

**EXECUTIVE PROGRAMME
STUDY MATERIAL**

**SECURITIES LAWS
AND COMPLIANCES**

MODULE II - PAPER 6



**THE INSTITUTE OF
Company Secretaries of India**

IN PURSUIT OF PROFESSIONAL EXCELLENCE
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EXECUTIVE PROGRAMME

SECURITIES LAWS AND COMPLIANCES

IMPORTANT NOTE

This study material has been published to aid the students in preparing for the Securities Laws & Compliances paper of the CS Executive Programme. It is part of the educational kit and takes the students step by step through each phase of preparation stressing key concepts, pointers and procedures. Company Secretaryship being a professional course, the examination standards are set very high, with emphasis on knowledge of concepts, applications, procedures, for which sole reliance on the contents of this study material may not be enough. Besides, as per the Company Secretaries Regulations, 1982, students are expected to be conversant with the amendments to the laws made upto six months preceding the date of examination. The material may, therefore, be regarded as the basic material and must be read alongwith the original Bare Acts, Rules, Regulations, Student Company Secretary bulletin published and supplied to the students by the Institute every month. This study has been updated upto June 30, 2011.

The subject of Securities Laws & Compliances is inherently complicated and is subject to constant refinement through new primary legislations, rules and regulations made thereunder. It, therefore becomes necessary for every student to constantly update himself with the various legislative changes made from time to time by referring to the Institute's journal 'Chartered Secretary' and bulletin 'Student Company Secretary' as well as other professional journals.

In the event of any doubt, students may write to the Directorate of Academics and Professional Development of the Institute for clarification.

Although care has been taken in publishing this study material yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same is brought to its notice for issuance of the corrigendum in the Student Company Secretary.

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EXECUTIVE PROGRAMME
SYLLABUS
FOR
PAPER 6 - SECURITIES LAWS AND COMPLIANCES

Level of knowledge: Expert knowledge

Objective: To provide expert knowledge and understanding of securities laws and the regulatory framework concerning capital markets in India.

Detailed contents:

PART-A : SECURITIES LAWS (60 MARKS)

1. An Overview of Legal and Regulatory Framework

Capital market regulatory framework – Securities Contracts (Regulation) Act, 1956; SEBI Act, 1992; Depositories Act, 1996; authorities governing capital markets; objective, power and functions of SEBI; Securities Appellate Tribunal, appearance before SAT.

Profile of securities market; securities market reforms and regulatory measures to promote investor confidence; growth of money market in India – structure and institutional mechanism.

2. Capital Market Instruments and Rating

Capital market instruments - equity, debentures, preference shares, sweat equity, non-voting shares; new instruments of capital market - pure, hybrid and derivatives; money market instruments - treasury bills, commercial bills, commercial paper, participatory notes; rating and grading of instruments; concept, scope and significance; regulatory framework; rating agencies in India, rating methodologies.

3. Capital Market Intermediaries

Primary market and secondary market intermediaries - role and functions, merchant bankers, stock brokers, registrars to an issue, underwriters, bankers to issue, portfolio managers, debenture- trustees, foreign Institutional investors etc., self regulatory organisations, guidelines on anti money laundering; surveillance; holding of enquiry.

4. Secondary Market Institutions

Functions and significance of stock exchanges; regulatory framework; operations and trading mechanism of stock exchanges; Settlement of securities, surveillance mechanism at stock exchanges, straight through processing, demutualisation of stock exchanges.

5. Mutual Funds

Introduction, definitions, types, risks involved, setting up of mutual fund; concept

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of Trustee and Asset Management Company; regulatory framework.

6. Venture Capital

Concept of venture capital, regulatory framework, registration, investment conditions and restrictions, foreign venture capital investors, private capital funds.

7. Collective Investment Schemes

Regulatory framework governing collective investment schemes, restrictions on business activities, submission of information and documents, trustees and their obligations.

8. Buy-Back of Securities

Objectives of buy-back; available sources for buy-back of securities; conditions to be fulfilled and obligations for buy-back of securities of both listed and unlisted companies; pricing for buy back; modes of buy-back.

9. Depository System

Overview of depository system in India; Depositories Act; definitions, setting up of depository; role and functions of depository; depository participants; inspection and penalties; internal audit and concurrent audit of depository participants.

PART-B : ISSUE MANAGEMENT AND COMPLIANCES (40 MARKS)

10. Issue of Capital

Listing of securities; SEBI Guidelines for Disclosure and Investor Protection (DIP), procedure for issue of various types of shares and debentures, employee stock option scheme; and employee stock purchase scheme, delisting of securities.

11. Resource Mobilisation in International Capital Market

Listing of securities issued outside India - Foreign Currency Convertible Bonds, Global Depository Receipts, American Depository Receipts; External Commercial Borrowings, procedure for issue of various instruments.

12. Indian Depository Receipts

Indian Depository Receipts, procedure for making an issue of IDRs; conditions for issue of IDRs; listing of IDRs.

LIST OF RECOMMENDED BOOKS
SECURITIES LAWS AND COMPLIANCES

Readings:

1. E. Gordon & K. Natarajan : Capital Market in India; Himalaya Publishing House, Ramdoot, Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.
2. H.R. Machiraju : Indian Financial System; Vikas Publishing House Pvt. Ltd., 576, Masjid Road, Jangpura, New Delhi - 110014.
3. Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi - 110034.
4. V.L. Iyer : SEBI Practice Manual, Taxman Allied Service (P) Ltd., 59/32, New Rohtak Road, New Delhi-110005.
5. M.Y. Khan : Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi - 110002.
6. S. Suryanarayanan & V. Varadarajan : SEBI – Law, Practice & Procedure, Commercial Law Publishers (India) Pvt. Ltd., 151, Rajindra Market, Opp. Tis Hazari Court, Delhi - 110054
7. Mamta Bhargava : Compliances and Procedures under SEBI Law, Shreeji Publishers, 8/294, Sunder Vihar, New Delhi - 110087
8. Taxman : SEBI Manual

References:

1. V.K. Bhalla : Investment Management - Security Analysis and Portfolio Management; S. Chand & Co. Ltd.
2. A.K. Sengupta & A.K. Agarwal : Money Market Operations in India; Skylark
3. H.R. Machiraju : The Working of Stock Exchange in India.
4. N. Gopaldaswamy : Inside Capital Market.
5. Christian Helmenstein : Capital Markets in Central and Eastern Europe.

