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Protection of Investors in Banking Sector-Comparative Study

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KEYWORDS

Investors are the ultimate investors in market dynamism. The investor should have strong confidence in the regulatory framework through RBI and SEBI. Their money should be protected at any cost when invested in different securities pertaining to government and private enterprises.

The market mechanism and regulatory frame work should guarantee that good money will always get good assets in return. The risk in transactions arising due to time gap between the execution of the trade and its settlement when default takes place should be minimized. This time gap increases the risk factor and possible gains for defaulters.

Regarding companies registered under the NSDL (National Securities Depository Limited) and CDSL (Central Depository Services Limited), the interest of the investor is protected regarding the participant (Companies registered under NSDL). This reduces the time gap for getting the investors money back in case of default by the participant.

Benefits of the depository system are that there is no physical risk such as loss, theft of these securities. Due to introduction of compulsory rolling settlement the gap between the time a trade takes place and the time it is finally settled is very less. The operation becomes as easy as having a bank account. Transfer of securities becomes very simple and less complicated as the manual paper transfer is replaced by an electronic system. Execution instructions are accepted only after the participant has satisfied itself that the instructions have been given by the client. Statement of accounts is to be furnished to the client regularly at least on a quarterly basis.

The NSDL can always cross check the correctness of the statements provided by the participants as the depository randomly chooses some clients and sends the details. Therefore as the participant is registered with the depository (NSDL), the depository is liable to indemnify the beneficial owners for any loss caused to them due to the negligence of the depository or the participant. Settlement of disputes of all claims, disputes between participants and clients is referred to arbitration according to the arbitration and conciliation act 1996.

Investor protection fund:
The NSDL has set up an Investor Protection Fund known as 'The National Securities Depository Limited Investor Protection Fund' to make good the claims which may be submitted by the clients who has suffered pecuniary loss due to the negligence of the depository or of the participant while carrying out the instruction of the client. NSDL has taken a comprehensive insurance policy to protect the interest of the investors in case of failure of any participant to resolve a genuine loss.

Upper limit per claim is - 20 crores.
Number of claims allowed – unlimited.
Minimum value of the claim – 1.5 lakhs.
To cover claims valued at less than 1.5 lakhs, NSDL has an investor protection fund in place.

Regulation in Private Participation in banking sector.
In India we have many Banking Companies registered and regulated by RBI and SEBI. The securities are issued either directly, (IPO) or through Brokerage. When a default takes place by the Banking Company, the investigation is conducted by the RBI and SEBI. During this process, the investor's money is at risk. The shares issued by the Banking Company are normally in the form of deposits while in the case of other companies it is in the form of shares, either equity or preference shares. This calls for great concern. While in the case of depository system we have an insurance undertaken by the NSDL, while these banking companies have no such insurance scheme. The Bank Scam glares at the investors as the investigation continues. The case of Integrated Finance Ltd; which is still not resolved, still reminds the investors of the sudden fear it created in their minds when their hard earned money fell into wrong hands. This creates apprehension in the mind of investors, when it comes to investing in private banking companies. We need to resolve this on the lines of Investor Protection Fund.

US Reforms:
Obama Administration released on June 17th 2009 the 'Financial Regulatory Reforms, a new foundation: Rebuilding Financial Supervision and Regulation.' This document was prepared in response to what is described as the most severe financial crisis since the great depression. The department of Treasury adopted an interim final rule establishing standards for compensation and corporate governance for TARP recipients. It establishes the office of the special master for TARP executive compensation. The new regulation limits bonuses paid to Senior Executive Officers and to a specified number of the most highly compensated employees of TARP recipients.

In response to concerns regarding conflicts of interests, in the offering of securities by a member firm or control entity of the firm in a private placement, the SEC (Securities and Exchange Commission) has approved FINRA Rule 5122[2] (Financial Industry Regulatory Authority – Largest Independent Regulator). Private placements are non public offerings of securities conducted through an exemption from registration under the securities act. Rule 5122 will require firms that conduct private placements of the firm's securities or those of a control entity to comply with disclosure and filing requirements and limitations on the use of proceeds. The rule will require such firms to disclose the intended use of offering proceeds and expenses to investors in a private placement memorandum and file the placement memorandum with FINRAS's corporate financing department, prior to distributing the document to investors and commit that at least 85% of the offering proceeds will be used for business purposes and will not include offering costs, discounts, commissions and any cash or non cash sales incentives. Rule 5122 will not apply retroactively.

Companies receiving exceptional financial assistance due to recession are AIG, CITI Group, Bank of America, Chrysler, Chrysler Financial and GM. Therefore in India before we allow more private banks to issue securities, we should prepare ourselves with a strong security system in case of any scam. Thus an insurance system to protect the investor's interest would be a good beginning.

References
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2. SECURITIES AND EXCHANGE COMMISSION (Release No. 34-59599; File No. SR-FINRA-2008-020) March 19, 2009, edgar.sec.gov/rules/sro/finra/2009/34-59599.pdf