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COMMERCE
PAPER No: 10. CORPORATE LEGAL FRAMEWORK
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TABLE OF CONTENTS

- 1. Learning Outcomes**
- 2. Introduction**
- 3. Basic Definitions related to Securities Market**
 - 3.1 Definitions**
- 4. Stock Exchange- Definition and Recognition**
 - 4.1 Definition**
 - 4.2 Procedure for Recognition**
- 5. Corporatization and Demutualization**
 - 5.1 Definition**
 - 5.2 Procedure**
 - 5.3 Powers of Central Government Over Recognized Stock Exchanges**
 - 5.4 Requirements for Listing of Companies**
- 6. Summary**

1. Learning Outcomes

After studying this module, we shall be able to

- Know about the Securities Market.
- Learn about the laws relating to trading of securities in the stock market.
- Identify the steps to be followed for recognition of Stock Exchanges in India.
- Analyze the meaning and procedure of corporatization and demutualization of Stock Exchanges.
- Understand the role played by the Central Government in controlling the function of Recognized Stock Exchanges.
- Learn about the process of listing of companies on a Recognized Stock Exchange.

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2. Introduction

Stock market plays a significant role in development of an economy by mobilizing finance from savers (suppliers) to the corporate (users) of funds. It plays a pivotal role in growth of an economy as it seeks to channelize funds into productive sectors of the economy as and when needed. Also, it ensures safety of investment to the investors and provides them various avenues to maintain their liquidity intact.

Through various legislations governing its functioning, the stock market ensures smooth operations of transactions as well as fair and equitable trade practices. In order to promote fair trade practices and prohibit undesirable dealings, The Securities Contract (Regulation) Act 1956 was enacted by Parliament under Act No. 42 of 1956, and the scope of this Act spreads to all over India.

3. Basic Definitions related to Stock Market

3.1 Definitions:

- "**Contract**" means a contract for or relating to the purchase or sale of securities;
- "**Member**" means a member of a Recognized Stock Exchange;
- "**Option in securities**" means a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities. in future, and includes a teji, mandi, a galli, a put, a call or a put and call in securities;
- "**Prescribed**" means prescribed by rules made under this Act;
- "**Stock exchange**" means anybody of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities. Recognized Stock Exchange means a stock exchange which is for the time being recognized by the Central Government under section 4;

- "**Derivative**" includes—
 - (A) A security derived from a debt instrument, share, loan, whether secured or Unsecured, risk instrument or contract for differences or any other form of Security;
 - (B) A contract which derives its value from the prices, or index of prices, of underlying securities.
- "**Scheme**" means a scheme for Corporatization or Demutualization of a recognized Stock Exchange which may provide for—
 - (i) The issue of shares for a lawful consideration and provision of trading rights in lieu of membership cards of members of a recognized Stock Exchange;
 - (ii) The restrictions on voting rights;
 - (iii) The transfer of property, business, assets, rights, liabilities, recognitions, contracts of the recognized Stock Exchange, legal proceedings by, or against, the recognized Stock Exchange, whether in the name of the recognized Stock

Exchange or any trustee or otherwise and any permission given to, or by, the recognized Stock Exchange;

(iv) The transfer of employees of a recognized Stock Exchange to another Recognized Stock Exchange;

(v) Any other matter required for the purpose of, or in connection with, the Corporatization or Demutualization, as the case may be, of the recognized Stock Exchange;

- **“Securities Appellate Tribunal”** means a Securities Appellate Tribunal established under sub-section (1) of section 15K of the Securities and Exchange Board of India Act, 1992 (15 of 1992);
- **“spot delivery contract”** means a contract which provides for,—
 - (a) Actual delivery of securities and the payment of a price therefore either on the same day as the date of the contract or on the next day, the actual period taken for the dispatch of the securities or the remittance of money therefore through the post being exclude from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality;
 - (b) Transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository.