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6. Young Patrick : Capital Market Revolution: The Future of Markets in an Online World.
7. Nasser Sabar : Speculative Capital: The Nature of Risk in Capital Markets.
8. SEBI, Mumbai : SEBI Annual Report
9. NSE Yearly Publication : Indian Securities Market - A Review
10. V.K. Bhalla : Financial Derivatives - Risk Management; S. Chand & Co. Ltd.
11. Website : www.sebi.gov.in

Journals:

1. SEBI and Corporate Laws : Taxmann
2. Corporate Law Adviser : Corporate Law Adviser, Post Bag No. 3, Vasant Vihar, New Delhi - 110052.
3. SEBI Monthly Bulletin : SEBI, Mumbai.
4. NSE News : National Stock Exchange of India Ltd., Mumbai.

Note: Students are advised to read relevant Bare Acts and Rules and Regulations relating thereto. 'Student Company Secretary' and 'Chartered Secretary' should also be read regularly for updating the knowledge.

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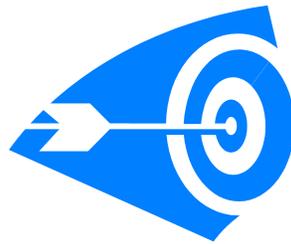
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EXECUTIVE PROGRAMME
SECURITIES LAWS AND COMPLIANCES
PART A — SECURITIES LAWS

STUDY I

GENESIS AND DEVELOPMENT OF REGULATORY FRAMEWORK



LEARNING OBJECTIVES

The study will enable the students to understand

- Concept & Organisational structure of financial system
- Securities Market & Economic Growth
- Legislations governing securities market
- Powers and functions of Securities and Exchange Board of India
- Investigation Procedure
- Penalties for failure, default, contravention
- Establishment , Composition of Securities Appellate Tribunal
- Securities Appellate Tribunal and Securities Appellate Tribunal (Procedure) Rules, 2000

INTRODUCTION

Every 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.

Financial system covers both credit and cash transactions. All financial transactions are dealt with by cash payment or issue of negotiable instruments like cheque, bills of exchanges, hundies etc. Thus a financial system is a set of institutional arrangements through which financial surpluses are mobilised from the units generating surplus income and transferring them to the others in need of them. The activities include production, distribution, exchange and holding of financial assets/instruments of different kinds by financial institutions, banks and other intermediaries of the market. In a nutshell, financial market, financial assets, financial services and financial institutions constitute the financial system.

Various factors influence the capital market and its growth. These include level of savings in the household sector, taxation levels, 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 traditional form of financing companies projects consist of internal resources and debt financing, particularly from financial institutions for modernisation, expansion and diversification. The upsurge in performance of certain large companies and the astounding increase of their share prices boost the market sentiment to divert the savings more and more into equity investments in companies. This lead to the growth of equity cult among investors to contribute resources not only for companies but even for financial institutions and banks.

The functions of a good financial system are manifold. They 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.

I. ORGANISATIONAL STRUCTURE OF FINANCIAL SYSTEM

Broadly, organisational structure of financial system includes various components i.e., Financial Markets, Products and Market Participants.

Points to Remember

Constituents of Financial System

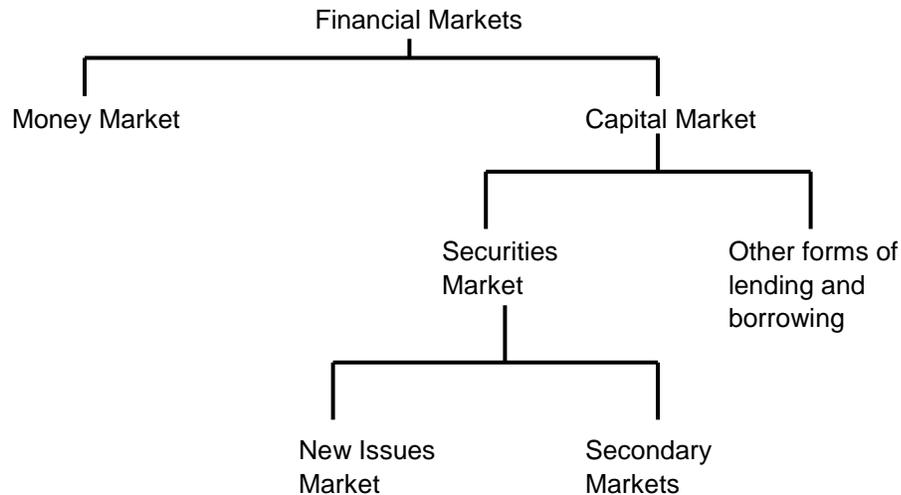
- **Financial Market**
- **Products**
- **Market participants**



Financial Markets

Efficient transfer of resources from those having idle resources to others who have a pressing need for them is achieved through financial markets. Stated formally, financial markets provide channels for allocation of savings to investment. These provide a variety of assets to savers as well as various forms in which the investors can raise funds and thereby decouple the acts of saving and investment. The savers and investors are constrained not by their individual abilities, but by the economy's ability, to invest and save respectively. The financial markets, thus, contribute to economic development to the extent that the latter depends on the rates of savings and investment.

The financial markets have two major components; the money market and the capital market.



Money Market

The money market refers to the market where borrowers and lenders exchange short-term funds to solve their liquidity needs. 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. The Capital Market comprises the complex of institutions and mechanisms through which intermediate term funds and long term funds are pooled and made available to business, government and individuals. The Capital Market also encompasses the process by which securities already outstanding are transferred.

The capital market and in particular the stock exchange is referred to as the barometer of the economy. Government's policy is so moulded that creation of wealth

through products and services is facilitated and surpluses and profits are channelised into productive uses through capital market operations. Reasonable opportunities and protection are afforded by the Government through special measures in the capital market to get new investments from the public and the Institutions and to ensure their liquidity.

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 issuer of securities sells the securities in the primary market to raise funds for investment and/or to discharge some obligation.

In other words, the market wherein resources are mobilised by companies through issue of new securities is called the primary market. These resources are required for new projects as well as for existing projects with a view to expansion, modernisation, diversification and upgradation.

