Lesson 1

Overview of Capital Market

Modern economy is based on a sound financial system which helps in production, capital and economic growth by encouraging savings habits, mobilising savings from households and other segments and allocating savings into productive usage such as trade, commerce, manufacture etc. Various factors influence the capital market and its growth. These include level of savings in the household sector, taxation levels, and health of economy, corporate performance, industrial trends and common patterns of living. The strength of the economy is calibrated by different economic indicators like growth in GDP (Gross Domestic Product), Agricultural production, quantum and spread of rain fall, interest rates, inflation, position on balance of payments and balance of trade, levels of foreign exchange reserves and investments and growth in capital formation.

The functions of a good financial system are:

(a) regulation of currency

(b) banking functions

(c) performance of agency services and custody of cash reserves

(d) management of national reserves of international currency

(e) credit control

(f) administering national, fiscal and monetary policy to ensure stability of the economy

(g) supply and deployment of funds for productive use

(h) maintaining liquidity.

Long term growth of financial system is ensured through:

(a) education of investors

(b) giving autonomy to FIs to become efficient under competition

(c) consolidation through mergers

(d) facilitating entry of new institutions to add depth to the market

(e) minimising regulatory measures and market segmentation.

Constituents of Financial System

- Financial Market
    - Money Market
    - Capital Market
        - Securities Market
            - New Issue Market
            - Secondary Market
        - Other forms of lending and borrowing
- Products
- Market participants

Money Market

Where borrowers and lenders exchange short-term funds to solve their liquidity needs is known as money market. Money market instruments are generally financial claims that have low default risk, maturities under one year and high marketability

Capital Market

The Capital Market is a market for financial investments that are direct or indirect claims to capital. It is wider than the Securities Market and embraces all forms of lending and borrowing, whether or not evidenced by the creation of a negotiable financial instrument.

Need for Capital Market

- Capital market plays important role in promoting and sustaining the growth of an economy.
- It is an important and efficient conduit to channel and mobilize funds to enterprises, both private and government.
- It is effective source of investment in the economy.
- mobilizing savings for investment in productive assets, with a view to enhancing a country's long-term growth prospects, and thus acts as a major catalyst in transforming the economy into a more efficient, innovative and competitive marketplace within the global arena.
- Capital markets also provide a medium for risk management by allowing the diversification of risk in the economy.
- A well-functioning capital market tends to improve information quality as it plays a major role in encouraging the adoption of stronger corporate governance principles, thus supporting a trading environment, which is founded on integrity.
- Capital market has played a crucial role in supporting periods of technological progress and economic development throughout history.

- Among other things, liquid markets make it possible to obtain financing for capital-intensive projects with long gestation periods. This certainly held true during the industrial revolution in the 18th century and continues to apply even as we move towards the so-called "New Economy".
- Capital markets make it possible for companies to give shares to their employees via ESOPs.
- Capital markets provide a currency for acquisitions via share swaps.
- Excellent route for disinvestments to take place.
- Venture Capital and Private Equity funds investing in unlisted companies get an exit option when the company gets listed on the capital markets
- Capital market also provides a valuable source of external finance.

Functions of the capital market

The major objectives of capital market are:

- To mobilize resources for investments.
- To facilitate buying and selling of securities.
- To facilitate the process of efficient price discovery.
- Facilitating settlement of transaction in accordance with predetermined time schedule

Securities Market

The Securities Market, however, refers to the markets for those financial instruments/claims/obligations that are commonly and readily transferable by sale.

The Securities Market has two inter-dependent and inseparable segments, the new issues (primary) market and the stock (secondary) market.

Primary Market

The primary market provides the channel for sale of new securities, while the secondary market deals in securities previously issued. The securities are sold by the issuer of securities in the primary market to raise funds for investment and/or to discharge some obligation.

Secondary Market

The secondary market enables those who hold securities to adjust their holdings in response to changes in their assessment of risk and return. They also sell securities for cash to meet their liquidity needs. The price signals, which subsume all information about the issuer and his business including, associated risk, generated in the secondary market, help the primary market in allocation of funds.

This secondary market has further two components, First, the spot market where securities are traded for immediate delivery and payment, The other is futures market where the securities are

traded for future delivery and payment. Another variant is the options market where securities are traded for conditional future delivery.

Generally, two types of options are traded in the options market. A put option permits the owner to sell a security to the writer of the option at a pre-determined price before a certain date, while a call option permits the buyer to purchase a security from the writer of the option at a particular price before a certain date.

Securities Market –

- Is a link between investment & savings
- Mobilises & channelises savings
- Provides Liquidity to investors
- Is a market place for purchase and sale of securities

The main legislations governing the Capital Market are:–

1. The SEBI Act, 1992 which establishes SEBI to protect investors and develop and regulate securities market.

2. The Securities Contracts (Regulation) Act, 1956, SC(R)A which regulates transactions in securities through control over stock exchanges.

3. The Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities.

4. The Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities and disclosures to be made in public issues.

SECURITIES MARKET REFORMS & REGULATORY MEASURES TO PROMOTE INVESTOR CONFIDENCE

The major initiatives taken by SEBI to promote investors' confidence are:

Control over Issue of Capital - A major initiative of liberalisation was the repeal of the Capital Issues (Control) Act, 1947 in May 1992.

Establishment of Regulator - A major initiative of regulation was, establishment of a statutory autonomous agency, called SEBI, to provide reassurance that it is safe to undertake transactions in securities.

Screen Based Trading - A major developmental initiative was a nation-wide on-line fully-automated screen based trading system (SBTS) where a member can punch into the computer quantities of securities and the prices at which he likes to transact and the transaction is executed as soon as it finds a matching sale or buy order from a counter party.

Risk management - A number of measures were taken to manage the risks in the market so that the participants are safe and market integrity is protected.

Depositories Act - The earlier settlement system gave rise to settlement risk. This was due to the time taken for settlement and due to the physical movement of paper.

Derivatives - To assist market participants to manage risks better through hedging, speculation and arbitrage, SC(R)A was amended in 1995 to lift the ban on options in securities.

Settlement Guarantee: A variety of measures were taken to address the risk in the market. Clearing corporations emerged to assume counter party risk. Trade and settlement guarantee funds were set up to guarantee settlement of trades irrespective of default by brokers.

Securities Market Awareness- In January 2003, SEBI launched a nation-wide Securities Market

Awareness Campaign that aims at educating investors about the risks associated with the market as well as the rights and obligations of investors.

Green Shoe Option- As a stabilization tool for post listing price of newly issued shares, SEBI has introduced the green shoe option facility in IPOs.

Securities Lending and Borrowing- A clearing corporation/clearing house, after registration with SEBI, under the SEBI scheme for Securities Lending and Borrowing, as an approved intermediary, may borrow securities for meeting shortfalls in settlement, on behalf of the members.

Corporate Governance - To improve the standards of corporate governance, SEBI amended Clause

49 of the Listing Agreement.

Debt Listing Agreement- In order to further develop the corporate debt market, SEBI prescribed a model debenture listing agreement for all debenture securities issued by an issuer irrespective of the mode of issuance.

Minimum Public Shareholding- In order to maintain uniformity and also for the purpose of continuous listing, it was decided to amend SEBI (DIP) Guidelines, 2000 providing a minimum public shareholding of 25 per cent in case of all listed companies barring a few exceptions.

Grading of Initial Public offerings (IPOs) - Grading of all IPOs was made mandatory. The grading would be done by credit rating agencies, registered with SEBI.

Introduction of Fast Track Issuances- To enable compliant listed companies to access Indian primary market in a time effective manner through follow-on public offerings and rights issues, SEBI introduced fast track issue mechanism.

FEATURES OF DEVELOPED CAPITAL MARKET: THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO)

The International Organization of Securities Commissions (IOSCO) was created in 1983 with the decision to change from an inter-American regional association (created in 1974) into a global cooperative body. Eleven securities regulatory agencies from North and South America took this decision in April 1983 at a meeting in Quito, Ecuador.

Today IOSCO is recognized as the international standard setter for securities markets. Its membership regulates more than 95% of the world's securities markets and it is the primary international cooperative forum for securities market regulatory agencies. IOSCO members are drawn from, and regulate, over 100 jurisdictions and its membership continues to grow.

IOSCO OBJECTIVE OF SECURITIES REGULATION

There are three Objectives of securities regulation –

– protecting investors;

– ensuring that markets are fair, efficient and transparent;

– reducing systemic risk

MULTILATERAL MEMORANDUM OF UNDERSTANDING CONCERNING CONSULTATION AND CO-OPERATION AND EXCHANGE OF INFORMATION (MMoU)

The MMoU represents a common understanding amongst its signatories about how they will consult, cooperate, and exchange information for securities regulatory enforcement purposes.

It also sets out specific requirements regarding the confidentiality of the information exchanged, and ensures that no domestic banking secrecy, blocking laws or regulations prevents securities regulators from sharing this information with their counterparts in other jurisdictions.

Key Features of Depository System in India :

1. ***Multi-Depository System***
2. ***Depository services through depository participants***
3. ***Dematerialisation***
4. ***Fungibility***
5. ***Registered Owner/ Beneficial Owner***
6. ***Free Transferability of shares***

Answer the following:

1. _________trading uses modern telecommunication and computer technology to combine information transmission with trading in financial markets.

Ans: Screen Based Trading

2. __________enable compliant listed companies to access Indian primary market in a time effective manner through follow-on public offerings.

Ans: Fast Track Issue

3. In spot market securities are traded for__________delivery and payment.

Ans: Immediate

Lesson 2

Capital Market Instruments

The instruments used by the corporate sector to raise funds are selected on the basis of— (i) investor preference for a given instrument and (ii) the regulatory framework, where under the company has to issue the security.

The tax liability of the company, the purpose for which funds are required, debt servicing ability and willingness to broad base the shareholding of the company, all influence the choice of the instrument.

Investor preferences vary with their attitude towards risk, and their investment goals and investment horizon. Financial innovation has been a continuous and integral part of growth of the capital markets. A variety of factors such as increased interest rate, volatility, frequency of tax and regulatory changes etc. have stimulated the process of financial innovation.

Classification of Instruments that can be issued in the capital market:

Pure Instruments: Equity shares, preference shares and debentures/ bonds which were issued with their basic characteristics intact without mixing features of other classes of instruments are called Pure instruments.

Hybrid Instruments: Hybrid instruments are those which are created by combining the features of equity with bond, preference and equity etc. Examples of Hybrid instruments are: Convertible preference shares, Cumulative convertible preference shares, etc.

Derivative Instruments: Derivatives are contracts which derive their values from the value of one or more of other assets (known as underlying assets). Some of the most commonly traded derivatives are futures, forward, options and swaps.

Equity Shares:

Equity shares, 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 holder of such shares is the member of the company and has voting rights.

Section 43 of Companies Act, 2013 ‘‘equity share capital’’, with reference to any company limited by shares, means all share capital which is not preference share capital. Section 43 further provides for equity share capital (i) with voting rights, or (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed.

Equity share holders enjoy different rights as members under the Companies Act, 2013 such as:

(a) The right to vote on every resolution placed before the company – (Section 47)

(b) The rights to subscribe to shares at the time of further issue of capital by the company

(Pre-emptive Right) – (Section 62)

(c) Right to appoint proxy to attend and vote at the meeting on his behalf – (Section 105)

(d) Right to receive copy of annual accounts of the Company – (Section 136)

(e) Right to receive notice of the meeting of members – (Section 101)

(f) Right to inspection of various statutory registers maintained by the company.

(g) Right to requisition extraordinary general meeting of the company – (Section 100).

Shares With Differential Voting Rights

Section 43(a)(ii) of the Companies Act, 2013, authorized equity share capital with differential rights as to dividend, voting or otherwise in accordance with Rule 4 of Companies (Share Capital and Debentures) Rules, 2014.

Preference shares:

Owners of this kind 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 shares. They also enjoy privity over the equity shareholders in payment of surplus. But in the event of liquidation their claims rank below the claims of company's creditors, bondholders/debenture holders.

According to explanation (ii) to Section 43 of Companies Act, 2013 ''preference share capital'', with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right i.e. the preference shares are those shares which have rights of preference over equity shares in the case of distribution of dividend and distribution of surplus in the case of winding up. They generally carry a fixed rate of dividend and redeemable after specific period of time. According to Section 55 of the Companies Act, 2013, a Company cannot issues preference shares which are irredeemable.

- **Cumulative Preference Shares**

This type of preference share the dividend payable every year becomes a first claim while declaring dividend by the company. If the company does not have adequate profit or for some reason the company does not want to pay preference dividend, it gets accumulated for being paid subsequently. If a company goes into the liquidation no arrears of preference dividend will be

payable unless the Articles of Association of the issuing company contains a specific provision to make such payment even in winding up.

- **Non-Cumulative Preference Shares**

Dividend does not accumulate in the case of these preference shares. If there are no profits or the profits are inadequate in any year, the shares are not entitled to any dividend for that year

- **Convertible Preference Shares**

The terms of issue of preference shares includes a right for converting them into equity shares at the end of a specified period they are called convertible preference shares. In the absence of such condition, the preference shares are not converted into equity shares to become eligible for various rights such as voting, higher dividend, bonus issue etc. as in the case of equity shares.

- **Redeemable Preference Shares**

These are such preference shares in which are redeemed after specific period and money is returned to shareholders.

- **Participating Preference Shares**

Preference shareholders are not entitled to dividend more than what has been indicated as part of the terms of issue, even in a year in which the company has made huge profits.

- **Non Participating Preference Shares**

All preference shares are to be regarded as nonparticipating preference shares, unless the terms of issue indicate specifically otherwise

Debentures:

Debenture is a document evidencing a debt or acknowledging it and the debenture holder is entitled to interest from the company.

Section 2(30) of the Companies Act, 2013 defines debentures. “Debenture” includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not;

Types of Debentures :

1. Naked or Unsecured debenture: Debentures of this kind do not carry any charge on the assets of the company.
2. Secured Debenture: Debentures that are secured by a mortgage of the whole or part of the

assets of the company are called mortgage debentures or secured debentures.

3. Redeemable debentures: Debentures that are redeemable on expiry of certain period are called redeemable debentures.

4. Perpetual debentures: If the debentures are issued subject to redemption on the happening of specified events which may not happen for an indefinite period.

5. Bearer Debenture: The name of the debenture holder is not registered in the books of the company, but the holder is entitled to claim interest and principal as and when due.

6. Registered debenture: Such debentures are payable to the registered holders whose name appears on the debenture certificate/ letter of allotment and is registered on the companies register of debenture holders maintained as per Section 88(1)(b) of the Companies Act, 2013.

Categories of Debentures :

1. Fully Convertible Debentures (FCDs)
2. Non Convertible Debentures (NCDs)
3. Partly Convertible Debentures (PCDs)

I. Hybrid Instruments

SECURED PREMIUM NOTES (SPN): These instruments are issued with detachable warrants and are redeemable after a notified period say 4 to 7 years. The warrants enable the holder to get equity shares allotted provided the secured premium notes are fully paid. During the lock in period no interest is paid.

EQUITY SHARES WITH DETACHABLE WARRANTS: The holder of the warrant is eligible to apply for the specified number of shares on the appointed date at the predetermined price. These warrants are separately registered with the stock exchanges and traded separately. The practice of issuing non convertible debentures with detachable warrants also exists in the Indian market.

DUAL OPTION WARRANTS: Dual option warrants are designed to provide the buyer with good potential of capital appreciation and limited downside risk. Dual option warrants may be used to sell equity shares in different markets.

DEBT INSTRUMENTS WITH DEBT WARRANTS: Debt instruments may be issued with debt warrants which give the holder the option to invest in additional debt on the same terms within the period specified in the warrant.

DEBT FOR EQUITY SWAP: These instruments give an offer to the debt holders to exchange the debt for equity shares of the company.

INDEXED RATE NOTES In indexed rate notes, the interest rate fixation is postponed till the actual date of placement, rather than fixing it on the date of the commitment.

EXTENDABLE NOTES: Extendable notes are issued for 10 years with flexibility to the issuer to review the interest rate every two years. The interest rate is adjusted every two years to reflect the then prevailing market conditions by trying the interest rate to a spread over a bond index such as two years treasury notes. However, investors have a put option at par value every two years i.e. they have the right to sell the bond to the issuer at a fixed rate on the expiry of every two years.

LEVEL PAY FLOATING RATE NOTES: Level pay floating rate notes are issued for a long period of time say 20 years, with adjustment in interest rate every five years.

ZERO COUPON CONVERTIBLE NOTES: These are debt convertible into equity shares of the issuer. If investors choose to convert, they forgo all the accrued and unpaid interest. These convertibles are generally issued with put option to the investors. The advantage to the issuer is the raising of convertible debt without heavy dilution of equity. Since the investors give up acquired interest by exercise of conversion option, the conversion option may not be exercised by many investors.

FLOATING RATE BONDS AND NOTES: In this case interest is not fixed and is allowed to float depending upon market conditions. This instrument is used by the issuers to hedge themselves against the volatility in interest rates.

CLIP AND STRIP BONDS: Clip and strip bonds also referred to as coupon notes, split the principal and coupon portions of a bond issue and two separate coupon instruments are sold to the investors.

DUAL CONVERTIBLE BONDS: A dual convertible bond is convertible into either equity shares or fixed interest rate debentures/preference shares at the option of the lender.

CARROT AND STICK BOND: The carrot is the lower than normal conversion premium i.e. the premium over the present market price of the equity shares is fixed at a reasonable level so that the price of the equity shares need not increase significantly to make conversion practical. The stick is the issuer’s right to call the issue at a specified premium if the price of the equity shares is traded above a specified percentage of the conversion price.

CAPITAL INDEXED BONDS: Capital indexed bonds are inflation-protection securities. Such bonds, therefore, provide good hedge against inflation risk. The benefits do extend beyond hedging. Capital index bonds can be used as a market indicator for inflation expectation. This will help investors take a more intelligent decision on their current consumption.

GLOBAL DEPOSITORY RECEIPTS: It is a form of depository receipt or certificate created by the Overseas Depository Bank outside India denominated in dollar and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company. In simple words, it is basically a negotiable instrument denominated in US dollars. It is traded in Europe or the US or both.

INDIAN DEPOSITORY RECEIPTS: An IDR is an instrument denominated in Indian Rupee in the form of a depository receipt created by a domestic depository (Custodian of securities registered with SEBI) against the underlying equity of issuing company to enable foreign companies to raise funds from Indian Securities Markets.

FOREIGN CURRENCY CONVERTIBLE BONDS (FCCBs): A Foreign Currency Convertible Bond (FCCB) is a quasi debt instrument which is issued by any corporate entity, international agency or sovereign state to the investors all over the world. They are denominated in any freely convertible foreign currency.

TRACKING STOCKS: A Tracking stock is a type of common stock that "tracks" or depends on the financial performance of a specific business unit or operating division of a company, rather than the operations of the company as a whole. As a result, if the unit or division performs well, the value of the tracking stocks may increase, even if the company's performance as a whole is not up to mark or satisfactory. The opposite may also be true.

MORTGAGE BACKED SECURITIES: These securities assure a fixed return which is derived from the performance of the specific assets. They are issued with a maturity period of 3 to 10 years and backed by pooled assets like mortgages, credit card receivables, etc.

II. Derivative Instruments

FUTURES: Futures is a contract to buy or sell an underlying financial instrument at a specified future date at a price when the contract is entered. Underlying assets for the purpose include equities, foreign exchange, interest bearing securities and commodities.

OPTIONS: An option contract conveys the right to buy or sell a specific security or commodity at specified price within a specified period of time. The right to buy is referred to as a call option whereas the right to sell is known as a put option.

HEDGE FUNDS: Hedge funds, including fund of funds are unregistered private investment partnerships, funds or pools that may invest and trade in many different markets, strategies and instruments (including securities, non-securities and derivatives) and are not subject to the same regulatory requirements as mutual funds, including mutual fund requirements to provide certain periodic and standardized pricing and valuation information to investors.

EXCHANGE TRADED FUNDS (ETFS): Exchange traded funds (ETFs) are a new variety of mutual fund that was first introduced 1993. ETFs are sometimes described as more "tax efficient" than traditional equity mutual funds, since in recent years, some large ETFs have made smaller distributions of realized and taxable capital gains than most mutual funds.

FUND OF FUNDS (FOFS): Fund of funds (FoFs) is a mutual fund scheme, which invests in the schemes of same mutual funds or other mutual funds, instead of investing in securities. These funds can invest in equity oriented, debt oriented and liquid schemes or sector specific schemes.

Answer the following:

1. ________is a contract to buy or sell an underlying financial instrument at a specified future date at a price when the contract is entered.

Ans: Future

2. ________are inflation-protection securities.

Ans: Capital indexed bonds

3. A share warrant________be issued by a private company.

Ans: Cannot

Lesson 3

Credit Rating & IPO Grading

Credit rating, is the evaluation of the credit worthiness of an individual or of a business concern or of an instrument of a business based on relevant factors indicating ability and willingness to pay obligations as well as net worth. Credit Rating is a symbolic indication of the current opinion regarding the relative capability of a corporate entity to service its debt obligations in time with reference to the instrument being rated. It enables the investor to differentiate between debt instruments on the basis of their underlying credit quality. In determining a rating, both qualitative and quantitative analyses are employed. The judgment is qualitative in nature and the role of the quantitative analysis is to help make the best possible overall qualitative judgment or opinion.

In India, the capital markets regulator, the Securities and Exchange Board of India (SEBI), regulates the rating agencies.

USES OF CREDIT RATING

- Credit rating is extremely important as it plays a pivotal role in investor protection
- Rating also provide a marketing tool to the company and its investment bankers in placing company's debt obligations with a investor base.
- Ratings also encourage discipline amongst corporate borrowers to improve their financial structure and operating risks

Important issues in credit rating

Investments and Speculative Grades: Debt instrument rated 'BBB' & above are classified as investment grade ratings. Instruments that are rated 'BB' and below are classified as speculative grade ratings.

Surveillance: The rating published by credit rating agencies is subjected to a continuous surveillance during the life of the instrument or so long as any amount is outstanding against the specific instrument.

Credit Watch: When a major deviation from the expected trends of the issuers business occurs, or when an event has taken place, it creates an impact on the debt servicing capability of the issuer and warrants a rating change, the rating agency may put such ratings under credit watch till the exact impact of such unanticipated development is analyzed and decision is taken regarding the rating change.

Ownership as a rating consideration: Ownership by a strong concern may enhance the credit rating of an entity, unless there exists a strong barrier separating the activities of the parent and the subsidiary. The important issues involved in deciding the relationship are - the mutual dependence on each other, legal relationship, to what extent one entity has the desire and ability to influence the business of the other, and how important is the operation of the subsidiary to the owner.

Rating agency keeps the information provided by the issuer confidential and completes the rating within 2 to 4 weeks.

The **rating methodology** depends on the nature of the company. In case of manufacturing companies, the industry risk, company position, accounting policies, earning potential, management evaluation etc are taken into consideration. The rating methodology for non-banking financial services companies is based on CAMEL model encompassing, Capital adequacy, Asset quality, Management, Earnings and Liquidity.

REGULATORY FRAMEWORK

SEBI (CREDIT RATING AGENCIES) REGULATIONS, 1999

SEBI regulations for Credit Rating Agencies (CRAs) cover rating of securities only and not rating of fixed deposits, foreign exchange, country ratings, real estates etc. CRAs can be promoted by public financial institutions, scheduled commercial banks, foreign banks operating in India, foreign credit rating agencies recognised in the country of their incorporation, having at least five years experience in rating, or any company or a body corporate having continuous net worth of minimum `100 crore for the previous five years.

CRAs would be required to have a minimum net worth of Rs 5 crore.

A CRA cannot rate a security issued by its promoter.

For ensuring that corporates provide correct/ adequate information to CRAs, a clause would be incorporated in the listing agreement of the stock exchanges requiring the companies to co-operate with the rating agencies in giving correct and adequate information.

Registration of Credit Rating Agencies

Application should be made to SEBI for the grant of a certificate of registration for commencing any activity as a credit rating agency.

SEBI upon being satisfied of the eligibility and other conditions of the applicant shall grant a certificate to the credit rating agency to commence its business. The period of validity of certificate of registration shall be three years and shall be subject to renewal at the discretion of the CRA.

Promoter of Credit Rating Agency

SEBI should not consider an application unless the applicant is promoted by a person belonging to any of the following categories, namely:
(i) a public financial institution;
(ii) a scheduled commercial bank;
(iii) a foreign bank operating in India with the approval of the Reserve Bank of India;
(iv) a foreign credit rating agency recognized under Indian Law and having at least five years experience in rating securities;
(v) any company or a body corporate, having continuous net worth of minimum rupees one hundred crores as per its audited annual accounts for the previous five years in relation to the date on which application to SEBI is made seeking registration.

Eligibility Criteria:

- the applicant is set up and registered as a company under the Companies Act, 2013;
- the applicant has, in its Memorandum of Association, specified rating activity as one of its main objects;
- the applicant has a minimum net worth of ` 5 crores. However a credit rating agency existing at the commencement of these regulations, with a net worth of less than ` 5 crores, shall be deemed to have satisfied this condition, if it increases its net worth to the said minimum within a period of three years of such commencement.
- the applicant has adequate infrastructure, to enable it to provide rating services in accordance with the provisions of the Act and these regulations;
- the applicant and the promoters of the applicant, have professional competence, financial soundness and general reputation of fairness and integrity in business transactions, to the satisfaction of SEBI;
- neither the applicant, nor its promoter, nor any director of the applicant or its promoter, is involved in any legal proceeding connected with the securities market, which may have an adverse impact on the interests of the investors;
- neither the applicant, nor its promoters, nor any director, of its promoter has at any time in the past been convicted of any offence involving moral turpitude or any economic offence;
- the applicant has, in its employment, persons having adequate professional and other relevant experience to the satisfaction of the SEBI;
- neither the applicant, nor any person directly or indirectly connected with the applicant has in the past been –
  (i) refused by SEBI a certificate under these regulations or
  (ii) subjected to any proceedings for a contravention of the Act or of any rules or regulations made under the Act.
- the applicant, in all other respects, is a fit and proper person for the grant of a certificate;
- grant of certificate to the applicant is in the interest of investors and the securities market.