4. Stock Exchange- Definition and Recognition

4.1 Definition:

According to Securities Regulation Contract Act 1956, a Stock Exchange is defined as:

(a) Anybody of individuals, whether incorporated or not, constituted before Corporatization and Demutualization under sections 4A and 4B, or

(b) A body corporate incorporated under the Companies Act, 1956 (1 of 1956)

Whether under a scheme of Corporatization and Demutualization or otherwise, for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

4.2 Recognition of a Stock Exchange

1) Application for Recognition of Stock Exchanges

- A Stock Exchange which is desirous of seeking recognition must fill an application in prescribed manner to give effect to same.
- Each application must contain the particulars as desired by the act, along with a copy of bye laws of stock exchange and a copy of rules related to constitution of stock exchange in general and in particular.
- Governing body of the stock exchange, its constitution, powers of management and the manner in which its business is conducted.
- Powers and duties of its office bearers, procedure of inclusion of a class of members in the stock exchange and their qualifications.
- The process of suspension, exclusion, expulsion and re- admission of its members.
- Procedure by which partnerships may be admitted as members to Stock Exchange, where permissible; procedure for nomination and appointment of clerks and authorized representatives.

2) Grant of Recognition to Stock Exchanges

The Central Government after being satisfied by inquiry of Stock Exchange as may be necessary in this behalf and after obtaining any information in this regard as:

(a) that the rules and bye-laws of a stock exchange applying for registration are in conformity with such conditions as may be prescribed with a view to ensure fair dealing and to protect investors;

(b) that the Stock Exchange is willing to comply with any other conditions (including conditions as to the number of members) which the Central Government, after consultation with the governing body of the stock exchange and having regard to the area served by the stock exchange and its standing and the nature of the securities dealt with by it, may impose for the purpose of carrying out the objects of this Act, and;

(c) that it would be in the interest of the trade and also in the public interest to grant recognition to the Stock Exchange;
it may grant recognition to the Stock Exchange subject to the conditions imposed upon it as aforesaid and in such form as may be prescribed.

(2) The conditions which the Central Government may prescribe and that it would be in the interest of the trade and also in the public interest to grant recognition to the Stock Exchange; it may grant recognition to the stock exchange subject to the conditions imposed upon it as aforesaid and in such form as may be prescribed.

3) Withdrawal of Recognition

If Central Government is of the opinion that recognition granted to a Stock Exchange should be withdrawn in interest of public or to accommodate provisions of the Act, it shall serve governing body of the required Stock Exchange a written notice of withdrawal and give reasonable notice to them to be heard in the matter; and the Central Government shall withdraw the recognition.

5. Corporatization and Demutualization

5.1 Meaning

Demutualisation means “segregation of membership right in a recognised Stock Exchange into a distinct ownership right through the ownership of shares and distinct trading and/or clearing right of that recognised Stock Exchange”. In simpler terms it is a process by which a mutually owned stock exchange is converted into a company owned by shareholders through transforming its existing legal structure into a business entity.

Corporatisation- Exchanges like BSE were not a corporate entity and needed to be converted from “an association of persons” to a “Company limited by shares”. This process of conversion is termed as “Corporatisation”.

5.2 Procedure

According to the provisions of Section 4B of the Act, all recognized Stock Exchanges shall be corporatized and demutualised from an appointed date determined by SEBI which it shall notify in the official Gazette.

If SEBI is of the opinion that any recognized Stock Exchange has been prevented from being corporatized and demutualised by sufficient cause on same specified date, it shall specify some other date in respect.

Sec1 (4B) of the Act states that recognized Stock Exchanges shall within a time limit submit a scheme for corporatization and demutualization for approval to SEBI. However, any demutualised Stock Exchange need not submit application for the same again.

- On receipt the SEBI as per sub section 1 after making an enquiry in subject matter and after being fully satisfied in such regard, approve the scheme either with or without modification.
- As per sub section 2, SEBI shall not approve a scheme if issue of shares for a lawful consideration for or; provision of trading rights in lieu of membership card of members of a recognized Stock Exchange or; payment of dividend to members have been proposed out any reserves or assets of that Stock Exchange.
- The approved scheme must be immediately published by the SEBI in official gazette: and by the recognized Exchange in 2 daily newspapers specified by SEBI which are circulated in India.
- Where SEBI is of the view and satisfied that scheme is unjust and not in public interest, it may reject the scheme and publish the order of rejection in official gazette.