The issue of securities by companies can take place in any of the following methods:

1. Initial public offer (securities issued for the first time to the public by the company);
2. Further issue of capital;
3. Rights issue to the existing shareholders. (On their renunciation, the shares can be sold by the company to others also);
4. Offer of securities under reservation basis to:
 - (i) foreign partners and collaborators,
 - (ii) mutual funds,
 - (iii) merchant bankers,
 - (iv) banks and institutions,
 - (v) non resident Indians and overseas corporate bodies,
 - (vi) employees;
5. Offer to public;
6. Bonus Issue.

The Primary Market (New Issues) is of great significance to the economy of a country. It is through the primary market that funds flow for productive purposes from investors to entrepreneurs. The latter use the funds for creating new products and rendering services to customers in India and abroad. The strength of the economy of

a country is gauged by the activities of the Stock Exchanges. The primary market creates and offers the merchandise for the secondary market.

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.

Secondary market essentially comprises of stock exchanges which provide platform for purchase and sale of securities by investors. The trading platform of stock exchanges are accessible only through brokers and trading of securities is confined only to stock exchanges.

The corporate securities market dates back to the 18th century when the securities of the East India company were traded in Mumbai & Kolkata. The brokers used to gather under a banyan tree in Mumbai and under a neem tree in Kolkata for the purpose. However, the real beginning came in the 1850s with the introduction of joint stock companies with limited liability. The 1860s witnessed feverish dealings in securities and securities speculation. This brought brokers to Bombay together in July 1875 to boom the first organised stock exchange in the country, viz. The Stock Exchange, Mumbai, Ahmedabad Stock Exchange in 1894 and 22 others followed with 20th century.

The stock exchanges are the exclusive centres for trading in securities and the trading platform of an exchange is accessible only to brokers. The regulatory framework heavily favours the recognised stock exchanges by almost banning trading activity outside the stock exchanges.

The stock market or secondary market ensures free marketability, negotiability and price discharge. For these reasons the stock market is referred to as the nerve centre of the capital market, reflecting the economic trend as well as the hopes, aspirations and apprehensions of the investors.

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.

Products and Market Participants

Savings are linked to investments by a variety of intermediaries through a range of complex financial products called "securities" which is defined in the Securities Contracts (Regulation) Act, 1956 to include shares, scrips, stocks, bonds, debentures, debenture stock, or other marketable securities of like nature in or of any incorporate company or body corporate, government securities, derivatives of securities, units of collective investment scheme, security receipts, interest and rights in securities, or any other instruments so declared by the central government. There

are a set of economic units who demand securities in lieu of funds and others who supply securities for funds. These demand for and supply of securities and funds determine, under competitive market conditions in goods and securities market, the prices of securities.

It is not that the suppliers of funds and suppliers of securities meet each other and exchange funds for securities. It is difficult to accomplish such double coincidence of wants. The amount of funds supplied by the supplier of funds may not be the amount needed by the supplier of securities. Similarly, the risk, liquidity and maturity characteristics of the securities may not match preference of the supplier of funds. In such cases, they incur substantial search costs to find each other. Search costs are minimised by the intermediaries who match and bring these suppliers together. They may act as agents to match the needs of the suppliers of funds / securities, help them in creation and sale of securities or buy the securities issued by supplier of securities and in turn, sell their own securities to suppliers of funds. It is, thus, a misnomer that securities market disintermediates by establishing a direct relationship between the suppliers of funds and suppliers of securities. The market does not work in a vacuum; it requires services of a large variety of intermediaries like merchant bankers, brokers, etc to bring the suppliers of funds and suppliers of securities together for a variety of transactions. The disintermediation in the securities market is in fact an intermediation with a difference; it is a risk-less intermediation, where the ultimate risks are borne by the suppliers of funds/securities (issuers of securities and investors in securities), and not the intermediaries.

The securities market, thus, has essentially three categories of participants, namely the issuers of securities, investors in securities and the intermediaries. The issuers and investors are the consumers of services rendered by the intermediaries while the investors are consumers of securities issued by issuers. Those who receive funds in exchange for securities and those who receive securities in exchange for funds often need the reassurance that it is safe to do so. This reassurance is provided by the law and custom, often enforced by the regulator. The regulator develops fair market practices and regulates the conduct of issuers of securities and the intermediaries so as to protect the interests of investors in securities. The regulator ensures a high standard of service from intermediaries and supply of quality securities and non-manipulated demand for them in the market.

II. FUNCTIONS OF SECURITIES MARKET

The Securities Market allows people to do more with their savings than they would otherwise could. It also provides financing that enables people to do more with their ideas and talents than would otherwise be possible. The people's savings are matched with the best ideas and talents in the economy. Stated formally, the Securities Market provides a linkage between the savings and the investment across the entities, time and space. It mobilises savings and channelises them through securities into preferred enterprises.

The Securities Market also provides a market place for purchase and sale of securities and thereby ensures transferability of securities, which is the basis for the joint stock enterprise system. The existence of the Securities Market makes it possible to satisfy simultaneously the needs of the enterprises for capital and the need of investors for liquidity.

Takeaways*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 liquidity, the market confers and the yield promised or anticipated on security ownership may be sufficiently great to attract net savings of income which would otherwise have been consumed. Net savings may also occur because of other attractive features of security ownership, e.g. the possibility of capital gain or protection of savings against inflation.

A developed Securities Market enables all individuals, no matter how limited their means, to share the increased wealth provided by competitive private enterprises (Jenkins, 1991)¹. The Securities Market allows individuals who can not carry an activity in its entirety within their resources to invest whatever is individually possible and preferred in that activity carried on by an enterprise. Conversely, individuals who can not begin an enterprise, they can attract enough investment from others to make a start. In both cases individuals who contribute to the investment made in the enterprise share the fruits.

The Securities Market, by allowing an individual to diversify risk among many ventures to offset gains and losses, increases the likelihood of long-term, overall success.