Renewal of Certificate

Application fee — Rs 50,000/-

Registration fee for grant of certificate	— Rs 5,00,000/-
Renewal fees	— Rs 10,00,000

Disclosure of Rating Definitions

Credit rating agency should make public the definitions of the concerned rating, along with the symbol and state that the ratings do not constitute recommendations to buy, hold or sell any securities. The information relating to the rationale of the ratings should also be made available to general public, which shall cover an analysis of the various factors justifying a favourable assessment, as well as factors constituting a risk.

RATING SYMBOLS

SEBI observed that the Credit Rating Agencies registered with it use different raring symbols and definitions. So there was a need to be common rating symbols and definitions (i) for easy understanding of the rating symbolsand their meanings by the investors, and (ii) to achieve high standards of integrity and fairness in ratings. SEBI in consultation with the CRAs and on the recommendation of its Corporate Bonds and Securitisation Advisory

Committee, standardised rating symbols and their definitions have been devised for the following:

(a) Long term debt instruments

(b) Short term debt instruments

(c) Long term structured finance instruments

(d) Short term structured finance instruments

(e) Long term mutual fund schemes and

(f) Short term mutual fund schemes.

Rating symbols should have CRA's first name as prefix. For Example: CARE AAA, CARE AA etc.

IPO GRADING

IPO grading (Initial Public Offering Grading) is a service aimed at facilitating the assessment of equity issues offered to public. The grade assigned to any individual issue represents a relative assessment of the 'fundamentals' of that issue in relation to the universe of other listed equity securities in India. IPO grading is expressed on a five-point scale and it is one of the inputs to the investor to aiding in the decision making process. IPO grading is positioned as a service that provides 'an independent assessment of fundamentals' to aid comparative assessment that would prove useful as an information and investment tool for investors.

A company cannot make an initial public offer, unless as on the date of registering prospectus or red herring prospectus with the Registrar of Companies, the issuer has obtained grading for the initial public offer from at least one credit rating agency registered with SEBI. IPO grading is mandatory for making an IPO.

As per SEBI (ICDR) Regulations, every unlisted company obtaining grading for IPO shall disclose all the grades obtained, along with the rationale discretion furnished by the credit rating agency(ies) for each of the grades obtained, in the prospectus, abridged prospectus, issue advertisements and at all other places where the issuer company is advertising for the IPO.

Procedure for IPO Grading

Credit Rating agencies (CRAs) registered with SEBI will carry out IPO grading.

The company needs to first contact one of the grading agencies and mandate it for the grading exercise. The agency would then follow the process outlined below.

– information required for the grading from the company.

– On receipt of required information, have discussions with the company's management and visit the company's operating locations, if required.

– Prepare an analytical assessment report.

– Present the analysis to a committee comprising senior executives of the concerned grading agency.

This committee would discuss all relevant issues and assign a grade.

– Communicate the grade to the company along with an assessment report outlining the rationale for the grade assigned.

Answer the following:

1. Rating is mandatory for_______issue by the company.

Ans: IPO

2. The registration certificate granted to Credit Rating Agencies is valid for________years.

Ans: Three

3. Instruments that are rated 'BB' and below are classified as_________grade ratings.

Ans: speculative

Lesson 4

Securities Market Intermediaries

Market intermediaries are the institutions which facilitate the smooth functioning of the securities market. They enable the issuers of securities to interact with the investors in the primary as well as the secondary arena. The objective of these intermediaries is to smoothen the process of investment and to establish a link between the investors and the users of funds. They help the investors by providing investment consultancy by their expertise in market analysis and also help the corporates for fund raising by their marketing skills.

Role of Capital Market Intermediaries

The role of intermediaries makes the market vibrant, and to function smoothly and continuously. Intermediaries possess professional expertise and play a promotional role in organising a perfect match between the supply and demand for capital in the market. All those, institutions or individuals, who help to bring the savers and seekers of capital and enable a regular flow of funds from supply to demand points are intermediaries.

The following market intermediaries are involved in the Securities Market:

- Merchant Bankers
- Registrars and Share Transfer Agents
- Underwriters
- Bankers to issue
- Debenture Trustees
- Portfolio managers
- Syndicate members
- Foreign Institutional Investor (FII)
- Stock-brokers and sub-brokers
- Custodians
- Investment Advisers
- Credit rating Agencies
- Depository Participant

MERCHANT BANKER

'Merchant Banker' means any person engaged in the business of issue management by making arrangements regarding selling buying or subscribing to securities or acting as

manager/consultant/advisor or rendering corporate advisory services in relation to such issue management.

REGISTRARS AND SHARE TRANSFER AGENTS

'*Registrar to an Issue'* means the person appointed by a body corporate or any person or group of persons to carry on the following activities on its or his or their behalf

'Share Transfer Agent' means:

(i) any person who on behalf of any body corporate, maintains the records of holders of securities issued by such body corporate and deals with all matters connected with the transfer and redemption of its securities;

(ii) the department or division, by whatever name called, of a body corporate performing the activities as share transfer agents if at any time the total number of holders of its securities issued exceed one lakh.

UNDERWRITERS

Underwriter means a person who engages in the business of underwriting of an issue of securities of a body corporate. It is an arrangement whereby certain parties assure the issuing company to take up shares, debentures or other securities to a specified extent in case the public subscription does not amount to the expected levels.

It is Compulsory for a public issue. It is necessary for a public company which invites public subscription for its securities to ensure that its issue is fully subscribed. The company cannot depend on its advertisements to bring in the full subscription. In case of any short-fall, it has to be made good by underwriting arrangements made in advance of the opening of the public issue.

BANKERS TO AN ISSUE

Banker to an Issue means a scheduled bank carrying on all or any of the following activities:

- Acceptance of application and application monies;
- Acceptance of allotment or call monies;
- Refund of application monies;
- Payment of dividend or interest warrants.

DEBENTURE TRUSTEES

'Debenture Trustee' means a trustee of a trust deed for securing any issue of debentures of a body corporate.

Debentures, Bonds and other hybrid instruments in most cases unless otherwise specified, carry securities for the investors. It is necessary that the company makes proper arrangements to extend assurances and comply with legal requirements in favour of the investors who are entitled to this type of security. Intermediaries such as Trustees who are generally Banks and Financial Institutions render this service to the investors for a fee payable by the company.

PORTFOLIO MANAGERS

Portfolio manager means any person who pursuant to contract or arrangement with the client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the clients as the case may be.

SYNDICATE MEMBERS

It is an intermediary registered with SEBI and who is permitted to carry on the activity as an underwriter. The Book Runner(s) may appoint those intermediaries who are registered with the SEBI and who are permitted to carry on activity as an 'Underwriter' as syndicate members. The syndicate members are mainly appointed to collect the entire bid forms in a book built issue.

STOCK BROKERS & SUB-BROKER

Stock-broker is a member of stock exchange and they are the intermediaries who are allowed to trade in securities on the exchange of which they are members. They can buy and sell on their own behalf as well as on behalf of their clients.

Sub-broker means any person who is not a member of stock exchange who acts on behalf of a stock broker as an agent or otherwise for assisting the investors in buying, selling or dealing in securities through such stock brokers.

CUSTODIANS

Who carries on the business of providing custodial services to the client is a custodian. The custodian keeps the custody of the securities of the client. The custodian also provides incidental services like maintaining the accounts of securities of the client, collecting the benefits or rights accruing to the client in respect of securities.

INVESTMENT ADVISERS

Any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called is investment advisor . Investment advisers are those, who guide one about his or her financial dealings and investments.

CREDIT RATING AGENCY

Credit ratings agency means a body corporate engaged in or proposes to be engaged in the business of rating of securities offered by way of public or rights issue. They provide a yardstick against which to measure the risk inherent in any instrument. An investor uses the ratings to assess the risk level and compares the offered rate of return with his expected rate of return (for the particular level of risk) to optimise his risk-return trade-off.

DEPOSITORY PARTICIPANT

The Depositories Act defines a depository to mean "a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under sub-section (IA) of section 12 of the Securities and Exchange Board of India Act, 1992."

A "Depository Participant" (DP) is an agent of the depository who is authorised to offer depository services to investors.

Complying with the requirements prescribed by SEBI/ Depositories the following can be registered as DP Financial institutions, banks, custodians and stockbrokers.

Answer the following:

1. Underwriting is Compulsory for a________.

Ans: public issue

2. Syndicate Member means an intermediary registered with SEBI and who is permitted to carry on the activity as a_________.

Ans: underwriter

3. Market Intermediaries are a link between investors and________.

Ans: users of funds

Lesson 5

Market Infrastructure Institutions – Stock Exchange Trading Mechanism

The stock exchanges in India are regulated in terms of Securities Contract (Regulation) Act, 1956 and SEBI Act, 1992 and the rules and regulations made thereunder.

Membership of stock exchanges is generally given to persons financially sound and with adequate experience/ training in stock market. Their enrolment as member is regulated and controlled by SEBI to whom they have to pay an annual charge. A member of the stock exchange is called 'broker' who can transact on behalf of his clients as well as on his own behalf. A non-member can deal in securities only through members. A broker can also take the assistance of sub-broke whom he can appoint under the procedure of registration.

STOCK EXCHANGE TRADING MECHANISM

The stock exchange is a key institution facilitating the issue and sale of various types of securities. It is a pivot around which every activity of the capital market revolves. In the absence of the stock exchange, the people with savings would hardly invest in corporate securities for which there would be no liquidity (buying and selling facility). Corporate investments from the general public would have been thus lower.

Stock exchanges thus represent the market place for buying and selling of securities and ensuring liquidity to them in the interest of the investors.

Securities are traded in three different ways in stock exchanges ring, namely–settlement basis, spot basis and cash basis.

As far as spot trading is concerned the actual delivery of securities must be made to the buying broker within 48 hours of the contract. It is expected that the seller would be paid by the buyer immediately on delivery of securities.

Types of Securities

Securities traded in the stock exchanges can be classified as under:

(1) *Listed cleared Securities:* The securities admitted for dealing on stock exchange after complying with all the listing requirements and played by the Board on the list of cleared securities are called by this name.

(2) *Permitted Securities*: The securities listed on some of the recognised stock exchanges, when permitted to be traded by those stock exchanges where they are not listed are called permitted securities. Such permission is given if suitable provisions exist in the regulations of the concerned stock exchanges.

Types of Delivery

Types of delivery in the stock exchanges are spot delivery, hand delivery and special delivery.

If the delivery of and payment for securities are to be made on the same day or the next day is said to be spot delivery,.

The delivery is said to be hand delivery, if the delivery and payment are to be made on the delivery date fixed by the stock exchange authorities.

A special delivery is one where the delivery is to be made after the delivery period fixed by the stock exchange authorities.

Margins

An advance payment of a portion of the value of a stock transaction. The amount of credit a broker or lender extends to a customer for stock purchase.

Margin Trading

Margin trading was introduced by SEBI to curb speculative dealings in shares leading to volatility in the prices of securities.

"Initial margin" in this context means the minimum amount, calculated as a percentage of the transaction value, to be placed by the client, with the broker, before the actual purchase. The broker may advance the balance amount to meet full settlement obligations.

"Maintenance margin" means the minimum amount, calculated as a percentage of market value of the securities, calculated with respect to last trading day's closing price, to be maintained by client with the broker.

Book Closure and Record Date

Book closure is the periodic closure of the Register of Members and Transfer Books of the company, to take a record of the shareholders to determine their entitlement to dividends or to bonus or right shares or anyother rights pertaining to shares. Record date is the date on which the records of a company are closed for the purpose of determining the stock holders to whom dividends, proxies rights etc. are to be sent.

Trend Line

When the price of shares moves in a particular direction which persists for a period of time, a price line is regarded as established. When the movement is upward, the trend is called '**BULLISH'** and when the movement is downward it is called **'BEARISH'**. Bear market is a weak or falling market characterised by the dominance of sellers. Whereas Bull market is a rising market with abundance of buyers and relatively few sellers.

Secondary movements that reverse the uptrend temporarily are known as reactions. The movements that reverse the down trend temporarily are known as rallies. When an uptrend breaks in the downward direction, it is called trend reversal.

Trading Volume

Trading volumes confirm whether the rise or fall in prices is in line with the trend. They respectively reflect a BULLISH trend and a BEARISH trend.

MARKET MAKING

Though there are thousand companies listed on the stock exchanges in India only a few of them are being MARKET MAKING. A process known as market making was clearly needed to build up liquidity. Market-making is aimed at infusing liquidity in securities that are not frequently traded on stock exchanges. A market-maker is responsible for enhancing the demand supply situation in securities such as stocks and futures & options (F&O). A market-maker usually is responsible for enhancing activity in a few chosen securities. In the process, the market-maker provides both a buy and a sell quote for his chosen securities. He profits from the spread between buy and sell quotes. For example, if the market-maker gives a bid-ask quote of ` 505-500 (which means the market-maker will buy from the market at ` 500 and sell at ` 505), then the profit is ` 5. For illiquid securities, the profit spreads are usually higher (within a regulator-prescribed band) because of the higher risk taken by the market-maker.

SECURITIES' LENDING AND BORROWING

Securities' Lending and Borrowing describes the market practice whereby securities are temporarily transferred by one party (the lender) to another (the borrower) via an approved intermediary. The Borrower is obliged to return them either on demand or at the end of an agreed term and also has an option to early return. Lender may recall securities at any time within normal market settlement cycle. SLB is a major and growing activity which provides significant benefits for issuers, investors and traders alike. SLB helps in improving market liquidity, more efficient settlement, tighter dealer prices and perhaps a reduction in the cost of capital.

Short Selling

– "Short selling" shall be defined as selling a stock which the seller does not own at the time of trade.

– All classes of investors, viz., retail and institutional investors, shall be permitted to short sell.

– All investors would be required to mandatorily honour their obligation of delivering the securities at the time of settlement.

Settlement System

Settlement is the process of netting of transactions and actual delivery/receipt of securities and transfer deeds against receipts/payment of agreed amount. It is necessary to make a settlement to know the net effect of a series of transaction during a given period.

Settlement date is the date specified for delivery of securities between securities firms. For administrative convenience, a stock exchange divides the year into a number of settlement periods so as to enable members to settle their trades. All transactions executed during the settlement period are settled at the end of the settlement period.

TRADE SETTLEMENT CYCLE

India is one of the most advanced markets when it comes to settlement of trade. The domestic market follows a T+2 settlement cycle.

ROLLING SETTLEMENT

In a rolling settlement, each trading day is considered as a trading period and trades executed during the day are settled based on net obligations for the day. In India, trades in rolling settlement are settled on a T+2 basis i.e. on the 2nd working day after a trade.

AUCTION

On account of non-delivery of securities by the trading member on the pay-in day, securities are put up for auction by the exchange. This ensures that buying trading member receives the securities. The Exchange purchases the requisite quantity in auction market and gives them to the buying trading member.

BOMBAY STOCK EXCHANGE LTD.

Bombay Stock Exchange Ltd., popularly known as "BSE" was established in 1875 as "The Native Share and Stock Brokers Association". It is the oldest one in Asia. The Exchange, provides market for trading in securities, debt and derivatives upholds the interests of the investors and ensures redressal of their grievances whether against the companies or its own member-brokers. It also strives to educate and enlighten the investors by conducting investor education programmes and making available to them necessary informative inputs.

Trading at BSE

The scrips traded on BSE have been classified into various groups.

BSE has, for the guidance and benefit of the investors, classified the scrips in the Equity Segment into 'A', 'B', 'T', and 'Z' groups on certain qualitative and quantitative parameters.

The “F” Group represents the Fixed Income Securities.

The “T” Group represents scrips which are settled on a trade-to-trade basis as a surveillance measure.

Trading in Government Securities by the retail investors is done under the “G” group.

The 'Z' group was introduced by BSE in July 1999 and includes companies which have failed to comply with its listing requirements and/or have failed to resolve investor complaints and/or have not made the required arrangements with both the Depositories, viz., Central Depository Services (I) Ltd. (CDSL) and National Securities Depository Ltd. (NSDL) for dematerialization of their securities.

The scrips of companies which are in demat can be traded in market lot of 1. However, the securities of companies which are still in the physical form are traded in the market lot of generally either 50 or 100. Investors having quantities of securities less than the market lot are required to sell them as “Odd Lots”. This facility offers an exit route to investors to dispose of their odd lots of securities, and also provides them an opportunity to consolidate their securities into market lots.

BASKET TRADING SYSTEM

With a view to provide investors the facility of creating Sensex linked portfolios and also to create a linkage of market prices of the underlying securities of Sensex in the Cash Segment and Futures on Sensex, the Exchange has provided to the investors as well its member-brokers, a facility of Basket Trading System on BOLT. In the Basket Trading System, the investors through the member-brokers of the Exchange are able to buy/sell all 30 scrips of Sensex in one go in the proportion of their respective weights in the Sensex. The investors need not calculate the quantity of Sensex scrips to be bought or sold for creating Sensex linked portfolios and this function is performed by the system. The investors can also create their own baskets by deleting certain scrips from 30 scrips in the Sensex.

SETTLEMENT SYSTEM AT BSE

Compulsory Rolling Settlement

All transactions in all groups of securities in the Equity segment and Fixed Income securities listed on BSE are required to be settled on T+2 basis (w.e.f. April 1, 2003). The settlement calendar, which indicates the dates of the various settlement related activities, is drawn by BSE in advance and is circulated among the market participants.

Market Abuse

Market abuse is a broad term which includes abnormal price/ volume movement, artificial transactions, false or misleading impressions, insider trading, etc. In order to detect aberrant behaviour/ movement, it is necessary to know the normal market behaviour. The department uses various tools to determine normal and abnormal market behaviour. The necessary actions are initiated like imposition of special margin, reduction of circuit filters, trade to trade settlement, suspensions, de-activation of terminals, etc. to control abnormal market behaviour.

NATIONAL STOCK EXCHANGE OF INDIA LTD. (NSEIL)

The National Stock Exchange of India Limited (NSEIL) was established to provide an efficient system eliminating all the deficiencies of stock exchanges and is geared to meet the requirements of the large investor population. It is a single stock exchange and all other centres are electronically linked to this exchange. NSEIL was promoted by leading FIs at the behest of Government of India and was incorporated in November 1992.

Capital Market Segment

The Capital Market (CM) segment of NSEIL provides a fully automated screen based trading system for trading of equity and preference shares, debentures, warrants and coupons. The trading system, known as the National Exchange for Automated Trading (NEAT) system, is an anonymous order-driven system and operates on a strict price/time priority. It enables members from across the country to trade simultaneously with enormous ease and efficiency.

Wholesale Debt Market Segment

The WDM segment provides the only formal trading platform for trading of a wide range of debt securities. Initially, government securities, treasury bills and bonds issued by public sector undertakings (PSUs) were made available for trading. This range has been widened to include non-traditional instruments like floating rate bonds, zero coupon bonds, index bonds, commercial papers, certificates of deposit, corporate debentures, state government loans, SLR and non-SLR bonds issued by financial institutions, units of mutual funds and securitised debt. This market is also fully automated and screen based trading is enabled.

Contracts

Futures contract on the NSEIL is based on S&P CNX Niftv Index. Currently, it has a maximum of 3-month expiration cycle. Three contracts are available for trading with 1 month, 2 months and 3 months expiry.

TRADING AND SETTLEMENT AT NSE

NSE introduced for the first time in India, fully automated screen based trading. It uses a modern, fully computerized trading system designed to offer investors across the length and breadth of the country a safe and easy way to invest.

National Securities Clearing Corporation Limited (NSCCL)

This company incorporated as a wholly owned subsidiary of the National Stock Exchange of India Limited carries out clearing and settlement of the trades executed in the capital market segment of National StockmExchange. This company completes the settlement promptly without delay or deferment.

Clearing Mechanism

Trades in rolling segment are cleared and settled on a netted basis. Trading and settlement periods are specified by the Exchange/Clearing Corporation from time to time. Deals executed during a particular trading period are netted at the end of that trading period and settlement obligations for that settlement period are computed. A multilateral netting procedure is adopted to determine the net settlement obligations.

In a rolling settlement, each trading day is considered as a trading period and trades executed during the day are netted to obtain the net obligations for the day.

SME EXCHANGE

SME exchange means a trading platform of a recognised stock exchange having nationwide trading terminals permitted by SEBI to list the specified securities issued in accordance with SEBI (ICDR) Regulation and includes a stock exchange granted recognition for this purpose.

The two stock exchange of India i.e. Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) have begun their SME listing platforms. While BSE SME Exchange began its operation in March, 2012, NSE's SME exchange titled EMERGE commenced operations in September, 2012.

Model Listing Agreement for SMEs

To facilitate listing of specified securities in the SME exchange, “Model Equity Listing Agreement” to be executed between the issuer and the Stock Exchange, to list/migrate the specified securities on SME Exchange. The listing agreement covers routine listing compliances such as intimation to exchange, publication requirements, Corporate Governance compliances etc. All listed SMEs on SME platform are also required to appoint the Company Secretary of the Issuer as Compliance Officer who will be responsible for monitoring the share transfer process and report to the Issuers board in each meeting.

ALGORITHMIC TRADING

Any order that is generated using automated execution logic shall be known as algorithmic trading. With the increasing trend amongst capital market players of generating orders through automated execution logic called Algorithmic Trading. SEBI have formulated broad guidelines

to be followed by both Stock Exchanges and Stock Brokers for Algorithmic Trading. These guidelines permits secure systems for algorithmic trading and help to keep pace with the speed of trade and volume of data that may arise through it.

Answer the following:

1. A rising market with abundance of buyers and relatively few sellers is known as_______.

Ans: Bull Market

2. ________ are member brokers of a stock exchange who specialize, by giving two way quotations, in buying and selling of securities from and to fellow members.

Ans: Jobber

3. Selling a stock which the seller does not own at the time of trade is__________.

Ans: Short Selling

Lesson 6

Debt Market

Debt markets are markets for the issuance, trading and settlement of various types and features of fixed income securities. Fixed income securities can be issued by any legal entity like central and state governments, public bodies, statutory corporations, banks and institutions and corporate bodies. The debt market in India comprises mainly of two segments viz., the Government securities market consisting of Central and State Governments securities, Zero Coupon Bonds (ZCBs), Floating Rate Bonds (FRBs), T-Bills and the corporate securities market consisting of FI bonds, PSU bonds, and Debentures/Corporate bonds. Government securities form the major part of the market in terms of outstanding issues, market capitalization and trading value.

Negotiated Dealing System (NDS) is an electronic platform for facilitating dealing in Government Securities and Money Market Instruments. NDS facilitates electronic submission of bids/application by members for primary issuance of Government Securities by RBI through auction and floatation. It will provide an interface to the Securities Settlement System.

DEBT MARKET INSTRUMENTS

Corporate debenture

A Debenture is a debt security issued by a company, which offers to pay interest in lieu of the money borrowed for a certain period. In essence it represents a loan taken by the issuer who

pays an agreed rate of interest during the lifetime of the instrument and repays the principal normally, unless otherwise agreed, on maturity.

Fixed income products

Deposit: Deposits serve as medium of saving and as a means of payment and are a very important variable in the national economy. A bank basically has three types of deposits, i.e. time deposit, savings deposit and current account.

Fixed Deposit: Fixed Deposits are sums accepted by most of the NBFCs and banks. The amount of deposits that may be raised by NBFCs is linked to its net worth and rating. However, the interest rate that may be offered by a NBFC is regulated.

Zero Coupon Bonds

A plain bond is offered at its face value, earns a stream of interest till redemption and is redeemed with or without a premium at maturity. A zero coupon bond is issued at a discount to its face value, fetches no periodic interest and is redeemed at the face value at maturity.

DERIVED INSTRUMENT

These instruments are not direct debt instruments. Instead they derive value from various debt instruments. Mortgage bonds, Pass Through Certificates, Securitised Debt Instruments etc. fall under this category.

Mortgage Bonds

Mortgage backed bonds is a collateralized term-debt offering. Every issue of such bonds is backed by a pledged collateral. Property that can be pledged as security for mortgage bonds is called eligible collateral.

Pass Through Certificates

When mortgages are pooled together and undivided interest in the pool are sold, pass-through securities are created. The pass-through securities promise that the cash flow from the underlying mortgages would be passed through to the holders of the securities in the form of monthly payments of interest and principal.

Participation Certificates

These are strictly inter-bank instruments confined to the Scheduled Commercial Banks. This instrument is a money market instrument with a tenure not exceeding 90 days. The interests on such participation certificate are determined by the two contracting banks.

BENCHMARKED INSTRUMENTS

There are certain debt instruments wherein the fixed income earned is based on a benchmark. For instance, the

Floating Interest rate Bonds are benchmarked to either the LIBOR, MIBOR etc.

MONEY MARKET INSTRUMENTS

Call Money

Call/Notice money is an amount borrowed or lent on demand for a very short period. If the period is more than one day and upto 14 days it is called 'Notice money' otherwise the amount is known as Call money. No collateral security is required to cover these transactions.

