirectly, till further orders. Moreover, the company was asked to submit a report audited by a qualified chartered

accountant or a practising company secretary on the reconciliation of records of dematerialised securities with all the securities issued by the company.

V. Irregularities in Trading of Some Scrips on the Calcutta Stock Exchange

In course of on-going surveillance, SEBI came across instances wherein the brokers have artificially jacked up the price and created false volumes in several scrips. SEBI observed a spurt in the price of scrips of several Kolkata-based companies. The said companies have recorded poor or negative financial performance and have not filed up-to-date financial statements with Calcutta Stock Exchange. Illiquid scrips were being traded amongst a set of brokers at the CSE, employing unfair trade practices, giving rise to artificial market and fancy values to the scrips of companies with hardly any fundamentals. It was also seen that the brokers have indulged in continuous self deals executed on the same terminal and cross deals amongst themselves, thereby not only enriching themselves, but also aiding and abetting the process of legitimising the gains. Such acts by a group of brokers pose a serious risk to the stability of the market and continuity to the settlement system of the stock exchange. Moreover, the innocent investors may be misled by the artificial trading volumes generated by these brokers and, in the process, may be attracted to invest in the shares of these fundamentally weak companies at unjustifiable market prices. Since the activities of the brokers were not limited to one or two scrips, it was felt that this would have a palpably adverse impact on the investors and hence, there was a need to have demonstrative deterrent action. In this connection, SEBI passed interim *ex parte* orders against 21 concerned brokers directing them not to buy, sell or deal

in securities, in any manner, either directly or indirectly, till further directions in this regard. The brokers were Sanju Kabra, Shivam Stock Broking Pvt. Ltd., D B & Co., Rajendra Prasad Shah, Badri Prasad & Sons, M. Bhiwaniwala & Co., Ram Mohan Sarada, A V Shares & Stock Brokers Pvt. Ltd., Shyam Lal Sultania, Ahilya Commercial Pvt. Ltd., S Jhunjhunwala & Co., Basant Periwal & Co., Binoy Poddar, P K Agarwal & Co., Pramod K Kothari, Purshottam Lal Kejdiwal, Santosh K Kejriwal Securities (P) Ltd., Dinesh Kumar Lodha, Ashish Stock Broking, Sunil Kedia and Murari Lal Goenka.

In addition to the above actions, tradings in the shares of the following 11 companies were suspended from the exchange till further directions. The companies were Prime Capital Market Ltd., Subh Laxmi Projects Ltd., Global Capital Market Ltd., Bankam Investments Ltd., S. T. Services Ltd., Amluckie Investment Co., Nageshwar Investment Ltd., Adinath Bio-labs Ltd., Globe Stocks & Securities Ltd., Goenka Business & Finance Ltd. and Coronet Industries Ltd.

VI. Detection of Fraud Committed by Unregistered Entities

SEBI received a complaint from an investor's forum alleging that unregistered entities (M/s Digital Stocks and Ganpati Finsec Pvt. Ltd.) acting as sub-brokers defrauded investors by running away with funds and securities. SEBI immediately initiated a preliminary examination into the matter. It was found that these unregistered entities were using trading terminals of registered brokers. Based on preliminary examination, SEBI passed interim *ex parte* orders directing that:

- a. The unregistered sub-brokers and their directors have been prohibited, with immediate effect from buying, selling, or dealing in securities, or being associated with the securities market in any manner;
- b. Demat accounts of these entities and their trading accounts with other brokers have been frozen; and
- c. Appropriate proceedings are being initiated against the brokers.

VII. Detection of Irregularities in Respect of Recommendations Given by Research Analysts/Firms

SEBI has been looking into the publishing of research reports on stocks by various entities as well as broking firms through their websites. Such recommendations often attract the general investors' attention and affect the investment decisions; more so on account of perceived 'knowledge' and 'expert' recommendation. Hence, it is important that the person giving such recommendations to the public at large should be doing so in a responsible and unbiased manner. Equally, it is required that the author of the research report makes adequate disclosures of his interest so as to address issues of potential conflict of interest. During the course of ongoing surveillance, SEBI noticed regulatory violations when recommendations were aired. This has the effect of resulting in betrayal of trust and confidence in the market by purveyors of such recommendations. It was also found that a distinct *modus operandi* was adopted by such analysts disseminating research reports. The reports bring out favourable projections of the company, especially those companies whose shares are thinly traded or give out misleading news regarding the company. Prior to dissemination of the reports, the analysts / their associated entities build up a purchase position in the shares of the company. Thereafter, they sell the shares after publishing the research reports which recommends buying of the shares. Thus, in contrast to the recommendations, the analysts/ associated entities used to offload shares (purchased prior to the

recommendations) of such companies on the back of induced investor interest created by their recommendations. This pointed out to *prima facie* breaches of the regulations and hence, appropriate directions were issued.

Based on the findings of preliminary examination, SEBI passed *ex parte* orders in case of Mathew Easow, VBC Ferro Alloys / BLB Ltd. and Lalit Dua/LRS Portfolio & Advisory Services Ltd.

The orders passed were in the nature of directing these entities to cease and desist from giving any recommendations about any investment in the securities market in any public media. Besides, adjudication proceedings have also been initiated in these cases, wherever warranted. Additionally, investors were also cautioned to take informed decisions without being influenced by such recommendations given in the public media. The concerned websites were also advised to ensure that their portal is not misused by persons giving advice purely on considerations of personal gains.

VIII. Misuse of IPO Allotment in Retail Category

As a part of ongoing surveillance activity by SEBI into various aspects of working of securities market and based on market intelligence, SEBI advised the stock exchanges to look into the dealings in the shares issued through Initial Public Offerings (IPOs) before the shares are listed on the stock exchanges. This was the initial step which SEBI undertook for further investigations. For the purpose of examination, the off-market transactions data, obtained from the depositories, were provided by SEBI to the stock exchanges. In October 2005, the stock exchanges submitted their preliminary observations on the IPO of Yes Bank Ltd. (YBL) which hinted at the possibility of large scale off-market transactions immediately following the date of allotment

and prior to the listing on the stock exchanges. SEBI, therefore, carried out a preliminary scrutiny by calling for data from the depositories and the Registrar to the Issue (RTI).

