PLUTUS IAS
CURRENT AFFAIRS
Argasia Education PVT. Ltd. (GST NO.-09AAPCAI478E1ZH)
Address: Basement C59 Noida, opposite to Priyagold Building gate, Sector 02, Pocket I, Noida, Uttar Pradesh, 201301, CONTACT NO:-8448440231

Date –14 Aug 2024

SEBI: A ROLLER COASTER RIDE FOR THE REGULATOR

SEBI: A Roller Coaster Ride for the Regulator

This article covers "Daily Current Affairs" and details the topic of SEBI its role and responsibilities.

Syllabus mapping:

GS- 3: Indian economy and various regulatory institutions.

For Prelims:

What is the SEBI, Short selling ?

For Mains:

What are the functions and powers of the SEBI, various issues associated with its functioning, and various recommendations by the committees to make it more efficient?

Why In the News?

Hindenburg Research has recently brought forth serious allegations regarding SEBI Chairperson Madhabi Buch and her husband, claiming their investments in offshore funds are linked to Adani Group's alleged financial misconduct. According to Hindenburg, these investments could indicate a conflict of interest and raise questions about SEBI's effectiveness in overseeing the Adani Group's financial activities.

Who is the Hindenburg Research?

Hindenburg Research is a US based, financial research firm specializing in forensic analysis and investigative research. Founded by Nate Anderson in 2017, the firm is known for its in-depth investigations into publicly traded companies, focusing on uncovering financial irregularities, corporate governance issues, and potential fraud.

What is Short Selling?

Short selling is a trading strategy used to profit from an anticipated decline in the price of a security. It involves borrowing shares of a stock (or other financial instruments) that the investor does not own, selling them at the current market price, and then repurchasing them later at a lower price to return to the lender.

HOW SHORT SELLING WORKS

Borrowing Shares: An investor borrows shares of a stock from a broker. These shares are typically borrowed from the broker's own inventory or from other clients' accounts.

Selling the Borrowed Shares: The investor sells the borrowed shares at the current market price. This action generates cash proceeds from the sale.

Repurchasing Shares: At a later time, the investor buys back the same number of shares, ideally at a lower price than at which they were sold.
Returning Shares: The repurchased shares are returned to the broker to replace the borrowed shares.
Profit or Loss: If the price of the stock has dropped, the investor buys back the shares at a lower price than they sold them for, realizing a profit. Conversely, if the price has risen, the investor incurs a loss.

EXAMPLE OF SHORT SELLING

Initial Sale: An investor believes that Company XYZ's stock, currently trading at $100, will decline. They borrow 100 shares and sell them for $10,000 ($100 x 100 shares).
Repurchase: The stock price drops to $80. The investor buys back 100 shares for $8,000 ($80 x 100 shares).
Return and Profit: The investor returns the borrowed shares and realizes a profit of $2,000 ($10,000 from initial sale – $8,000 for repurchase).

USES OF SHORT SELLING

Speculation: Traders and investors use short selling to profit from expected declines in stock prices. **Hedging:** Investors might short sell to hedge against potential losses in other parts of their portfolio. **Market Efficiency:** Short selling can contribute to market efficiency by exposing overvalued stocks and providing liquidity.

What is the SEBI?

The Securities and Exchange Board of India (SEBI): The Securities and Exchange Board of India (SEBI) was established on April 12, 1988, by the Government of India to ensure the smooth functioning of the capital market. SEBI gained statutory authority through an ordinance issued on January 30, 1992. This ordinance was later formalized through the SEBI Act, of 1992, which was amended by the Securities Laws (Amendment) Act, of 1995.

HISTORY OF SEBI

1988: SEBI was established in response to the need for a regulatory framework to manage and oversee the Indian securities market, following a series of market scams and irregularities.
1992: SEBI was given statutory status through the SEBI Act, 1992. This act empowered SEBI with the authority to regulate and supervise the securities market, marking a significant shift towards a more formal and structured regulatory environment.

ORGANIZATIONAL STRUCTURE

Chairperson: Leads SEBI and represents it in official capacities. Appointed by the Government of India.
Members: Includes executive and non-executive members:
1. Two members from the Ministry of Finance
2. One member from the Reserve Bank of India (RBI).
3. One member each from the financial sector and the stock exchanges.
4. Three other members are appointed by the Government (usually experts from fields like law, finance, or business).

Objectives of SEBI

Investor Protection: Safeguard the interests of investors and protect them from fraud and malpractice.

Market Development: Promote and develop the securities market by introducing reforms and innovations to enhance market efficiency and transparency.