III. SECURITIES MARKET AND ECONOMIC GROWTH

A well functioning securities market is conducive to sustained economic growth. There have been a number of studies, starting from World Bank and IMF to various scholars, which have established robust relationship not only one way, but also the both ways, between the development in the securities market and the economic growth. The securities market fosters economic growth to the extent that it-(a) augments the quantities of real savings and capital formation from any given level of national income, (b) increases net capital inflow from abroad, (c) raises the productivity of investment by improving allocation of investible funds, and (d) reduces the cost of capital.

It is reasonable to expect savings and capital accumulation and formation to respond favourably to developments in securities market. The provision of even simple securities decouples individual acts of saving from those of investment over both time and space and thus allows savings to occur without the need for a concomitant act of investment. If economic units rely entirely on self-finance, investment is constrained in two ways: by the ability and willingness of any unit to save, and by its ability and willingness to invest. The unequal distribution of

¹ Jenkins Jessey, "Capital Markets and Development: Essential and Irrelevant", in Steve Henke and Alan Walters, eds., Capital Market and Development, ICS Press, san Francisco, 1991.

entrepreneurial talents and risk taking proclivities in any economy means that at one extreme there are some whose investment plans may be frustrated for want of enough savings, while at the other end, there are those who do not need to consume all their incomes but who are too inert to save or too cautious to invest the surplus productively. For the economy as a whole, productive investment may thus fall short of its potential level. In these circumstances, the securities market provides a bridge between ultimate savers and ultimate investors and creates the opportunity to put the savings of the cautious at the disposal of the enterprising, thus promising to raise the total level of investment and hence of growth. The indivisibility or lumpiness of many potentially profitable but large investments reinforces this argument. These are commonly beyond the financing capacity of any single economic unit but may be supported if the investor can gather and combine the savings of many. Moreover, the availability of yield bearing securities makes present consumption more expensive relative to future consumption and, therefore, people might be induced to consume less today. The composition of savings may also change with fewer saving being held in the form of idle money or unproductive durable assets, simply because more divisible and liquid assets are available.

International Linkage

The securities market facilitates the internationalisation of an economy by linking it with the rest of the world. This linkage assists through the inflow of capital in the form of portfolio investment. Moreover, a strong domestic stock market performance forms the basis for well performing domestic corporate to raise capital in the international market. This implies that the domestic economy is opened up to international competitive pressures, which help to raise efficiency. It is also very likely that existence of a domestic securities market will deter capital outflow by providing attractive investment opportunities within domestic economy.

Improved Investment Allocation

Any financial development produces allocational improvement over a system of segregated investment opportunities. The benefits of improved investment allocation is such that Mc Kinnon defines economic development as reduction of the great dispersion in social rate of return to existing and new investments under domestic entrepreneurial control. Instead of emphasising scarcity of capital, he focuses on the extra-ordinary distortions commonly found in the domestic securities markets of the developing countries. In the face of great discrepancies in rate of return, the accumulation of capital does not contribute much to development. A developed securities market successfully monitors the efficiency with which the existing capital stock is deployed.

Standardised products and reduction in costs

In as much as the securities market enlarges the financial sector, promoting additional and more sophisticated financing, it increases opportunities for specialisation, division of labour and reductions in costs in financial activities. The securities market and its institutions help the user in many ways to reduce the cost of capital. They provide a convenient market place to which investors and issuers of securities go and thereby avoid the need to search a suitable counterpart. The market provides standardised products and thereby cuts the information costs

associated with individual instruments. The market institutions specialise and operate on large scale which cuts costs through the use of tested procedures and routines.

Developmental benefits

There are also other developmental benefits associated with the existence of a securities market.

1. The securities market provides a fast-rate breeding ground for the skills and judgement needed for entrepreneurship, risk bearing, portfolio selection and management.
2. An active securities market serves as an 'engine' of general financial development and may, in particular, accelerate the integration of informal financial systems with the institutional financial sector. Securities directly displace traditional assets such as gold and stocks of produce or, indirectly, may provide portfolio assets for unit trusts, pension funds and similar FIs that raise savings from the traditional sector.
3. The existence of securities market enhances the scope, and provides institutional mechanisms, for the operation of monetary and financial policy.

IV. EVOLUTION, GROWTH AND FUNCTIONS OF FINANCIAL SYSTEM IN INDIA

Indian financial system was characterised by:

1. Absence of organised capital market
2. Dependence of industries and other users on internal sources
3. Rare cases of public issue of capital for expansion and modernisation
4. Restricted and underdeveloped state of capital market
5. Cumbersome and stringent conditions for loan assistance to companies
6. Few financial institutions and players in the market

Nationalisation of banks in 1969 was a major step to ensure that timely and adequate credit support was available for all viable productive endeavour in the country. Growth of banking facilities, better regional balance of economic activity and the diffusion of economic power were the other objectives of bank nationalisation. This policy extended large support to individuals and small traders in the rural and semi-urban areas earlier neglected by the banking system. Agriculture and small industry received a new fillip. Grant of credit to agriculture and small industry by expansion of rural banking proved to be a boon offered by the new policy. The wider network of branches promoted growth in deposits and grant of loan assistance. The expansion of priority sector lending and the emphasis on the area approach led to a degree of evening out of regional disparities in banks.

The last few decades have also witnessed a significant expansion of the activities of term lending or development financial institutions (DFIs) with commercial banks confining themselves to the traditional form of providing working capital to trade and industry. The role of specialised financial institutions such as DFIs consisted in meeting the needs of medium and long term finance for industry.

The DFIs now account for a major share of corporate financing and also have their nominees on the boards of assisted companies with covenants relating to aspects of management and deployment of financial resources.

The Indian financial system has made commendable progress in extending its geographic spread and functional reach. The spurt of banking system has been a major factor in promoting financial intermediation in the economy and growth of financial savings. The credit reach of banking system has been so extensive that it now caters to several million borrowers and customers.

Indian money market consists of formal and informal segments. The formal market comprises of RBI, various commercial banks, cooperative banks, UTI etc. Informal market consists of chitfunds, nidhis, indigenous bankers etc. Money market instruments include treasury bills, commercial bills, certificate of deposit.

Money market has gained greater strength with the liberalisation of monetary and trade policies the world over. With the arrival of World Trade Organisation and removal of artificial barriers among Countries impeding free flow of goods and services, capital markets have grown multifold and the potential for the future is even more larger. With the increasing industrial and trade activities following liberalisation, the demand for capital mobilisation from the market has surpassed all estimates giving rise to many innovations and reforms.