Consequent to the preliminary scrutiny, SEBI found that certain entities had cornered IPO shares reserved for retail investors by making applications in the retail category through thousands of fictitious / benami IPO applicants with each of the application being for small value so as to be eligible for allotment under the retail category. It was found that a large number of multiple dematerialised accounts with common addresses was opened by a few entities. It was also noticed that first the bank accounts were opened in the names of fictitious / benami entities and this facilitated the fictitious / benami bank account holders to open dematerialised accounts.

Subsequent to the receipt of IPO allotment, these fictitious / benami allottees had transferred shares to their principals, who in turn, transferred the shares to the financiers who had originally made available the funds for executing the game plan. The financiers in turn sold most of these shares on the first day of listing thereby realising the windfall gain of the price difference between issue price and the listing price.

The entire *modus operandi*, as detailed above, led to the suspicion that thousands of entities in each of whose name separate dematerialised accounts and bank accounts had been opened and IPO applications made were merely name-lenders or non-existent. The findings of RBI also confirm the preliminary findings of SEBI that these thousands of name-lenders are fictitious. RBI has also initiated action against banks and levied penalty. Even the key persons who had executed the game plan were merely intermediaries acting on behalf of the

financiers. These key persons and their financiers were not investors but mere rank opportunists who seek to make a killing by disposing the IPO shares cornered by them on the date of listing. The banks have also played their part by opening bank accounts and providing a pro-tempore loan to these fictitious entities with the objective of earning interest and other charges. While all participants in the above scheme of arrangement may have gained in some way or the other, the only losers were the genuine retail investors who failed to get allotment or who got allotment of a fewer number of shares than they would have got otherwise.

Thus, the entire problem is not with the allotment process, which has by and large come to stay as stable and secure, but the way in which banks and DPs have connived with the key operators in derailing the tried and tested process of fair and transparent allotment of IPO shares.

On noticing the irregularities and widespread abuse, SEBI acted with alacrity against entities that were responsible for the irregularities by passing interim order restraining them from participating in all future IPOs and also directing the depositories to effectively freeze their dematerialised accounts. Close on the heels of the order in the case of Yes Bank IPO, SEBI lost no time in examining the dealings in another major IPO of IDFC wherein the very same players were suspected to have played a major role in cornering the shares. Further, detailed investigations in the matter are in progress and every aspect of the matter is being probed in order to bring to book those who have abused the IPO allotment process.

The swift moves on the part of SEBI, culminating in the interim orders as above, were the first of its kind by SEBI relating to IPOs. But for SEBI's lead effort and timely action in exposing the complex strands of the

abuse in the IPO process, such rampant abuse would have gone undetected and unchecked. SEBI took the following immediate steps to ensure that there is no recurrence of such irregularities.

- i) SEBI directed the depositories i.e., NSDL and CDSL to advise their respective depository participants to verify the genuineness of the dematerialised account-holders where 20 or more dematerialised account-holders have a common address and to close those dematerialised accounts where the Depository Participants are unable to do the above verification.
- ii) SEBI directed the depositories to form a Co-ordination Committee to co-ordinate with the Surveillance Department of SEBI for monitoring abnormal transactions in dematerialised accounts. The depositories have been advised to put in place a system including the necessary software to identify multiple accounts suspected to be benami / fictitious.
- iii) The Permanent Account Number (PAN) has been made compulsory for opening DP accounts.
- iv) In order to check misuse through off-market transfer prior to listing, SEBI, issued a circular in January 2006, advising the depositories that in case of IPOs, they should activate the International Securities Identification Number (ISIN) only on the date of commencement of trading on the stock exchanges.
- v) SEBI authorised Investigative Audit of suspected Depository Participants as well as a System Audit for NSDL.
- vi) The matter has been referred to the CBI to examine the criminal angle in the matter with inter-state ramifications.

The matter has also been referred to the Ministry of Company Affairs, RBI and the Income Tax Department.

The salutary impact of the prompt measures taken by SEBI has been noticed in the IPOs that have entered the market subsequent to the issuance of the above SEBI orders.

IX. Integrated Market Surveillance System

Effective surveillance mechanism is one of the primary requirements of a well functioning capital market. In order to further enhance efficacy of the surveillance function so as to protect the interests of investors more effectively, SEBI decided to put in place a world-class comprehensive Integrated Market Surveillance System (IMSS) across stock exchanges and across market segments (cash and derivatives markets). The IMSS solution envisaged by SEBI sought to achieve the following objectives:

- An online data repository with the capacity to capture market transaction data and reference data from a variety of sources like stock exchanges, clearing corporations/houses, depositories etc., in different formats for the securities and derivatives markets;
- A research and analysis regulatory platform to check for instances of potential market abuse; and
- Sophisticated alert engines, that can work with various data formats (database, numeric and text data) to automatically detect patterns of abuse and then issue an alert. These include insider trading engine, fraud alert engine and market surveillance engine.

SEBI had signed an agreement with a consortium of SMARTS Pty. Ltd., Australia and HCL Technologies Limited for implementation of the IMSS in the Indian

capital market. The IMSS system, implemented by SEBI, uses state-of-the-art technology and is one of its kind available with the capital market regulators across the world. The system is unique in view of the complexities and dimensions of the capital market in India.

SEBI has put in place necessary infrastructure to obtain the relevant data from different data sources such as stock exchanges (BSE and NSE) and depositories (CDSL and NSDL). Data obtained from stock exchanges (cash and derivatives segments) and depositories were integrated into the IMSS for generating alerts that would help SEBI identify and detect serious market abuses such as market manipulations, insider trading and other types of frauds that undermine the market integrity. The system has also started generating basic alerts and reports based on pre-defined parameters since February 2006. The IMSS will provide SEBI the capability to analyse information on market transaction immediately and develop parameters that will generate alerts highlighting abnormal market movements. These alerts would also provide SEBI with a tool to manage the voluminous information characteristics of today's markets. It may be emphasised here that IMSS is in no way proposed to be a substitute for the surveillance activities being carried out by the stock exchanges at present. The primary responsibility for surveillance vests and would continue to vest with the stock exchanges. The IMSS is intended to help SEBI supplement the surveillance activities undertaken by the stock exchanges and share information with stock exchanges on cross market alerts.