Regulation: Regulate market intermediaries, including brokers, investment advisors, and portfolio managers, to ensure they adhere to fair practices and standards.

Transparency: Enhance the transparency of the securities market by enforcing disclosure norms and regulations.

Efficient Markets: Ensure the orderly functioning of the securities markets by maintaining a fair and efficient trading environment.

Functions of SEBI

SEBI performs several key functions to achieve its objectives of protecting investors, ensuring market integrity, and promoting market development. To meet its three primary objectives—protective, regulatory, and developmental—SEBI carries out the following functions:

1. PROTECTIVE FUNCTION

The protective function of SEBI is aimed at safeguarding the interests of investors and ensuring the safety of their investments. Key activities under this function include:

Price Rigging Prevention: SEBI works to prevent the manipulation of securities prices, which can artificially inflate or depress the market price of securities. This involves monitoring and investigating any activities that could lead to price rigging and taking necessary action against those involved.

Regulation of Insider Trading: SEBI prohibits insider trading, which is the use of non-public, material information by individuals to make profits in the securities market. This practice undermines market integrity and fairness, and SEBI actively works to detect and penalize insider trading activities.

Prevention of Fraudulent and Unfair Trade Practices: SEBI ensures that companies do not engage in misleading or deceptive practices that could mislead investors. This includes prohibiting fraudulent activities, misstatements, and any unfair practices that might influence the buying or selling decisions of securities.

Investor Education: SEBI undertakes various initiatives to educate investors, helping them understand the securities market better. By providing information and resources, SEBI aims to empower investors to evaluate different securities and make informed investment decisions.

2. REGULATORY FUNCTION

The regulatory function of SEBI involves overseeing and enforcing rules and regulations in the securities market to maintain orderly conduct and prevent market abuses. This includes:

Regulating Market Intermediaries: SEBI oversees and regulates market intermediaries such as brokers, investment advisors, portfolio managers, and mutual funds to ensure they operate fairly and adhere to prescribed standards.

Issuance and Trading Regulations: SEBI formulates and enforces regulations concerning the issuance and trading of securities. This includes setting rules for public offerings, secondary market transactions, and the conduct of market participants.

Surveillance and Monitoring: SEBI continuously monitors market activities to detect and address any irregularities or violations. This includes using technology and data analytics to enhance surveillance capabilities and ensure compliance with market regulations.

3. DEVELOPMENTAL FUNCTION

The developmental function of SEBI focuses on fostering the growth and development of the securities market. Key activities include:

Market Infrastructure Improvement: SEBI works on enhancing the infrastructure of the securities market, including trading systems, clearing and settlement mechanisms, and other market facilities.

Promotion of New Products: SEBI encourages the introduction and development of new financial products and instruments, such as derivatives and alternative investment funds, to meet the evolving needs of investors and market participants.

Facilitation of Market Efficiency: SEBI aims to improve the efficiency and transparency of the market by introducing reforms and regulations that promote fair trading practices and reduce market inefficiencies.

Powers of SEBI

SEBI possesses several powers to effectively regulate and oversee the securities market:

Periodical Returns: SEBI has the authority to call for periodic returns from recognized stock exchanges to monitor their operations and compliance.

Listing of Securities: SEBI can compel public companies to list their securities on stock exchanges, promoting market transparency and accessibility.

Levy of Fees: SEBI has the power to levy fees for regulatory activities, supporting its operational needs.

Information and Explanations: SEBI can demand information or explanations from stock exchanges and their members to ensure adherence to regulations.

Approval of Byelaws: SEBI approves the byelaws of recognized stock exchanges, ensuring that their rules align with regulatory standards.

Control and Regulation: SEBI controls and regulates stock exchanges to maintain orderly market operations.

Directing Inquiries: SEBI can direct inquiries into the affairs of stock exchanges and their members to investigate and address any issues or violations.

SEBI's primary roles and responsibilities:

Effective Surveillance: SEBI strives to create a robust surveillance mechanism to monitor the securities market and ensure compliance with regulations.

Encouraging Accountability: SEBI promotes responsible and accountable behavior among market participants, adhering to established rules and regulations.

Policy Review and Regulation: SEBI continuously reviews and updates its policies and regulations to address emerging market trends and ensure effective market growth.

Dematerialization: SEBI has facilitated the dematerialization of securities, streamlining the trading process and improving market efficiency.

Market Development: SEBI has taken steps to enhance the development of both primary and secondary markets, including improvements in the clearing and settlement systems.

Establishment of Depositories: SEBI has supported the establishment of depositories such as NSDL (National Securities Depository Limited) and CDSL (Central Depository Services Limited), and a clearing corporation, NSCCL (National Securities Clearing Corporation Limited), to facilitate efficient and secure securities transactions.