Treasury Bills

In the short term, the lowest risk category instruments are the treasury bills. RBI issues these at a prefixed date and a fixed amount. These include 91-day T-bills, 182-Day T-bills, and 364-day T-bills.

The banks are the usual investors who invest not only to part their short-term surpluses. These T-bills, which are issued at a discount, can be traded in the market. The transaction cost on T-bills is nonexistent and trading is considerably high in each bill, immediately after its issue and immediately before its redemption.

Term Money Market

Inter-bank market for deposits of maturity beyond 14 days and upto three months is referred to as the term money market.

Certificates of Deposits (CDs)

This is a lower risk category investment option issued by banks and Financial Institutions.

CDs are issued by banks and FIs mainly to augment funds by attracting deposits from corporates, high net worth individuals, trusts, etc.

Commercial Papers (CP)

CPs are negotiable short-term unsecured promissory notes with fixed maturities, issued by well rated companies generally sold on discount basis. Companies can issue CPs either directly to the investors or through banks /merchant banks (called dealers).

Inter-corporate Deposits

An ICD is an unsecured loan extended by one corporate to another. This market allows funds surplus corporates to lend to other corporates. As the cost of funds for a corporate is much higher than a bank, the rates in this market remain higher than those in the other markets.

Commercial Bills

Bills of exchange are negotiable instruments drawn by the seller of the goods on the buyer of the goods for the value of the goods delivered. These bills are called trade bills. These trade bills are called commercial bills when they are accepted by commercial banks.

INVESTORS IN DEBT MARKET

Investors are the entities who invest in fixed income instruments. The investors in such instruments are generally Banks, Financial Institutions, Mutual Funds, Insurance companies, Provident Funds, Trusts, Corporate Treasuries, Foreign Institutional Investors and Retail Investors The individual investors

DEBT MARKET INTERMEDIARIES/PARTICIPANTS

Primary Dealers

Primary dealers (PDs) are important intermediaries in the government securities markets. They act as underwriters in the primary market, and as market makers in the secondary market invest to a great extent in Fixed Income products.

Brokers

Brokers play an important role in secondary debt market by bringing together counterparties and negotiating terms of the trade. It is through them that the trades are entered on the stock exchanges. The brokers are regulated by the stock exchanges and also by SEBI.

DEBT MARKET IN INDIA – REGULATORY FRAMEWORK

The Union government and the State Governments have been empowered under Articles 292 and 293 of the Constitution of India to borrow money upon the security of the Consolidated Fund of India and the States within permissible limits. The Constitution also empowers the

Union and the State Governments to give guarantees within such limits as may be fixed. The Union Government debt consists of three components,–internal debt, external debt and "other liabilities".

ROLE OF RBI

The Reserve Bank of India manages the public debt and issues new loans on behalf of the Union and the State Governments under the powers derived from the Reserve Bank of India Act. It also undertakes cash and liquidity management for the Government of India and State Governments and administers the scheme of Ways and Means Advances (WMA).The Reserve Bank of India is, therefore, the main regulator for the Money Market. Reserve Bank of India also controls and regulates the G-Secs Market.

ROLE OF SEBI

The Securities and Exchange Board of India (SEBI) controls bond market and corporate debt market in cases where entities raise money from public through public issues. It regulates the manner in which such moneys are raised and ensure a fair play for the retail investor. The issuers are required to make the retail investor aware, of the risks inherent in the investment, by way of disclosure. Being regulator for the Mutual Funds in India SEBI regulates the entry of new mutual funds in the industry and also the instruments in which mutual funds can invest.

SEBI (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2009

Issue and listing of non-convertible debt securities, whether issued to the public or privately placed, are required to be made in accordance with the provisions of SEBI (Issue and Listing of Debt Securities) Regulations, 2008. Issue of debt securities that are convertible, either partially or fully or optionally into listed or unlisted equity shall be guided by the disclosure norms applicable to equity or other instruments offered on conversion in terms of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

SEBI (ISSUE AND LISTING OF DEBT SECURITIES) REGULATIONS, 2008

SEBI issued (Issue and Listing of Debt Securities) Regulations, 2008 pertaining to issue and listing of debt securities which are not convertible, either in whole or part into equity instruments. They provide for a rationalized disclosure requirements and a reduction of certain onerous obligations erstwhile attached to an issue of debt securities. These Regulations are applicable to a company with a public issue of

(i) Debt Securities

(ii) Listing of debt securities issued through public issue or on private placement basis on a recognized stock exchange.

SEBI (PUBLIC OFFER AND LISTING OF SECURITISED DEBT INSTRUMENTS) REGULATIONS, 2008

SEBI notified SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 on May 26, 2008 taking into account the market needs, cost of the transactions, competition policy, the professional expertise of credit rating agencies, disclosures and obligations of the parties involved in the transaction and the interest of investors in such instruments.

OTHER REGULATOR

Apart from the two main regulators, the RBI and SEBI, there are several other regulators specific for different classes of investors. The Central Provident Fund Commissioner and the Ministry of Labour regulate the Provident Funds. Religious and Charitable trusts are regulated by some of the State governments of the states, in which these trusts are located.

LISTING AND TRADING OF DEBT SECURITIES

Continuous Listing

All the Companies shall comply with the conditions of listing specified in the respective listing agreement for debt securities while making public issues of debt securities or seeking listing of debt securities issued on private placement basis.

Trading

While issuing debt securities to the public or on a private placement basis, which are listed in recognized stock exchanges, shall be traded and such trades shall be cleared and settled in recognized stock exchanges it should satisfy the conditions as specified by SEBI.

SIMPLIFIED LISTING AGREEMENT FOR DEBT SECURITIES

The disclosures in the draft listing agreement are based on the principle that if an issuer has his equity already listed such issuer is required to make only minimal incremental disclosures specific to its debt issuance. Issuers who have only listed its debt securities listed and not equity, reasonably elaborate disclosures are prescribed.

Answer the following:

1. __________ is an electronic platform for facilitating dealing in Government Securities and Money Market Instruments.

Ans: Negotiated Dealing System

2. Mortgage backed bonds is a______term-debt offering.

Ans: collateralized

3. The risk involved in the_____is the least.

Ans: Treasury Bills

Lesson 7

Money Market

Money Market is the market for dealing in monetary assets of short-term nature. Short-term funds up to one year and financial assets that are close substitutes for money are dealt in the money market. Money market instruments have the characteristics of liquidity (quick conversion into money), minimum transaction cost and no loss in value.

The money market functions as a wholesale debt market for low-risk, highly liquid, short term instruments. Funds are available in this market for periods ranging from a single day upto a year. Mostly government, banks and financial institutions dominate this market. It is a formal financial market that deals with short-term fund management.

FEATURES OF MONEY MARKET

1. A balancing mechanism for short-term surpluses and deficiencies.

2. A focal point of central bank intervention for influencing liquidity in the economy, and

3. A reasonable access to the users of short-term funds to meet their requirements at realistic/reasonable price or cost.

DIFFERENCE BETWEEN MONEY MARKET Vs. CAPITAL MARKET

Basis of Difference	Money Market	Capital Market
Regulator	Reserve Bank of India	Securities Exchange Board of India
Maturity Period	Short term, generally less than a year	Long term, generally more than a year.
Credit Instruments	Call money, treasury bills, commercial bills, commercial papers, and bills of exchange.	shares, debentures, bonds, corporate deposits etc.
Institutions	central banks, commercial banks, acceptance houses, non banking financial institutions, bill brokers, etc .	stock exchanges, commercial banks and non banking institutions, such as insurance companies, mortgage banks, etc
Purpose of Loan	Short term	Long term

Risk & Liquidity	Low risk and high liquidity	High risk and low liquidity

The Indian Money Market consists of two types of segments: an organized segment and an unorganized segment. In the unorganized segment interest rates are much higher than that in the organized segment.

The Indian Money Market

- *Organised*
  - Reserve Bank of India, State Bank of India with its associate Banks,
  - Public Sector Banks, Private Sector Commercial Banks including Foreign Banks, Regional Rural Banks, Non- Scheduled Commercial Banks, apart from Non-banking Financial Intermediaries such as LIC, GIC etc
- *Unorganiesd*
  - Indigenous bankers, money lenders and other non-bank financial intermediaries such as Chit Funds.

MONEY MARKET INSTRUMENTS

1. **Treasury bills**

Treasury Bills are money market instruments issued by RBI to finance the short term requirements of the Government of India. These are discounted securities and thus are issued at a discount to face value. The return to the investor is the difference between the maturity value and issue price.

In the short term category of investment instruments, the treasury bill carry the lowest risk. RBI issues these at a prefixed date and of a fixed amount.

There are four types of treasury bills:

14-day T bill, 91-day T bill, 182-day T bill and 364-day T bill.

Benefits of investment in treasury bills

(a) no tax deducted at source

(b) Zero default risk being sovereign paper

(c) Highly liquid money market instrument

(d) Better returns especially in the short term

(e) Transparency

(f) Simplified settlement

(g) High degree of tradeability and active secondary market facilitates meeting unplanned fund requirements.

Trading in T-Bill

In the primary market, treasury bills are issued by ***auction technique***.

There are two types of auction for treasury bills:

Multiple Price Based or French Auction: Under this method, all bids equal to or above the cut-off price are accepted. However, the bidder has to obtain the treasury bills at the price quoted by him.

Uniform Price Based or Dutch Auction: Under this system, all the bids equal to or above the cut-off price are accepted at the cut- off level. However, unlike the Multiple Price based method, the bidder obtains the treasury bills at the cut-off price and not the price quoted by him.

Secondary Market

The participants can also trade T-bills held from primary market in the secondary market established for the purpose. The major advantages of dealing in treasury bill secondary market are: Market related yields, ideal matching for funds management particularly for short-term tenors of less than 15 days, Transparency in operations as the transactions would be put through Reserve Bank of India's SGL or Client's Gilt account only, two way quotes offered by primary dealers for purchase and sale of treasury bills and certainty in terms of availability, entry and exit.

2. **Certificates of deposits**

Certificate of Deposits (CDs) is a negotiable money market instrument which are issued in dematerialised form or as Usance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period. Guidelines for issue of CDs are presently governed by various directives issued by the Reserve Bank of India, as amended from time to time.

CDs can be issued by:

(i) scheduled commercial banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs);

(ii) selected all-India Financial Institutions that have been permitted by RBI to raise short-term resources within the umbrella limit fixed by RBI.

The maturity period of CDs issued by banks should be not less than 7 days and not more than one year. The FIs can issue CDs for a period not less than 1 year and not exceeding 3 years from the date of issue.

3. **Inter-corporate deposits**

Apart from CDs, corporates also have access to another market called the Inter Corporate Deposits (ICD) market. An ICD is an unsecured loan extended by one corporate to another. Existing mainly as a refuge for low rated corporates, this market allows corporates with surplus funds to lend to other corporates facing shortage of funds. Another aspect of this market is that the better-rated corporates can borrow from the banking system and lend in this market to make speculative profits.

4. Commercial bills

Commercial bills are basically negotiable instruments accepted by buyers for goods or services obtained by them on credit. Such bills being bills of exchange can be kept upto the due maturity date and encashed by the seller or may be endorsed to a third party in payment of dues owing to the latter. The most common practice is that the seller who gets the accepted bills of exchange discounts it with the Bank or financial institution or a bill discounting house and collects the money (less the interest charged for the discounting).

5. Commercial paper

Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note. CP, as a privately placed instrument, was introduced in India in 1990 with a view to enable highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors.

A corporate would be eligible to issue CP provided:

(a) the tangible net worth of the company, as per the latest audited balance sheet, is not less than Rs. 4 crore.

(b) the company has been sanctioned working capital limit by bank/s or FIs

(c) the borrowal account of the company is classified as a Standard Asset by the financing bank/institution.

All eligible participants shall obtain credit rating for issuance of CP from any one of the registered credit rating agencies. CP can be issued for maturities between a minimum of 7 days and a maximum of up to one year from the date of issue. The maturity date of the CP should not go beyond the date up to which the credit rating of the issuer is valid.

6. Factoring

Factoring is a financial transaction where an entity sells its receivables to a third party called a 'factor', at discounted prices. Factoring is a financial option for the management of receivables. In simple definition it is the conversion of credit sales into cash. In factoring, a financial institution (factor) buys the accounts receivable of a company (Client) and pays up to 80% (rarely up to 90%) of the amount immediately on formation of agreement. Factoring company pays the remaining

amount (Balance 20%-finance cost-operating cost) to the client when the customer pays the debt. Collection of debt from the customer is done either by the factor or the client depending upon the type of factoring.

Parties in factoring

The factoring transaction involves three parties:

– The Seller, who has produced the goods/services and raised the invoice.

– The Buyer, the consumer of goods/services and the party to pay.

– The Factor, the financial institution that advances the portion of funds to the seller.

Advantages for the seller

– Seller gets funds immediately after the sale is effected and on presentation of accepted sales invoices and Promissory notes.

– Major part of paper work and correspondence is taken care of by the factor.

– Follow-up, for recovery of funds, is done mainly by the factor.

– Interest rates are not as high as normal discounting.

– Increased cash flow to meet payroll.

– Immediate funding arrangements.

– No additional debt is incurred on balance sheet.

– Other assets are not encumbered.

– Approval is not based on seller's credit rating.

Types of factoring

Non-Recourse or Full factoring: Under this type of factoring the bank takes all the risk and bear all the loss in case of debts becoming bad debts.

Recourse Factoring: Under this type of factoring the bank purchases the receivables on the condition that any loss arising out or bad debts will be borne by the company which has taken factoring.

Maturity Factoring: Under this type of factoring bank does not give any advance to the company rather bank collects it from customers and pays to the company either on the date of collection from the customers or on a guaranteed payment date.

Advance Factoring: Under advance factoring arrangement the factor provides an advance against the uncollected and non-due receivables to the firm.

Undisclosed Factoring: Under this type of factoring, the customer is not informed of the factoring arrangement. The firm may collect dues from the customer on its own or instruct to make remit once at some other address.

Invoice Discounting: Under this type of factoring the bank provide an advance to the company against the account receivables and in turn charges interest rate from the company for the payment which bank has given to the company.

7. **Bills rediscounting**

Bill redisounting means the rediscounting of trade bills, which have already been purchased by/discounted with the bank by the customers. Trade bills arise out of supply of goods/services. Bill rediscounting is a money market instrument where the bank buys the bill before it is due and credits the value of the bill after a discount charge to the customer's account. Now, the bank which has discounted the bill may require getting it 'rediscounted' with some other bank to get the fund.

Answer the following:

1. Credit rating is mandatory for the issue of________________.

Ans: Commercial Paper.

2. In ______ the bidder has to obtain the treasury bills at the price quoted by him.

Ans: French Auction

3.__________is a financial option for the management of receivables.

Ans: Factoring

Lesson 8

Mutual Funds

Mutual fund is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with objectives as disclosed in offer document. Mutual fund issues units to the investors in accordance with quantum of money invested by them. Investors of mutual funds are known as unit holders. The profits or losses are shared by

the investors in proportion to their investments. The mutual funds normally come out with a number of schemes with different investment objectives which are launched from time to time. A mutual fund is required to be registered with SEBI which regulates securities markets before it can collect funds from the public.

Advantages of mutual funds

- Professional Management
- Diversification
- Convenient Administration
- Return Potential
- Low Costs
- Liquidity
- Transparency

SCHEMES OF MUTUAL FUND

According to maturity period

(i) Open ended mutual funds: is a fund with a non-fixed number of outstanding shares/units, that stands ready at any time to redeem them on demand.

(ii) Close ended mutual funds: It is the fund where mutual fund management sells a limited number of shares and does not stand ready to redeem them.

According to investment objective

(a) Income Oriented Schemes: The fund primarily offers fixed income to investors. Naturally enough, the main securities in which investments are made by such funds are the fixed income yielding ones like bonds.

(b) Growth Oriented Schemes: These funds offer growth potentialities associated with investment in capital market namely: (i) high source of income by way of dividend and (ii) rapid capital appreciation, both from holding of good quality scrips.

(c) Hybrid Schemes: These funds cater to both the investment needs of the prospective investors – namely fixed income as well as growth orientation.

(d) High Growth Schemes: these funds primarily invest in high risk and high return volatile securities in the market and induce the investors with a high degree of capital appreciation.

(e) Capital Protection Oriented Scheme: It is a scheme which protects the capital invested in the mutual fund through suitable orientation of is portfolio structure.

(f) Tax Saving Schemes: These schemes offer tax rebates to the investors under tax laws as prescribed from time to time.

(g) Special Schemes: This category includes index schemes that attempt to replicate the performance of particular index such as the BSE, Sensex or the NSE-50 or industry specific schemes or sectoral schemes.

(h) Real Estate Funds: These are close ended mutual funds which invest predominantly in real estate and properties.

(i) Off-shore Funds: Such funds invest in securities of foreign companies with RBI permission.

(j) Leverage Funds: Such funds, also known as borrowed funds, increase the size and value of portfolio and offer benefits to members from out of the excess of gains over cost of borrowed funds.

(k) Hedge Funds: They employ their funds for speculative trading, i.e. for buying shares whose prices are likely to rise and for selling shares whose prices are likely to dip.

(l) Fund of Funds: They invest only in units of other mutual funds. Such funds do not operate at present in India.

(m) New Direction Funds: They invest in companies engaged in scientific and technological research such as birth control, anti-pollution, oceanography etc.

*(n) Exchange Trade Funds (ETFs):*An exchange-traded fund (ETF) is an investment fund traded on stock exchanges, much like stocks.[1] An ETF holds assets such as stocks, commodities, or bonds, and trades close to its net asset value over the course of the trading day.

(o) Money Market Mutual Funds: These funds invest in short- term debt securities in the money market like certificates of deposits, commercial papers, government treasury bills etc. Owing to their large size, the funds normally get a higher yield on such short term investments than an individual investor.

(p) Infrastructure Debt Fund: They invest primarily in the debt securities or securitized debt investment of infrastructure companies.

Investment Strategies

Bottom up Investing: This is an investment strategy which considers the fundamental factors driving individual stock performance before considering the economic prospectus which affect the industry and within which the company operates.

Top down Investing: This is an investment strategy which first takes a view on the economy and then looks at the industry scenario to assess the potential performance of a company. This is opposite to Bottom up Technique.

Equity funds are considered aggressive in so far as higher capitalisation is sought. Investors should have a long term orientation, since companies shares give fluctuating dividends and offer benefits only in the long run through rights issue, bonus issue etc.

Balanced funds: are considered moderate since investors seek growth and stability but with moderate risk.

Income funds are regarded as conservative since investors want regular income and can not wait for more than short to medium term.

Money market funds are regarded as high liquidity oriented as investors attach more value for safety and liquidity.

Sector funds invest only in shares of companies belonging to a specific industry. These funds perform well so long as the industry or the sector is in the upswing, but the risk could be high, if the industry or the sector goes down.

Mode of Payment

- Cheque/Demand Draft

- ASBA process - Application Supported By Blocked Amount

The Mutual Funds/AMCs have to compulsorily provide ASBA facility to the investors for all the NFOs launched by them

Risks Involved In Mutual Funds

Mutual funds may face the following risks, leading to non-satisfactory performance:

1. Excessive diversification of portfolio, losing focus on the securities of the key segments.

2. Too much concentration on blue-chip securities which are high priced and which do not offer more than average return.

3. Necessity to effect high turnover through liquidation of portfolio resulting in large payments of brokerage and commission.

4. Poor planning of investment with minimum returns.

5. Unresearched forecast on income, profits and Government policies.

6. Fund managers being unaccountable for poor results.

7. Failure to identify clearly the risk of the scheme as distinct from risk of the market.

NET ASSET VALUE (NAV)

Mutual funds raise money by selling their shares to public and redeeming them at current net asset value. Net asset value is the value of the assets of each unit of the scheme. Every mutual fund shall compute the NAV of each scheme by dividing the net asset of the scheme by the number of units of that scheme outstanding on the date of valuation and public the same at least in two daily newspapers at intervals not exceeding one week. However, the net asset value of any scheme for special target segment or any monthly scheme which are not mandatorily required to be listed in the stock exchange may publish the NAV at monthly or quarterly intervals as permitted by SEBI.

NAV (Rs) = Market/Fair Value of Scheme's investments + Current Assets - Current liabilities and Provision/ No. of units outstanding under scheme on the valuation date

The NAV shall be calculated upto four decimals.

SEBI (MUTUAL FUND) REGULATIONS, 1996

These regulations were notified by SEBI in exercise of its powers conferred by section 30 read with clause (c) of section 11(2) of SEBI Act, 1992.

Important definitions

Advertisement: shall include all forms of communication issued by or on behalf of the asset management company/mutual fund that may influence investment decisions of any investor/prospective investors.

Asset Management Company: means a company formed and registered under the Companies Act, 1956 and approved as such by SEBI under Regulation 21(2).

Custodian: means a person who has been granted a certificate of registration to carry on the business of custodian securities under SEBI (Custodian of Securities) Regulations, 1996.

Sponsor: means any person who, acting alone or in combination with another body corporate establishes a mutual fund.

Trustees: mean the Board of Trustees or the Trustee Company who hold the property of the mutual fund in trust for the benefit of the unit holders.

Unit: means the interest of the unit holders in a scheme which consists of each unit representing one undivided share in the assets of a scheme.

Unit Holder: means a person holding one or more units in a scheme of a mutual fund.

Listing of close ended scheme

Regulation 32 lays down that every close ended scheme other than an equity linked saving scheme shall be listed in a recognised stock exchange within such time period and subject to condition as specified by SEBI. It also indicates cases in which such listing may not be mandatory.

Guaranteed returns

Regulation 38 lays down that **no guaranteed return** shall be provided in a scheme unless fully guaranteed by the sponsor or AMC. The name of the person guaranteeing the return shall be mentioned in the offer document and the manner in which the guarantee is to be met be also indicated therein.

Delisting of units

The units of a mutual fund scheme shall be delisted from a recognized stock exchange in accordance with the regulations as may be specified by SEBI.

Duties of Asset Management Company

(1) Lay down an adequate system of internal controls and risk management.

(2) Exercise due diligence in maintenance of the assets of an infrastructure debt fund scheme and shall ensure that there is no avoidable deterioration in their value.

(3) Record in writing, the details of its decision making process in buying or selling infrastructure companies' assets together with the justifications for such decisions and forward the same periodically to trustees.

(4) Investment of funds of the Infrastructure Debt Fund schemes is not made contrary to provisions of this chapter and the trust deed.

(5) Obtain prior in principle approval from the recognized stock exchange(s) where units are proposed to be listed.

(6) Ensure that proper care is taken for collection, monitoring and supervision of the debt assets by appointing a service provider having extensive experience thereof, if required.

Answer the following:

1. ________facility is compulsory for new NFOs launched by AMC.

Ans: ASBA

2. As per SEBI Regulation, AMC______guarantee a fixed return to the unit holders.

Ans: cannot

3. _______means any person who, acting alone or in combination with another body corporate establishes a mutual fund.

Ans: Sponsor

Lesson 9

Alternative Investment Fund

SEBI had earlier framed the SEBI (Venture Capital Funds) Regulations, 1996 ("VCF Regulations") to encourage investments into start-ups and mid-size companies. Since the introduction of the VCF Regulations, it was observed by SEBI that the venture capital route was being used by several other categories of funds such as private equity funds, real estate funds etc. Further since registration as a venture capital fund ("VCF") was not mandatory under the VCF Regulations, not all private equity or other categories of funds were registering with

the SEBI. While these funds did not enjoy certain exemptions that were available to VCFs, they were not subjected to any investment restrictions either.

Accordingly, SEBI notified the Alternative Investment Fund (AIF) Regulations to govern unregulated entities and create a level playing ground for existing venture capital investors.

The AIF Regulations aim to regulate funds involved in the pooling or raising of private capital from institutional investors or high net worth investors ("HNI"). Existing VCFs will be permitted to continue and shall be governed by the VCF Regulations till such fund or scheme managed by the fund is wound up. VCFs will not be permitted to raise any fresh funds after notification of these regulations, as aforesaid, except or commitments already made by investors as on the date of the notification.

SEBI (ALTERNATIVE INVESTMENT FUNDS) REGULATIONS, 2012

The Securities and Exchange Board of India ("SEBI") has notified the SEBI (Alternative Investment Funds) Regulations, 2012 on 21 May, 2012 - a comprehensive regulatory framework for regulating private pools of capital or Alternative Investment Funds, thus bringing various funds investing in Indian securities under a unified regulatory umbrella. This Regulation has replaced the existing SEBI (Venture Capital Funds)

Alternative Investment Fund

AIF means any fund established in India in the form of a trust, company, limited liability partnership or a body corporate which:-

(i) is a privately pooled investment vehicle that collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors; and

(ii) is not covered under the SEBI (Mutual Funds) Regulations, 1996, SEBI (Collective Investment Schemes) Regulations, 1999 or any other regulations of SEBI, which aims to regulate fund management activities.

Sponsor

It means any person or persons who set up the Alternative Investment Fund and includes promoter in case of a company and designated partner in case of a limited liability partnership.

Venture Capital Funds

These funds will primarily invest in unlisted securities of startups, emerging or early stage venture capital undertakings mainly involved in new products, new services, technology or intellectual property rights based activities or a new business model.

Categories of AIF

SEBI has classified AIF into the following broad categories:

Category I: - Funds that invest in start-up or early stage ventures or social ventures or Small Medium Enterprises (SMEs) or infrastructure or other sectors which the government or regulators consider as socially or economically desirable which include VCF, SME Funds, Social Venture Funds (SVF), Infra Funds and such other AIFs as may be specified in the AIF Regulations.