X. RBI-SEBI Joint Group on Integrated System of Alerts

The Joint Parliamentary Committee (JPC) on stock market scam and matters

relating thereto, recommended the necessity for RBI and SEBI to put in place an integrated system of alerts which would piece together disparate signals from different elements of the market to generate special attention to any unusual activity anywhere in the system which might have a bearing on integrity of the stock market. The JPC has also noted that regulation of the market could only be provided through constant vigil and co-ordination with various other regulatory agencies. Towards this end, a SEBI-RBI Group on integrated system of alerts has been set up to share information and to recommend suitable measures so that co-ordinated action may be taken. In accordance with the recommendations made by the Group, appropriate alerts have been identified. These are in the nature of pay-in alerts at the stock exchange level involving top brokers accounting for large pay-in. In addition, bank guarantee details of top 25 brokers (based on turnover) as well as information on securities pledged by such brokers are being shared. A system making use of the same has been put in place since February 2004 and this system is now fully functional.

SEBI has been regularly informing the prevailing market conditions to the Ministry of Finance and the Ministry of Company Affairs, Government of India. Special references and information have also been shared with other enforcement agencies such as Income Tax Department, Enforcement Directorate and the CBI.

XI. Anti-Money Laundering Provisions

The Prevention of Money Laundering Act, 2002 (PMLA) was notified on July 1, 2005. As per the provisions of the Act, every banking company, financial institution (which includes chit fund company, co-operative bank, housing finance institution and non-banking financial company) and intermediary

(which includes stock broker, sub-broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and any other intermediary associated with securities market and registered under Section 12 of the Securities and Exchange Board of India Act, 1992) shall have to maintain a record of all the transactions, the nature and value of which are being prescribed in the Rules under the PMLA, which are concurrently being notified. Such transactions include:

- All cash transactions of the value of more than Rs. 10 lakh or its equivalent in foreign currency;
- All series of cash transactions integrally connected to each other which have been valued below Rs. 10 lakh or its equivalent in foreign currency, where such series of transactions take place within one calendar month; and
- All suspicious transactions made in cash or otherwise.

The Act, *inter alia*, requires intermediaries registered with SEBI, to follow certain stipulations with respect to maintenance of records of transactions specified therein, furnishing information to the Financial Intelligence Unit of India as well as verifying and maintaining records of identity of clients in the prescribed manner. Accordingly, SEBI has framed guidelines for the purpose and advised intermediaries to ensure compliance with the relevant provisions of the Act. The guidelines provide a general background on the subjects of money laundering and terrorist financing, summarise the main provisions of the applicable anti-money laundering and anti-terrorist financing legislation in India and provide guidance on the practical implications of the Act. The guidelines also set out the steps that a registered intermediary and any

of its representatives, should implement to discourage and identify any money laundering or terrorist financing activities. The guidelines also specify indicative approaches to be adopted in respect of client acceptance, client due diligence, transactions monitoring (especially suspicious transactions) and maintenance of records.

Apart from the broad policy framework as contained in these guidelines, detailed operational procedures and formats of reporting to be followed by the intermediaries have also been prescribed by SEBI. This has been communicated to the market *vide* circulars issued by the stock exchanges in July 2005 and by SEBI in January 2006. The operational framework would help market intermediaries better understand their obligations under the PMLA and rules framed thereunder and is also intended to bring about uniformity in reporting by them.

The market intermediaries were also sensitised towards compliance with the regulatory requirements under the PMLA, 2002 by means of participation in meetings and seminars arranged by the concerned organisations.

XII. Surveillance Actions

During 2005-06, Integrated Surveillance Department of SEBI made 155 and 85 references to BSE and NSE, respectively for examination and investigation. BSE completed examination / investigation in 120 cases while the NSE completed examination / investigation in 85 cases during 2005-06. NSE shifted 259 scrips to Trade-for-Trade segment wherein compulsory delivery is mandatory, whereas BSE shifted a total of 1,169 scrips to Trade-for-Trade segment in 2005-06 (Table 3.13).

During the year, NSE imposed price band (2 per cent, 5 per cent and 10 per cent) on a total of 850 scrips. BSE also imposed

Table 3.13: Surveillance Actions during 2005-06

Nature of Action	NSE	BSE
1	2	3
Scrips Shifted to Trade-for-Trade Segment	259 (209)	1,169 (842)
No. of Scrips in which Price Bands were Changed (2 per cent, 5 per cent and 10 per cent)	850 (650)	3,698 (1,922)
Preliminary Investigation Taken up	294 (164)	893 (783)
Rumours Verified	294 (301)	426 (538)

Note: Figures in the parentheses pertain to 2004-05.

price band on 3,698 scrips. Exchanges have been assigned the responsibility to verify the rumours in the market. NSE and BSE verified 294 and 426 rumours, respectively during 2005-06.

5. INVESTIGATION

I. Process of Investigation

The major objective of investigation is to identify persons/entities behind irregularities and violation of rules and regulations, which broadly fall under: (a) price manipulation; (b) creation of artificial market; (c) insider trading; (d) public issue related irregularities; (e) takeover violations; and (f) other misconducts.

The process begins with preliminary investigation. At this stage, information/data relating to the case are collated to assess whether a formal investigation is required. Once the case is taken up for formal investigation, investigating officer has the power under SEBI Act to: (a) call for information, (b) compel production of documents; and (c) examine the witness. Pursuant to completion of investigation, various actions like administrative directions and penal actions under the SEBI Act and

various SEBI Rules and Regulations are taken. These actions include monetary penalties, warning, suspension of activities, cancellation of registration, prohibition of dealing in securities and access to the capital market etc.

