SECONDARY MARKET AND ITS REGULATION

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Abstract
This paper examines the role of SEBI for the financial market and also the corporate objective, function in corporate productivity and efficiency. In this paper a great stress is taken to discuss the regulation and regulatory body for the financial market. Here, we discuss mainly the secondary market and its regulation. Secondary market is those markets where the already traded shares or financial instruments are traded. In this paper we briefly discuss about the various markets and try to examine the difference between all. Different types of shares and financial securities are traded in the secondary market, which is categorically dealt in this paper. We are also supposed to discuss here the various functions of this market and importance as well.

SEBI is a body which is regulatory body and gives certain directions to the market and also imposes the various restrictions on the market. SEBI plays various function like regulatory function, developmental function etc. These all are deeply discussed in this paper.

Keywords: Financial Market, Secondary Market, SEBI, Regulatory function

Introduction
The secondary market, also called aftermarket, is the financial market in which previously issued financial instruments such as stock, bonds, options, and futures are bought and sold. Another frequent usage of "secondary market" is to refer to loans which are sold by a mortgage bank to investors such as Fannie Mae and Freddie Mac. The term "secondary market" is also used to refer to the market for any used goods or assets, or an alternative use for an existing product or asset where the customer base is the second market (for example, corn has been traditionally used primarily for food production and feedstock, but a "second" or "third" market has developed for use in ethanol production) [1]. With primary issuances of securities or financial instruments, or the primary market, investors purchase these securities directly from issuers such as corporations issuing shares in an IPO or private placement, or directly from the federal government in the case of treasuries. After the initial issuance, investors can purchase from other investors in the secondary market. The secondary market for a variety of assets can vary from loans to stocks, from fragmented to centralized, and from illiquid to very liquid. The major stock exchanges are the most visible example of liquid secondary markets in this case, for stocks of publicly traded companies. Exchanges such as the New York Stock Exchange, London Stock Exchange and NASDAQ provide a centralized, liquid secondary market for the investors who own stocks that trade on those exchanges [2]. Most bonds and structured

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[1] Available at https://www.google.co.in/url?url=https://www.investopedia.com/terms/s/secondarymarket.asp&rct=j&sa=U&ved=2ahUKEwid58vH96raAhWEOI8KHdU5C0YQFjAMegQICBAB&q (last seen on 02/03/2018)
[2] Available at https://www.google.co.in/url?url=https://www.investopedia.com/terms/s/secondarymarket.asp&rct=j&sa=

products trade "over the counter," or by phoning the bond desk of one's broker dealer. Loans sometimes trade online using a Loan Exchange.

In simple words, secondary market is a market where the existing shares or securities are traded. It is an option available to the holder to trade his securities and convert those assets into cash or kind. SEBI is a body which has regulatory body and gives certain directions to the market and also imposes the various restrictions on the market.

Understanding of financial market in India

Before discussing and understanding of the secondary market and its regulation it is important to discuss about financial market. Generally speaking, there is no specific location place or location to indicate a financial market. Whenever a financial transaction takes place it is deemed to have been taken place in the financial market. Hence financial markets are pervasive in nature since financial transactions are themselves very pervasive throughout the economic system.

However financial markets can be referred to as those centers and arrangements which facilitate buying and selling of financial assets, claims and services. In India the financial markets are divided into following;

- Unorganized Markets
- Organized Markets

Organized markets can be further classified into money and capital market.

- Money market
- Capital market

Money Market:

Money market is a market for debt securities that pay off in the short term usually less than one year, for example the market for 90-days treasury bills. This market encompasses the trading and issuance of short term non equity debt instruments including treasury bills, commercial papers, bankers acceptance, certificates of deposits, etc[3].

Capital Market: Capital market is a market for long term debt and equity shares. In this market, the capital funds comprising of both equity and debt are issued and traded, this also includes private placement sources of debt and equity as well as organized markets like stock exchanges.