Angel Fund
Angel fund means a sub-category of Venture Capital Fund under Category I- Alternative Investment Fund that raises funds from angel investors and invests in accordance with the provisions of Chapter III-A of these regulations.

Category II: - Funds that do not fall in Category I and III AIF and those that do not undertake leverage or borrowing other than to meet the permitted day to day operational requirement including Private Equity Funds or Debt Funds.

Category III: - Funds that employ diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives, for e.g. Hedge Funds.

Registration of AIF

– All AIFs are required to be mandatorily registered under any one of the above mentioned categories.

– AIF Regulations permit launch of multiple schemes under an AIF without separate registration from SEBI subject to filing of Information Memorandum with SEBI.

– The certificate of registration, once granted, shall be valid till the concerned AIF is wound up.

Investment in alternative investment fund

Investment in all categories of Alternative Investment Funds shall be subject to the following conditions:-

(a) the Alternative Investment Fund may raise funds from any investor whether Indian, foreign or non resident Indians by way of issue of units;

(b) each scheme of the Alternative Investment Fund shall have corpus of atleast 25 crore rupees;

(c) the Alternative Investment Fund shall not accept from an investor, an investment of value less than 1crore rupees. However, in case of investors who are employees or directors of the Alternative Investment Fund or employees or directors of the Manager, the minimum value of investment shall be 25 lakh rupees.

General Investment Conditions and Restrictions

– The minimum investment in AIF shall be INR 200 million.

– The minimum investment by each investor shall be INR 10 million. In case the investor

– is a director or employee or manager or sponsor of AIF, the minimum investment threshold is relaxed to shall be INR 2.5 million

– AIF may invest in securities of foreign companies subject to certain conditions.

– Un-invested portion of the fund's corpus may be invested in liquid mutual funds or bank deposits or other liquid assets till deployment of funds in accordance with the investment objective of the fund.

– Alternative Investment Fund may act as Nominated Investor.

Alternative Investment Fund can raise funds through private placement by issue of information memorandum or placement memorandum, by whatever name called.

Listing

– Units of close ended Alternative Investment Fund may be listed on stock exchange subject to a minimum tradable lot of one crore rupees.

– Listing of Alternative Investment Fund units shall be permitted only after final close of the fund or scheme.

Obligation of manager

The Manager shall be obliged to:

(a) address all investor complaints;

(b) provide to SEBI any information sought by Board;

(c) maintain all records as may be specified by SEBI;

(d) take all steps to address conflict of interest as specified in these regulations;

(e) ensure transparency and disclosure as specified in the regulations.

Maintenance of records

The Manager or Sponsor shall be required to maintain following records describing:

(a) the assets under the scheme/fund;

(b) valuation policies and practices;

(c) investment strategies;

(d) particulars of investors and their contribution;

(e) rationale for investments made.

The records shall be maintained for a period of five years after the winding up of the fund

SEBI (FOREIGN VENTURE CAPITAL INVESTORS) REGULATIONS, 2000

Foreign Venture Capital Investor means an investor incorporated and established outside India, which proposes to make investment in venture capital fund(s) or venture capital undertakings in India and is registered under these Regulations.

Investment criteria for a foreign venture capital investor

All investments to be made by a foreign venture capital investors should be subject to the following conditions:

(a) it should disclose to SEBI its investment strategy.

(b) it can invest its total funds committed in one venture capital fund.

(c) it shall make investments as enumerated below:

(i) atleast 66.67% of the investible funds should be invested in unlisted equity shares or equity linked instruments of venture capital undertaking.

(ii) not more than 33.33% of the investible funds may be invested by way of:

(a) subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed;

(b) debt or debt instrument of a venture capital undertaking in which the foreign venture capital investor has already made an investment by way of equity.

(c) preferential allotment of equity shares of a listed company subject to lock in period of one year.

(d) the equity shares or equity linked instruments of a financially weak company or a sick industrial company whose shares are listed.

(e) Special Purpose Vehicles which are created for the purpose of facilitating or promoting investment in accordance with these Regulations.

The investment conditions and restrictions stipulated in clause (c) of regulation 11 shall be achieved by the Foreign Venture Capital Investor by the end of its life cycle.

(f) It shall disclose the duration of life cycle of the fund.

Investment in Angel Funds

Angel funds shall only raise funds by way of issue of units to angel investors. An angel fund shall have a corpus of at least ten crore rupees. Angel funds shall accept, up to a maximum period of three years, an investment of not less than twenty five lakh rupees from an angel investor.

Investment by Angel Funds

Angel funds shall invest only in venture capital undertakings which:

(a) have been incorporated during the preceding three years from the date of such investment;

(b) have a turnover of less than twenty five crore rupees;

(c) are not promoted or sponsored by or related to an industrial group whose group turnover exceeds three hundred crore rupees; and

(d) are not companies with family connection with any of the angel investors who are investing in the company.

(2) Investment by an angel fund in any venture capital undertaking shall not be less than fifty lakh rupees and shall not exceed five crore rupees.

(3) Investment by an angel fund in the venture capital undertaking shall be locked-in for a period of three years.

(4) Angel funds shall not invest in associates.

(5) Angel funds shall not invest more than twenty-five per cent of the total investments under all its schemes in one venture capital undertaking:

Provided that the compliance to this sub-regulation shall be ensured by the Angel Fund at the end of its tenure.

Answer the following:

1. Listing of Alternative Investment Fund units shall be permitted only after_____of the fund.

Ans: final close

2. Any AIF shall not have more than______.

Ans: 1,000 investors

3. Alternative Investment Fund can raise funds through private placement by issue of ________ memorandum.

Ans: information /placement

Lesson 10

Collective Investment Schemes

A collective investment scheme is a trust based scheme that comprises a pool of assets that is managed by a collective investment scheme manager and is governed by the Collective Investment Schemes Regulations given by SEBI. Collective Investment Schemes provide a relatively secure means of investing on the Stock Exchange and other financial instruments. The sums of money that are exchanged on the Stock Exchange and in the money markets make them too pricy for most people. With a CIS, the money or funds from a group of investors are pooled or collected together to form a CIS portfolio. Each investor has a proportional stake in the CIS portfolio based on how much money he or she contributed. The word 'unit' refers to the portion or part of the CIS portfolio that is owned by the investor. The 'trust' is the financial instrument that is created in order to manage the investment. The trust enables financial experts to invest the money on behalf of the CIS investor.

The CIS, however, does not include any scheme or arrangement –

(a) made or offered by a co-operative society,

(b) under which deposits are accepted by Non Banking Financial Companies,

(c) being a contract of insurance,

(d) providing for any Scheme, Pension Scheme or the Insurance Scheme framed under the Employees Provident Fund and Miscellaneous Provision Act, 1952,

(e) under which deposits are accepted under section 58A of the Companies Act, 1956,

(f) under which deposits are accepted by a company declared as Nidhi or a mutual benefit society under section 620A of the Companies Act, 1956,

(g) falling within the meaning of Chit business as defined in clause (d) of section 2 of Chit Fund Act, 1982 and

(h) under which contributions made are in the nature of subscription to a mutual fund.

SEBI (collective investment schemes) regulations, 1999 – an overview

SEBI (Collective Investment Schemes) Regulations, 1999 defines Collective Investment Management Company to mean a company incorporated under the Companies Act, 1956 and registered with SEBI under these regulations, whose object is to organize, operate and manage a collective investment. Every application for registration should be accompanied by a non-refundable application fee as specified. An application, which is not complete in all respects or does not conform to the requirements, should be rejected by SEBI.

Restrictions on business activities

Collective Investment Management Company should not:

(i) undertake any activity other than that of managing the scheme;

(ii) act as a trustee of any scheme;

(iii) launch any scheme for the purpose of investing in securities;

(iv) invest in any schemes floated by it.

However, it has been provided that a CIMC may invest in its own scheme, if it makes a disclosure of its intention to invest in the offer document of the scheme, and does not charge any fees on its investment in that scheme.

Allotment of units and refunds of money

The Collective Investment Management Company should specify in the offer document the minimum and the maximum subscription amount it seeks to raise under the scheme; and in case of oversubscription, the process of allotment of the amount oversubscribed. The CIMC should refund the application money to the applicants, if the scheme fails to receive the minimum subscription amount.

Listing of schemes

The units of every scheme shall be listed immediately after the date of allotment of units and not later than six weeks from the date of closure of the scheme on each of the stock exchanges as mentioned in the offer document.

Winding up of scheme

A scheme should be wound up on the expiry of duration specified in the scheme or on the accomplishment of the objective of the scheme as specified in the offer document. A scheme may be wound up

(a) on the happening of any event which, in the opinion of the trustee, requires the scheme to be wound up and the prior approval of SEBI is obtained; or

(b) if unit holders of a scheme holding at least three-fourth of the nominal value of the unit capital of the scheme, pass a resolution that the scheme be wound up and the approval of SEBI is obtained thereto; or

(c) if in the opinion of SEBI, the continuance of the scheme is prejudicial to the interests of the unit-holders; or

(d) if in the opinion of the CIMC, the purpose of the scheme cannot be accomplished and it obtains the approval of the trustees and that of the unit holders of the scheme holding at least three-fourth of the nominal value of the unit capital with a resolution that the scheme be wound up and the approval of SEBI is obtained.

Answer the following:

1. Mutual Funds are a types of Collective Investment Scheme.

Ans: False

2. Listing of schemes of units should be done within the maximum period of______weeks.

Ans: Six

3. _______is the basic concept behind collective investments.

Ans: Pooling

Lesson 11
Resource Mobilisation In International Capital Market

The onset of globalisation is securities markets have widened the periphery of domestic companies to raise funds from foreign sources. India being an emerging market has been following the trend and is approaching the offshore market for funds. The Government of India has taken various policies initiatives to allow India companies to raised funds from International Market.

Regulatory Framework In India

Issue of ADR/GDR/FCCBs/FCEBs are regulated by the following regulations in India:

- The Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme,1993.
- Foreign Currency Exchangeable Bonds Scheme, 2008
- Notifications/Circulars issued by Ministry of Finance (MoF), GOI.
- Consolidated FDI Policy.
- RBI Regulations/Circulars.
- Companies Act and Rules thereunder.
- Listing Agreement.

Euro issue

Euro issue means modes of raising funds by an Indian company outside India in foreign currency. There are different modes of Euro issue which is as follows:

Euro Issue

- Depository Receipts
  - American Depository Receipts
    - ✓ Existing Shares (Sponsored ADRs)
    - ✓ Issue of Fresh Shares
  - Indian Depository Receipts
    - ✓ From Euro Market
    - ✓ From US Market
- Foreign Currency Convertible Bonds/Foreign Currency Exchangable Bonds

Depository receipts

Depository Receipt (DR) is a negotiable instrument evidencing a fixed number of equity shares of the issuing company being an Indian company, denominated in foreign currency and is being traded in foreign exchanges

Company Issue Depository Receipts for the following purposes:

• To raise Capital

• Diversify Shareholder base into extended geographies

• Increase visibility & recognition in international market

• Global Image

• Set Up Employee Stock Option Plans

• Facilitate Merger & Acquisition activity by creating a desirable acquisition currency.

Purpose of Investors to Invest in Depository Receipts

• Diversify Portfolio

• Convenience of holding foreign securities in their markets

• Simplification of trading and settlements (DRs trade and settle just like US or EURO securities)

• No restrictions on dealing: DRs are recognized as domestic securities

• Avoid Currency risk.

An **American Depository Receipt** ("ADR") is a dollar denominated form of equity ownership in the form of depository receipts in a non-US company. It represents the foreign shares of the company held on deposit by a custodian bank in the company's home country and carries the corporate and economic rights of the foreign shares.

Global Depository Receipt (GDR) have access usually to Euro market and US market. The US portion of GDRs to be listed on US exchanges to comply with SEC requirements and the European portion are to be complied with EU directive. Listing of GDR may take place in international stock exchanges such as London Stock Exchange, New York Stock Exchange, American Stock Exchange, NASDAQ, Luxemburg Stock Exchange etc.

✓ ADR are US $ denominated and traded in US.
✓ GDRs are traded in various places such as New York Stock Exchange, London Stock Exchange, etc.

One way fungibility – Here investors could cancel their depository receipt and recover the proceeds by selling the underlying shares in the Indian market; DRs once redeemed cannot be converted into shares.

Two way fungibility – It means that the shares so released can be reconverted by the company into DRs for purchase by the overseas investors. It implies that the re-issuance of DRs would be permitted to the extent of DRs that have been redeemed and underlying shares are sold in domestic market.

Sponsor – It is a process of disinvestment by the Indian shareholders of their holding in overseas market.

The New Companies Act, 2013 has laid down provisions for issue of Global Depository receipts under Section 41 and Companies (Issue of Global Depository Receipts) Rules, 2014.

According to Section 2(44) of Companies Act, 2013, "Global Depository Receipt" means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorised by a company making an issue of such depository receipts;

Section 41 provides that a company may, after passing a special resolution in its general meeting, issue depository receipts in any foreign country in such manner, and subject to such conditions, as may be prescribed.

Companies (Issue of Global Depository Receipts) Rules, 2014.

Rule 4 lays down the following conditions to be fulfilled by a company for issue of depository receipts:

(1) The Board of Directors of the company intending to issue depository receipts shall pass a resolution authorising the company to do so.

(2) The company shall take prior approval of its shareholders by a special resolution to be passed at a general meeting. Provided that a special resolution passed under section 62 for issue of shares underlying the depository receipts, shall be deemed to be a special resolution for the purpose of section 41 as well.

(3) The depository receipts shall be issued by an overseas depository bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank.
(4) The company shall ensure that all the applicable provisions of the Scheme and the rules or regulations or guidelines issued by the Reserve Bank of India are complied with before and after the issue of depository receipts.
(5) The company shall appoint a merchant banker or a practising chartered accountant or a practising cost accountant or a practising company secretary to oversee all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practising chartered accountant or practising cost accountant or practising company secretary, as the case may be, shall be placed at the meeting of the Board of Directors of the company or of the committee of the Board of directors authorised by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts.
Provided that the committee of the Board of directors referred to above shall have at least one independent director in case the company is required to have independent directors.

FOREIGN CURRENCY EXCHANGEABLE BONDS

Issue of Foreign Currency Exchangeable Bonds (FCEB) are regulated by Foreign Currency Exchangeable Bond Scheme 2008 issued by Ministry of Finance, Department of Economic Affairs. FCCB is

(i) a bond expressed in foreign currency,

(ii) the principal and the interest in respect of which is payable in foreign currency

(iii) issued by an issuing company, being an Indian company

(iv) subscribed by a person resident outside India

(v) Exchangeable into equity shares of another company, being offered company which is an Indian company.

(vi) Either wholly or partly or on the basis of any equity related warrants attached to debt instruments.

It may be noted that issuing company to be the part of promoter group of offered company and the offered company is to be listed and is to be eligible to receive foreign investment.

APPROVALS REQUIRED

The issue of GDRs/FCCBs requires the Approval of a Board of Directors, shareholders, ”In principle and Final” approval of Ministry of Finance, Approval of Reserve Bank of India, In-principle consent of Stock Exchange for listing of underlying shares and In-principle consent of Financial institutions.

Difference Between FCCB And FCEB

There is a fundamental difference between an FCCB and an FCEB whereby in the case of an FCCB offering, the bonds convert into shares of the company that issued the bonds, while in the case of an FCEB offering, the bonds are convertible into shares not of the issuer company, but that of another company forming part of its group.

Issue Of Foreign Currency Exchangeable Bonds (FCEB) Scheme, 2008

In Financial Year 2007-08, the Indian Government notified the Foreign Currency Exchangeable Bonds Scheme, 2008 for the issue of FCEBs.

An issuing company desirous of raising funds by issuing Foreign Currency Convertible Bonds or ordinary shares for equity issues through Global Depository Receipts is required to obtain prior permission of the Department of Economic Affairs, Ministry of Finance, and Government of India. An Indian company, which is not eligible to raise funds from the Indian capital market including a company which has been restrained from accessing the securities market by the Securities and Exchange Board of India (SEBI) is not eligible to issue Foreign Currency Convertible Bonds and Ordinary Shares through Global Depository Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

External Commercial Borrowing

External Commercial Borrowings (ECB) refer to commercial loans in the form of bank loans, buyers’ credit, suppliers’ credit, securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares) availed of from non-resident lenders with a minimum average maturity of 3 years. ECB can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route.

The following agencies are normally involved in the Euro issue:

(i) Lead Manager (ii) Co-Lead/Co-Manager (iii) Overseas Depository Bank (iv) Domestic Custodian Banks (v) Listing Agent (vi) Legal Advisors (vii) Printers (viii) Auditors (ix) Underwriter

Answer the following:

1. ADRs are denominated in_______.

Ans: US dollar

2. In the Indian context, DRs are treated as_______.

Ans: Foreign Direct Investment

3. External Commercial Borrowings (ECB) are also referred to as_______.

Ans: Commercial loans

Lesson 12

Indian Depository Receipts

Companies that previously had to raise capital in the domestic market can now tap foreign sources of capital through ADR/GDR/FCCB/FCEB in overseas market to raise fund from international market. As India is a preferred investment destination among international investors, the Government of India has introduced the concept of Indian Depository Receipts (IDRs) to facilitate listing by foreign companies on India Stock Exchanges.

Indian Depository Receipt means any instrument in the form of a depository receipt created by Domestic Depository in India against the underlying equity shares of issuing company. The Indian IDR holder would thus indirectly own the equity shares of overseas issuer company. IDRs are to be listed and denominated in India Currency. An issuing company cannot raise funds in India by issuing IDRs unless it has obtained prior permission from SEBI.

"Domestic Depository" means custodian of securities registered with SEBI and authorized by the issuing company to issue Indian Depository Receipts.

Overseas Custodian Bank means a banking company which is established in a country outside India and has a place of business in India and acts as custodian for the equity shares of issuing company against which IDRs are proposed to be issued by having a custodial arrangement or agreement with the Domestic Depository or by establishing a place of business in India.

Process involved in issue of India Depository Receipts (IDRs)

Step 1: Issuing Company (company incorporated outside India delivers equity shares to overseas custodian)

Step 2: Overseas Custodian Bank (instructs Domestic Depository to issue depository receipts in respect of shares held)

Step 3: Domestic Depository (issues Depository Receipts to Indians against the equity shares of the company incorporated outside India)

Step 4: Indians (i.e. investors of IDR issue)

Step 5: Foreign shares being traded in Indian Exchanges in IDR form

Advantages of the IDR

Benefits to the Issuing Company

• It provides access to a large pool of capital to the issuing capita.

• It gives brand recognition in India to the issuing company.

• It facilitates acquisitions in India.

• Provides an exit route for existing shareholders.

Benefits to Investors

• It provides portfolio diversification to the investor.

• It gives the facility of ease of investment.

• There is no need to know your customer norms.

• No resident Indian individual can hold more than $200,000 worth of foreign securities purchased per year as per Indian foreign exchange regulations. However, this will not be applicable for IDRs which gives Indian residents the chance to invest in an Indian listed foreign entity.

REGULATORY FRAMEWORK OF IDRs

Regulatory Bodies

• The Securities and Exchange Board of India

• The Ministry of Corporate Affairs

• The Reserve Bank of India

Statutes Governing IDRs

• Section 605A of the Companies Act, 1956

• Companies (Issue of Indian Depository Receipts) Rules 2004

• Chapter X & XA of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

- Rule 13 Of The Companies (Registration Of Foreign Companies) Rules, 2014

Companies (Issue of Indian Depository Receipts) Rules, 2004

These rules are applicable to those companies incorporated outside India, whether they have or have not established any place of business in India.

An issuing company can issue IDRs only if it satisfies the following conditions:

(a) its pre-issue paid-up capital and free reserves are at least US$ 50 million and it has a minimum average market capitalization (during the last 3 years) in its parent country of at least US$ 100 million;

(b) it has a continuous trading record or history on a stock exchange in its parent country for at least three immediately preceding years;

(c) it fulfills such other eligibility criteria as may be laid down by Securities and Exchange Board of India (SEBI) from time to time in this behalf.

RULE 13 OF THE COMPANIES (REGISTRATION OF FOREIGN COMPANIES) RULES, 2014

These rules are applicable to those companies incorporated outside India, whether they have

or have not, or will or will not, establish any place of business in India.

For the purposes of section 390, no company incorporated or to be incorporated outside India, whether the company has or has not established, or may or may not establish, any place of business in India (hereinafter in this rule called 'issuing company') shall make an issue of Indian Depository Receipts (IDRs) unless such company complies with the conditions mentioned under this rule, in addition to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and any directions issued by the Reserve Bank of India.

An issuing company making an issue of IDR shall satisfy the following:

(a) its pre-issue paid-up capital and free reserves are at least US$ 50 million and it has a minimum average market capitalization (during the last three years) in its parent country of at least US$ 100 million;

(b) it has been continuously trading on a stock exchange in its parent or home country (the country of incorporation of such company) for at least three immediately preceding years;

(c) it has a track record of distributable profits in terms of section 123 of the Act, for at least three out of immediately preceding five years;

(d) It fulfills such other eligibility criteria as may be laid down by the Securities and Exchange Board of India from time to time in this behalf.

Answer the following:

1. IDR issued by any issuing company in any financial year should not exceed of its paid-up capital and free reserves.
   Ans: 25 percent
2. _______means any instrument in the form of a depository receipt created by Domestic Depository in India against the underlying equity shares of issuing company.
   Ans: Indian Depository Receipt
3. The application form for the securities of issuing company should not be issued unless the form is accompanied by a containing the salient features of prospectus in the specified form.
   Ans: memorandum

Lesson 13 SECURITIES LAW

Regulatory Framework Governing Stock Exchanges

Stock Market plays a significant role in development of Economy. Stock Market facilitates mobilization of funds from small investors and channelizes these resources into various development needs of various sectors of the economy. In order to prevent undesirable transactions in securities by regulating the business of dealing therein, and by providing for certain other matters connected therewith, the Securities Contracts (Regulation) Act, 1956 was enacted by Parliament.

The Securities Contracts (Regulation) Act, 1956 provides for direct and indirect control of all aspects of the securities trading including the running of stock exchanges which aims to prevent undesirable transaction in securities. It gives the Central Government regulatory jurisdiction over (a) Stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges.

The stock exchange frame their own listing regulations in consonance with the minimum listing criteria set out in Securities contracts Regulation Rules 1957.
SEBI issued the Securities Contracts (Regulation) (Stock Exchanges and Cleaning Corporations) Regulations, 2012 to regulate recognition, ownership and governance in stock exchanges and cleaning corporations.

Securities Contracts (Regulation) Act, 1956

This Act defines various terms in relation to securities and provides the detailed procedure for the stock exchanges to get recognition from Government/SEBI, procedure for listing of securities of companies and operations of the brokers in relation to purchase and sale of securities on behalf of investors.
However, the provisions of this Act shall not apply to –
(a) the Government, the Reserve Bank of India, any local authority or any corporation set up by a special law or any person who has effected any transaction with or through the agency of any such authority as is referred to in this clause;

(b) any convertible bond or share warrant or any option or right in relation thereto, in so far as it entitles the person in whose favour any of the foregoing has been issued to obtain at his option from the company or other body corporate, issuing the same or from any of its shareholders' or duly appointed agents, shares of the company or other body corporate, whether by conversion of the bond or warrant or otherwise, on the basis of the price agreed upon when the same was issued.

Recognition of stock exchanges

Section 3 lays down that any stock exchange, desirous of being recognized for the purposes of this Act may make an application in the prescribed manner to the Central Government.

Section 4 lays down that if the Central Government is satisfied (powers are exercisable by SEBI also) after making such inquiry as may be necessary and after obtaining such further information, it may grant recognition to the stock exchange subject to the conditions imposed upon it in such form as may be prescribed.

The conditions which the Central Government can prescribe for the grant of recognition to the stock exchanges may include, among other matters, conditions relating to –

(i) the qualifications for membership of stock exchanges;

(ii) the manner in which contracts shall be entered into and enforced as between members;

(iii) the representation of the Central Government on each of the stock exchanges by such number of persons not exceeding three as the Central Government may nominate in this behalf; and

(iv) the maintenance of accounts of members and their audit by chartered accountants whenever such audit is required by the Central Government.

Corporatisation and demutualisation of stock exchanges

Corporatisation (Section 4A) - stock exchange should be organized as a company. Separate ownership, management and trading rights from each other.

Demutualisation (Section 4B) - converting mutual non-profit body into a corporate body where management and trading activities are separated.

SCRA was amended on 12/10/2004 to compel stock exchanges to compulsorily corporatize and demutualise.

Benefits of Demutualisation

- Stock exchanges owned by members tend to work towards the interest of members alone, which could on occasion be detrimental to rights of other stakeholders. Division of ownership between members and outsiders can lead to a balanced approach, remove conflicts of interest, create greater management accountability, and take into consideration the interest of other players.

- To cope with competition, stock exchanges require funds. While member-owned stock exchanges have limitations in raising funds, publicly owned stock exchanges can tap capital markets.
- Publicly owned stock exchanges can be more professional when compared to member-owned organisations. Further, as a result of the role played by shareholders, strengthening of the management and the organization, there is greater transparency in dealings, accountability and market discipline.
- This would enhance management flexibility. A publicly held company is better equipped to respond to changes when compared to a closely held mutually owned organisation. Further, a company can spin-off its subsidiaries, get into mergers and acquisitions, raise funds, etc.