II. Trends in Investigation Cases

SEBI has so far undertaken 1,073 cases of investigation, of which, 836 cases have been completed. During 2005-06, 165 new cases were taken up for investigation and 81 cases were completed (Table 3.14 and Chart 3.4).

a) Nature of Investigation Cases

During 2005-06, of the 165 cases taken up for investigation, 137 cases were related to market manipulation and price rigging (Table 3.15 and Chart 3.5). This constitutes 83.0 per cent of cases taken up for investigation during the year as against 84.6 per cent of such cases in the previous year. Other cases pertained to insider trading, takeover violations, irregularities in public issues, and miscellaneous cases. It may be

Table 3.14: Investigations by SEBI

Year	Cases Taken up for Investigation	Cases Completed
1	2	3
1992-93	2	2
1993-94	3	3
1994-95	2	2
1995-96	60	18
1996-97	122	55
1997-98	53	46
1998-99	55	60
1999-00	56	57
2000-01	68	46
2001-02	111	29
2002-03	125	106
2003-04	121	152
2004-05	130	179
2005-06 (P)	165	81
Total	1,073	836

P: Provisional

Note: The pending cases are in the nature of preliminary scrutiny as well as of formal investigation.

Chart 3.4: Investigation Cases Taken up and Completed

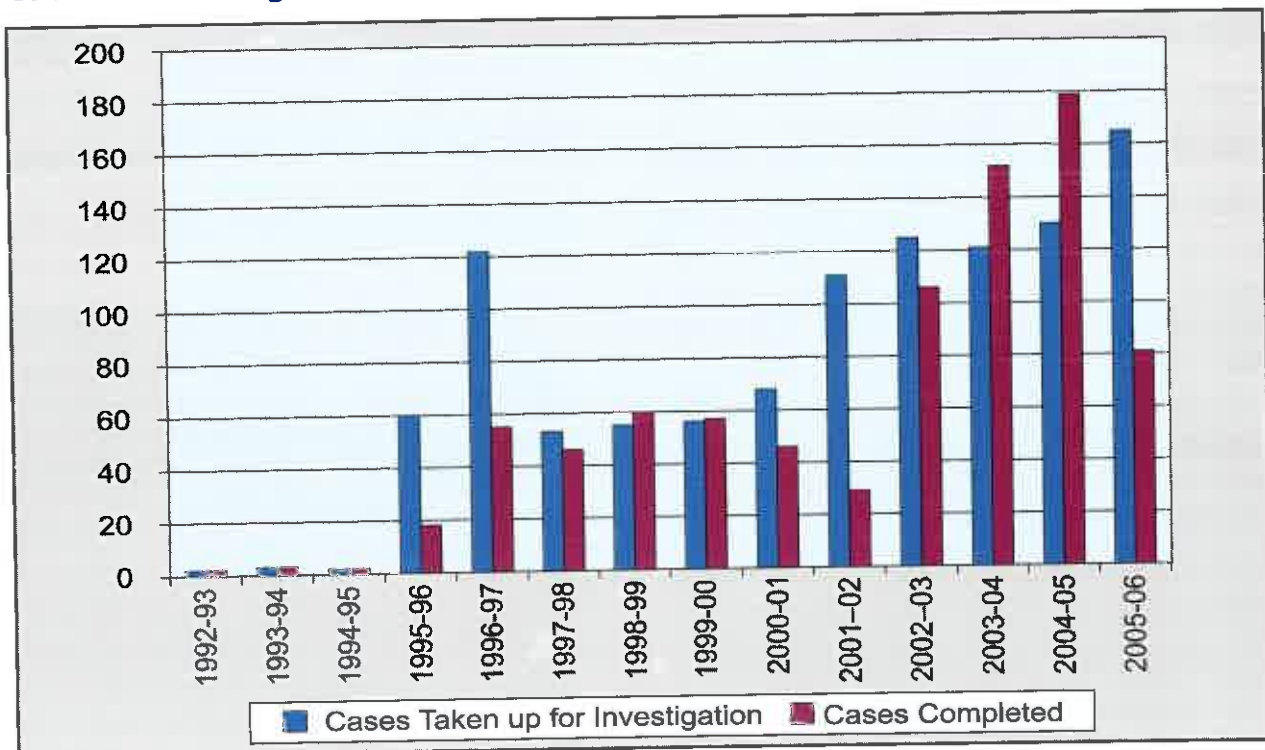


Table 3.15: Nature of Investigation Cases Taken up

Particulars	Number of Cases 2004-05	Number of Cases 2005-06 (P)
1	2	3
Market Manipulation and Price Rigging	110	137
"Issue" Related Manipulation	2	3
Insider Trading	7	6
Takeovers	1	4
Miscellaneous	10	15
Total	130	165

P: Provisional

mentioned that many investigation cases were taken up on the basis of multiple allegations of violations and hence strict classification under specific category becomes difficult. Such cases have been classified on the basis of main charge/violation.

b. Investigation Cases Completed

During 2005-06, of the total cases of investigation completed, cases related to

market manipulation and price rigging accounted for 76.5 per cent as against 82.7 per cent in the previous year. Other cases which were completed pertained to insider trading, public issue related irregularities and others like takeover violations, misleading advertisements, unfair practices, etc. (Table 3.16 and Chart 3.6).

Table 3.16: Nature of Investigation Cases Completed

Particulars	Number of Cases 2004-05	Number of Cases 2005-06
1	2	3
Market Manipulation and Price Rigging	148	62
"Issue" Related Manipulation	2	1
Insider Trading	10	8
Takeovers	2	3
Miscellaneous (Unfair Practices, Misleading Advertisements, etc.)	17	7
Total	179	81

Chart 3.5: Nature of Investigation Cases Taken up (2005-06)