5.3 POWERS OF CENTRAL GOVERNMENT OVER RECOGNISED STOCK EXCHANGES

- The Central Government has the power to call for periodic inspection of accounts of recognized Stock Exchange and conduct inquiries at any time on any matter it may deem fit for public interest.

- All the recognized Stock Exchanges are required to furnish their annual reports to the Central Government regularly complete in all respects as require by law.
- The Central Government has the power to make rules to be followed by the recognized Stock Exchanges and also to direct them to make or amend some rules.
- The Central Government is fully authorized to supersede the governing body of a recognized Stock Exchange.
- The Central Government has the power to suspend the functioning of any recognized Stock Exchange in case of an emergent situation.
- It has the power to issue directions to all the recognized Stock Exchanges which are to be followed by them.

5.4 REQUIREMENTS WITH RESPECT TO THE LISTING OF SECURITIES ON A RECOGNISED STOCK EXCHANGE

(1) A public company as defined under the Companies Act, 1956, desirous of getting its securities listed on a recognised stock exchange, shall apply for the purpose to the stock exchange and forward along with its application the following documents and particulars:

(a) Memorandum and Articles of Association and, in case of debenture issue, a copy of the trust deed.

(b) Copies of all prospectuses or statements in lieu of prospectuses issued by the company.

(c) Copies of offers for sale and circulars or advertisements offering any securities for subscription or sale during the last five years.

(d) Copies of balance sheets and audited accounts for the last five years, or in the case of new companies, for such shorter period for which accounts have been made up.

(e) A list of highest ten holders of each class or kind of securities of the company as on the date of application along with particulars as to the number of shares or debentures held by and the address of each such holder.

(f) Particulars of shares or debentures for which permission to deal is applied for: provided that a recognized Stock Exchange may either generally by its bye-laws or in any particular case call for such further particulars or documents as it deems proper.

(2) Apart from complying with such other terms and conditions as may be laid down by a recognized Stock Exchange, an applicant company shall satisfy the Stock Exchange that:

(a) Its Articles of Association provide for the following among others-

(i) That the company shall use a common form of transfer;

- (ii) That the fully paid shares will be free from all lien, while in the case of partly paid shares, the company's lien, if any, will be restricted to moneys called or payable at a fixed time in respect of such shares;
- (iii) That any amount paid-up in advance of calls on any share may carry interest but shall not entitle the holder of the share to participate in respect thereof, in a dividend subsequently declared;
- (iv) There will be no forfeiture of unclaimed dividends before the claim becomes barred by law;
- (v) that option or right to call of shares shall not be given to any person except with the sanction of the company in general meeting: provided that a recognized Stock Exchange may provisionally admit to dealings the securities of a company which undertakes to amend its Articles of Association at its next general meeting so as to fulfill the foregoing requirements and agrees to act in the meantime strictly in accordance with the provisions of this clause.
- (b) At least 25% (twenty five percent) of each class or kind of securities issued by the company was offered to the public for subscription through advertisement in newspapers for a period not less than two days and that applications received in pursuance of such offer were allotted fairly and unconditionally.
- (c) Copies of offers for sale and circulars or advertisements offering any securities.
- (3) A company applying for listing shall, as a condition precedent, undertake inter alia-
- (a)(i) That letters of allotment will be issued simultaneously and that, in the event of its being impossible to issue letters of regret at the same time, a notice to that effect will be inserted in the press so that it will appear on the morning after the letters of allotment have been posted,
- (ii) That letters of right will be issued simultaneously,
- (iii) that letters of allotment, acceptance or rights will be serially numbered, printed on good quality paper and, examined and signed by a responsible officer of the company and that whenever possible, they will contain the distinctive numbers of the securities to which they relate,
- (iv) that letters of allotment and renounceable letters of right will contain a provision for splitting and that, when so required by the exchange, the form of renunciation will be printed on the back of or attached to the letters of allotment and letters of right,
- (v) That letters of allotment and letters of right will state how the next payment of interest or dividend on the securities will be calculated;
- (b) To issue, when so required, receipts for all securities deposited with it whether for registration, sub-division, exchange or for other purposes and not to charge any fees for registration of transfers, for sub-division and consolidation of certificates and for sub-division. Recommended or declared immediately after a meeting of the board of the company has been held to finalize the same;