Withdrawal of recognition

Section 5 lays down that if the Central Government is of opinion that the recognition granted to a stock exchange should in the interest of the trade or in the public interest, be withdrawn, the Central Government may serve on the governing body of the stock exchange a written notice that the Central Government is considering the withdrawal of the recognition for the reasons stated in the notice and after giving an opportunity to the governing body to be heard in the matter, the Central Government may withdraw, by notification in the Official Gazette, the recognition granted to the stock exchange. However, the withdrawal shall not affect the validity of any contract entered into or made before the date of the notification, and the Central Government may, after consultation with the stock exchange, make such provision as it deems fit in the notification of withdrawal or in any subsequent notification similarly published for the due performance of any contracts outstanding on that date.

Clearing corporation

Section 8A(1) provides that a recognised stock exchange may, with the prior approval of SEBI, transfer the duties and functions of a clearing house to a clearing corporation, being a company incorporated under the Companies Act, 1956, for the purpose of –

(a) the periodical settlement of contracts and differences thereunder;

(b) the delivery of, and payment for, securities;

(c) any other matter incidental to, or connected with, such transfer.

The National Securities Clearing Corporation Limited, a subsidiary of National Stock Exchange of India Ltd., was incorporated in August 1995 to carry out the clearing and settlement of the trades executed in the Equities and Derivatives segments of NSE.

Indian Clearing Corporation Limited (ICCL) was incorporated in 2007 as a wholly owned subsidiary of BSE Ltd. ICCL has been set up with an objective of promoting financial stability and integrity.

Power of recognised stock exchanges to make bye-laws

Accordingly to Section 9, any recognised stock exchange may, subject to the previous approval of SEBI, make bye-laws for the regulation and control of contracts.\

Power of SEBI to make or amend bye-laws of recognised stock exchanges
SEBI may, either on a request in writing received by it in this behalf from the governing body of a recognised stock exchange or on its own motion, if it is satisfied after consultation with the governing body of the stock exchange that it is necessary or expedient so to do and after recording its reasons for so doing, make bye- laws, for all or any of the matters specified in section 9 or amend any bye-laws made by such stock exchange under that section.

Public issue and listing of securities
Section 17A provides for public issue and listing of securities.
No securities shall be offered to the public or listed on any recognized stock exchange unless the issuer fulfills such eligibility criteria and complies with such other requirements as may be specified by regulations made by SEBI.

Delisting of securities
Section 21A provides that a recognised stock exchange may delist the securities, after recording the reasons therefor, from any recognised stock exchange on any of the ground or grounds as may be prescribed under this Act. The securities of a company shall not be delisted unless the company concerned has been given a reasonable opportunity of being heard.
A listed company or an aggrieved investor may file an appeal before the Securities Appellate Tribunal against the decision of the recognised stock exchange delisting the securities within fifteen days from the date of the decision of the recognized stock exchange delisting the securities and the provisions of Sections 22B to 22E of this Act, shall apply, as far as may be, to such appeals.

Right of appeal to SAT against refusal to list securities of public companies by stock exchanges: Where a recognised stock exchange, refuses to list the securities of any company, the company shall be entitled to be furnished with reasons for such refusal.

Procedure and powers of SAT and appeal against its orders
The Securities Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules, the Securities Appellate Tribunal shall have powers to regulate their own procedure including the places at which they shall have their sittings.
The Securities Appellate Tribunal shall have, for the purpose of discharging their functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely –
(a) summoning and enforcing the attendance of any person and examining him on oath;
(b) requiring the discovery and production of documents;
(c) receiving evidence on affidavits;
(d) issuing commissions for the examination of witnesses or documents;
(e) reviewing its decisions;

(f) dismissing an application for default or deciding it ex-parte;
(g) setting aside any order of dismissal of any application for default or any order passed by it ex-parte; and
(h) any other matter which may be prescribed.

Right to legal representation

The appellant may either appear in person or authorise are or more chartered accountants or company secretary or cost accountant or legal practitioners or any of its officers to present his or its case before the SAT.

Appeal to supreme court

Any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of fact or law arising out of such order; Provided that the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Penalties: The Act prescribes various penalties against persons who might be found guilty of offences under the Act.

- ✓ *Penalty for failure to furnish information, return, etc*: one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.
- ✓ *Penalty for failure by any person to enter into an agreement with clients:* one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less for every such failure.
- ✓ *Penalty for failure to redress investors' grievances:* one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.
- ✓ *Penalty for failure to segregate securities or moneys of client or clients:* not exceeding one crore rupees
- ✓ *Penalty for failure to comply with listing conditions or delisting conditions:* not exceeding twenty-five crore rupees
- ✓ *Penalty for excess dematerialisation or delivery of unlisted securities:* not exceeding twenty-five crore rupees.
- ✓ *Penalty for failure to furnish periodical returns, etc.:* twenty-five crore rupees
- ✓ *Penalty for contravention where no separate penalty has been provided:* one crore rupees

Power to adjudicate: SEBI shall appoint any officer to an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.

Factors to be taken into account by the adjudicating officer

While adjudging the quantum of penalty, the adjudicating officer shall have due regard to the following factors, namely –
(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
(b) the amount of loss caused to an investor or group of investors as a result of the default;
(c) the repetitive nature of the default.

All sums realised by way of penalties under this Act shall be credited to the Consolidated Fund of India.

Appeal to Securities Appellate Tribunal

Any person aggrieved, by the order or decision of the recognised stock exchange or the adjudicating officer or any order made by SEBI under Section 4B, may prefer an appeal before the Securities Appellate Tribunal.
Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order or decision is received by the appellant and it shall be in such form and be accompanied by such fee as may be prescribed.

Rights of investors

- Entitlement of the Investors to Dividend declared by the Company
- Right to Receive Income From Collective Investment Scheme
- Right to receive Income from Mutual Fund

Securities contract (regulation) (stock exchange and clearing corporations) regulations, 2012

With an intent to regulate recognition, ownership and governance in stock exchanges and clearing corporations, SEBI on June 20, 2012 issued the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012.

Recognition of Stock Exchanges and Clearing Corporations

As per the provisions of these Regulations, all Stock Exchanges and Clearing Corporations are required to apply for recognition by the SEBI.

Networth Requirements

Stock Exchanges and Clearing Corporations are required to maintain minimum networth requirements of Rs. 100 crores at all times. The existing recognized Stock Exchanges and Clearing Corporations are required to fulfill the networth requirement within a maximum period of 3 years from the date of commencement of these Regulations.

Ownership of Stock Exchanges

As per the provisions of the Regulations, the shareholding or ownership of a stock exchange shall be as following:

Shareholder	**Equity share holding limit**
Equity Share Capital to be held by Public	Atleast 51% total
Individual resident in India (either directly or indirectly and either individually or with person acting in concert (PAC))	Not more than 5% individually
Further • Stock exchange • Depository • Banking company • Insurance company • Public financial Institution (either directly or indirectly and either individually or with PAC)	Not more than 15% individually
All the residents outside India taken together	Not more than 49% total
An Individual resident outside India (either directly or indirectly and either individually or with PAC)	Not more than 5% individually
Total holding of residents outside India through FDI route	Not to exceed 26% in total
Total holding of Foreign Institutional Investors (no shares to be acquired other than through secondary market)	Not to exceed 23% in total

Answer the following:

1. At present there are_______clearing corporation in India.

Ans: Two

2. Stock Exchanges and Clearing Corporations are required to maintain minimum networth requirements of______at all times.

Ans: Rs. 100 crores

3. All sums realised by way of penalties under this Act shall be credited to the _________

Ans: Consolidated Fund of India.

Lesson 14 Securities and Exchange Board of India

SEBI, a market regulator has come into existence through the passing of the SEBI Act in 1992. SEBI is empowered with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market.

Jurisdiction extends to:

Corporates in the issuance of capital and transfer of securities
Intermediaries and
Persons associated with securities market.

OBJECTIVE OF SEBI

• To protect the interests of investors in securities
• To promote the development of, and
• To regulate, the securities market and for matters connected therewith or incidental thereto.

Before 1992, the three principal Acts governing the securities markets were:

(a) The Capital Issues (Control) Act, 1947, which restricted issuer's access to the securities market and controlled the pricing of issues;

(b) The Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; and

(c) The Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges.

As a part of liberalizing the capital market, The Capital Issues (Control) Act, 1947 was repealed in May 1992. With this, Government's control over issue of capital, pricing of the issues, fixing of premia and rates of interest on debentures etc. ceased. The office which administered the Act was abolished and the market was allowed to allocate resources to competing uses. And the statutory powers were bestowed on SEBI to ensure fair play.

SEBI Act 1992 is divided into the following chapters.
Chapter I – Definitions
Chapter II – Establishment and Management
Chapter III - Transfer of assets, liabilities, etc., of existing Securities and Exchange Board to the Board
Chapter IV – Powers and Functions of SEBI
Chapter V – Registration of Intermediaries
Chapter VA - Prohibition of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control.
Chapter VI – Finance, Accounts and Audit of SEBI
Chapter VIA – Penalties for failure
Chapter VIB – Securities Appellate Tribunal
Chapter VII – Miscellaneous

Powers and functions of SEBI
Chapter IV of SEBI Act, 1992 deals with the powers and functions of the Board.
An exhaustive chapter which incorporates 16 points under which the powers and functions of SEBI is covered. The powers and functions are drawn from the three fold objectives of SEBI.

To regulate or prohibit issue of prospectus, offer document or advertisement soliciting money for issue of securities.
Section 11A of SEBI Act provides that SEBI may prohibit for the protection of the investors, any company from issuing any offer document including a prospectus or advertisement soliciting money from the public for the issue of securities, and specify the conditions subject to which such offer documents can be issued.

Investigations: SEBI is empowered u/s 11 C to investigate the affairs of any intermediary or persons. Investigation can be *suo-moto* started by SEBI if it has reasonable grounds to believe that the transactions in securities are dealt in manner detrimental to the investors or the securities market or any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the regulations made or directions issued by the Board thereunder

Cease and desist proceedings
If the Board finds, after causing an inquiry to be made, that any person has violated, or is likely to violate any provisions of this Act, or any rules or regulations made thereunder, it may pass an order requiring such person to cease and desist from committing or causing such violation.

Consent order: settling administrative or civil proceedings between the regulator and a person (Party) who may prima facie be found to have violated securities laws.

Compounding of Offences: a process whereby an accused pays compounding charges in lieu of undergoing consequences of prosecution. Compounding of offence can take place after filing criminal complaint by SEBI.

Registration of intermediaries – Chapter V

All intermediaries working in the Stock Exchange i.e. stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser, depository, participant, custodian of securities, foreign institutional investor and credit rating agency shall necessarily obtain certificate of registration from SEBI and thereafter buy, sell or deal in securities.

No person shall sponsor or carry on any venture capital funds or collective investment schemes including mutual funds, unless he obtains a certificate of registration from SEBI in accordance with the regulations.

Finance, accounts and audit of SEBI – Chapter VI

Fund:

The Central Government shall constitute a fund to be called the Securities and Exchange Board of India General Fund and credit thereto all grants, fees and charges received by SEBI under this Act; all sums received by SEBI from such other sources as may be decided upon by the Central Government. The Fund shall be applied for meeting the salaries, allowances and other remuneration of members, officers and other employees of SEBI, the expenses of SEBI in the discharge of its functions and the expenses on objects and for purposes authorized by this Act.

Accounts and Audit:

SEBI shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor General of India. The accounts of SEBI shall be audited by the Comptroller and Auditor General of India

Penal Provisions for failure: SEBI as a market watchdog can levy heavy penalty for various failures. Section 11(2)(i) empowers SEBI to call for information and conduct enquiries and audits

of the stock exchanges, mutual funds, other persons associated with securities markets, intermediaries and self regulatory organisations in the security market. Also Section 11(ia) of the Act requires calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any central, state or provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Board.

The penalties levied by the Board for various failures are -

To Furnish information, return etc – Rs. 1 lakh for each day of default or Rs 1 crore whichever is less

By any person to enter into an agreement with clients - Rs 1 lakh for each day of default or Rs 1 crore whichever is less

To redress Investors' grievances - Rs 1 lakh for each day of default or Rs 1 crore whichever is less

Certain Defaults incase of Mutual Funds – Rs. 1 lakh for each day of default or Rs 1 crore whichever is less

To observe rules and regulations by an asset management company –Rs. 1 lakh for each day of default or Rs 1 crore whichever is less

Default in case of stock brokers – Varies according to the nature of default.

Penalty for Insider Trading – Rs. twenty five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

Penalty for Non-Disclosure of Acquisition of Shares and Takeovers -Rs. twenty five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

Penalty for fraudulent and unfair trade practices - Rs. twenty five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

For contravention where no separate penalty has been provided – Rs 1 crore

Adjudications

Section 15-I & J deal with SEBI's power to adjudicate and factors to be taken into account by the adjudicating officer.

(1) SEBI may appoint any of its officers not below the rank of Division Chief to be an adjudicating officer for holding an inquiry for the purpose of imposing any penalty.

(2) While holding an inquiry, the adjudicating officer has powers to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which may be useful for or relevant to the subject matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions, he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.

Factors to be taken into account by the adjudicating officer

Section 15J lays down that while adjudging the amount of penalty, the adjudicating officer shall have due regard to the following factors viz.,

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default.

Section 15JA provides that all sums realised by way of penalties under this Act shall be credited to the **Consolidated Fund of India.**

SECURITIES APPELLATE TRIBUNAL (SAT)

In order to afford proper appellate remedies, Chapter VIB of SEBI Act provides for the establishment of the Securities Appellate Tribunals to consider appeals against SEBI's orders, of penalties.

Requirements for Appeal to the Tribunal

Section 15T and 15U deal with the appeal procedure and power of Securities Appellate Tribunals. Section 15T lays down that any person aggrieved:

(1) (a) by an order of SEBI made, under this Act, or the rules or regulations made thereunder; or

(b) by an order made by an adjudicating officer under this Act may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.

(2) No appeal shall lie to the Securities Appellate Tribunals from an order made

(a) by SEBI;

(b) by an adjudicating officer, with the consent of the parties.

(3) Every appeal shall be filed within a period of 45 days from the date on which a copy of the order made by

SEBI or the Adjudicating Officer is received by him and it shall be in such form and be accompanied by prescribed fee.

However, the Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of 45 days if it is satisfied that there was sufficient cause for not filing it within that period.

(4) On receipt of an appeal, the Securities Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

(5) The Securities Appellate Tribunal shall send a copy of every order made by it to SEBI and the parties to the appeal and to the concerned Adjudicating Officer.

(6) The appeal filed before the Securities Appellate Tribunal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

POWERS OF SECURITIES APPELLATE TRIBUNAL

The Securities Appellate Tribunals shall have, for the purposes of discharging their functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:

(a) summoning and enforcing the attendance of any person and examining him on oath;

(b) requiring the discovery and production of documents;

(c) receiving evidence on affidavits;

(d) issuing commissions for the examination of witnesses or documents;
(e) reviewing its decisions;
(f) dismissing an application for default or deciding it ex-parte;
(g) setting aside any order of dismissal of any application for default or any order passed by it ex-parte;
(h) any other matter which may be prescribed.
Every proceeding before the Securities Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code and the Securities Appellate Tribunal shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Legal representation
Section 15V permits the Appellant either to appear in person or authorise one or more of Practising Company Secretaries, Chartered Accountants, Cost Accountants or Legal practitioners or any of its officers to present his or its case before the Securities Appellate Tribunal.

Appeal to Supreme Court
Section 15Z lays down that any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of fact or law arising out of such order;
It has been provided that the Supreme Court may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding 60 days.
To regulate the working of SAT for dealing with matters with the SEBI Act, **the Securities Appellate Tribunal (Procedure) Rules, 2000** came into force.

SEBI Annual Report
The Central Government notified SEBI (Annual Report) Rules 1994, on 7th April, 1994.
Rule 3 lays down that SEBI shall submit to the Central Government an annual report giving a true and full account of its activities, policies and programmes during the previous financial year in the prescribed form appended to these rules. Such annual report shall be submitted to the Central Government within 90 days after the end of each financial year. Section 18(3) of SEBI Act lays down that a copy of the annual report submitted by SEBI to Central Government shall be laid before each House of Parliament, as soon as may be after it is received by Central Government.
The form of the annual report is divided into four parts.
Part I deals with policies and programmes to be reviewed
Part II deals with a review of the working and operation of SEBI in respect of different segments of the market as detailed under part I.

Part III contains details of the functions of SEBI under 13 sub-headings
Part IV organisational matter of SEBI.

SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014

The regulations will enable the persons who have defaulted on any SEBI laws & civil proceedings have been initiated against them, to settle the proceedings. These regulations do not provide for settling proceedings which are under criminal in nature. SEBI may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may determined by SEBI in accordance with the regulations made under SEBI Act.

These regulations provides for the involved entity to file settlement plea within 60 days of the show cause notice served to them by SEBI. The regulation mentions the minimum amount to be paid by entities, which will vary as per the charges against them. These charges will be highest for the promoters. The SEBI (Settlement of Administrative & Civil Proceedings) Regulations, 2014 is divided into VIII chapters and two schedules.

Factors to be considered to arrive at the settlement terms

Regulation 9 deals with the factors to be considered by SEBI while arriving at the settlement terms, including but not limited to the following:

(a) conduct of the applicant in the investigation;

(b) the role played by the applicant in case the alleged default is committed by a group of persons;

(c) nature, gravity and impact of alleged defaults;

(d) whether any other proceeding against the applicant for non-compliance of securities laws is pending or concluded;

(e) whether the alleged default is minor or major in nature;

(f) the extent of amount of harm and/or loss to investors' and/or gain by the applicant;

(g) processes which have been introduced since the alleged default to minimize future defaults or lapses;

(h) compliance schedule proposed by the applicant;

(i) economic benefits accruing to any person from the non-compliance or delayed compliance;

(j) conditions which are necessary to deter future non-compliance by the same or another person;

(k) satisfaction of claim of investors regarding payment of money due to them or delivery of securities to them;

(l) whether the applicant has undergone any other enforcement action for the same violation;

(m) any other factors necessary in the facts and circumstances of the case.

SEBI (Procedure for Search and Seizure) Regulations, 2014,

It specifies the detailed procedures to be followed at different stages of an investigation. In order to exercise the powers of search and seizure at the time of Investigation, harmonious with the rights of the persons who are subjected to search of their person and property, while pursuing the SEBI's statutory mandate of investor protection, detailed procedures relating to the procedural safeguards during different stages of search and seizure and the rights of those persons subjected to search and the obligations of the authorized persons.

The Regulation states the detailed procedure to search in respect of the following:

1. Relating to witness
2. Relating to places and buildings
3. Relating to vessel, vehicle or aircraft
4. Search of person
5. Search of Computer

Obligations of persons under search and persons in charge

The following are the obligations on the part of the persons under search and persons in charge-

• Any person in charge of any building, place shall identify any person as may be required;

• Any person in charge of vessel, vehicle or aircraft on demand locate and identify the vessel, vehicle or aircraft;

• Allow the Authorized Officer free ingress and afford all reasonable facilities for a search;

• Stop the vessel or vehicle or stop and cause to be landed any aircraft on communication of the Authorized Officer;

• Bound to disclose the password and such other information in case of computer devices;

• Provide necessary facility to inspect books of account or other documents;

• Identify the locker etc., and to hand over keys of the same to the Authorized Officer;

• No officer shall be prevented from execution of Warrant of Authority.

Answer the following

1.________ a process whereby an accused pays compounding charges in lieu of undergoing consequences of prosecution

Ans: Compounding of Offences

2. SEBI engages in_______of Securities Market.

Ans: Development

3. Securities and Exchange Board of India General Fund and credited with______received by SEBI.

Ans: grants, fees and charges

Lesson 15 Depositories

In the pre liberalization the settlement system on Indian stock exchanges involved movement of paper securities to the issuer for registration, with the change of ownership being evidenced by an endorsement on the security certificate. Theft, forgery, mutilation of certificates and other irregularities provided the issuer right to refuse the transfer of a security. Added costs and delays in settlement, restricted liquidity and made investor grievance redressal time–consuming. To obviate these problems, the Depositories Act, 1996 was passed and subsequently the regulations were notified.

There are two Depositories functioning in India, namely the National Securities Depository Limited (NSDL) and the Central Depository Services (India) Limited (CDSL). Under the provisions of the Depositories Act, these Depositories provide various services to investors and other Participants in the capital market.

NSDL is a joint venture of: IDBI, NSE, and UTI.
NSDL is the first depository to be set up in India.
Registered by SEBI on June 7, 1996.
Depository Participants: 281 (As on May 31, 2013).
Demat Custody Quantity (mn. securities) 7,02,066(As on May 31, 2013).

CDSL is a joint venture of: BSE, Bank of India, Bank of Baroda, State Bank of India and HDFC Bank.
Registered by SEBI in 1999.
Depository Participants: 576 (As on June 29, 2013).
Demat Custody Quantity (mn. securities) 1,56,650 (As on June 29, 2013).

A Depository is an organization like a Central Bank where the securities of a shareholder are held in the electronic form at the request of the shareholder through the medium of a Depository Participant. To utilize the services offered by a Depository, the investor has to open an account with the Depository through a Depository Participant.

Similarities Between Bank and Depositories	
Bank	**Depositories**
Holds funds in accounts	Holds securities in accounts
Transfers funds between accounts	Safekeeping of securities
Transfers without handling cash	Transfers without handling securities
Safekeeping of money	Transfers securities between accounts

Difference between Bank and Depositories

Bank	Depositories
Banking business regulated by Reserve Bank of India.	Depositories are regulated by SEBI
Either of holders can sign instructions	All joint holders to sign instructions
Minimum balance to be maintained	No Minimum balance to be maintained
Entitled for interest	Interest can be earned only by participating in Stock Lending Scheme
Uses balances in accounts	Does not move balances in account without authorization

Benefits of Depository System: In the depository system, the ownership and transfer of securities takes place by means of electronic book entries. This system rids the capital market of the dangers related to handling of paper. The system provides numerous direct and indirect benefits, like:

- *Elimination of bad deliveries:* In the depository environment, once holdings of an investor are dematerialised, the question of bad delivery does not arise i.e. they cannot be held "under objection".
- *Elimination of all risks associated with physical certificates:* Dealing in physical securities have associated security risks of theft of stocks, mutilation of certificates, loss of certificates during movements through and from the registrars, thus exposing the investor to the cost of obtaining duplicate certificates and advertisements, etc. This problem does not arise in the depository environment.
- *Immediate transfer and registration of securities:* In the depository environment, once the securities are credited to the investors account on pay out, he becomes the legal owner of the securities.
- *Faster disbursement of non cash corporate benefits like rights, bonus, etc:* Depository system provides for direct credit of non cash corporate entitlements to an investors account, thereby ensuring faster disbursement and avoiding risk of loss of certificates in transit.
- *Reduction in brokerage by many brokers for trading in dematerialized securities:* Brokers provide this benefit to investors as dealing in dematerialized securities reduces their back office cost of handling paper and also eliminates the risk of being the introducing broker.
- *Elimination of problems related to change of address of investor, transmission, etc.:* In case of change of address or transmission of demat shares, investors are saved from undergoing the entire change procedure with each company or registrar. Investors have to only inform their DP with all relevant documents and the required changes are effected in the database of all the companies, where the investor is a registered holder of securities.

- *Elimination of problems related to selling securities on behalf of a minor:* A natural guardian is not required to take court approval for selling demat securities on behalf of a minor.

Services offered by Depository Participant (DP)

Account Opening:

A person needs to have a demat account with a DP.

The holder of such demat account is called as "Beneficial Owner (BO)".

Zero balance demat account.

More than one account with the same or multiple DPs.

The investor can approach any DP/s of his/her choice to open a demat account.

Dematerialisation:

A process by which physical certificates (of shares / debentures/ other securities) are converted into electronic balances.

First open an account with a DP and then request for the dematerialisation of share certificates through the DP so that the dematerialised holdings can be credited into that account.

Dematerialisation of shares is optional, an investor can still hold shares in physical form.

Investor has to demat the shares if he/she wishes to sell/purchase the same through the Stock Exchanges.

Processing Delivery & Receipt Instructions

To settle trades done on a stock exchange (on-market trades) and trades, which are directly settled between two BOs (off-market trades), BOs submit duly completed delivery instructions in the prescribed form to DP.

For receipt of securities into his/her account, a BO can give one time "standing instruction" to DP.

Account Statement

Sent Monthly or Quarterly to the BOs.

Rematerialisation

Rematerialisation is the process by which the electronic balances held in the demat account can be converted back into physical certificates.

Pledging

If the BO decides to pledge any securities in his BO account, he can avail of the same by submitting the pledge creation form duly completed, to his DP.

Nomination

Individual BOs have a facility for nomination in favour of an individual.

Transmission of securities

DPs facilitate for transmission of balances held in BO account/s (to other BO account/s) if so required due to death, lunacy, bankruptcy, insolvency or required due to operation of any law.

The legal framework for a depository system has been laid down by the Depositories Act, 1996 and is regulated by SEBI.

Process of Dematerialisation

Step I: Investor fills up Demat Request Form (DRF)

Step II: DRP submitted to DP along with physical shares.

Step III: Depository intimated of the request by the DP.

Step IV: Certificates submitted to issuer company's RTA.

Step V: Dematerialization request confirmed by the RTA.

Step VI: RTA then updates accounts and informs DP of the completion of the process.

Step VII: Depository updates accounts and information is passed to DP.

Step VIII: Investor's Demat account is updated by DP.