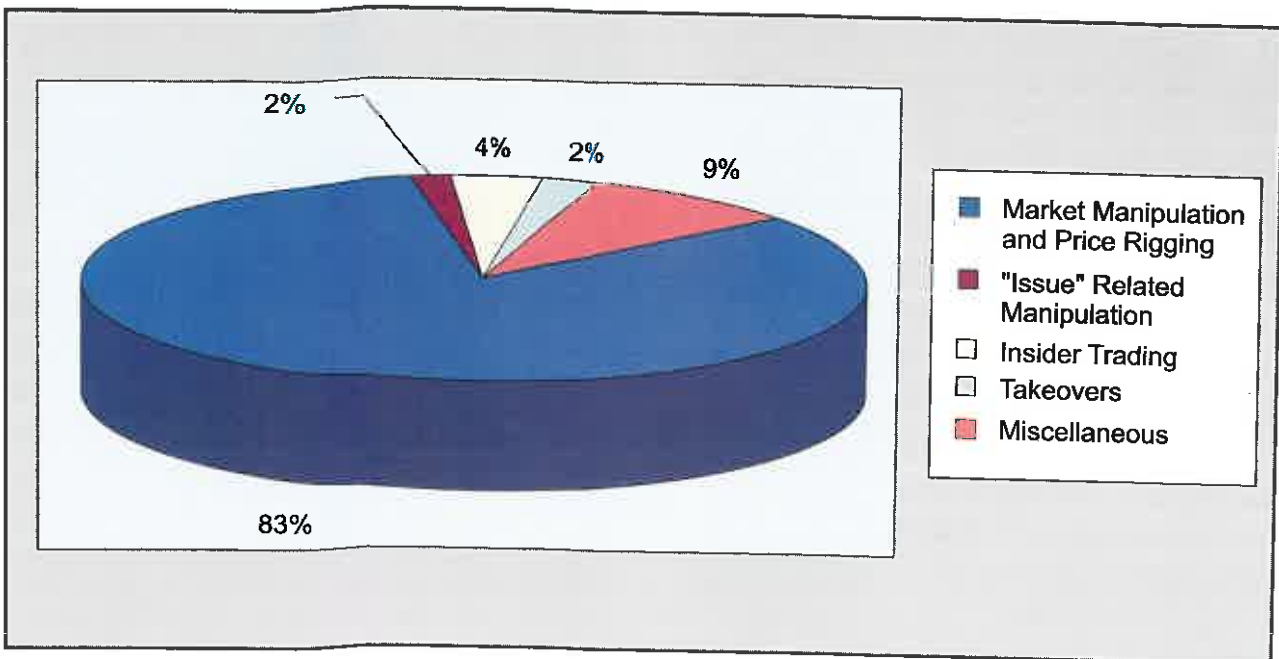
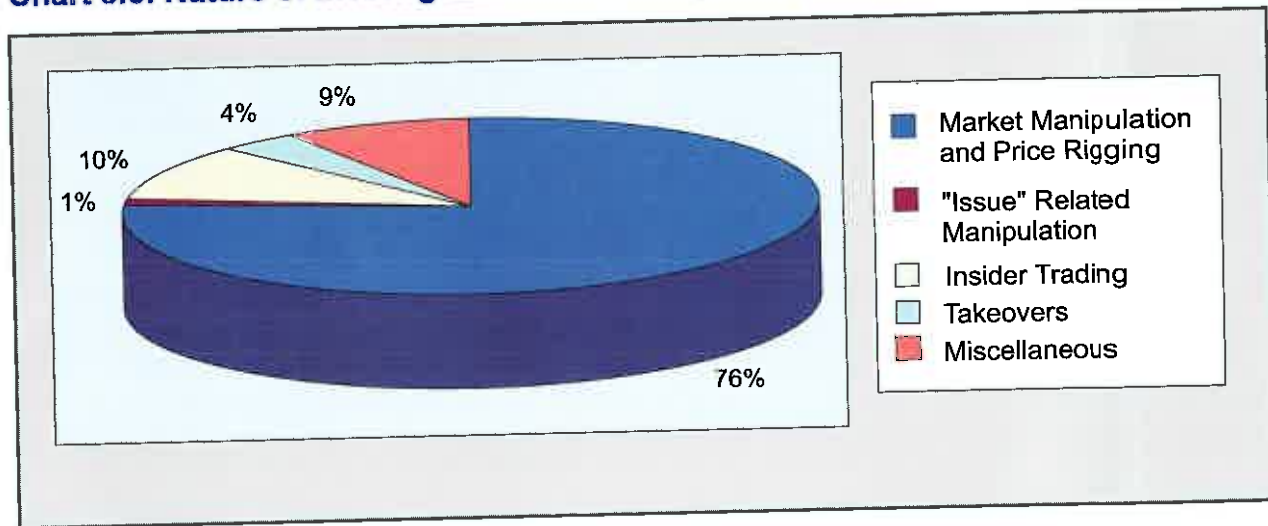


Chart 3.6: Nature of Investigation Cases Completed (2005-06)



III. Regulatory Actions Taken

The regulatory actions, *inter alia*, include: (a) issue of warning letters; (b) cancellation of registration; (c) suspension from participating in the capital market activities; (d) prohibitory directions issued under Section 11 of the SEBI Act; and (e) prosecution.

With a view to enhancing regulatory effectiveness, prompt actions were taken during the year against various entities. The total number of entities against whom actions initiated was significantly higher at 741 during 2005-06 as against 232 in the previous year, indicating a rise of 219.4 per cent over the previous year (Table 3.17). This was mainly because of the interim orders passed in various cases to prevent malpractices in the markets. Under Section 11 of the SEBI Act, 632 prohibitive directions were issued to various entities in 2005-06 as against 134 in the previous year. The number of intermediaries suspended for varying periods during 2005-06 was 36 as against 42 in the previous year. Letters of warning issued in 2005-06 were also higher than that in the previous year (Chart 3.7).

6. ENFORCEMENT OF REGULATIONS

Enforcement makes a regulatory system effective. Active follow-up of cases of

Table 3.17: Type of Regulatory Actions Taken

Particulars	No. of Entities 2004-05	No. of Entities 2005-06
1	2	3
Cancellation	3	2
Suspension	42	36
Warning Issued	53	71
Prohibitive Directions Issued under Section 11 of the SEBI Act *	134	632
Total	232	741

* Against intermediaries and non-intermediaries.

misconduct sends the right signal to the market participants. Disciplinary actions in the form of justified penalties are indispensable for ensuring market integrity.

I. Enquiry and Adjudication

During 2005-06, 411 orders were passed/ reports submitted, of which, 221 pertained to enquiries and 190 to adjudications. During the same period, hearings for 196 cases were conducted of which, 88 belonged to enquiries and 108 to adjudications. During 2005-06, 247 show cause notices were issued to different entities, of which, 214 pertained to adjudication cases and 33 related to enquires (Table 3.18).