Various Regulations

SEBI Act, 1992: Provides SEBI with statutory powers and outlines its responsibilities and functions.

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015: Regulates the disclosure and compliance requirements for listed companies.

SEBI (Prohibition of Insider Trading) Regulations, 2015: Addresses insider trading and outlines penalties for violations.
SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011: Governs the acquisition of substantial shares and takeovers of listed companies.
SEBI (Mutual Funds) Regulations, 1996: Regulates mutual funds and their operation.
SEBI (Alternative Investment Funds) Regulations, 2012: Provides guidelines for alternative investment funds.

Issues and challenges associated with SEBI

Conflicts of Interest: Concerns about potential conflicts of interest within SEBI and among its officials. The ongoing controversy is the best example of a conflict of interest.
Regulatory Overlap and Coordination: There are instances of overlap with other regulatory bodies like the Reserve Bank of India (RBI) and the Ministry of Corporate Affairs (MCA), leading to confusion and inefficiencies.
Market Manipulation: Despite efforts, market manipulation and fraudulent activities continue to pose challenges, requiring constant vigilance and improved enforcement mechanisms.
Investor Protection: Ensuring comprehensive protection for all types of investors, especially retail investors, remains an ongoing concern, particularly in light of complex financial products and market dynamics.
Technology and Cybersecurity: As market operations become increasingly digital, SEBI must address cybersecurity threats and ensure robust technology infrastructure to prevent data breaches and fraud.
Enforcement Challenges: Difficulties in enforcing regulations consistently and effectively.
Transparency Issues: Calls for greater transparency in SEBI's decision-making processes and operations have been made by scholars. The ongoing instances show that transparency is lacking in decision-making.

Recommendations suggested by the various committees.

K. R. Gupta Committee (2008):
Strengthening Governance: Recommendations often include enhancing governance structures within SEBI to avoid conflicts of interest and ensure that decisions are made impartially. This might involve clearer rules for disclosure and management of personal and professional interests.
U.K. Sinha Committee (2013):
Regulatory Framework: Suggested measures to strengthen SEBI's regulatory framework, including the need for clearer guidelines and better coordination with other regulators.
N. R. Narayana Murthy Committee (2011):
Corporate Governance: Recommended enhancements in corporate governance standards and transparency within the securities market.
Investor Protection: Advocated for measures to improve investor protection and confidence in the market.
Chandrashekhar Committee (2015):
Market Transparency: Recommended measures to enhance market transparency and efficiency, including improvements in reporting and disclosure practices.
Financial Market Regulation: Addressed the need for comprehensive regulation of financial markets and intermediaries to prevent market abuses.
T.K. Viswanathan Committee (2018):
Legal and Regulatory Framework: Proposed reforms to strengthen the legal and regulatory framework for securities markets, including changes to improve the adjudication process and enforcement of regulations.

Streamlining Regulations: Suggested streamlining regulations to reduce complexity and improve market accessibility for investors and intermediaries.

Apart from the above recommendations the following are ways to make the SEBI more relevant to the present needs and challenges:

Improved Enforcement: This can be done by enhancing Resources, Use Advanced Technology, and Speed Up Compliance

Independent Audits: Conduct independent audits to identify and address shortcomings.

Focus on Monitoring, Not Over-Regulation: Prioritize monitoring over stringent regulation to maintain market integrity.

Cross-Border Cooperation: Collaborate Internationally: Work with global regulators and industry professionals.

Development of Self-Regulatory Organizations (SROs): Guide market sub-systems to become self-regulating.

Conclusion:

The Securities and Exchange Board of India (SEBI) plays a pivotal role in regulating and developing India's capital markets, ensuring their integrity, efficiency, and growth. With over thirty years of experience and a deep-rooted market history of more than a century, SEBI's functions—spanning protective, regulatory, and developmental roles—are crucial for maintaining market stability and investor confidence.

Prelims questions:

Q. Which of the following best describe the short selling?

A. It is a trading strategy where an investor borrows shares, sells them at the current market price, and later buys them back at a lower price to profit from the decline

B. It is the illegal act of buying or selling a company's stock based on non-public, material information, undermining market fairness and transparency.

C. It is a standardized contracts to buy or sell an asset at a predetermined future date and price, used for hedging against price fluctuations or speculating on future price movements.

D. It is an financial contracts whose value is derived from the performance of an underlying asset, index, or rate. They are used for hedging, speculation, or arbitrage.