Capital market can be further divided into primary and secondary markets.

Finally capital market is again divided into three categories as follows[4];

- Industrial Securities market
- Government securities Market
- Long term Issues Market

Industrial Securities Market is generally classified into two types. They are

1. Primary Market
2. Secondary Market

Secondary Market

Secondary Market refers to a market where securities are traded after being initially offered to the public in the primary market

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[3] S.R. Myneni., Law of Investment and Securities 241 (Asia Law House, Hyderabad, 1st edn., 2012).

[4] *Ibid.*

or listed on the Stock Exchange[5]. Majority of the trading is done in the secondary market. Secondary market comprises of equity markets and the debt markets. For the general investor, the secondary market provides an efficient platform for trading of his securities. For the management of the company, Secondary equity markets serve as a monitoring and control conduit by facilitating value enhancing control activities, enabling implementation of incentive-based management contracts, and aggregating information (via price discovery) that guides management decisions.

The term "secondary market" is also used to refer to the market for any used goods or assets, or an alternative use for an existing product or asset where the customer base is the second market (for example, corn has been traditionally used primarily for food production and feedstock, but a "second" or "third" market has developed for use in ethanol production). With primary issuances of securities or financial instruments, or the primary market, investors purchase these securities directly from issuers such as corporations issuing shares in an IPO or private placement, or directly from the federal government in the case of treasuries [6]. After the initial issuance, investors can purchase from other investors in the secondary market. The secondary market for a variety of assets can vary from loans to stocks, from fragmented to centralized, and from illiquid to very liquid. The major stock exchanges are the most visible example of liquid secondary markets in this case, for stocks of publicly traded companies. Exchanges such as the New York Stock Exchange, London Stock Exchange and NASDAQ provide a centralized, liquid secondary market for the investors who own stocks that trade on those exchanges. Most bonds and structured products trade "over the counter," or by phoning the bond desk of one's broker dealer. Loans sometimes trade online using a Loan Exchange.

Functions of Secondary Market:

In the secondary market, securities are sold by and transferred from one investor or speculator to another. It is therefore important that the secondary market be highly liquid (originally, the only way to create this liquidity was for investors and speculators to meet at a fixed place regularly; this is how stock exchanges originated, see History of the Stock Exchange). As a general rule, the greater the number of investors that participate in a given market place and the greater the centralization of that market place, the more liquid the market[7].

Fundamentally, secondary markets mesh the investor's preference for liquidity (i.e., the investor's desire not to tie up his or her money for a long period of time, in case the investor needs it to deal with unforeseen circumstances) with the capital user's preference to be able to use the capital for an extended period of time.

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[5] Dr. S Gurusamy, *Financial Services* 492 (Mc Graw Hill (India) Private Limited, New Delhi, 2nd edn., 2013).

[6] Available at https://www.google.co.in/url?url=https://economictimes.indiatimes.com/definition/secondary-market&rct=j&sa=U&ved=2ahUKEwid58vH96raAhWEOI8KHdU5C0YQFjANegQIBhAB&q (last seen on 05/03/2018)

[7] Supra note 5 at 503

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Instrument dealt in the secondary market

Following are the main financial products or instruments dealt in the secondary market:

Equity: The ownership interest in a company of holders of its common and preferred stock. The various kinds of equity shares are as follows[8]:-

Equity Shares:

An equity share, commonly referred to as ordinary share also represents the form of fractional ownership in which a shareholder, as a fractional owner, undertakes the maximum entrepreneurial risk associated with a business venture. The holders of such shares are members of the company and have voting rights.

Bonus Shares: Shares issued by the companies to their shareholders free of cost by capitalization of accumulated reserves from the profits earned in the earlier years.