Chart 3.7: Type of Regulatory Actions Taken

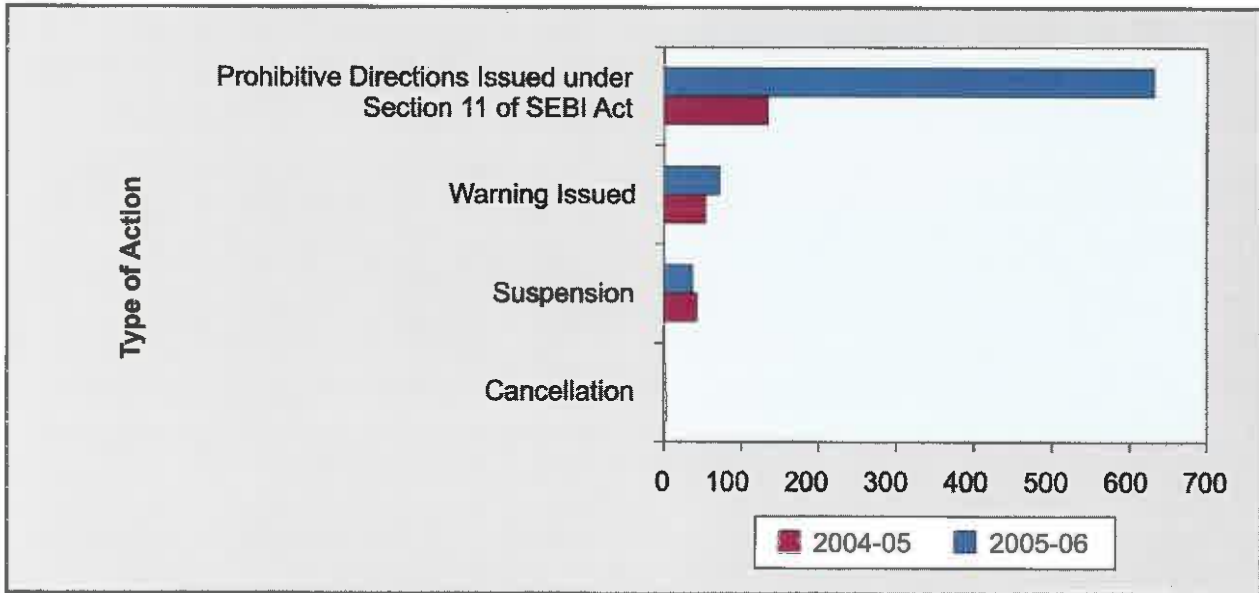


Table 3.18: Enquiry and Adjudication during 2005-06

Particular	Enquiry	Adjudication	Total
1	2	3	4
Orders Passed/Report Submitted	221	190	411
Hearing Conducted	88	108	196
Show Cause Notices Issued	33	214	247

Table 3.19: Enquiry and Adjudication against Brokers/Sub-brokers

Particulars	2004-05	2005-06
1	2	3
Enquiry Proceedings – Brokers	21	6
Summary Proceedings Initiated – Brokers	106	26
Enquiry Proceedings Initiated – Sub-brokers	9	8
Adjudications Proceedings Initiated	29	22
Warning Pursuant to Chairman / Member's Orders	4	45
Administrative Warnings/ Advice Letters Issued	26	—
Total No. of Warnings Issued	30	45
Suspended	24	7
Registration Cancelled	288	Nil
Censure	1	34

II. Market Intermediaries

Since 1992 onwards, SEBI has been calling for information from the brokers. The number of summary proceedings initiated against brokers was lower in 2005-06 than that in 2004-05 (Table 3.19). Adjudication proceedings initiated against broking entities were 22 in 2005-06 compared to 29 in the previous year. During 2005-06, the total number of warnings issued to brokers and sub-brokers was higher at 45 compared to 30 in the previous year.

Among other intermediaries, enquiry and adjudication proceedings (one each) were initiated against a Registrar to an Issue during the year. Two enquiry cases, one each relating to Depository Participant and

Registrar to an Issue, were completed during 2005-06. Three adjudication cases, completed during the year, related to one DP and two Registrars to the Issue. Moreover, warning / advice letters were issued to 25 Depository Participants and to 8 Merchant Bankers in 2005-06 (Table 3.20).

Table 3.20: Enquiry and Adjudication Proceedings against Other Intermediaries

		Depository Participant	Registrar to the Issue	Merchant Banker	Under-writer	Total
1	2	3	4	5	6	7
Enquiry Proceedings	Initiated	—	1	—	—	1
	Completed	1	1	—	—	2
Adjudication Proceedings	Initiated	—	1	—	—	1
	Completed	1	2	—	—	3
Administrative Warning / Advise Letters Issued	—	25	—	8	—	33

III. Regulatory Actions Against Stock Exchanges under Delegated Powers and Functions

The following regulatory actions were initiated by SEBI during 2005-06 under delegated powers and functions:

- i. Magadh Stock Exchange Association (MSEA) was directed not to assist, regulate or control the dealings in securities in any manner whatsoever until further directions *vide* interim order dated August 19, 2005 under Section 19 of the SEBI Act, read with Section 12A of the Securities Contracts (Regulation) Act, 1956.
- ii. Further, Shri C. M. Pandey, Officiating Executive Director (OED) of MSEA was suspended from acting as OED or in any capacity in MSEA or in any other institution related to the securities market till further orders.
- iii. The above interim order dated August 19, 2005 was confirmed *vide* order dated December 6, 2005.
- iv. In view of various violations like non-recovery of dues / shortfall in base minimum capital from members and inadequate infrastructure facilities, the Governing Board of Cochin Stock Exchange Ltd. was directed to be more vigilant, cautious and careful in future in discharge of its functions as a self regulatory organisation *vide* order dated February 2, 2006 under Section 19, read with Section 11 and 11B of the SEBI Act, 1992 and Section 12A of the Securities Contracts (Regulation) Act, 1956.
- v. Shri K. C. Pandey, Executive Director of Uttar Pradesh Stock Exchange Association Ltd. was suspended with effect from August 26, 2005 for alleged misuse of powers.
- vi. In view of various irregularities, violations of the SCRA, the SEBI Act, SEBI circulars and for non-implementation of specific directives of SEBI issued from time to time, a show cause notice dated November 22, 2005 was served under Section 11 of the Securities Contracts (Regulation) Act, 1956 on the Council of Management of Coimbatore Stock Exchange Ltd.
- vii. A show cause notice, dated February 16, 2006, under Section 11 of Securities Contracts (Regulation) Act, 1956 was served on the Governing Board of Madhya Pradesh Stock Exchange for lapses in handling listing application of preferential allotment of shares.