The market players in the Indian capital market essentially consist of a variety of investors from different walks of life including small investors, mutual funds, banks, companies, financial institutions and so on. As stated earlier, these players drew upon the services of various intermediaries such as merchant bankers, brokers, market makers, stock exchanges, portfolio managers, mutual funds, underwriters, registrars and share transfer agents, loan syndicates etc. Many of them operate as individuals, partnerships and even incorporated companies and are subject to rules and regulations imposed by the regulatory authorities as well as model practices which have evolved over time. These intermediaries have a great role in investor servicing.

The investors are expected to inquire and inform themselves about the strengths and weaknesses of the different instruments and the institutions in which they invest by reference to the terms and conditions of investment and the past record of working results of such institutions. They are also expected to have a knowledge of the basic law of the Country applicable to such investments and institutions. The concept of safety, liquidity and profitability of the investments should weigh with the investors when they decide on their plans of investment.

V. A PROFILE OF SECURITIES MARKET

The securities markets in India and abroad witnessed recovery from the financial crisis during 2009. This was reflected in the rising market capitalization of stock exchanges of emerging and developing countries. The market capitalization of the emerging markets increased to 28.3% of the world total market capitalization in 2009, up from 25.9% in 2008. The market value of emerging markets increased by 48.8% in 2009. United States which accounted for 30.9% of the world total market capitalisation in 2009 registered a rise of 28.4% in its market capitalization. However,

neither the emerging countries nor the developed economies were able to surpass the levels of growth witnessed in market capitalization and turnover during the year 2007. The stock markets worldwide have grown in size as well as depth over the years. The market capitalization of all listed companies in developed and emerging economies taken together on all markets stood at US\$48.71 trillion in 2009 up from US \$34.88 trillion in 2008. In terms of market capitalization, nearly all the countries showed an increase in the year 2009 as compared with the year 2008. However, in terms of turnover, all the countries compared to the year 2009, the share of US in worldwide market capitalization remained at 30.9% at the end of 2009 as it was at the end of 2007.

Following the implementation of reforms in the securities market in the past years, Indian stock markets have stood out in the world ranking. India has the distinction of having the largest number of listed companies followed by United States, Canada, Spain, Japan and United Kingdom. As per Standard and Poor's Fact Book 2010, India ranked 11th in terms of market capitalization and 11th in terms of turnover ratio as of December 2009. India posted a turnover ratio of 119.3% at the end of 2009.

Household Investment Pattern

According to the Preliminary estimates by Reserve Bank of India, net financial savings of the household sector in 2009-10 stood at 11.9 per cent of GDP at current market prices, which is higher than the estimates for 2008-09 at 10.2 per cent. Despite a slower growth in bank deposits partly due to lower deposit interest rates, a turnaround in the household financial savings in 2009-10 was made possible by a revival in almost all other components. Sharp recovery was noted in the household savings in life insurance, public provident funds, small savings, senior citizen deposit schemes and mutual funds. Moreover, recovery in economic growth contributed to a pickup in household financial savings.

Issuers

Primary markets

An aggregate of Rs. 10,075,102 million (US \$ 223, 197 million) were raised by the government and corporate sector during 2009-10 as against Rs. 6,588,920 million (US \$ 129,321 million) in 2008-09, an increase of 52.91%. Private placement accounted for 93.07% of the domestic total resource mobilization by the Corporate Sector. Resource mobilization through euro issues escalated significantly by 233.48% to Rs. 159,670 million (US \$ 3,537 million) in 2009-10.

Secondary Market

Exchanges in the country offer screen based trading system. There were 9,772 trading members registered with SEBI as at end March 2010. The market capitalization has grown over the period indicating more companies using the trading platform of the stock exchange. The All-India market capitalization was around Rs. 61,704,205 million (US \$ 1,366,952 million) at the end of March 2010. The market capitalization ratio is defined as market capitalization of stocks divided by GDP. It is used as a measure to denote the importance of equity markets relative to the GDP. It is of economic significance since market is positively correlated with the ability to

mobilize capital and diversify risk. The All-India market capitalization ratio increased to 94.20% in 2009-10 from 55.40% in 2008-09. At end of March 2010, NSE Market Capitalization ratio fell to 76.28% during 2009-10 while BSE Market Capitalization ratio was 78.26%.

Cash Market

During 2009-10, the trading volumes on the equity segment of Exchanges increased significantly by 43.26% y-o-y to Rs. 55,184.700 million (US \$ 1,222,523 million) from Rs. 38,520,970 million (US \$ 756,054 million) in 2008-09. The turnover during April 2010 – September 2010 in the equity markets was Rs. 23,547,240 crore US \$ 522,807 million.

Government Securities

The aggregate trading volumes in central and state government dated securities on SGL was Rs. 9,018,385 crore in 2009-10 as compared with Rs. 6,645,488 crore in 2008-09.

Shareholding Pattern

In the interest of transparency, the issuers are required to disclose shareholding pattern on a quarterly basis. It is observed that on an average the promoters held 56.46% of the total shares while public holding was 40.97%. Individuals held 11.97% and the institutional holding (FIIs, MFs, VCFs-Indian and Foreign) accounted for 13.63%. In 2009, SEBI made it mandatory for promoters of listed companies to disclose the number of shares they had pledged. 9.17% of the total shares held by promoters are pledged as of September 2010.

Derivatives Market

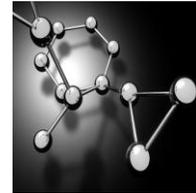
The number of instruments available in derivatives market has gone up over the years. To begin with, SEBI had only approved trading in index futures contracts based on Nifty 50 Index and BSE-30 (Sensex) Index. This was followed by approval for trading in options based on these indices and options on individual securities. In 2008, the currency futures on USD-INR were allowed for trading. The total exchange traded equity derivatives in Indian stock markets witnessed a turnover of Rs. 176,638,990 million (US \$ 39, 21,825 million) during 2009-10 as against Rs. 110,227,501 million (US \$ 3,335,698 million) during the preceding fiscal year. Trading in currency futures increased from Rs. 1,622,724 million (US \$ 31,849 million) in 2008-09 to Rs. 17,826,080 million (US \$ 394,907 million) in 2009-10.