Preferred Stock / Preference Shares: Owners of these kinds of shares are entitled to a fixed dividend or dividend calculated at a fixed rate to be paid regularly before dividend can be paid in respect of equity share. They also enjoy priority over the equity shareholders in payment of surplus. But in the event of liquidation, their claims rank below the claims of the company's creditors, bondholders / debenture holders.

Cumulative Preference Shares: A type of preference shares on which dividend accumulates if remains unpaid. All arrears of preference dividend have to be paid out before paying dividend on equity shares.

Cumulative Convertible Preference Shares: A type of preference shares where the dividend payable on the same accumulates, if not paid. After a specified date, these shares will be converted into equity capital of the company.

Participating Preference Share: The right of certain preference shareholders to participate in profits after a specified fixed dividend contracted for is paid. Participation right is linked with the quantum of dividend paid on the equity shares over and above a particular specified level.

Security Receipts: Security receipt means a receipt or other security, issued by a securitisation company or reconstruction company to any qualified institutional buyer pursuant to a scheme, evidencing the purchase or acquisition by the holder thereof, of an undivided right, title or interest in the financial asset involved in securitisation.

Government securities (G_Secs): These are sovereign (credit risk free) coupon bearing instruments which are issued by the Reserve Bank of India on behalf of Government of India, in lieu of the Central Governments market.

Borrowing programme: These securities have a fixed coupon that is paid on specific dates on half yearly basis. These securities are available in wide range of maturity dates, from short dated (less than one year) to long dated (up to twenty years).

Debentures: Bonds issued by a company bearing a fixed rate of interest usually

[8] Dr. G.K Kapoor and Sanjay Dhamija, Company law, 171 ,(University Edition 20th Edn.,2017).

payable half yearly on specific dates and principal amount repayable on particular date on redemption of the debentures. Debentures are normally secured / charged against the asset of the company in favour of debenture holder.

Bond: A negotiable certificate evidencing indebtedness. It is normally unsecured. A debt security is generally issued by a company, municipality or government agency. A bond investor lends money to the issuer and in exchange, the issuer promises to repay the loan amount on a specified maturity date. The issuer usually pays the bond holder periodic interest payments over the life of the loan. The various types of Bonds are as follows-

Zero Coupon Bond: Bond issued at a discount and repaid at a face value. No periodic interest is paid. The difference between the issue price and redemption price represents the return to the holder. The buyer of these bonds receives only one payment, at the maturity of the bond.

Convertible Bond: A bond giving the investor the option to convert the bond into equity at a fixed conversion price.

Commercial Paper: A short term promise to repay a fixed amount that is placed on the market either directly or through a specialized intermediary. It is usually issued by companies with a high credit standing in the form of a promissory note redeemable at par to the holder on maturity and therefore, doesn't require any guarantee. Commercial paper is a money market instrument issued normally for tenure of 90 days.

Treasury Bills: Short-term (up to 91 days) bearer discount security issued by the Government as a means of financing its cash requirements.

Process of Trading in Secondary Market: The Procedure of trading in securities can be explained with the help of an example given below[9]:

- **Placement of Order and Execution of Transaction:** Investor A want to sell 1000 shares of ONGC Ltd and Investor B want to purchase the same shares. Both the investors would first contact their respective brokers. Let X be the broker of A and Y be the broker of B. A would place his sell order through X and B would place his buy order through Y. The Transaction would take place only if the price of the two investors would match. Now brokers X and Y will have to issue contract notes to their respective client A and B respectively. The contract note is an evidence of the fact that the broker has executed a transaction in a given security for his client.

- **Payment and Delivery**: The seller client A after receiving the contract note will have to transfer shares in the broker account and the buyer client, B, after receiving the contract note from his broker will have to deposit money in the brokers account for the shares purchased by him

[9] Available at https://www.google.co.in/url?url=http://www.businessdictionary.com/definition/secondary-market.html&rct=j&sa=U&ved=2ahUKEwid58vH96raAhWEOI8KHdU5C0YQFjAOegQIBxAB (last seen on 15/03/2018)

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- **Settlement of Transaction in stock exchange**: The stock exchanges have the responsibility of settling the transactions among its brokers. Therefore for each trading day, there is pay in and pay out of securities and funds.