- viii. The Executive Director of Saurashtra Kutch Stock Exchange Limited, who was appointed without prior approval of SEBI, was advised to relinquish his post immediately *vide* letter dated January 6, 2006. Accordingly, the position has been relinquished.
- ix. The supersession of Governing Boards of three stock exchanges was extended twice during 2005-06 (Table 3.21).

repurchase / redemption proceeds to the unit holders. The mutual funds are required to report these cases of delays to SEBI on a bi-monthly basis. During 2005-06, 17 mutual funds paid Rs. 2.57 lakh to 767 investors for delay in despatch as against Rs. 22.04 lakh paid to 12,058 investors in 2004-05 (Table 3.22). Due to action by SEBI making it mandatory to pay interest for the delays, such cases have declined considerably from the previous year.

IV. Regulatory Actions Against Mutual Funds

a. Warning and Deficiency Letters

During 2005-06, four warning letters were issued to four mutual funds on the basis of monitoring through various periodic reports considering the magnitude and seriousness of violations of SEBI Regulations. Of these, three warnings were issued for violating the investment restrictions and one was issued for violation of advertisement code.

b. Payment of Penal Interest

SEBI has made it mandatory that mutual funds must pay interest @ 15 per cent per annum for delays in the despatch of

V. Regulatory Actions under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997

During 2005-06, 16 cases were referred for adjudication under Section 15 of the SEBI Act, 1992 for alleged violation of the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. During the year, a sum of Rs. 89,57,000 was received as monetary penalty.

7. PROSECUTION

I. Trends in Prosecution

During 2005-06, the number of prosecution cases launched was significantly

Table 3.21: Supersession of Governing Boards of Stock Exchanges during 2005-06

Sr. No.	Stock Exchange	Date of Notifications	Period
1	2	3	4
1.	The Uttar Pradesh Stock Exchange Association Ltd.	June 30, 2005 March 28, 2006	Supersession extended w.e.f. July 12, 2005 to March 31, 2006. Supersession extended w.e.f. April 1, 2006 to September 30, 2006.
2.	The Calcutta Stock Exchange Association Ltd.	June 29, 2005 March 28, 2006	Supersession extended w.e.f. July 1, 2005 to March 31, 2006. Supersession extended w.e.f. April 1, 2006 to September 30, 2006.
3.	Bhubaneswar Stock Exchange Limited	June 30, 2005 March 28, 2006	Supersession extended w.e.f. July 3, 2005 to March 31, 2006. Supersession extended w.e.f. April 1, 2006 to September 30, 2006.

Table 3.22: Interest Paid by Mutual Funds to the Investors for Delayed Redemptions / Repurchases

Bi-monthly Mutual Fund	May-05		Jul-05		Sep-05		Nov-05		Jan-06		Mar-06		Fund-wise Total	
	Rs.	Inves- tors	Rs.	Inves- tors	Rs.	Inves- tors	Rs.	Inves- tors	Rs.	Inves- tors	Rs.	Inves- tors	Rs.	Inves- tors
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Birla MF	1,738	1	3,125	9	2,353	5	420	1	0	0	1,307	7	8,942	23
Fidelity MF	0	0	62	2	0	0	11,250	6	422	4	62	2	11,797	14
HDFC MF	4,215	2	1,156	4	8,359	16	80	4	889	7	2,583	10	17,283	43
HSBC MF	156	1	344	2	23,919	3	2,410	3	409	2	0	0	27,239	11
ING Vysya MF	0	0	0	0	0	0	0	0	139	14	0	0	139	14
J M Financial MF	669	2	260	6	4,121	3	611	2	4,962	7	151	2	10,775	22
Kotak Mahindra MF	0	0	504	6	114	10	94	4	268	9	0	0	980	29
LIC MF	0	0	0	0	8	2	0	0	0	0	0	0	8	2
Prudential-ICICI MF	2,621	5	649	3	900	2	225	1	24,879	6	835	1	30,110	18
Sahara MF	82	2	47	1	0	0	0	0	0	0	0	0	129	3
SBI MF	30,053	13	4,401	4	0	0	0	0	4,976	89	1,811	45	41,242	151
Standard Chartered MF	133	1	0	0	0	0	0	0	0	0	0	0	133	1
Sundaram MF	42	1	18,298	4	0	0	0	0	0	0	218	2	18,558	7
Tata MF	8,078	1	0	0	1,080	3	515	1	531	3	2,206	21	12,410	29
Taurus MF	0.00	0	0	0	0	0	0	0	0	0	7,566	2	7,566	2
Templeton MF	713	3	652	2	85	1	25,267	2	2,453	9	1,566	1	30,716	18
UTI	26,616	182	1,173	13	261	7	2,470	38	3,046	43	5,723	97	39,289	380
TOTAL	75,116	214	30,671	56	41,190	52	43,344	62	42,975	193	24,028	190	2,57,316	767

lower than that in 2004-05 (Table 3.23). The number of persons / entities against whom such cases were launched was also lower at 81 in 2005-06 compared to 410 in the previous year. This was due to the fact that prosecutions launched during the financial years 2001-02, 2003-04 and 2004-05 mostly pertained to bulk of CIS cases and cases relating to securities scam of 2001. Region-wise, 48.5 per cent of total cases launched up to 2005-06 were from the Western Region, followed by 32.1 per cent from the Northern Region (Table 3.24).

II. Nature of Prosecution

The prosecutions were launched under the Companies Act, SEBI Act, Depositories Act, SC(R)A, and the Indian Penal Code (Table 3.25). Of the 1,014 cases, 920 prosecution cases were launched under the SEBI Act, followed by 60 cases under different Sections of Companies Act, 1956.