(Each security has an unique International Securities Identification Number & each different ISIN requires a different DRF to be furnished)

The depository business in India is regulated by:

–The Depositories Act, 1996

–The SEBI (Depositories and Participants) Regulations, 1996

– Bye-laws of Depository

– Business Rules of Depository

Depositories are also governed by certain provisions of:

– The Companies Act, 1956 (now changed to Companies Act, 2013)

– The Indian Stamp Act, 1899

– Securities and Exchange Board of India Act, 1992

– Securities Contracts (Regulation) Act, 1956

– Benami Transaction (Prohibition) Act, 1988

– Income Tax Act, 1961

– Bankers' Books Evidence Act, 1891

A depository cannot act as a depository unless it obtains a certificate of commencement of business from SEBI.

Objectives of The Depositories Act, 1996

–To conduct the task of maintenance of ownership records

of securities and effect changes in ownership records through book entry;

– Dematerilisation of securities;

– Making the securities fungible;

– Making the shares, debentures and any interest thereon of a public limited company freely transferable;

– Exempting all transfers of shares within a depository from stamp duty.

ELIGIBILITY CONDITION FOR DEPOSITORY SERVICES

Any company or other institution to be eligible to provide depository services must:

– be formed and registered as a company under the Companies Act, 1956.

– be registered with SEBI as a depository under SEBI Act, 1992.

– has framed bye-laws with the previous approval of SEBI.

– has one or more participants to render depository services on its behalf.

– has adequate systems and safeguards to prevent manipulation of records and transactions to the satisfaction of SEBI.

– complies with Depositories Act, 1996 and SEBI (Depositories and Participants) Regulations, 1996.

– meets eligibility criteria in terms of constitution, network, etc.

RIGHTS OF DEPOSITORIES AND BENEFICIAL OWNER

Depositories: deemed to be the registered owner

Beneficial owner: has the voting rights or any other rights related to the securities.

ELIGIBLE SECURITIES REQUIRED TO BE IN THE DEPOSITORY MODE

Section 8 of the Depositories Act gives the option to the investors to receive securities in physical form or in depository mode. It is not necessary that all eligible securities must be in the depository mode. In the scheme of the Depositories legislation, the investor has been given supremacy. The investor has the choice of holding physical securities or opt for a depository based ownership record.

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FUNGIBILITY (u/s 9)

All securities held in depository shall be fungible i.e. all certificates of the same security

shall become interchangeable in the sense that investor loses the right to obtain the exact certificate he surrenders at the time of entry into depository. It is like withdrawing money from the bank without bothering about the distinctive numbers of the currencies.

RIGHTS OF DEPOSITORIES AND BENEFICIAL OWNER

A depository should be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner.

REGISTER OF BENEFICIAL OWNER

Every depository is required to maintain a register and an index of beneficial owners in the manner provided in the Companies Act.

PLEDGE OR HYPOTHECATION OF SECURITIES HELD IN A DEPOSITORY

A beneficial owner may with the previous approval of the depository create a pledge or hypothecation in respect of a security owned by him through a depository

FURNISHING OF INFORMATION AND RECORDS BY DEPOSITORY AND ISSUER

Every depository shall furnish to the issuer information about the transfer of securities in the name of beneficial owners at such intervals and in such manner as may be specified by the bye-laws. Every issuer shall make available to the depository copies of the relevant records in respect of securities held by such depository.

OPTION TO OPT OUT IN RESPECT OF ANY SECURITY (u/s 14)

If a beneficial owner seeks to opt out of a depository in respect of any security he should inform the depository accordingly. After the receipt of intimation the depository should make appropriate entries in its records and also inform the issuer. Every issuer may, within thirty days of the receipt of intimation from the depository and on fulfillment of such conditions and on payment of such fees as may be specified by the regulations, issue the certificate of securities to the beneficial owner or the transferee, as the case may be.

Governing Board, Disclosures and Corporate Governance

This regulations deal with the composition of Governing board of a Depository.

– The governing board of every depository is required to include:

(a) shareholder directors;

(b) public interest directors; and

(c) managing director.

– Any employee of a depository may be appointed on the governing board in addition to the managing director, and such director shall be deemed to be a shareholder director.

– The chairperson shall be elected by the governing board from amongst the public interest directors subject to prior approval of SEBI.

– The number of public interest directors shall not be less than the number of shareholder directors in a

depository.

– The managing director shall be an ex-officio director on the governing board and shall not be included

in either the category of public interest directors or shareholder directors.

The disclosure requirements and corporate governance norms as specified for listed companies shall mutatis mutandis apply to a depository.

Investor Protection Fund

Every depository is required to establish and maintain an Investor Protection Fund for the protection of interest

of beneficial owners. Every depository should credit twenty five per cent of its profits every year to the Investor Protection Fund.

Audit under SEBI (Depositories and Participants) Regulations, 1996

Internal Audit: Both Depositories allow Company Secretary in Whole Time Practice to undertake internal audit of the operations of DP.

Areas

* reconciliation of Capital
  - total issued capital
  - listed capital
  - capital held by depositories in dematerialized form
* changes in share capital during the quarter
* approval obtained by the issuer for further issued capital.
* status of the register of members
* Time taken for dematerialisation of securities.
  (Disclose reasons if dematerialisation time taken is beyond the stipulated period of 21 days)

Concurrent Audit: mandated by NSDL

Areas

(I) Issuance of DIS

The procedure followed by the Participants with respect to:

(a) Issuance of DIS booklets including loose slips.

(b) Existence of controls on DIS issued to Clients including pre-stamping of Client ID and unique preprinted

serial numbers.

(c) Record maintenance for issuance of DIS booklets (including loose slips) in the back office.

(II) Verification of DIS

The procedure followed by the Participants with respect to:

(a) Date and time stamping (including late stamping) on instruction slips.

(b) Blocking of used/reported lost/stolen instruction slips in back office system/ manual record.

(c) Blocking of slips in the back office system/manual record which are executed in DPM directly.

(d) Two step verification for a transaction for more than Rs. 5 lakh, especially in case of off-market transactions.

(e) Instructions received from dormant accounts.

Auditor

Company Secretary in Whole Time Practice or Internal Auditor

Period of Audit

Audit for all accounts opened, DIS issued and control during the day to be completed by next working day. For large volume audit should be completed within a week.

Audit Report

- Submitted to NSDL, on a quarterly basis, in a hard copy form.

QUALIFIED DEPOSITORY PARTICIPANTS

A Depository Participant that has taken approval from / registered with SEBI to offer services to Qualified Foreign Investor (QFI) is called Qualified Depository Participants (QPD).

Eligibility criteria

To become a qualified Depository Participant, a SEBI registered DP shall fulfill the following:

(i) DP shall have net worth of ` 50 crore or more.

(ii) DP shall be either a clearing bank or clearing member of any of the clearing corporations;

(iii) DP shall demonstrate that it has systems and procedures to comply with the FATF Standards, Prevention

of Money Laundering (PML) Act, Rules and SEBI circulars issued from time to time; and

(iv) DP shall obtain prior approval of SEBI before commencing the activities relating to QFI.

BASIC SERVICES DEMAT ACCOUNT (BSDA)

With a view to achieve wider financial inclusion, encourage holding of demat accounts and to reduce the cost of maintaining securities in demat accounts for retail individual investors, SEBI introduced the concept of basic services demat account (BSDA). All depository participants (DPs) shall make available a "Basic Services Demat Account" (BSDA) with limited services and reduced costs compared to conventional demat accounts. These BSDA will also offer SMS alert facility for debit transactions.

Eligible Investor

The “Basic Services Demat Account” (BSDA) promises to provide limited services at reduced costs to retail investors. All individual who currently have one account or plan to open an demat account where they are the sole first holder will be allowed to open the BSDA, provided that the value of securities held will not be more than Rs 2 lakh at any given point of time. However,

Investors can open only one BSDA across all DPs. An existing eligible individual who holds a demat account with a DP can convert demat account into BSDA on the date of the next billing cycle based on value of holding of securities as on the last day of previous billing cycle.

Charges

The Annual Maintenance Charges (AMC) which will have to pay for BSDA will be as per predetermined slabs. If the value of holdings is up to Rs 50,000 there won't be any annual maintenance charge. However, if the value of holding is in between Rs 50,001 to Rs 200,000, a fee of Rs 100 as AMC may be charged. If the value of holdings exceeds, DPs are permitted to charge the same as they charge non- BSDA regular demat accounts.

Valuation of Holding

The value of holding shall be determined on the basis of the daily closing price or Net Asset Value of the securities or units of mutual funds. Where such price is not available the last traded price may be taken into account and for unlisted securities other than units of mutual funds, face value may be taken in to account.

Answer the following:

1. ____________conversion of electronic holdings into physical certificate.

Ans: Rematerialisation

2. ________minimum balance to be maintained with the depositories.

Ans: No

3. Concurrent Audit Report should be submitted________.

Ans: On a quarterly basis

Lesson 16

Listing and Delisting of Securities

Listing is the admission of securities to dealings on a recognized stock exchange. For a company to be listed on a stock exchange, the company has to enter into a listing agreement with the respective stock exchange(s). Any company offering its shares to the public for subscription is required to be listed on the stock exchange and has to comply with the conditions as provided in the SEBI (ICDR) Regulations, 2009. According to SEBI (ICDR) Regulations, 2009, a company has to file a draft offer document along with prescribed fees to SEBI through the lead merchant banker, at least thirty days prior to registering the prospectus with the Registrar of Companies. A company intending to have its share listed has to comply with the listing requirements prescribed by the Stock Exchange. A company seeking listing of their securities on the Stock Exchange is required to enter into a formal listing agreement with the Stock Exchange. The listing agreement specifies all the quantitative and qualitative requirements to be continuously complied with by the issuer for continued listing. The Stock Exchange monitors such compliance and companies who do not comply with the provisions of the listing agreement may be suspended from trading on the Stock Exchange. *The listing agreement is being increasingly used as a means to improve corporate governance.*

Listing of Securities on Indian Stock Exchanges, is governed by the provisions in the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956, the Securities Contracts (Regulation) Rules, 1957, Rules, bye laws, regulations of concerned stock exchange, the listing agreement entered into by the issuer and stock exchange and circulars/guidelines issued by the Central Government and SEBI.

TYPES OF LISTING

Listing of securities falls under 5 groups –

Initial Listing: If the shares or securities are to be listed for the first time by a company on a stock exchange is called initial listing.

Listing for Public Issue: When a company whose shares are listed on a stock exchange comes out with a public issue of securities, it has to list such issue with the stock exchange.

Listing for Rights Issue: When companies whose securities are listed on the stock exchange issue securities to existing shareholders on rights basis, it has to list such rights issues on the concerned stock exchange.

Listing of Bonus Shares: Shares issued as a result of capitalisation of profit through bonus issue shall list such issues also on the concerned stock exchange.

Listing for merger or amalgamation: When new shares are issued by an amalgamated company to the shareholders of the amalgamating company, such shares are also required to be listed on the concerned stock exchange.

Benefits of Listing

(1) Public image of the company is enhanced.

(2) The liquidity of the security is ensured making it easy to buy and sell the securities in the stock exchange.

(3) Tax concessions are made available both to the investors and the companies.

(4) Listing procedure compels company management to disclose important information to the investors enabling them to make crucial decisions with regard to keeping or disposing of such securities.

(5) Listed companies command better support such as loans and investments from Banks and FIs.

Multiple listing

A company with a paid up capital of over Rs. 5 crores should list its securities or have its securities permitted for trading, on atleast one stock exchange having nationwide Trading Terminals. Multiple listing provides arbitrage opportunities to the investors, whereby they can make profit based on the difference in the prices prevailing in the said exchanges.

For compliance under the LODR, SEBI prescribes various reporting and disclosure categorised

Appointment of a Company Secretary to act as compliance officer responsible for monitoring the Share Transfer process and report to the Company's Board in each Meeting. Compliance officer will directly liase with the authorities such as SEBI, Stock Exchanges, ROC etc. and investors with respect to implementation of various clauses, rules, regulations and other directives of such authorities and investor service and compliances of related matter.

Corporate Governance through LODR. Corporate governance deals with laws, procedures, practices and implicit rules that determine a company's ability to take informed managerial decisions vis-à-vis its claimants – in particular, its shareholders, creditors, customers, the State and employees. There is a global consensus about the objective of 'good' corporate governance: maximising long-term shareholder value.

This clauses mandates the following requirements and disclosures:

(a) Board of Directors and composition of Board

(b) Code of conduct of Directors to be published on the website

(c) Audit committee and its composition and frequency of its meeting

(d) Mandatory review of certain information by Audit Committee

(e) Subsidiary Companies

(f) Disclosures

(g) CEO/CFO Certification

(h) Report on Corporate Governance, Quarterly compliance report

(i) Compliance Certificate from Practising Company Secretary or Company's auditor

(j) Monitoring report/Monitoring Agency

(k) Advertisement in respect of adverse comments.

If a company fails to comply with the listing agreement, as a consequence, the stock exchange may delist the securities of the company for non-compliance under Section 21A of SCRA Act, 1956.

The Companies Act, 2013 was enacted on August 30, 2013 which provides for a major overhaul in the Corporate Governance norms for all companies. The rules pertaining to Corporate Governance were notified on March 27, 2014.

1. The term Independent Director wherein SEBI has amended the definition of Independent Director in alignment with the provisions of Companies Act, 2013 and Nominee Director is excluded from the definition of ID.

2. Companies (Appointment and Qualification of Directors) Rules,
2014: which states the qualification of ID's that An independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.

3. Section 177(9) of Companies Act 2013 and Regulation (22) of LODR, states the provisions for Vigil Mechanism wherein section 177(9) states as follows:

Every listed company and other Classes of companies to establish a Vigil mechanism for directors

and employees to report genuine concern. It provide adequate safeguards against victimization of employees and directors who avail of the Vigil mechanism and also provide for direct access to the chairperson of the Audit committee or the director nominated to play the role of audit committee, as the case may be, in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization. The details of establishment of Vigil mechanism

1. Section 149 read with Schedule IV and LODR states to hold separate meeting of ID's wherein ID's shall at least hold one meeting in a year, without the attendance of non independent directors and members of management.
   All the independent directors of the company shall strive to be present at such meeting.

2. Section 149(12) and Clause 49(II)(E) deals with the provisions of liability of ID wherein the independent director shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the Listing agreement.

3. Section- 178(5) and Clause 49(VIII)(E) states to constitute Stakeholders Relationship Committee to consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non- receipt of balance sheet, non-receipt of declared dividends, debenture-holders, deposit holders and any other security holders at any time during a financial year.

4. Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 and Clause 49(VIII)(C) states the detailed list of the Disclosures regarding Remuneration of Directors in the Annual Report.

5. Section 178(2) read with Schedule IV and Clause 49(II)(B)(5) states the provisions

regarding performance evaluation of ID's by the Nomination Committee wherein the committee shall lay down the evaluation criteria for performance evaluation of independent directors and such criteria shall be disclosed in the Annual Report.

6. Section 2(76) and section 188 and Clause 49 (VII) defines RPT and also states the Detailed provisions in respect of Related Party Transactions.

7. Section-129(5) and Clause 49(VIII)(B) directs the companies to state to disclose the deviation in Accounting Standard.

8. Section 178 and Companies (Meetings of Board and its Powers) Rules, 2014 and Clause 49(IV) of the Listing Agreement states the provision w.r.t. Constitution of Nomination & Remuneration Committee to Identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, Recommend to the Board their appointment and removal, carry out evaluation of every director 's performance.

9. Section 149(1) and Companies (Appointment and Qualification of Directors) Rules, 2014 and Clause 49 (II)(A) requires that at least one woman director in every listed Company and Companies Act also states to appoint woman director in every other public Company having Paid up share Capital of Rs. 100 Crores or more or turnover of Rs. 300 Crore or more.

10. Section 165 states that a person shall hold not office as a director, including any alternate directorship in more than 20 companies. The max no. of public companies in which a person can be appointed as a director shall not exceed 10 and Clause 49 (II)(B)(3) states that a person shall not serve as an independent director in more than seven listed companies. Any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.

11. Section 149 and Clause 49(II)(B) deals with Maximum tenure of IDs wherein it states that an independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report. No independent director shall hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director.

12. Section 134(3) and Clause 49 (VI) deals with the provisions w.r.t. Risk management.

13. Section 169 and Clause 49(VIII)(F) deals with the provisions of Disclosure of Resignation of Directors

DELISTING

The term "delisting" of securities means permanent removal of securities of a listed company from a stock exchange. As a consequence of delisting, the securities of that company would no longer be traded at that stock exchange. Delisting can be Voluntary or Compulsory.

Difference Between Compulsory And Voluntary Delisting

Compulsory delisting refers to permanent removal of securities of a listed company from a stock exchange as a penalizing measure at the behest of the stock exchange for not making submissions/comply with various requirements set out in the Listing agreement within the time frames prescribed. In voluntary delisting, a listed company decides on its own to permanently remove its securities from a stock exchange.

Delisting of equity shares of a company from all or any of the recognised stock exchanges where such shares are listed are governed by **SEBI (Delisting of Equity Shares) Regulations, 2009.**

Circumstances where delisting is not permissible

– Buy back of equity shares by the company; or

– Preferential allotment made by the company; or

– Unless a period of three years has elapsed since the listing of that class of equity shares; or

– Instruments which are convertible into the same class of equity shares that are sought to be delisted are outstanding.

– Delisting of convertible securities.

Delisting can be initiated by the Stock Exchange where the securities of the company are listed in any of the following situations:

(a) the company has incurred losses during the preceding three consecutive years and it has negative networth;

(b) trading in the securities of the company has remained suspended for a period of more than six months;

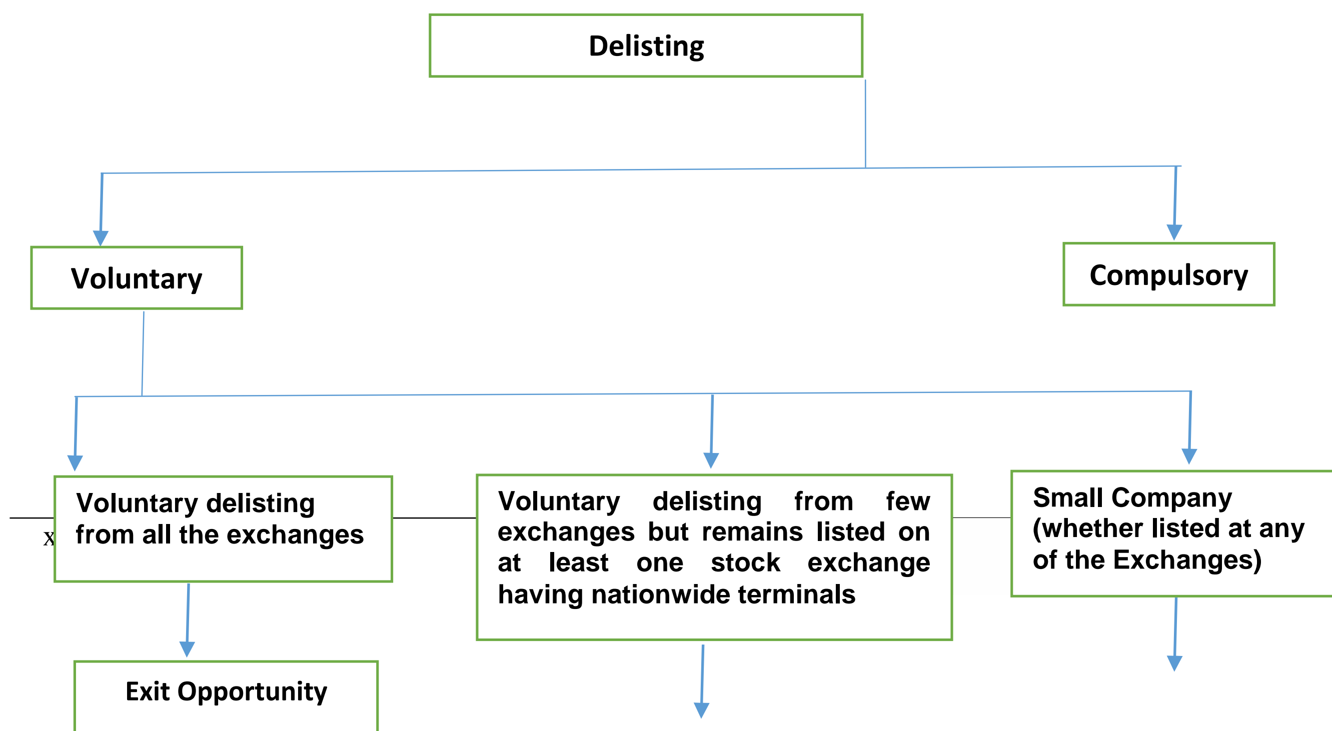
(c) the securities of the company have remained infrequently traded during the preceding three years;

(d) the company or any of its promoters or any of its director has been convicted for failure to comply with any of the provisions of the Act or SEBI Act, 1992 or the Depositories Act, 1996 or rules, regulations, agreements made thereunder, as the case may be and awarded a penalty of not less than rupees one crore or imprisonment of not less than three years;

(e) the addresses of the company or any of its promoter or any of its directors, are not known or false addresses have been furnished or the company has changed its registered office in contravention of the provisions of the Companies Act, 1956, or;

(f) shareholding of the company held by the public has come below the minimum level applicable to the company as per the listing agreement under the Act and the company has failed to raise public holding to the required level within the time specified by the recognized stock exchange.

However, no securities shall be delisted unless the company concerned has been given a reasonable opportunity of being heard.



No Exit Opportunity

No Bidding but Exit Opportunity is there

VOLUNTARY DELISTING

Delisting From All Recognized Stock Exchanges

A company may delist its equity shares from all or from the only recognised stock exchange where they are listed. However, all public shareholders holding equity shares of the class which are sought to be delisted are given an exit opportunity in accordance with these regulations.

The price at which the securities will be delisted can be determined through reverse book building process or fixed offer price.

Special provisions for small companies and delisting by operation of law

Where a company has paid up capital upto one crore rupees and its equity shares were not traded in any recognised stock exchange in the one year immediately preceding the date of decision, such equity shares may be delisted from all the recognised stock exchanges where they are listed, without following the procedure provided for exit opportunity ,under these regulations.

Where a company has three hundred or fewer public shareholders and where the paid up value of the shares held by such public shareholders in such company is not more than one crore rupees, its equity shares may be delisted from all the recognised stock exchanges where they are listed, without following the procedure provided for exit opportunity under these regulations.

Compulsory delisting: Compulsory Delisting means permanent removal of securities of a listed company from a stock exchange as a penalizing measure at the behest of the stock exchange for not making submissions/ complying with various requirements set out in the Listing agreement within the time frames prescribed

Consequences of Delisting

An application for listing shall not be made in respect of any equity shares

(a) which have been delisted under voluntary delisting or by operation of law except delisting of small companies, for a period of five years from the delisting.

(b) which have been delisted under compulsory delisting, for a period of ten years from the delisting.

Answer the following

1. In case of buy-back of securities_________is not permitted.

Ans: Delisting

2. For compulsory delisted securities, further listing is not permitted for a period of ________ for the date of delisting

Ans: 10 years

3. Small company is the one having________public shareholders.

Ans: Three hundred or fewer.

Lesson 17

Issue of Securities

The Indian stock market witnessed transformation after the opening up of the economy in the early nineties, especially after the establishment of SEBI. The companies are also raising funds through new avenues to fulfill its fund requirement for different purpose. SEBI regulates the issue of securities by listed public companies in India by **SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations)**, that regulates various types of issues relating to aspects such as eligibility, Promoters' Contribution, Pricing and other Procedural aspects.

Management of a public issue involves coordination of activities and cooperation of a number of agencies such as managers to the issue, underwriters, brokers, registrar to the issue; solicitors/legal advisors, printers, publicity and advertising agents, financial institutions, auditors and other Government/Statutory agencies such as Registrar of Companies, Reserve Bank of India, SEBI etc. The whole process of issue of shares can be divided into two parts (i) pre-issue activities and (ii) post issue activities.

All activities beginning with the planning of capital issue till the opening of the subscription list are pre-issue activities while all activities subsequent to the opening of the subscription list may be called post issue activities. Since only the demat shares are being admitted for dealings on the stock exchanges, hence the securities can be issued only with the purpose of alloting the shares in Dematerialised Form.

SEBI (ICDR) regulations shall apply to the following:

(a) Public issue

(b) Rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more

(c) Preferential issue

(d) Issue of bonus shares by a listed issuer

(e) Qualified institutions placement by a listed issuer

(f) Institutional Placement Programme (IPP)

(g) Issue of Indian Depository Receipts.

The eligibility norms for public issue are different for unlisted company and listed company which are rigorous and elaborate.

Alternative eligibility norms for public issue

To provide sufficient flexibility and also to ensure that genuine companies do not suffer on account of rigidity of the parameters, SEBI has provided alternative route to company not satisfying any of the above conditions, for accessing the primary Market, if the company fulfills the following:

- If the issue is made through the book-building process and
- The issuer undertakes to allot, at least seventy five percent of the net offer to public, to qualified institutional buyers and
- To refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers.
- Addition Conditions: the company shall also satisfy the criteria of having at least 1000 prospective allotees in its issue.

Types of issue

A company can raise funds from the primary market through different method which are as follows:

(a) Public issue: When an issue/offer of securities is made to new investors for becoming part of shareholders' family of the issuer it is called a public issue. Public issue can be further classified into Initial public offer (IPO) and Further public offer (FPO).

(i) Initial public offer (IPO): When an unlisted company makes either a fresh issue of securities or offers its existing securities for sale or both for the first time to the public, it is called an IPO. This paves way for listing and trading of the issuer's securities in the Stock Exchanges.

(ii) Further public offer (FPO) or Follow on offer: When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, it is called a FPO.

