Protecting Investors from Market Volatility

Prelims: Market Volatility, SEBI, Supreme Court, RBI.

Mains: Protecting Investors from Market Volatility.

Why in News?

Recently, the **SC (Supreme Court)** asked the **SEBI (Securities and Exchange Board of India)** and the government about the existing regulatory framework in place to protect Indian middle-class investors.

- This comes after the **Adani Group was accused of stock manipulation** and accounting fraud by the **American firm Hindenburg Research.**
- Earlier, a number of small investors lost lakhs of crores due to rapid market volatility following a collapse in the value of the shares of the Adani Group.

What is the SC's Observation?

- The stock market is no longer a place for just "high value investors", rather it is a place now where **a whole wide spectrum of the middle class is investing** due to changes in the financial and tax regimes.
- Therefore, there is a need for circuit-breakers like in other areas, so that market volatility does not cost much.
- Stock market goes entirely by sentiment, Capital is moving seamlessly, funds are flowing in and out of India, making it imperative to devise robust mechanisms in **place to protect Indian investors.**

What is Market Volatility?

- **About:**
    - The stock markets sometimes experience sharp and unpredictable price movements, either down or up. These movements are **often referred to as a "volatile market"** and can occur over **a period of days, weeks, or months.**
- **Causes:**
    - **Surprising economic news** that differs from the expectations of investors.
    - A **sudden change in monetary policy**, such as the Federal Reserve announcing plans to.
    - Political **developments including unexpected election results**, an event such as a government shutdown or passage of key legislation designed to give the economy a boost.
    - Geopolitical events such as **an outbreak of a military conflict or flaring tensions** between powerful nations that could have economic ramifications.
    - Events specific to markets, **such as stocks becoming overvalued.**
        - This occurred in 2000 when a number of overpriced **"dot-com" stocks faced a sudden and dramatic selloff** as investors became concerned that prices had outdistanced underlying company fundamentals.

How can Market Volatility be Dealt with?

- **Monetary Policy:**
  - The [Reserve Bank of India (RBI)]() can adjust **interest rates to influence the supply of money and credit** in the economy, which can have an impact on **market sentiment and stability.** The stock market and the interest rates have an inverse relationship.
  - For example, a **rate cut can help calm investor concerns** and boost market confidence.
- **Fiscal Policy**:
  - Governments can use **fiscal measures such as tax cuts, spending increases,** and targeted subsidies to boost economic activity and provide support to affected industries and individuals.
- **Regulatory Measures:**
  - Governments and regulatory authorities can introduce **measures to increase transparency and stability in financial markets.**
  - This may include increased **disclosure requirements for companies**, stricter standards for financial institutions, and greater oversight of hedge funds and other speculative investors.
- **International Cooperation:**
  - In a globalized financial system, **sudden market volatility can spread quickly across borders.**
  - Coordination among central banks and **regulatory authorities can help mitigate the impact** of market volatility and prevent financial contagion.
- **Financial Education and Literacy:**
  - Encouraging financial education and literacy among the public **can help reduce the risk of market speculation** and improve overall financial stability.
- **Diversification:**
  - By spreading investments across different assets and markets, investors can reduce the impact of market volatility on their portfolios.

What are the Investor Protection Measures?

- Investor protection **legislation is implemented under the Section 11(2) of the SEBI Act.** The measures are as follows:
  - Stock Exchange and other securities market business regulation.
  - Registering investment schemes like Mutual fund & venture Capital funds, and regulating their functioning.
  - Promotion and controlling of **self-regulatory companies.**
- **Investor Education and Protection Fund (IEPF):**
  - Government of India established IEPF under the 1956 Company Act.
  - According to the act, the company which has completed seven years in the business should **hand over all the unclaimed fund dividends, matured deposits, and Debentures, share application money etc. to the Government through IEPF.**
- **Investor Protection Fund:**
  - IPF is set up by Inter-connected Stock Exchange (ISE) in accordance with the guidelines issued by the Ministry of Finance for investor protection, in order to **compensate the claims of investors against the members** of exchanges (brokers) who have defaulted or failed to pay.

What is a Capital Market?

- Capital market is a market where **securities, such as stocks and bonds, are bought and sold.**
- It provides a platform for **companies, governments, and other entities to raise capital** by issuing securities and for investors to invest in these securities with the expectation of earning a return.
- The capital market can be divided into two main segments, the **Primary Market and the Secondary Market.**
  - The **primary market** is where new securities are issued and sold directly to investors.

- The **secondary market** is where securities that have already been issued are bought and sold among investors.

- Capital markets play a **critical role in the functioning of the economy by connecting savers with borrowers and facilitating the flow of capital** to its most productive uses. Capital markets also provide **investors with the opportunity to diversify their portfolios,** manage risk, and potentially earn higher returns.

UPSC Civil Services Examination, Previous Year Question (PYQ)

Q. Which of the following is issued by registered foreign portfolio investors to overseas investors who want to be part of the Indian stock market without registering themselves directly? (2019)

(a) Certificate of Deposit
(b) Commercial Paper
(c) Promissory Note
(d) Participatory Note

Ans: (d)

Source: TH