III. Disposal of Prosecution Cases

Of the 23 court cases decided till March 31, 2006, 15 resulted into convictions, and

Table 3.23: Prosecutions Launched

Year	No. of Cases in which Prosecution have been Launched	No. of Persons/ Entities against whom Prosecution have been Launched
1	2	3
Up to and including 1995-96	10	58
1996-97	13	63
1997-98	11	81
1998-99	15	145
1999-00	23	121
2000-01	20	98
2001-02	115	613
2002-03	229	848
2003-04	468	2,377
2004-05	84	410
2005-06	26	81
Total	1,014	4,895

three were dismissed. Out of the remaining five cases, three were compounded, one abated and another one was withdrawn (Table 3.26).

IV. Litigations, Appeals and Court Pronouncements

Tables 3.27 and 3.28 present details with regard to cases lying before the Courts/

Table 3.24: Region-wise Data on Prosecution Cases up to March 31, 2006

Region	Number of Cases	Percentage of Total
1	2	3
Northern Region	326	32.1
Western Region	491	48.5
Southern Region	112	11.0
Eastern Region	85	8.4
Total	1,014	100.00

Table 3.25: Nature of Prosecutions Launched up to March 31, 2006

Nature of Prosecution Launched	Number of Cases
1	2
Sec. 63, 68 of Companies Act, 1956	18
Sec. 73, 77 and 113 of Companies Act, 1956	42
Indian Penal Code	5
Securities and Exchange Board of India Act, 1992	920
Depositories Act, 1996	13
Securities Contracts (Regulation) Act, 1956	16
Total	1,014

Securities Appellate Tribunal (SAT) and also information on the nature of violations. During 2005-06, 312 cases were filed where SEBI was a party. Further, 81 cases were either withdrawn or allowed or dismissed. During 2005-06, 244 appeals were filed with SAT, compared to 440 in 2004-05. Of the total appeals filed, 281 cases were dismissed/remanded/allowed or modified. As on March 31, 2006, the number of cases pending with SAT was 401 as against 438 a year ago.

Table 3.29 shows appeals under Section 15Z of the SEBI Act, against the order of the SAT. During 2005-06, SEBI filed 10 appeals

Table 3.26: Number of Cases Decided by Courts till March 31, 2006

Decision by Courts	Number of Cases
1	2
Convicted	15
Compounded	3
Abated	1
Dismissed	3
Withdrawn	1
Total	23

Table 3.27: Court Cases where SEBI was a Party during 2005-06

Subject Matter	Cases Filed	Cases Pending	Cases Dismissed / Allowed / Withdrawn
1	2	3	4
Brokers Registration Fees Cases	15	102	18
Collective Investment Scheme	3	33	—
Consumer Forum Cases	14	18	—
General Service Department	5	10	3
Investigations, Enforcement and Surveillance Dept.	12	30	11
Primary Market Department	10	49	18
Secondary Market Department	245	372	24
Takeovers	7	50	1
Mutual Funds	1	19	6
Total	312	683	81

Table 3.28: Appeals before the Securities Appellate Tribunal

Status of Appeals	2004-05	2005-06
1	2	3
Appeals Filed	440	244
Appeals Dismissed/ Remanded/Allowed/ Modified etc	151	281
Appeals Pending*	438	401

* Includes pending cases filed in the previous years.

and other parties filed two appeals against SEBI, of which four cases were dismissed / allowed.

8. RESEARCH ACTIVITIES

The Research Department of SEBI undertakes policy supportive research mostly to meet the requirements of SEBI consistent with Section 11(2)(l) of the SEBI Act, 1992 and the SEBI (Annual Report) Rules, 1994. The core activities of the Department, *inter alia*, include publication of the SEBI Annual Report, SEBI Bulletin and Handbook of Statistics on the Indian Securities Market; preparation of regular reviews, policy notes and country profiles for the use of higher executives; submission of material on capital market to the Government and other outside agencies; interaction with foreign dignitaries, delegates from the Ministry of Finance,

Table 3.29: Details of Appeals under Section 15Z of the SEBI Act against the Order of Securities Appellate Tribunal during 2005-06

Sr. No.	Subject Matter	Cases Filed	Cases Pending	Cases Dismissed / Allowed
1	2	3	4	5
1.	Appeals Filed by SEBI	10	7	3
2.	Appeals Filed by other Parties against SEBI	2	1	1
	Total	12	8	4

including the Standing Committee on Finance, on various issues relating to the capital market. Since September 2005, the Department was entrusted with the responsibility of sending a weekly report on the securities market developments to the Ministry of Finance. In addition to the regular items of work, the Department conducted a special workshop on securities market for the financial journalists during 2005-06. The Department also contributed to market surveillance by preparing policy notes on block deals, volatility, corporate profits, besides forwarding regular reviews / data on capital market in India and abroad. The Research Department co-ordinated the submission of Action Taken Report (ATR) on JPC to the Union Government. The Department also initiated work relating to Investor Survey in the Indian securities market.

Three research articles *viz.*, 'Options for a Bond Market in India', 'Integration of Capital Market in SAARC Region: Current Issues and Perspectives', and 'Volatility and Liquidity in Stock Prices: Co-existence or Correlation?'

were published. While the first one was published in *The Hindu Industrial Survey 2006*, the other two were published in SEBI Bulletin. Two research papers, namely, 'Growth of Small and Medium Enterprises: Role of Capital Market' and 'Stock Market Development and Economic Growth in India: A Causal Analysis' were presented at Bankers' Conference 2005, Kolkata and at the 42nd Annual Conference of The Econometric Society of India, held at Amritsar in January 2006. The other major research notes/ policy papers prepared by the Department during 2005-06, *inter alia*, include: (a) Gross Domestic Savings in India: Recent Trends; (b) Freezing of Demat Account before the Commencement of Trading: A Case Study; (c) Alert System in Securities Markets in India and Abroad; (d) A Case for Single Financial Services Ombudsman in India; (e) Central Public Sector Enterprise: Developing Global Competitiveness; (f) Indian Securities Market: Growth and Stability; and (g) Capital Market Reforms in India: Recent Initiatives.