- The Brokers X and Y after having received funds and shares for their respective clients would transfer them in their account.

SECURITIES & EXCHANGE BOARD OF INDIA

Under various circumstances, the government felt the need for setting up of an apex body to develop and regulate the stock market in India. Eventually, the Securities and Exchange Board of India (SEBI) was set up on April 12, 1988. To start with, SEBI was set up as a non statutory body. It took all most four years for the government to bring about a separate legislation called Securities & Exchange Board of India Act, 1992. The Act conferred SEBI comprehensive powers all aspects capital market operation. The SEBI is the regulatory authority established under Section 3 of SEBI Act I992 to protect the interests of the investors in securities and to promote the development of, and to regulate, the securities market and for matters connected herewith and incidental thereto[10].

Objectives

According to the preamble of the SEBI Act, the primary objects of the SEBI are to promote healthy and orderly growth of the securities market and secure investor protection. For this purpose, the SEBI monitors the activities of not only stock exchanges but also merchant bankers etc. The objectives of SEBI are as follows:

- To protect the interest of investors so that there is a steady flow of savings in to the capital market.
- To regulate the securities market & ensure fare practices by the issuers of securities so that they can raise resource at minimum cost.
- To promote efficient services by brokers, merchant bankers & other intermediaries so that they become competitive and professional.

Functions

Section 11 of the SEBI Act specifies the functions as follows[11]:

Regulatory Functions:

- Regulation of stock exchange and if regulatory organizations.
- Registration and regulations of stock brokers, sub brokers, registrar to all issue Merchant Bankers, Underwriters, Portfolio Managers and such other intermediaries who are associated with securities market.
- Registration and regulation of the working of the collective investment schemes including mutual funds.

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[10] Available at https://www.google.co.in/url?url=https://www.urbanpro.com/stock-market-investment/what-is-secondary-market-and-sebi&rct=j&sa=U&ved=2ahUKEwiG-Y2c (last seen on 18/03/2018)

[11] M. Y Khan, Indian Financial System 5.10 (MC Graw Hill Education 9th Edn.)

- Prohibition of fraudulent and unfair trade practices relating to securities market.
- Prohibition of insider trading in securities
- Calculating substantial acquisitions of shares and takeover of companies.

Developmental Functions[12]:

- Promoting investors education
- Training of intermediaries
- Conducting research and public information useful to all market participants
- Promoting Self Regulatory Organizations powers SEBI has been vested with the following powers

i. To call periodical returns from recognized stock exchanges.
ii. To call any information or explanations from recognized stock exchanges or their members.
iii. To direct enquiries to be made in relation to affairs of stock exchanges of their
iv. To grant approval to bye laws of recognized stock exchanges.
v. To make or amend bye laws of recognized stock exchanges.
vi. To compel listing of securities by public companies.
vii. To control and regulate stock exchanges.
viii. To grant registration to market intermediaries.
ix. .To levy fees or other charges for carrying out the purpose of regulation.
x. To declare applicability of Section 17 of the securities contract Organizations.

Necessities for Setting up of SEBI

Stock market regulation was a pre independence phenomenon in India. During the I World War period, in the Defense Rules of India, 1943, provisions were made to check the flow of capital into production of essential commodities. These rules, which were promulgated as a temporary measure continued alter the war and culminated into the Capital Issues (Control) Act, 1947.

This legislation had the following objectives[13]:

- To further the growth of companies with sound capital structure
- To avoid undue congestion or overcrowding of public issues to ensure that investment takes place in conformity with the objectives of Five Year Plan.
- To ensure orderly and healthy growth of capital markets with adequate protection to investors

Controller of Capital Issues (CCI)

For the purpose of achieving the above objectives, an office of the Controller of Capital Issues was set up. It was entrusted with the responsibility of regulating the capital issues in the country. The CCI was vested with the powers to the kind of instruments, size, timing and premium of issue.