(b) Right issue (RI): When an issue of securities is made by an issuer to its shareholders existing as on a particular date fixed by the issuer (i.e. record date), it is called a rights issue. The rights are offered in a particular ratio to the number of securities held as on the record date.

(c) Bonus issue: When an issuer makes an issue of securities to its existing shareholders as on a record date, without any consideration from them, it is called a bonus issue. The shares are issued out of the Company's free reserve or share premium account in a particular ratio to the number of securities held on a record date.

(d) Private placement: When an issuer makes an issue of securities to a select group of persons not exceeding 49, and which is neither a rights issue nor a public issue, it is called a private placement.

Private placement of shares or convertible securities by listed issuer can be of two types:

(i) *Preferential allotment:* When a listed issuer issues shares or convertible securities, to a select group of persons in terms of provisions of Chapter VII of SEBI (ICDR) Regulations, it is called a preferential allotment.

(ii) *Qualified institutions placement (QIP):* When a listed issuer issues equity shares or securities convertible in to equity shares to Qualified Institutions Buyers only in terms of provisions of Chapter VIII of SEBI (ICDR) Regulations, it is called a QIP.

For all the various types of Issue which the company may come out with, it has to follow the guidelines as given in SEBI (ICDR) Regulations. Different sets of regulation are prescribed for different classes of issue.

"Draft Offer Documents" means the offer document in draft stage. The draft offer documents are filed with SEBI, atleast 30 days prior to the filing of the Offer Document with ROC/SEs. SEBI may specifies changes, if any, in the Draft Offer Document and the Issuer or the Lead Merchant banker shall carry out such changes in the draft offer document before filing the Offer Document with ROC/SEs. The Draft Offer document is available on the SEBI website for public comments for a period of 21 days from the filing of the Draft Offer Document with SEBI.

"Offer document" means Prospectus in case of a public issue or offer for sale and Letter of Offer in case of a right issue, which is filed with Registrar of Companies (ROC) and Stock Exchanges.

"Red Herring Prospectus" is a prospectus, which does not have details of either price or number of shares being offered, or the amount of issue. In case price is not disclosed, the number of shares and the upper and lower price bands are disclosed. On the other hand, an issuer can state the issue size and the number of shares are determined later.

Filing of Offer Document

An issuer company cannot make any public issue of securities, unless a draft offer document has been filed with SEBI through a Merchant Banker, at least 30 days prior to registering the

prospectus with the Registrar of Companies (ROC) or filing the letter of offer with the designated stock exchange.

Issue of Securities in Dematerialised Form

A company cannot make public or rights issue or an offer for sale of securities, unless the company enters into an agreement with a depository for dematerialisation of securities already issued or proposed to be issued to the public or existing shareholders; and the company gives an option to subscribers/ shareholders/ investors to receive the security certificates or hold securities in dematerialized form with a depository.

Fast track issues

The fast-track route of fund raising is an alternative available for companies to access public funds by way of further capital offerings. Considering the need to enable well established and compliant listed companies to access Indian primary market in a time effective manner through follow-on public offerings and rights issues, SEBI decided to enable listed companies satisfying certain specified requirements to make Fast Track Issues (FTIs). Accordingly such listed companies are now able to proceed with follow-on public offering/rights issue by filing a copy of the Red Herring Prospectus (in case of book built issue)/Prospectus (in case of fixed price issue) registered with the Registrar of Companies or the letter of offer filed with Designated Stock Exchange, as the case may be, with SEBI and stock exchanges. *Such companies are not required to file draft offer document with SEBI and stock exchanges.*

Pricing

An issuer can determine the price or determine the coupon rate and conversion price of convertible debt instruments of specified securities in consultation with the lead merchant banker or through the book building process.

Differential Pricing

An issuer can offer specified securities at different prices, for retail investors, anchor investors and composite issue.

Face Value of Equity Shares

An eligible company shall be free to make public or rights issue of equity shares in any denomination determined by it in accordance with Sub-section (4) of Section 13 of the Companies Act, 1956 and in compliance with the following and other norms as may be specified by SEBI from time to time.

(i) In case of initial public offer by an unlisted company:

(a) if the issue price is ` 500/- or more, the issuer company shall have a discretion to fix the face value below Rs 10/- per share subject to the condition that the face value shall in no case be less than Re. 1 per share.

(b) if issue price is less than Rs 500 per share, the face value shall be Rs10/- per share.

This condition is not applicable to IPO made by Government company statutory authority, or corporation or any special purpose vehicle set up by any of them which is in infrastructure sector.

Promoters' Contribution to be Brought in Before Public Issue Opens

Promoters shall bring in the full amount of the promoters' contribution including premium at least one day prior to the issue opening date which shall be kept in an escrow account with a Scheduled Commercial Bank and the said contribution/ amount shall be released to the company along with the public issue proceeds.

Lock-in-requirements

For Securities Held by Promoters

– The promoters contribution including contribution made by alternative investment fund is subject to lock-in period of 3 years from the date of commencement of commercial production or date of allotment in the public issue whichever is later.

– Any contribution made by promoters over and above the minimum contribution shall be subject to a lock-in period of 1 year in case of all the companies.

– In case of issue of securities by a company listed on a stock exchange for at least 3 years and having a track record of dividend payment for at least 3 immediately preceding years promoter's contribution shall not be subject to lock-in-period.

Securities Held by Persons other than Promoters

The entire pre-issue share capital, other than that locked-in as minimum promoters' contribution, shall be locked in for a period of one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later.

This is not applicable in case of equity shares allotted to employees under employee stock option

prior to initial public offer, if the issuer has made full disclosures with respect to such option and equity shares held by a venture capital fund or alternative Investment fund of category I or a foreign venture capital investor for a period of one year prior to the date of filing the draft prospectus with SEBI.

Transferability of share under locked-in

Shares held by promoter(s) which are locked-in, can be transferred to and amongst promoter/promoter group or to a new promoter or persons in control of the company, subject to continuation of lock-in in the hands of transferees for the remaining period and compliance of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, as applicable.

Minimum Offer to Public [Rule 19(2) (B) Of SC(R) Rules, 1957]

In case of a public issue by an unlisted company, at least 10% or 25% of the post issue capital should be offered to the public and a listed company making public issue should make the net offer of at least 10% or 25% of the issue size to the public.

Manner of Call

The calls in which subscription is proposed to be called should be structured in such a manner that the entire subscription money is called within 12 months from the date of allotment and the subscription money shall be forfeited if the applicant fails to pay the call money within 12 months. Where the issue size exceeds Rs 500 crores, it is not necessary to call the entire subscription money within 12 months.

Issue opening date

A public issue may be open within 12 months from the date of issuance of the observation letter by SEBI, if any, or within 3 months of expiry from 31st day from the date of filing of draft offer document with SEBI, if no observation letter is issued.

However, in case of a fast track issue, the issue must open within the period stipulated in Section 60(4) of the Companies Act, 1956.

In case of shelf prospectus, the first issue can be opened within 3 months of issuance of observations by SEBI.

Subscription list

A public issue must be kept open for atleast 3 working days but not more than 10 working days including the days for which the issue is kept open in case of revision in price band. In case the price band in a public issue made through the book building process is revised, the bidding (issue) period disclosed in the red herring prospectus should be extended for a minimum period of 3 working days. However the total bidding period should not exceed 10 working days. Rights issue should be kept open for a minimum period of 15 days and for a maximum period of 30 days.

Minimum Subscription

The minimum subscription to be received in an issue should not be less than ninety percent of the offer through offer document. However, in the case of an initial public offer, the minimum

subscription to be received shall be subject to allotment of minimum number of specified securities, as prescribed in sub-clause (b) of clause (2) of rule 19 of Securities Contracts (Regulation) Rules, 1957.

In the event of non receipt of minimum subscription all applications moneys received should be refunded to the applicants forthwith, but not later than –

(a) fifteen days of the closure of the issue, in case of a non-underwritten issue.

(b) seventy days of the closure of the issue, in case of an underwritten issue where minimum subscription including devolvement obligations paid by the underwriters is not received within 60 days of the closure of issue.

The requirement of minimum subscription is not applicable to offer for sale.

Due Diligence

A merchant banker holding a valid certificate of registration is required to be appointed to manage the issue. A Memorandum of Understanding (MOU) is required to be entered into between lead merchant bankers and the issuer company specifying their mutual rights, liabilities and obligations relating to the issue. Lead manager who is responsible for preparation of the offer documents is required to submit to SEBI draft prospectus complete in all respects alongwith the Due Diligence Certificate, *Inter se* allocation of Responsibilities Certificate and a copy of Memorandum of Understanding and the requisite fee in accordance with SEBI (Merchant Bankers) Rules and Regulations, 1992.

Allotment of Securities

Allotment of securities offered to the public shall be made within 15 days of the closure of public issue.

The company shall pay interest @15% per annum if the allotment letters/ refund orders have not been despatched to the applicants or if, in a case where the refund or portion thereof is made in electronic manner, the refund instructions have not been given to the clearing system in the disclosed manner within 15 days from the date of the closure of the issue.

In case of book-built issue the refund instruction have not been given to the clearing system in the disclosed manner within 15 days from the date of the closure of the issue.

Book building

Book Building means a process undertaken to elicit demand and to assess the price for determination of the quantum or value of specified securities or Indian Depository Receipts, as the case may be.

Basis	Fixed price process	Book building process
Pricing	Price at which the securities are offered/allotted is known in advance to the investor	Price at which securities will be offered/allotted is not known in advance to the investor. Only an indicative price range in known/
Demand	Demand for the securities offered is known only after the closure of the issue.	Demand for the securities offered can be known everyday as the book is built
Payment	Payment if made at the time of subscription wherein refund is given after allocation	Payment only after allocation

Anchor investors

"Anchor investor" means a qualified institutional buyer who makes an application for a value of ten crore rupees or more in a public issue made through the book building process in accordance with these regulations.

Application supported by block amount (ASBA)

The ASBA process is available in all public issues made through the book building route. It shall co-exist with the current process, wherein cheque is used as a mode of payment.

ASBA is an application for subscribing to an issue, containing an authorization to block the application money in a bank account.

Self Certified Syndicate Bank

Self Certified Syndicate Bank (SCSB) is a bank which offers the facility of applying through the ASBA process. A bank desirous of offering ASBA facility shall submit a certificate to SEBI as per the prescribed format for inclusion of its name in SEBI's list of SCSBs.

Eligibility of Investors

An Investor is eligible to apply through ASBA process, if he/she:

(i) is a “Resident Retail Individual Investor”;

(ii) is bidding at cut-off, with single option as to the number of shares bid for;

(iii) is applying trough blocking of funds in a bank account with the SCSB;

(iv) has agreed not to revise his/her bid;

(v) is not bidding under any of the reserved categories.

Green shoe option facility

“Green Shoe Option” means an option of allocating shares in excess of the shares included in the public issue and operating a post-listing price stabilizing mechanism in accordance with the provisions of Regulation 45 of SEBI (ICDR) Regulations, 2009.

A company desirous of availing this option, should in the resolution of the general meeting authorising the public issue, seek authorisation also for the possibility of allotment of further shares to the ‘Stabilising Agent’ (SA) at the end of the stabilisation period.

Employee stock options

The term ‘Employee Stock Option’ (ESOP) has been defined under Sub-section (15A) of Section 2 of the Companies Act, 1956, according to which ‘employee stock option’ means the option given to the whole-time directors, officers or employees of a company, which gives such directors, officers or employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a pre-determined price. Under this scheme the company grants option to its employees and option means a right but not an obligation granted to an employee in pursuance of ESOS to apply for shares of the company at a pre-determined price.

The issue of ESOPs would be subject to approval by shareholders through a special resolution. In cases of employee being offered more than 1% shares, a specific disclosure and approval would be necessary in the annual general meeting.

A minimum period of one year between grant of options and its vesting has been prescribed. After one year, the period during which the option can be exercised would be determined by the company. Any company desirous of issuing ESOPS should abSide by the conditions set forth in SEBI ***Employee stock option scheme and employee stock purchase scheme) Guidelines, 1999.***

Employees stock purchase scheme (ESPS)

An employee eligible to participate in the scheme should be:

(a) a permanent employee of the company working in India or out of India; or

(b) a director of the company, whether a whole time director or not;

(c) an employee as defined in sub-clauses (a) or (b) of a subsidiary, in India or out of India, or of a holding company of the company.

(ii) The employee should neither be a promoter nor belongs to the promoter group.

No ESOS/ESPS shall involve in acquisition of securities from the secondary market.

SEBI (Listing of Securities on Institutional Trading Platform) Regulation 2013)

SEBI notified a new set of regulations called the SEBI (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013 (ITP Regulations) and amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 to insert a new "Chapter XC "Listing and Issue of Capital by Small and Medium Enterprises on Institutional Trading Platform without Initial Public Offering".

Under these Regulations, a separate institutional trading platform is available in an SME exchange for listing and trading of specified securities of SMEs for informed investors. Such listing may be availed of without going through a public offering process. In other words, this provides exit options to investors even where the company or the promoters do not require additional capital to be raised from the public. Chapter XB of the ICDR Regulations provides for issuance of specified securities by SMEs on SME exchange. Broadly, an SME was required to make an IPO without having to file the draft offer document with SEBI. Here, SME is defined to mean a public company, including Start-up Company that complies with all the eligibility conditions specified in these Regulations. The main highlights of the regulation are as under:

Answer the following:

1. ___________ investor is the one who applies or bids for specified securities for a value of not more than two lakhs rupees.

Ans: Retail Individual

2. The process of price discovery____________________.

Ans: Book Building

3. Shares held by promoter which are locked-in, can be________to and amongst promoter/promoter group or to a new promoter or persons in control of the company.

Ans: Transferred

Lesson 18

Regulatory Framework relating to Securities Market Intermediaries

Intermediaries are service providers and are an integral part of any financial system. The Market Regulator, i.e., SEBI regulates various intermediaries in the primary and secondary markets through its Regulations for these respective intermediaries. SEBI has defined the role of each of the intermediary, the eligibility criteria for granting registration, their functions and responsibilities and the code of conduct to which they are bound. These Regulations also empower SEBI to inspect the functioning of these intermediaries and to collect fees from them and to impose penalties on erring entities.

Primary market intermediaries

The following market intermediaries are involved in the primary market:

Merchant Bankers/Lead Managers

Registrars and Share Transfer Agents

Underwriters

Bankers to issue

Debenture Trustees

Merchant bankers

'Merchant Banker' means any person engaged in the business of issue management by making arrangements regarding selling buying or subscribing to securities or acting as manager/consultant/advisor or rendering corporate advisory services in relation to such issue management.

The activities of the merchant banker is regulated by the SEBI (Merchant Bankers) Regulations, 1992

Regulation 3 of SEBI (Merchant Bankers) Regulations, 1992 lays down that an application by a person desiring to become merchant banker shall be made to SEBI in the prescribed form seeking

grant of a certificate of initial registration alongwith a non-refundable application fee as specified in Schedule II of the Regulations.

Regulation 4 and 5 deal with the methodology for application and furnishing of information, clarification and personal representation by the applicant. Incomplete or non-conforming applications shall be rejected after giving an opportunity to remove the deficiencies within a time specified by SEBI.

Regulation 6 lists out the following considerations for being taken into account by SEBI to grant the certificate of registration. Regulation 7 prescribes that the capital adequacy requirement shall be a networth of not less than five crore rupees. Chapter III of the Regulations containing Regulations 13 to 28 deal with general obligations and responsibilities of Merchant Bankers.

Registrars and share transfer agents

The Registrars to an Issue and Share Transfer Agents constitute an important category of intermediaries in the primary market. They render very useful services in mobilising new capital and facilitating proper records of the details of the investors, so that the basis for allotment could be decided and allotment ensured as per SEBI Regulations.

SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 were notified by SEBI on 31st May, 1993.

Chapter I of the Regulations contains preliminary items and Chapter II consisting of Regulations 3 to 12 dealing

with procedure for applying for registration as Registrar to an Issue (RTI) and Share Transfer Agents (STA), either as Category-I to carry on both the activities of RTA and STA or Category-II to carry on the activity either as Registrar to an Issue or as a Share Transfer Agent. The application should be complete and conform to the requirements otherwise it will be rejected. But an opportunity will be given to remove the objections as may be indicated by SEBI. In case of failure the application may be rejected.

Underwriters

Underwriting is an arrangement whereby certain parties assure the issuing company to take up shares, debentures or other securities to a specified extent in case the public subscription does not amount to the expected levels. For this purpose, an arrangement (agreement) will be entered into between the issuing company and the assuring party such as a financial institution, banks, merchant banker, broker or other person.

SEBI (Underwriters) Regulations, 1993: These regulations were notified by SEBI in exercise of the powers conferred by Section 30 of SEBI Act, 1992 with the approval of Central Government.

Chapter I contains preliminary matters including definitions.

Chapter II deals with the procedure for registration of underwriters and it contains Regulations 3 to 12. Chapter III consisting of Regulation 13 to 18 deals with obligations and responsibilities of an underwriter. Chapter IV contains regulation 19 to 24 makes provisions on inspection and disciplinary proceedings. SEBI is empowered to appoint inspectors to ensure that books of accounts, records etc. are maintained properly and the Act along with the rules and regulations are duly complied with.

Bankers to an issue

Banker to an Issue means a scheduled bank carrying on all or any of the following activities:

- Acceptance of application and application monies;
- Acceptance of allotment or call monies;
- Refund of application monies;
- Payment of dividend or interest warrants.

SEBI (Bankers to an Issue) Regulations, 1994

SEBI notified these regulations effectiveness from 14th July, 1994 in exercise of the powers conferred by Section 30 of SEBI Act, 1994 after approval by the Central Government.

Chapter I deals with preliminary matters and definitions.

Chapter II containing Regulations 3 to 11 deals with registration of Bankers to an Issue with SEBI.

Debenture trustees

Debentures, Bonds and other hybrid instruments in most cases unless otherwise specified, carry securities for the investors unlike in the case of equity and preference shares. It is necessary that the company makes proper arrangements to extend assurances and comply with legal requirements in favour of the investors who are entitled to this type of security. Intermediaries such as Trustees who are generally Banks and Financial Institutions render this service to the investors for a fee payable by the company. The issuing company has to complete the process of finalising and executing the trust deed or document and get it registered within the prescribed period and file the charge with the Registrar of Companies (ROC) in respect of the security offered.

SEBI (Debenture Trustees) Regulations, 1993

These regulations were notified by SEBI effective from 29th December, 1993 in exercise of the powers conferred by Section 30 of SEBI Act, 1992 after previous approval of the Central Government.

Chapter I contains preliminary matters and definitions.

Chapter II consisting Regulations 3 to 12 deals with the procedure for initial or permanent registration of debenture trustees.

Regulation 15 explains in the detail the duties of Debenture Trustee

Secondary market intermediaries

The following market intermediaries are involved in the secondary market:

Stock brokers

Sub-brokers

Portfolio managers

Custodians

Foreign Institutional Investors

Investment Advisers

Stock broker & sub brokers

A stock-broker plays a very important role in the secondary market helping both the seller and the buyer of the securities to enter into a transaction.

A sub-broker is one who works along with the main broker and is not directly registered with the stock exchange as a member. He acts on behalf of the stock broker as an agent or otherwise for assisting the investors in buying, selling or dealing in securities through such stock brokers. No stock broker or sub-broker shall buy, sell or deal in securities unless he holds a certificate of registration granted by SEBI under the Regulations made by SEBI in relation to them.

SEBI (Stock Brokers & Sub-Brokers) Regulations, 1992 were notified by SEBI in exercise of the powers conferred by section 30 of SEBI Act, 1992 and came into effect on 23rd October, 1992.

SEBI (Stock Brokers & Sub Brokers) Regulations, 1992

Portfolio managers

Portfolio manager means any person who pursuant to contract or arrangement with the client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the clients as the case may be. "Discretionary portfolio manager" is defined as one who exercises or may exercise, under a contract relating to portfolio management, any degree of discretion as to the investment or the management of the portfolio of the securities or the funds of the client. "Portfolio" means the total holdings of securities belonging to any person.

A portfolio manager thus, with professional experience and expertise in the field, studies the market and adjusts the investment mix for his client on a continuing basis to ensure safety of investment and reasonable returns therefrom.

SEBI (Portfolio Managers) Regulations, 1993

SEBI issued SEBI (Portfolio Managers) Regulations, 1993 in exercise of the powers conferred by Section 30 of SEBI Act, 1992. These regulations took effect from 7th January, 1993.

Regulation 3A lays down that an application by a portfolio manager for grant of the certificate shall be made to SEBI in the prescribed form-A. The certificate of registration granted and its renewal granted under these regulation shall be valid for a period of three years from the date of its issue to the applicant.

Responsibilities of a portfolio manager

Regulation 15 lays down that the discretionary portfolio manager shall individually and independently manage the funds of each client in accordance with the needs of a client in a manner which does not partake the character of a mutual fund, whereas the nondiscretionary portfolio manager shall manage the funds in accordance with the directions of the client. The portfolio manager shall not accept from the client, funds or securities worth less than five lakhs rupees. The portfolio manager shall act in a fiduciary capacity with regard to the client's funds. He shall transact in securities within the limitation placed by the client for dealing in securities under the provisions of RBI Act, 1934. He shall not derive any direct or indirect benefit out of the client's funds or securities.

Custodian of securities

Custodian of securities means any person who carries on or proposes to carry on the business of providing custodial services. The term "custodial services" in relation to securities of a client or gold or gold related instruments held by a mutual fund in accordance with the SEBI (Mutual Funds)

Regulations, 1996 means safekeeping of securities or gold or gold related instruments and providing services incidental thereto, and includes –

(i) maintaining accounts of securities or gold or gold related instruments or title deeds of real estate assets;

(ii) undertaking activities as a Domestic Depository in terms of the Companies (Issue of Indian Depository Receipts) Rules, 2004.

(iii) collecting the benefits or rights accruing to the client in respect of securities or gold or gold related instruments;

(iv) keeping the client informed of the actions taken or to be taken by the issuer of securities, having a bearing on the benefits or rights accruing to the client; and

(v) maintaining and reconciling records of the services referred to in points (i) to (iii).

SEBI (Custodian of Securities) Regulations, 1996

In exercise of the powers conferred by section 30 of SEBI Act, 1992 (15 of 1992) SEBI issued SEBI (Custodian of Securities) Regulations, 1996 on May 16, 1996.

Foreign institutional investors

"Foreign Institutional Investor" means an institution established or incorporated outside India which proposes to make investment in India in securities. No person can buy, sell or otherwise deal in securities as a Foreign Institutional Investor unless he holds a certificate granted by SEBI under these regulations.

SEBI (Foreign Institutional Investors) Regulations, 1995

In exercise of the powers conferred by section 30 of SEBI Act, 1992 SEBI made these regulations.

When an application is made for grant of certificate, SEBI may require the applicant to furnish such further information or clarification as SEBI considers necessary regarding matters relevant to the activities of the applicant for grant of certificate. The applicant or his authorised representative, if so required by SEBI, appear before SEBI for personal representation in connection with the grant of a certificate.

Investment conditions and restrictions

A Foreign Institutional Investor can invest only in the following:

(a) securities in the primary and secondary markets including shares, debentures and warrants of companies unlisted, listed or to be listed on a recognised stock exchange in India; and

(b) units of schemes floated by domestic mutual funds including Unit Trust of India, whether listed on a recognised stock exchange or not, units of scheme floated by a collective investment scheme.

(c) dated Government Securities.

(d) derivatives traded on a recognised stock exchange.

(e) commercial paper.

(f) security receipts.

(g) Indian Depository Receipts

Qualified Foreign Investors

"QFI shall mean a person who fulfils the following criteria:

(i) Resident in a country that is a member of Financial Action Task Force (FATF) or a member of a group which is a member of FATF; and

(ii) Resident in a country that is a signatory to IOSCO's MMOU or a signatory of a bilateral MOU with SEBI.

Investment adviser

"Investment Adviser" means any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called.

"Investment advice" means advice relating to investing in, purchasing, selling or otherwise dealing in securities or investment products, and advice on investment portfolio containing securities or investment products, whether written, oral or through any other means of communication for the benefit of the client and shall include financial planning:

However, investment advice given through newspaper, magazines, any electronic or broadcasting or telecommunications medium, which is widely available to the public shall not be considered as investment advice for the purpose of these regulations;

SEBI (Investment Advisers) Regulations, 2013

In exercise of the powers conferred by sub-section (1) of Section 30 read with clause (b) of sub-section (2) of Section 11 of SEBI Act, 1992, SEBI made these regulations.

Guidelines on Anti Money Laundering Measures

The Prevention of Money Laundering Act, 2002 (PMLA) has been brought into force with effect from 1st July 2005.

As per the provisions of the Act, every banking company, financial institution and intermediary shall have to maintain a record of all the transactions; the nature and value of which has been prescribed in the Rules notified under the PMLA. Such transactions include:

– All cash transactions of the value of more than Rs 10 lakhs or its equivalent in foreign currency.

– All series of cash transactions integrally connected to each other which have been valued below Rs 10lakhs or its equivalent in foreign currency where such series of transactions take place within one calendar month.

– All suspicious transactions whether or not made in cash and including inter alia, credits or debits into from any non-monetary account such as demat account, security account maintained by the registered intermediary.

In terms of the PMLA rules, intermediaries are required to report information relating to cash and suspicious transactions to the Director, Financial Intelligence Unit-India (FIU-IND).

SEBI (Intermediaries) Regulations, 2008

In the present regime a dozen regulations govern different categories of intermediaries. The broad framework of such regulations is similar to one another. SEBI has issued Securities and Exchange Board of India (Intermediaries) Regulations, 2008. The new regulations seek to consolidate the common requirements and put in place a comprehensive framework which will apply to the intermediaries and prescribe the obligations, procedure, limitations etc. in so far as the common requirements are concerned. The new regulations seek to simplify procedures to make the registration/ regulation process of intermediaries less burdensome and cost effective without diluting the regulatory oversight.