VI. REGULATORY FRAMEWORK

The four main legislations governing the securities market are: (a) the SEBI Act, 1992 which establishes SEBI to protect investors and develop and regulate securities market; (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; (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges; and (d) the Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities.

Regulatory Framework

- The SEBI Act, 1992
- The Securities Contracts (Regulation) Act, 1956
- The Depositories Act, 1996
- The Companies Act, 1956



Legislations

SEBI Act, 1992: The SEBI Act, 1992 establishes SEBI 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. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. It can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. It has powers to register and regulate all market intermediaries and also to penalise them in case of violations of the provisions of the Act, Rules and Regulations made there under. SEBI has full autonomy and authority to regulate and develop an orderly securities market.

Securities Contracts (Regulation) Act, 1956: It provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims to prevent undesirable transactions in securities. It gives central government/SEBI 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. As a condition of recognition, a stock exchange complies with prescribed conditions of Central Government. Organised trading activity in securities takes place on a specified recognised stock exchange. The stock exchanges determine their own listing regulations which have to conform to the minimum listing criteria set out in the Rules.

Depositories Act, 1996: The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by (a) making securities of public limited companies freely transferable subject to certain exceptions; (b) dematerialising the securities in the depository mode; and (c) providing for maintenance of ownership records in a book entry form. In order to streamline the settlement process, the Act envisages transfer of ownership of securities electronically by book entry without making the securities move from person to person. The Act has made the securities of all public limited companies freely transferable, restricting the company's right to use discretion in effecting the transfer of securities, and the transfer deed and other procedural requirements under the Companies Act have been dispensed with.

Companies Act, 1956: It deals with issue, allotment and transfer of securities and various aspects relating to company management. It provides for standard of disclosure in public issues of capital, particularly in the fields of company management and projects, information about other listed companies under the same management, and management perception of risk factors. It also regulates

underwriting, the use of premium and discounts on issues, rights and bonus issues, payment of interest and dividends, supply of annual report and other information.

Rules and Regulations

The Government has framed rules under the SCRA, SEBI Act and the Depositories Act. SEBI has framed regulations under the SEBI Act and the Depositories Act for registration and regulation of all market intermediaries, and for prevention of unfair trade practices, insider trading, etc. Under these Acts, Government and SEBI issue notifications, guidelines, and circulars which need to be complied with by market participants.

Regulators

The responsibility for regulating the securities market is shared by Department of Economic Affairs (DEA), Ministry of Corporate Affairs, Reserve Bank of India (RBI) and SEBI. The activities of these agencies are coordinated by a High Level Committee on Capital Markets. The orders of SEBI under the securities laws are appellable before a Securities Appellate Tribunal.

Most of the powers under the SCRA are exercisable by DEA while a few others by SEBI. The powers of the DEA under the SCRA are also con-currently exercised by SEBI. The powers in respect of the contracts for sale and purchase of securities, gold related securities, money market securities and securities derived from these securities and carry forward contracts in debt securities are exercised concurrently by RBI. The SEBI Act and the Depositories Act are mostly administered by SEBI. The powers under the Companies Act relating to issue and transfer of securities and non-payment of dividend are administered by SEBI in case of listed public companies.

SECURITIES AND EXCHANGE BOARD OF INDIA

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. The Capital Issues (Control) Act, 1947 had its origin during the war in 1943 when the objective was to channel resources to support the war effort. The Act was retained with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were channelled into proper lines, i.e., for desirable purposes to serve goals and priorities of the government, and to protect the interests of investors. Under the Act, any firm wishing to issue securities had to obtain approval from the Central Government, which also determined the amount, type and price of the issue.

Major part of the liberalisation process was the repeal of the Capital Issues (Control) Act, 1947 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. However to ensure effective

regulation of the market, SEBI Act, 1992 was enacted to empower SEBI 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. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. SEBI can specify the matters to be disclosed and the standards of disclosure required for the protection of investors in respect of issues; can issue directions to all intermediaries and other persons associated with the securities market in the interest of investors or of orderly development for securities market; and can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. In short, it has been given necessary autonomy and authority to regulate and develop an orderly securities market.

I. SEBI ACT, 1992

Chapter I of the Act covers the definitions of various terms under the Act, while Chapter II deals with establishment of SEBI and its management. In terms of section 3 of the Act, SEBI is a body corporate having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable and to contract, sue and be sued in its own name. SEBI has its Head Office at Mumbai and has powers to establish its offices at other places in India. SEBI presently has offices also in Kolkata, New Delhi, Chennai and Ahmedabad.

Section 4(1) of SEBI Act provides that the SEBI Board shall consist of the following members, namely:

- (a) a Chairman;
- (b) two members from amongst the officials of the Ministry of the Central Government dealing with Finance and administration of the Companies Act, 1956;
- (c) one member from amongst the officials of the Reserve Bank;
- (d) five other members of whom at least three shall be the whole time members,

to be appointed by the Central Government.

The Chairman and the other members are from amongst the persons of ability, integrity and standing who have shown capacity in dealing with problems relating to securities market or have special knowledge or experience of law, finance, economics, accountancy, administration or in any other discipline which, in the opinion of the Central Government, shall be useful to SEBI.

The terms and conditions of service of Chairman and members are determined in the rules framed by Government in this regard.

The general superintendence, direction and management of the affairs of SEBI vests in a Board of members, which exercises all powers and do all acts and things which may be exercised or done by SEBI. Unless determined otherwise through regulations, the Chairman shall also have all these powers.

Powers and Functions of SEBI

Chapter IV of SEBI Act, 1992 deals with the powers and functions of the Board.

Section 11 of the Act lays down that it shall be the duty of SEBI to protect the interests of the investors in securities and to promote the development of, and to regulate the securities markets by such measures as it thinks fit. These measures would include:

- (a) regulating the business in stock exchanges and any other securities markets;
- (b) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;
- (c) registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as SEBI may, by notification, specify in this behalf;
- (d) registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds;
- (e) promoting and regulating self-regulatory organisations;
- (f) prohibiting fraudulent and unfair trade practices relating to securities markets;
- (g) promoting investors' education and training of intermediaries of securities markets;
- (h) prohibiting insider trading in securities;
- (i) regulating substantial acquisition of shares and takeover of companies;
- (j) calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organisations in the securities market;
- (k) 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 SEBI;
- (l) performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government;
- (m) levying fees or other charges for carrying out the purposes of this section;
- (n) conducting research for the above purposes;
- (o) calling from or furnishing to any such agencies, as may be specified by SEBI, such information as may be considered necessary by it for the efficient discharge of its functions;
- (p) performing such other functions as may be prescribed.