- (c) When documents are lodged for sub-division or consolidation [or renewal] through the clearing house of the exchange: (i) to accept the discharge of an official of the stock exchange clearing house on the company's split receipts and consolidation receipts and renewal receipts as good and sufficient discharge without insisting on the discharge of the registered holders; and
- (ii) To verify when the company is unable to issue certificates or split receipt or [consolidation receipts or renewal receipts] immediately on lodgment whether the discharge of the registered holders, on the documents lodged for sub-division or consolidation[or renewal] and their signatures on the relative transfers are in order;
- (d) on production of the necessary documents by shareholders or by members of the exchange, to make on transfers an endorsement to the effect that the power of attorney or probate or letters of administration or death certificate or certificate of the Controller of Estate Duty or similar other document has been duly exhibited to and registered by the company;
- (e) to issue certificates in respect of shares or debentures lodged for transfer within a period of one month of the date of lodgment of transfer and to issue balance certificates within the same period where the transfer is accompanied by a larger certificate;
- (f) to advise the Stock Exchange of the date of the board meeting at which the declaration or recommendation of a dividend [for the issue or right or bonus share] will be considered;
- (g) to notify the Stock Exchange of any material change in the general character or nature of the company's business;
- (i) to notify the Stock Exchange of any change-
- (i) in the company's directorate by death, resignation, removal or otherwise,
- (ii) of managing director, managing agent or secretaries and treasurers,
- (iii) of auditors appointed to audit the books and accounts of the company;
- (h) to forward to the Stock Exchange copies of statutory and annual reports and audited accounts as soon as issued, including director's report;
- (i) to forward to the Stock Exchange as soon as they are issued, copies of all other notices and circulars sent to the shareholders including proceedings of ordinary and extraordinary general meetings of the company and to file with the stock exchange certified copies of resolutions of the company as soon as such resolutions become effective;
- (j) to notify the Stock Exchange prior to intimating the shareholders, of any new issue of securities whether by way of right, privilege, bonus or otherwise and the manner in which it is proposed to offer or allot the same;

(k) to notify the Stock Exchange in the event of re-issue of any forfeited securities or the issue of securities held in reserve for future issue;


(l) to notify the Stock Exchange of any other alteration of capital including calls;

(m) to close the transfer books only for the purpose of declaration of dividend or issue of right or bonus shares or for such other purposes as the stock exchange may agree and to give notice to the stock exchange as many days in advance as the exchange may from time to time reasonably prescribe, stating the dates of closure of its transfer books (or, when the transfer books are not to be closed, the date fixed for taking a record of its shareholders or debenture holders) and specifying the purpose or purposes for which the transfer books are to be closed (or the record is to be taken); and in the case of a right or bonus issue to so close the transfer books or fix a record date only after sanctions of the competent authority subject to which the issue is proposed to be made have been duly obtained.



6. Summary

- Securities Contract (Regulation) Act 1956 was passed by a resolution by Parliament to make laws related to functioning of Stock Exchange in India.
- In order to ensure smooth and fair functioning of the Stock Exchanges, the act provides for their recognition and has made rules regarding grant and withdrawal of recognition of Stock Exchanges.
- The act has provided for Corporatization and Demutualization of stock exchanges so as to provide them status of corporate business entities.
- The Central Government exercises complete powers over recognized Stock Exchanges and ensures fair practices by them by calling for periodical inspections, making rules to be followed by them, issuing directions to them etc.
- The act provides for the procedure of listing of companies on a recognized Stock Exchange, documents to be submitted, etc.

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