Malpractices in Securities Market

With the growth of securities market, the number of malpractices also increased in both the primary and secondary markets. The malpractices were noticed in the case of companies, merchant bankers and broker who are all operating in the market.

A few examples of malpractices are follows:

- Manipulation of Security Prices
- Price rigging

[12] Supra note 11 at 5.7

[13] Com16_9_etext. Module 9,SGTB khalsa college, University of Delhi

- Insider Trading
- Delay in settlement
- Delay in Listing & commencement of Trading.

Deficiencies in the Market:

Besides, the Indian stock market is said to be deficient in the following respects:

- Lack of Diversity in Financial Instrument
- Disclosure of Financial Information
- Preponderance of Speculative Trading
- Poor Liquidity
- Lack of Control over Brokers.

SEBI and the Central Government:

The Central Government has the power to issue directions to the SEBI Board, to supersede the Board, if necessary and to call for returns and report etc. as and when necessary. The Central Government has also powers to give any guidelines or to make regulations and rules for SEBI and its operations. The activities of SEBI are financed by grants from the Government in addition to fees, charges etc. collected by SEBI. The fund called the SEBI General Fund is set up to which all grants, fees, charges etc. are credited. The fund is used to meet the expenses of the board and to pay salaries of staff and remuneration to officers, members of the Board etc[14].

SEBI GUIDELINES:

SEBI has brought out a number of guidelines separately, from time to time, for primary market, secondary market, Mutual funds, merchant bankers, foreign institutional investors, investor protection etc. Here we consider only those relating to the secondary market of India. The guidelines are described below[15].

Stock exchange:

1. Board of directors of stock exchange has to be recognized so as to include nonmembers, public representatives, government representative to the extent of 50% of total no of members.
2. Capital adequacy norms have been laid down for members of various stock exchanges depending upon their turnover of trade and other factors.
3. Working hours for all stocks exchanges have been fixed uniformly.
4. All the recognized stick exchanges will have to inform about the transaction within 24 hours.
5. Guidelines have been issuedfor introducing the system of market making in less liquid scrip's in a phased manner in all stock exchanges

Brokers :

1. Registration of brokers and sub brokers is made compulsory.
2. In order to ensure that brokers are professionally qualified and financially solvent, capital adequacy norms for registration of brokers have been evolved.
3. Compulsory audit of brokers book and filing of audit report with SEBI have been made mandatory.

14 Supra note 13

15 Available at https://www.google.co.in/url?url=https://www.urbanpro.com/stock-market-investment/what-is-secondary-market-and-sebi&rct=j&sa=U&ved=2ahUKEwiG-Y2c (last seen on 25/03/2018)

4. To bring about greater transparency and brokerage separately in the contract notes issued to client.
5. No broker is allowed to underwritemorethan5% of public issue.

Foreign Institutional Investors (FII):
1. Foreign institutional investors have been allowed to invest in all securities traded in primary and secondary markets.
2. There would be no restriction on the volume of the purpose of entry of FIIs.
3. The holding of single FII in a company will not exceed the ceiling of 5% of the equity capital of a company.
4. Disinvestment will be allowed only through stock exchanges in India.
5" FIIs have to pay a concessional tax rate of 10% on large capital gain (more than one year) and 30% on short term capital gains. A tax rate of 20% on dividend and interest is prescribed[16].

Bonus Issue:
The guidelines relating to the issue of bonus shares have undergone several changes since 1969. The latest sets of guidelines announced by SEBI were made effective from April 3, 1994. At present, there are in all 10 guidelines laid down for bonus shares[17].