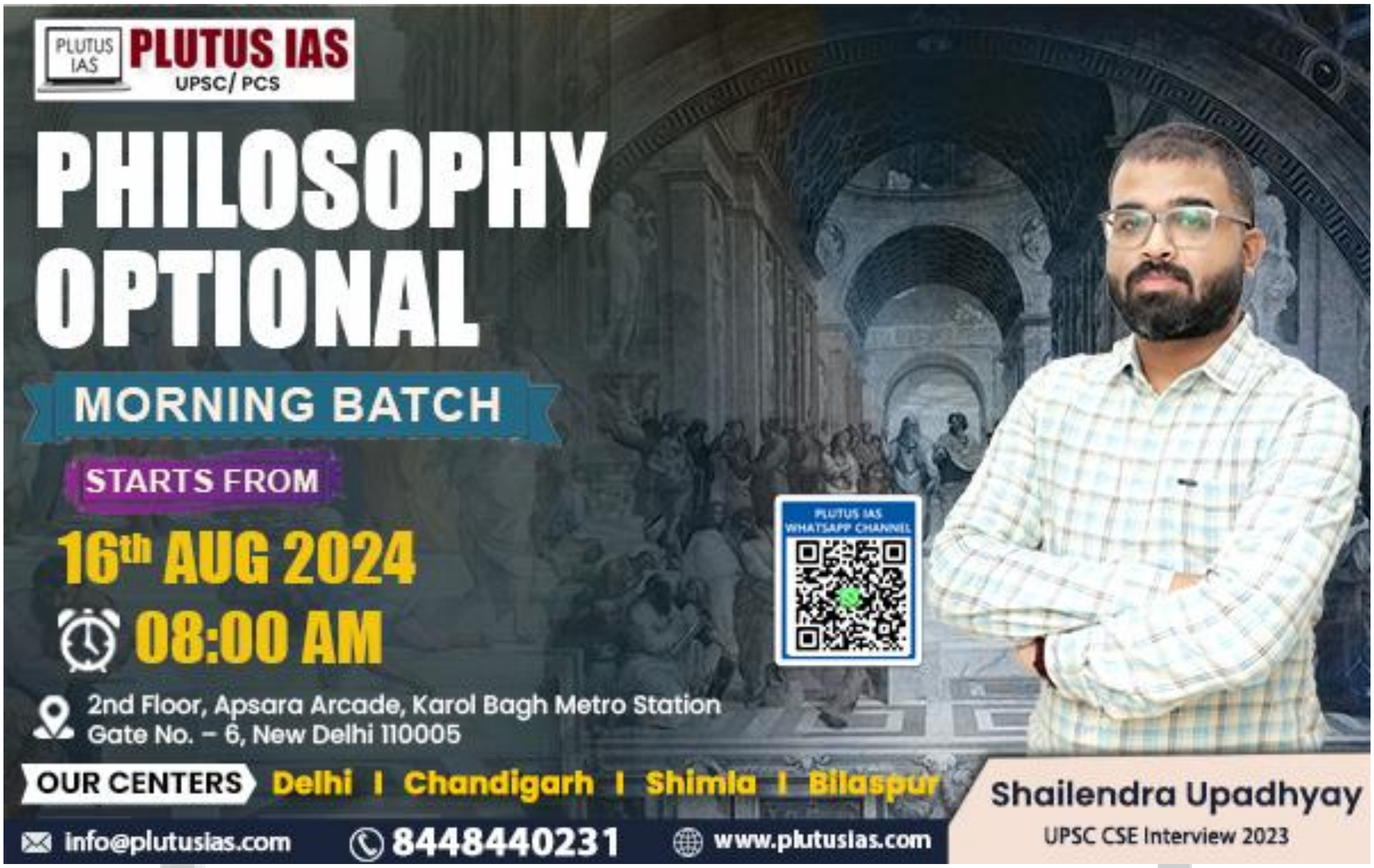
ANSWER: A.

MAINS QUESTION:

"How can SEBI enhance its role in maintaining market integrity and investor confidence while effectively managing and mitigating potential conflicts of interest within its regulatory framework?"

(150 words 10 marks)

MundeDhananjayNavnath


PLUTUS IAS
PLUTUS IAS
UPSC/ PCS
PHILOSOPHY OPTIONAL
MORNING BATCH
STARTS FROM
16th AUG 2024
08:00 AM
PLUTUS IAS WHATSAPP CHANNEL
2nd Floor, Apsara Arcade, Karol Bagh Metro Station
Gate No. – 6, New Delhi 110005
OUR CENTERS Delhi | Chandigarh | Shimla | Bilaspur
Shailendra Upadhyay
UPSC CSE Interview 2023
info@plutusias.com
8448440231
www.plutusias.com