SEBI {KYC (know your client) registration agency (KRA)}, Regulations, 2011

With a view to bring uniformity in the KYC requirements for the securities markets, SEBI has initiated usage of uniform KYC by all SEBI registered intermediaries. In this regard SEBI has issued the SEBI {KYC (Know Your Client) Registration Agency (KRA)}, Regulations, 2011.

KRA provides for centralization of the KYC records in the securities market. The client who is desirous of opening an account/trade/deal with the SEBI registered Intermediary shall submit the KYC details through the KYC Registration form and supporting documents. The Intermediary shall perform the initial KYC and upload the details on the system of the KYC Registration Agency (KRA). This KYC information can be accessed by all the SEBI Registered Intermediaries while

dealing with the same client. As a result, once the client has done KYC with a SEBI registered intermediary, he need not undergo the same process again with another intermediary.

In-person Verifications (IPV)

- SEBI has made it compulsory for all the intermediaries to carry out IPV of their clients. The intermediary shall ensure that the details like name of the person doing IPV, his designation, organization with his signatures and date are recorded on the KYC form at the time of IPV.
- The IPV carried out by one SEBI registered intermediary can be relied upon by another intermediary.
- In case of Stock brokers, their sub-brokers or Authorised Persons (appointed by the stock brokers after getting approval from the concerned Stock Exchanges) can perform the IPV.
- In case of Mutual Funds, their Asset Management Companies (AMCs) and the distributors who comply with the certification process of National Institute of Securities Market (NISM) or Association of Mutual Funds (AMFI) and have undergone the process of 'Know Your Distributor (KYD)', can perform the IPV.
- However, in case of applications received by the mutual funds directly from the clients i.e. not through any distributor), they may also rely upon the IPV performed by the scheduled commercial banks.

SEBI (Self Regulatory Organisations) Regulations, 2004

SEBI (Self Regulatory Organizations) Regulations, 2004 came into effect on 19th February, 2004.

Self Regulatory Organizations means an organization of intermediaries which is representing a particular organization segment of the securities market and which is duly recognised by SEBI under these regulations, but excludes a stock exchange. Regulation 3 provides that any group or association of intermediaries, which is desirous of being recognized as a Self Regulatory Organization, may form a company under section 25 of the Companies Act, 1956 and such company may make an application to the SEBI for grant of certificate of recognition as a Self Regulatory Organization. However, a distributors shall be deemed to be any intermediary for the purpose of this regulation.

Answer the following:

1. Custodian is an example of_____________market intermediary

Ans: Secondary

2. In terms of the PMLA rules, intermediaries are required to report information relating to cash and suspicious transactions to the_______________.

Ans: Director, Financial Intelligence Unit-India

3. An intermediary is appointed by SEBI.

Ans: No

Lesson 19

Insider Trading – An Overview

'Insider trading' is buying or selling a security, in breach of a fiduciary duty or other relationship of trust, and confidence, while in possession of material, nonpublic information about the security. Therefore, preventing such transactions is an important obligation for any capital market regulatory system, because insider trading undermines investor confidence in the fairness and integrity of the securities markets.

"Insider trading generally means trading in the shares of a company by the persons who are in the management of the company or are close to them on the basis of undisclosed price sensitive information regarding the working of the company, which they possess but which is not available to others."

PROVISIONS RELATING TO INSIDER TRADING IN COMPANIES ACT, 2013

Section 195 of the Companies Act, 2013 deals with the provisions on prohibition on insider trading of securities.

The section prohibits person including any director or key managerial personnel to enter into insider trading, however they are allowed to make any communication required in the ordinary course of business or profession or employment or under any law.

Further, if any person contravenes the provisions of this section, he shall be punishable with imprisonment for a term which may extend to five years or with fine which shall not be les than five lakh rupes but which may extend to twenty-five crore rupes or three times the amount of profits made out of insider trading, whichever is higher, or with both.

SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

The SEBI (Prohibition of Insider Trading) Regulation 2015, comprise of four chapters and three schedules encompassing the various regulations related to insider trading.

Price sensitive Information

“Price sensitive information” means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company.

The following shall be deemed to be price sensitive information:-

- periodical financial results of the company;
- intended declaration of dividends (both interim and final);
- issue of securities or buy-back of securities;
- any major expansion plans or execution of new projects;
- amalgamation, mergers or takeovers;
- disposal of the whole or substantial part of the undertaking;
- any significant changes in policies, plans or operations of the company.

Unpublished

“unpublished” means information which is not published by the company or its agents and is not specific in nature.

PROHIBITION ON DEALING COMMUNICATION OR COUNSELLING ON MATTERS RELATING TO INSIDER TRADING

Regulation 3 provides that insider shall not either on his own behalf or on behalf of any other person; deal in securities of a company listed on any stock exchange when in possession of any unpublished price sensitive.

DISCLOSURE OF INTEREST OR BY CERTAIN PERSONS

Initial Disclosure

- Every promoter, key managerial personnel and director of every company whose securities are listed on any recognised stock exchange shall disclose his holding of securities of the company as on the date of these regulations taking effect, to the company within thirty days of these regulations taking effect

Every person on appointment as a key managerial personnel or a director of the company or upon becoming a promoter shall disclose his holding of securities of the company as on the date of appointment or becoming a promoter, to the company within seven days of such appointment or becoming a promoter.

Continual Disclosure

Every promoter, employee and director of every company shall disclose to the company the number of such securities acquired or disposed of within two trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of ten lakh rupees or such other value as may be specified;

Every company shall notify the particulars of such trading to the stock exchange on which the securities are listed within two trading days of receipt of the disclosure or from becoming aware of such information. Explanation. — It is clarified for the avoidance of doubts that the disclosure of the incremental transactions after any disclosure under this sub-regulation, shall be made when the transactions effected after the prior disclosure cross the threshold specified in clause (a) of sub-regulation (2).

Disclosure By Company To Stock Exchanges

Every listed company, within 2 working days of receipt of the information mentioned above is required to disclose to all stock exchanges on which the company is listed.

The Model code of conduct for prevention of insider trading for listed companies mandates

Appointment of a Compliance Officer for setting forth policies, procedures, monitoring adherence to the rules for the preservation of "Price Sensitive Information", pre-clearing of designated employees' and their dependents' trades (directly or through respective department heads as decided by the company), monitoring of trades and the implementation of the code of conduct under the overall supervision of the Board of the listed company.

Preservation of "Price Sensitive Information"

Employees/ directors shall maintain the confidentiality of all Price Sensitive Information. Employees/ directors shall not pass on such information to any person directly or indirectly by way of making a recommendation for the purchase or sale of securities.

Need to Know

Price Sensitive Information is to be handled on a "need to know" basis, i.e., Price Sensitive Information should be disclosed only to those within the company who need the information to discharge their duty.

Limited access to confidential information

Files containing confidential information shall be kept secure. Computer files must have adequate security of login and pass word etc.

Prevention of misuse of "Price Sensitive Information"

All directors/ officers and designated employees of the company shall be subject to trading restrictions.

Trading window

The company shall specify a trading period, to be called "Trading Window", for trading in the company´s securities. The time for commencement of closing of trading window shall be decided by the company. The trading window shall be opened 24 hours after the following information is made public.

– *The trading window shall be closed during the time of:-*

- Declaration of Financial results (quarterly, half-yearly and annual)
- Declaration of dividends (interim and final)
- Issue of securities by way of public/ rights/bonus etc.
- Any major expansion plans or execution of new projects
- Amalgamation, mergers, takeovers and buy-back
- Disposal of whole or substantially whole of the undertaking
- Any changes in policies, plans or operations of the company.

When the trading window is closed, the employees / directors shall not trade in the company's securities in such period. The time for commencement of closing of trading window shall be decided by the company.

In case of ESOPs, exercise of option may be allowed in the period when the trading window is closed. However, sale of shares allotted on exercise of ESOPs shall not be allowed when trading window is closed.

In case it is observed by the company/Compliance Officer that there has been a violation of SEBI (Prohibition of Insider Trading) Regulations, 1992 SEBI shall be informed by the company.

Code of corporate disclosure practices for prevention of insider trading

To ensure timely and adequate disclosure of price sensitive information, the following norms shall be followed by listed companies: –

- Prompt disclosure of price sensitive information
- Overseeing and co-ordinating disclosure
- Responding to market rumours
- Timely Reporting of shareholdings/ownership and changes in ownership
- Disclosure/dissemination of Price Sensitive Information with special reference to Analysts, Institutional Investors
- Medium of disclosure/dissemination
- Dissemination by stock exchanges

The Company Secretary as the Compliance Officer has been given onerous responsibility for ensuring the prohibition of insider trading practices in the organization. The code of conduct has to be framed in accordance with the Model code as prescribed by SEBI. The role of a Company Secretary *inter alia* includes

To frame and then to monitor adherences to the rules for the preservation of "Price Sensitive information".

To ensure that computer data is adequately secured.

To keep records of periods specified as 'close period' and the 'Trading Widow'.

To ensure that the 'Trading Window' is closed at the required times *etc.*

In case of unlisted company the company secretary is required

(i) To prepare the Chinese wall policy for adoption in the company. Chinese walls mean artificial barriers to the flow of information set up in large firms to prevent the movement of sensitive information between departments.

(ii) To prepare Restricted/ Grey List of securities from time to time.

Answer the following:

1. The director cannot trade in their holdings in the company when the_______is closed.
Ans: Trading Window.

2. Decision of Buy back of securities falls under the category of_____________.
Ans: Price Sensitive Information

3. _________are artificial barriers to the flow of information set up in large firms to prevent the movement of sensitive information between departments.
Ans: Chinses Walls.

Q. Enumerate the obligations cast upon the Company Secretary in relation to the insider trading regulations. (Tip: Elaborate the duties which must be done to ensure fair disclosure and protection of the stakeholders)

Lesson 20

Takeover Code – An Overview

When an "Acquirer" takes over the control of the "Target Company", it is termed as Takeover. When an acquirer acquires "substantial quantity of shares or voting rights" of the Target Company, it results into substantial acquisition of shares.

The growth of Mergers & Acquisitions activity in India as the preferred mode of restructuring, the increasing sophistication of takeover market, the decade long regulatory experience and various judicial pronouncements, it was felt necessary to review the Takeover Regulations 1997. After considerable discussion and debate, SEBI, [Substantial Acquisition of Shares and Takeovers (SAST)] Regulations, 2011 was enacted. SAST aims at protecting interest of the investors in securities of a listed company providing amongst others, an opportunity for the public shareholders to exit where there is a substantial acquisition of shares or voting rights or control over a listed company, consolidation of holdings by existing shareholders and related disclosures and penalties for non- compliance etc. SAST requires an acquirer to make an offer to shareholders of the target company on acquiring shares exceeding stipulated thresholds. It also contains provisions relating to open offer size and price, time bound process for making an open offer, exemption from making an open offer etc.

Trigger point for making an open offer by an acquirer

25% shares or voting rights: An acquirer, along with Persons acting in concert (PAC) , if any, who intends to acquire shares which along with his existing shareholding would entitle him to exercise 25% or more voting rights, can acquire such additional shares only after making a Public Announcement (PA) to acquire minimum twenty six percent shares of the Target Company from the shareholders through an Open Offer.

Creeping acquisition limit: An acquirer who holds 25% or more but less than maximum permissible non-public shareholding of the Target Company, can acquire such additional shares as would entitle him to exercise more than 5% of the voting rights in any financial year ending March 31 only after making a Public Announcement to acquire minimum twenty six percent shares of Target Company from the shareholders through an Open Offer.

OPEN OFFER

SEBI Takeover Regulations, 2011 provides certain trigger events wherein the Acquirer is required to give Open Offer to the shareholders of the Target Company to provide them exit opportunity.

I. Mandatory open offer

Regulation 3 of the SEBI Takeover Regulations, 2011 provides that the Acquirer to give an open offer to the shareholders of Target Company on the acquisition of shares or voting rights entitling the Acquirer along with the persons acting in concert with him to exercise 25% or more voting rights in the Target Company.

II. Voluntary open offer

Voluntary Open Offer means the Open Offer given by the Acquirer voluntarily without triggering the mandatory Open Offer obligations as envisaged under the regulations. Voluntary Offers are an important means for substantial shareholders to consolidate their stake. Regulation 6 of the Takeover Regulations provides the threshold and conditions for making the Voluntary Open Offer.

III. Conditional offer

An offer in which the acquirer has stipulated a minimum level of acceptance is known as a conditional offer. Minimum level of acceptance implies minimum number of shares which the acquirer desires under the said conditional offer. If the number of shares validly tendered in the conditional offer, are less than the minimum level of acceptance stipulated by the acquirer, then the acquirer is not bound to accept any shares under the offer. In a conditional offer, if the minimum level of acceptance is not reached, the acquirer shall not acquire any shares in the target company under the open offer or the Share Purchase Agreement which has triggered the open offer.

Disclosures

In SEBI Takeover Regulations, 2011, the obligation to give the disclosures on the acquisition of certain limits is only on the acquirer and not on the Target Company. Further as against the Open Offer obligations where the individual shareholding is also to be considered, the disclosure shall be of the aggregated shareholding and voting rights of the acquirer or promoter of the target company or every person acting in concert with him.

Exemptions

Regulation 10 – Automatic exemptions: of the SEBI Takeover Regulations, 2011 provides the Acquirer automatic exemptions from the applicability of making Open Offer to the shareholders of the Target Company in respect of certain acquisitions subject to the compliance of certain conditions specified therein.

Regulation 11 - Exemption by SEBI:

Regulation 11 provides that on an application being made by the acquirer in writing giving the details of the proposed acquisition and grounds on which the exemption is sought along with duly sworn affidavit, SEBI may grant exemption to the acquirer from the Open Offer obligations subject to the compliance with such conditions as it deems fits.

The public announcement shall be sent to all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public.

In SEBI Takeover Regulations, 2011, the obligation to give the disclosures on the acquisition of certain limits is only on the acquirer and not on the Target Company.

Answer the following:

1. ___________________an offer made by a person other than the acquirer who has made the first public announcement.

Ans: Competitive Bid

2. _________ is a corporate device whereby one company acquires control over another company, usually by purchasing all or majority of its shares.

Ans: Takeover

3. The Voluntary Open Offer shall be made for the acquisition of at least_________of the voting rights in the Target Company.

Ans: Ten percent

Lesson 21

Investor Protection

Investor protection is one of the most important elements of a thriving securities market or other financial investment institution. Investor protection focuses on making sure that investors are fully informed about their purchases, transactions and the affairs of the company that they have invested in. Investors protections is a very popular phrase with all these concerned with regulation of the capital market these days, be the stock exchanges. SEBI, MCA, RBI, Investors Association, or the companies themselves – Various Procedures, Guidelines, Rules and Regulations have been issued in the Legislations to protect the 'Investors' right and repose the confidence.

Globally, there is increased evidence to suggest that investor protection has assumed an important role in the economic development of a country. Integrity of the financial markets and economic wellbeing of the country depend on corporate accountability and investors' confidence. The global concern to make capital markets safer and transparent can be achieved by strengthening financial system and managing the crisis efficiently. The revival of investors' protection in the corporate securities market is necessary to make market more efficient by means of converting savings to investment. If the investors are not protected properly by way of providing fair rate of return and safeguarding their capital, the corporate will not be able to mobilize funds from the market at reasonable rate in times to come.

Investors' rights and responsibilities

Equity shareholders are the real owner of the company and with the growth of the company equity shareholders also get capital appreciation, vice versa is also true.

The rights and responsibilities of a shareholder of a company can be clubbed under:

- The Rights of Investor as a shareholder
- Rights of Investors as a debenture holder
- Responsibilities of an Investor as a security holder

For lodging of grievances

Investors who are not satisfied with the response to their grievances received from the brokers/Depository Participants/listed companies, can lodge their grievances with the Stock Exchanges or Depositories. The grievance can be lodged at any of the offices of the BSE/NSE located at Chennai, Mumbai, Kolkata and New Delhi. In case of unsatisfactory redressal,

BSE/NSE has designated Investor Grievance Redressal Committees (IGRCs), or Regional Investor Complaints Resolution Committees (RICRC), this forum acts as a mediator to resolve the claims, disputes and differences between entities and complainants.

Types of grievances and dealing authority

Grievances pertaining to	**Regulator**
Banks deposits and banking Fixed Deposits with Non Banking Financial Companies (NBFCs) and other matters pertaining to NBFCs Primary Dealers	Reserve Bank of India (RBI)
Affairs relating to listed and unlisted company	Ministry of Corporate Affairs (MCA)
Insurance Companies/Brokers /Agents/products of and Service	Insurance Regulatory and Development Authority
Commodities	Forward Markets Commission (FMC)
Pension fund	Pension Fund Regulatory and Development Authority (PFRDA)
Monopoly and anti competitive practices	Competition Commission of India (CCI)
Chit Funds	Registrars of Chit Funds of the concerned State.
Housing Finance Companies	National Housing Bank (NHB)

Legal framework for investor protection in India

In order to afford adequate protection to the investors, provisions have been incorporated in different legislations such as the Companies Act, Securities Contracts (Regulation) Act, Consumer Protection Act, Depositories Act, and Listing Agreement of the Stock Exchanges supplemented by many guidelines, circulars and press notes issued by the Ministry of Finance, Ministry of Company Affairs and SEBI from time to time. The legislations as well as the rules and regulations notified thereunder specify disclosure requirements to be complied with by the companies and also punishments and remedies for failure of compliance.

Investors' education and protection fund

Investor Education and Protection Fund (IEPF) has been established under Section 205C of the Companies Act, 1956 by way of Companies (Amendment) Act, 1999, for promotion of investors' awareness and protection of the interests of investors. Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001 (IEPF Rules) stipulate the activities related

to investors' education, awareness and protection for which the financial sanction can be provided under IEPF.

Financial education

An increased need for financial education is felt in both developed and developing countries. In developed countries, the increasing number of financial products, its complexity, importance of retirement savings, increased growth of secondary market has made the imparting of financial education imperative for all age groups, including students so that individuals are educated about financial matters as early as possible in their lives. In the developing countries, the growing number of investors, technically advanced financial markets, liberalized economy etc. necessitates imparting of financial education for better operation of markets and economy and in the interest of investor. Further imparting of financial education is international concern due to growth of international transactions, international financial instruments like ADR, GDR, IDR etc., mobility of individuals from one country to another etc.

All the market regulators viz RBI, SEBI, MCA, IRDA, PFRDA are taking proactive steps for furthering the cause of financial literacy in India. Also, commercial banks, Broking Houses and Mutual Funds have initiatives in the field of financial education that spawns conducting of seminars, issuance of do's and don'ts, and newspaper campaigns.

Investor grievance redressal mechanism at SEBI

Investor grievances

There will be occasions when an investor has a complaint against, a listed company or an intermediary registered with SEBI. In the event of such complaint, the investor should first approach the concerned company/ intermediary against whom there is a complaint. Sometimes the response received may not be satisfactory. Therefore, investors should know as to which authority they should approach, to get their complaints redressed.

Scores (SEBI complaints redress system)

SCORES is a web based centralized grievance redress system of SEBI (http://scores.gov.in). SCORES enables investors to lodge and follow up their complaints and track the status of redressal of such complaints online from the above website from anywhere. This enables the market intermediaries and listed companies to receive the complaints online from investors, redress such complaints and report redressal online. All the activities starting from lodging of a complaint till its closure by SEBI would be online in an automated environment and the complainant can view the status of his complaint online. An investor, who is not familiar with SCORES or does not have access to SCORES, can lodge complaints in physical form at any of the offices of SEBI. Such complaints would be scanned and also uploaded in SCORES for processing.

The salient features of SCORES are:

– SCORES is web enabled and provides online access 24 x 7;

– Complaints and reminders thereon can be lodged online at the above website at anytime from anywhere;
– An email is generated instantaneously acknowledging the receipt of complaint and allotting a unique complaint registration number to the complainant for future reference and tracking;
– The complaint forwarded online to the entity concerned for its redressal;
– The entity concerned uploads an Action Taken Report (ATR) on the complaint;
– SEBI peruses the ATR and closes the complaint if it is satisfied that the complaint has been redressed adequately;
– The concerned investor can view the status of the complaint online from the above website by logging in the unique complaint registration number;
– The entity concerned and the concerned investor can seek and provide clarification on his complaint online to each other;
– Every complaint has an audit trail; and
– All the complaints are saved in a central database which generates relevant MIS reports to enable SEBI to take appropriate policy decisions and or remedial actions, if any.

These matters that are not considered as complaints by SEBI, viz

- ✓ Complaints that are incomplete or not specific
- ✓ Allegations without supporting documents
- ✓ Offering suggestions or seeking guidance/explanation
- ✓ Seeking explanation for non-trading of shares or illiquidity of shares
- ✓ Not satisfied with trading price of the shares of the companies
- ✓ Non-listing of shares of private offer
- ✓ Disputes arise out of private agreement with companies/intermediaries.

SEBI (informal guidance) Scheme, 2003

In the interests of better regulation of and orderly development of the Securities market, SEBI has issued SEBI (Informal Guidance) Scheme 2003 w.e.f. 24.6.2003. The following persons may make a request for informal Guidance under the scheme:
(a) any intermediary registered with the SEBI.
(b) any listed company.
(c) any company which intends to get any of its securities listed and which has filed either a listing application with any stock exchange or a draft offer document with the Board or the Central Listing authority.
(d) any mutual fund trustee company or asset management company.
(e) any acquirer or prospective acquirer under the SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 2011.
The Guidance Scheme, further deals with various aspects such as the nature of request, fees to be accompanied along with request letter, disposal of requests, SEBI's discretion not to respond certain types of requests and confidentiality of requests etc.
The informal guidance may be sought for and given in two forms:

– **No-action letters:** SEBI indicates that the Department would or would not recommend any action under any Act, Rules, Regulations, Guidelines, Circulars or other legal provisions administered by SEBI to the Board.
– **Interpretive letters:** SEBI provides an interpretation of a specific provision of any Act, Rules, Regulations, Guidelines, Circulars or other legal provision being administered by SEBI in the context of a proposed transaction in securities or a specific factual situation.

PROTECTION OF INVESTORS UNDER COMPANIES ACT, 2013

1. Acceptance of Deposits

Section 73 - This section provides that no Company shall accept or review deposit under this Act from the public except in a manner provided under Chapter V (Acceptance of Deposits by Companies) of Companies Act, 2013 and Companies (Acceptance of Deposits) Rules, 2014 made thereunder.

If a company fails to repay the deposit or part thereof or any interest thereon within the time specified under section 74 or such further times as may be allowed by the Tribunal, the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extent to seven years or with fine which shall not be less than twenty–five lakh rupees but which may extend to two crore rupees, or with both.

In case of continuing offence a fine of Rs. 5000/- for every day after the first day during which the contraventions continue.

2. Mis-statements in Prospectus

Section 34: Where a prospectus, issued, circulated or distributed, includes any statement which is

untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to be mislead, every person who authorises the issue of such prospectus shall be considered as criminal liability and shall be liable for action under section 447(Fraud) wherein he shall be punishable imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

3. Fraudulently inducing persons to invest money

Section 36: Any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to invest money enter into, or to offer to enter into-shall be liable for action under section 447.

4. Personation for acquisitions, etc. of securities

Section 38: Any person who makes or abets making an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or makes or abets making of multiple applications to the company in different names for acquiring or subscribing for its securities; or otherwise induces directly or indirectly a company to allot, or register any transfer thereof, securities to him, or to any other person in a fictitious name, shall be liable for action under section 447.

5. Non-payment of Dividend

Section 123 and section 124: when a company which declares the dividend (including interim dividend for any and financial year does not to deposit the amount of such dividend) in a scheduled bank in a separate account within 5 days from the date of declaration of such dividend and does not deposit the claims which remain unpaid /unclaimed amount within 30 days from the date of such declaration within 7 days of expiry of the said period of 30 days transfer the total amount of dividend to a special account to be opened by a company in this behalf in any scheduled bank to

be called the unpaid dividend account.

This section also provide for penalty for non complying with the above requirement and the same by way of interest @ 12% per annum and the interest accruing on the amount of Unpaid /unclaimed dividend not transferred to the unpaid dividend account.

6. Transfers and Transmission of Securities

Regarding transfers and transmissions of securities necessary provisions are available in Section 56, 58, 59 of the Companies Act, 2013. As regards listed companies, the clauses in the listing agreement contain provisions for prompt issue of certificates after effecting transfers.
Failure to comply with the provisions of Companies Act, 2013 can be brought before the Tribunal through an appeal under Section 58 and 59. After hearing the parties the Tribunal may by order direct the company to register the transfer.

7. **Failure to Send Financial Statements**

Section 136: This section provides for the right of a member to obtain copies of Balance-sheet and auditor's Report. Sub-section 3 provides that in case of default complying with this requirement, the company shall be liable for a penalty of twenty-five thousand rupees and every officer who is in default shall be liable to a penalty of five thousand rupees.

8. Protection to Debenture holders

Section 71 of the Companies Act, 2013 protects the debenture holds and contains stringent penalties for default and also empowers the denture trustee to makes an appeal to the Tribunal.

Answer the following:

1. SCORES stands for____________.
Ans: SEBI Compliant Redress System

2. An individual retail investor can seek guidance from SEBI under SEBI (informal guidance) Scheme, 2003.
Ans: False

3. Is Investor Protection a right or a necessity?
Ans: Both