1. There should be provision in the Articles of Association of the Company for issue of bonus shares. If not, the company should pass a resolution at the General Body Meeting, marketing provision for capitalizations of profits. The proposal for bonus issues is recommended by the Board of Directors and then approved in the general Body Meeting.
2. The bonus is made out of free reserves built out of the genuine profits or share premium collected in cash only.
3. Reserves created by revaluation of fixed assets are not permitted to be capitalized.
4. The declaration of bonus issue in lieu of dividend is not to be made.
5. Bonus issues are not permitted unless the partly paid shares exiting are fully paid up.
6. No bonus issue will be permitted if there are sufficient reasons to believe that the company has defaulted in respect of statutory dues to the employees such as provident fund, gratuity, bonus, etc. Further, no bonus issue is permitted if the Company defaults in payment of principal or fixed deposits or on debentures.
7. No bonus issue can be made within 12 months of any public issue/rights issue.
8. A company which announces bonus issue alter the approval of the Board of direct or must implement the proposals and shall not have the option of changing the decision.
9. Consequent to the issue of bonus shares, if the subscribed and paid up capital exceed the authorized share capital, a resolution shall be passed by the company at its general body meeting for increasing the authorized capital.
10. Issue of bonus shares aner any public/rights issue is subject to the condition that no bonus shall be made which will dilute the value or rights of a holders of debenture, convertible fully or partly.

[16] Available at https://www.googleadservices.com/pagead/aclk?sa=L&ai=DChcSEwiZjayA-KraAhVGDCsKHS-IDqQYABAAGgJzZg&ae=1&ohost=www.google.co.in&cid=CAESEeD2asi_C2N8qP1rfrg97hUl&sig=AOD64_2R2Nhlo3BNNaHRstGCfktQJZ2_vA&q=&ved=2ahUKEwig-aOA (last seen on 28/03/2018)
[17] *Ibid.*

Right Issue:
Section 81 of the Companies Act specifies the conditions to be satisfied by a public company for issuing rights shares. SEBl has issued the following guidelines for the issue of rights share.

1. Composite Issue: A public and rights issue can be made at different prices where these two kinds of issues are made as a composite issue by exiting listed companies.
2. Appointment of Merchant bankers: Appointment of merchant bankers is not mandatory, if the size of rights issue by a listed company does not exceed Rs. 50 lakh. For issues of listed companies exceeding Rs. 50 lakh, the issue is to be managed by an authorized merchant banker.

3. Minimum Subscription: If the company does not receive minimum subscription of 90% of the issue amount including development of underwriters within 120days from the date of opening of issue, the company has to refund the entire subscriptions within 128 days with interest at 15% p.a. for delay beyond 78 days from the date of closure of the issue.

Conclusion

After the above discussion I am trying to conclude my whole research work as, financial market is place where the entire financial instrument is traded. Broadly speaking there is two types of market namely primary market and secondary market. Primary market is a place where a financial instrument is introduced in the market for the trade, where secondary market is a place where existing shares or any financial instrument is traded. As we know for the smooth functioning of any system there must be a regulatory body which regulate that system, similarly for the secondary market there a Security exchange board of India (SEBI). SEBI gives various guideline time to time for the smooth functioning of the same. The main objective of the SEBI is as follows:

- To protect the interest of investors so that there is a steady flow of savings in to the capital market.
- To regulate the securities market & ensure fare practices by the issuers of securities so that they can raise resource at minimum cost.
- To promote efficient services by brokers, merchant bankers & other intermediaries so that they become competitive and professional.

For any business if investor are not protected then there is grave chance that, business will not successes. In case of secondary market as there is chance of malpractice like Manipulation of Security Prices, Price rigging, Insider Trading, and Delay in settlement, Delay in Listing & commencement of Trading etc. To avoid all these malpractices and fair trading of securities in the secondary market, SEBI is very much concern and it may impose reasonable restriction on the secondary market. There is a legislation named security and exchange board of India Act, 1992 which regulates the financial market.

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