For carrying out the duties assigned to it under the Act, SEBI has been vested

with the same powers as are available to a Civil Court under the Code of Civil Procedure, 1908 for trying a suit in respect of the following matters:

- (i) the discovery and production of books of account and other documents at the place and time indicated by SEBI.
- (ii) summoning and enforcing the attendance of persons and examining them on oath.
- (iii) inspection of any books, registers and other documents of any person listed in section 12 of the Act, namely stock brokers, sub brokers, share transfer agents, bankers to an issue, trustee of trust deed, registrar to an issue, merchant bankers, underwriters, portfolio managers, investment advisors and other such intermediaries associated with securities markets.
- (iv) inspection of any book or register or other document or record of any listed company or a public company which intends to get its securities listed on any recognized stock exchange.
- (v) issuing commissions for the examination of witnesses or documents.

As per Section 11(4) SEBI, may, by an order or for reasons to be recorded in writing take any of the following measures either pending investigation or inquiry or on completion of such investigation or enquiry:

- (a) suspend the trading of any security in a recognised stock exchange.
- (b) restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities.
- (c) suspend any office-bearer of any stock exchange or self regulatory organisation from holding such position.
- (d) impound and retain the proceeds or securities in respect of any transaction which is under investigation.
- (e) attach for a period not exceeding one month, with prior approval of a magistrate, one or more bank accounts of any intermediary or any person associated with the securities market in any of the Act or rules or regulations made thereunder.
- (f) direct any intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of any transaction which is under investigation.

Power to Issue Directions

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. The Board may specify the matters relating to issue of capital, transfer of securities and other matters shall be disclosed by the companies. It may also by issuing prospectus, any offer document or advertisement soliciting money from public for issue of securities. SEBI

may also specify the conditions subject to which the prospectus, such offer document or advertisement, if not prohibited, may be issued.

Section 11B of the Act provides that if SEBI is satisfied after making due enquiries, that it is necessary:

- (i) in the interest of investors, or orderly development of securities market; or
- (ii) to prevent the affairs of any intermediary or other persons referred to in section 12 being conducted in a manner detrimental to the interests of investors or securities market; or
- (iii) to secure the proper management of any such intermediary or person, it may issue such directions, -
 - (a) to any person or class of persons referred to in section 12, or associated with the securities market; or
 - (b) to any company in respect of matters relating to issue of capital, transfer of securities and other matter incidental thereto, as may be appropriate in the interests of investors in securities and the securities market.

Collective Investment Scheme

Collective Investment Scheme is defined in sub-section (2) of Section 11AA to mean any scheme or arrangement made or offered by any company under which:

- (i) the contributions, or payments made by the investors, by whatever name called, are pooled and utilized for the purposes of the scheme or arrangement;
- (ii) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable from such scheme or arrangement;
- (iii) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors;
- (iv) the investors do not have day to day control over the management and operation of the scheme or arrangement.

The Collective Investment Scheme however, does not include any scheme or arrangement:

- (i) made or offered by a co-operative society registered under the Co-operative Societies Act, 1912 or a society being a society registered or deemed to be registered under any law relating to co-operative societies for the time being in force in any State;
- (ii) under which deposits are accepted by non-banking financial companies as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934;
- (iii) being a contract of insurance to which the Insurance Act, 1938, applies;
- (iv) providing for any Scheme, Pension Scheme or the Insurance Scheme

framed under the Employees Provident Fund and Miscellaneous Provisions Act, 1952;

- (v) under which deposits are accepted under section 58A of the Companies Act, 1956;
- (vi) under which deposits are accepted by a company declared as a Nidhi or a mutual benefit society under section 620A of the Companies Act, 1956;
- (vii) falling within the meaning of Chit business as defined in clause (d) of section 2 of the Chit Fund Act, 1982;
- (viii) under which contributions made are in the nature of subscription to a mutual fund.

Investigations

Section 11C of the Act provides that where SEBI has reasonable ground to believe that the transactions in securities are being dealt with in a 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. It may, at any time by order in writing, direct any person specified in the order to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to SEBI.

It is the duty of every manager, managing director, officer and other employee of the company and every intermediary or every person associated with the securities market to preserve and to produce to the Investigating Authority or any person authorised by it in this behalf, all the books, registers, other documents and record of, or relating to, the company or, as the case may be, of or relating to, the intermediary or such person, which are in their custody or power.

The Investigating Authority may require any intermediary or any person associated with securities market in any manner to furnish such information to, or produce such books, or registers, or other documents, or record before it or any person authorized by it in this behalf as it may consider necessary if the furnishing of such information or the production of such books, or registers, or other documents, or record is relevant or necessary for the purposes of its investigation. The Investigating Authority may keep in its custody any books, registers, other documents and record produced for six months and thereafter shall return the same to any intermediary or any person associated with securities market by whom or on whose behalf the books, registers, other documents and record are produced.

The Investigating Authority may call for any book, or register, other document and record if they are needed again.

If the person on whose behalf the books, registers, other documents and record are produced requires certified copies of the books, registers, other documents and record produced before the Investigating Authority, it shall give certified copies of such books, registers, other documents and record to such person or on whose behalf the books, registers, other documents and record were produced.

Any person, directed to make an investigation may, examine on oath, any manager, managing director, officer and other employee of any intermediary or any person associated with securities market in any manner, in relation to the affairs of his business and may administer an oath accordingly and for that purpose may require any of those persons to appear before it personally.

If any person fails without reasonable cause or refuses to produce to the Investigating Authority or any person authorised by it in this behalf any book, register, other document and record which is his duty to produce; or to furnish any information which it is his duty to furnish; or to appear before the Investigating Authority personally when required to do so or to answer any question which is put to him by the Investigating Authority; or to sign the notes of any examination referred in sub-section (7), he shall be punishable with imprisonment for a term which may extend to one year, or with fine, which may extend to one crore rupees, or with both, and also with a further fine which may extend to five lakh rupees for every day after the first during which the failure or refusal continues.

Notes of any examination under sub-section (5) shall be taken down in writing and shall be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him.

Where in the course of investigation, the Investigating Authority has reasonable ground to believe that the books, registers, other documents and record of, or relating to, any intermediary or any person associated with securities market in any manner, may be destroyed, mutilated, altered, falsified or secreted, the Investigating Authority may make an application to the Judicial Magistrate of the first class having jurisdiction for an order for the seizure of such books, registers, other documents and record. After considering the application and hearing the Investigating Authority, if necessary, the Magistrate may, by order, authorize the Investigating Authority to enter, with such assistance, as may be required, the place or places where such books, registers, other documents and record are kept; to search that place or those places in the manner specified in the order; and to seize books, registers, other documents and record it considers necessary for the purposes of the investigation.

It is provided that the Magistrate shall not authorize seizure of books, registers, other documents and record, of any listed public company or a public company which intends to get its securities listed on any recognised stock exchange unless such company indulges in insider trading or market manipulation.

The Investigating Authority shall keep in its custody the books, registers, other documents and record seized under this section for such period not later than the conclusion of the investigation as it considers necessary and thereafter shall return the same to the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person, from whose custody or power they were seized and inform the Magistrate of such return. The Investigating Authority may, before returning such books, registers, other documents and record as aforesaid, place identification marks on them or any part thereof. Every search or seizure made under this section shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1973 relating to searches or seizures made under that Code.

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. SEBI shall not pass such order in respect of any listed public company or a public company which intends to get its securities listed on any recognized stock exchange unless SEBI has reasonable grounds to believe that such company has indulged in insider trading or market manipulation.

Consent Orders

SEBI has brought the concept of consent order/compounding of offence into force for resolving the disputes in more smooth manner through negotiations and discussions instead of lengthy litigation. SEBI vide its Circular No. EFD/ED/Cir-1/2007 dated 20th April 2007 has issued Guidelines for (i) Consent Orders and (ii) For considering requests for composition of offences, under SEBI Act, SC(R) Act and Depositories Act.

Consent Order means an order settling administrative or civil proceedings between the regulator and a person (Party) who may prima facie be found to have violated securities laws. Here, Administrative/Civil enforcement actions include issuing directions, suspension or cancellation of certificate of registration, imposition of monetary penalty, pursuing suits and appeals in Courts and Securities Appellate Tribunal (SAT). It may settle all issues or reserve an issue or claim, but it must precisely state what issues or claims are being reserved. Consent Order provides flexibility of wider array of enforcement and remedial actions which will achieve the twin goals of an appropriate sanction, remedy and deterrence without resorting to litigation, lengthy proceedings and consequent delays.

Compounding of offence can take place after filing criminal complaint by SEBI. Compounding is a process whereby an accused pays compounding charges in lieu of undergoing consequences of prosecution. Prosecution includes Filing of criminal complaints before various criminal courts by SEBI for violation of provisions of securities laws which may lead to imprisonment and/ or fine. Compounding of offence allows the accused to avoid a lengthy process of criminal prosecution, which would save cost, time, mental agony, etc in return for payment of compounding.

What is a consent order ?



Consent Order means an order settling administrative or civil proceedings between the regulator and a person (Party) who may prima facie be found to have violated securities laws. Consent Order provides flexibility of wider array of enforcement and remedial actions which will achieve the twin goals of an appropriate sanction, remedy and deterrence without resorting to litigation, lengthy proceedings and consequent delays.

Case study

In the Matter of Irregularities relating to Initial Public Offer



SEBI had conducted investigations into the alleged irregular dealings in the shares issued through Initial Public offerings (IPO's) during 2003- 05 before these were listed on the stock exchanges. The preliminary investigations, prima facie, revealed that certain entities, including Dharmesh K. Katakia and Dhaval K. Katakia (herein after referred to as the 'applicants') had cornered the shares meant for retail individual investors in several IPOs and made unlawful profits on the sale of such shares immediately after listing. It was, therefore, alleged that the applicant violated Section 12 A of the SEBI Act, 1992, Regulation 3 & 4 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities markets) Regulations, 2003 and provisions of SEBI (Disclosure and Investor Protection) Guidelines, 2000. Based on these findings, SEBI initiated following actions:

It passed an ad interim ex parte order dated April 27, 2006 under Section 11B of the SEBI Act, 1992 directing the applicants not to buy, sell or deal in the securities market, including IPOs, directly or indirectly , till further orders,. The applicants filed their reply.

It initiated adjudication proceedings against the applicants under Chapter VI A of the SEBI Act, 1992. The adjudication officer issued show cause notice dated June 07, 2006. While proceedings were in progress, the applicants proposed settlement of the said proceedings through a consent order. The High Powered Advisory Committee, constituted by SEBI, considered the consent terms proposed by the applicant and after deliberations, recommended the case for settlement.

As per the Term of settlement, the applicants shall pay as under:

<i>Sl No.</i>	<i>Name of the applicants</i>	<i>Particulars</i>	<i>Amount (Rs.)</i>
1	Dharmesh Katakia	Disgorgement of Unlawful gain	77,02,460
		Settlement charges	23,10,738
2	Dhaval Katakia	Disgorgement of Unlawful gain	41,19, 068
		Settlement charges	12,35,720

SEBI accepted the recommendations of the Committee and communicated the same to the applicants. Accordingly, the applicants without admitting or denying the charges, have remitted a sum of Rs. 1, 53, 67,986.40 (Rupees one crore fifty three lakh sixty seven thousand nine hundred eighty six and paise forty only. In view of the above, SEBI ordered that this consent order disposes of the pending proceedings under Section 11 B of the SEBI Act, 1992 as well as the adjudication proceedings against the applicants.

Registration of Intermediaries

Chapter V of the Act provides for registration of various intermediaries such as stock broker, sub-broker, share transfer agents etc.

Section 12(1) of the Act provides that no 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 and such other intermediary who may be associated with securities market shall buy, sell or deal in securities except under, and in accordance with, the conditions of a certificate of registration obtained from SEBI in accordance with the regulations made under this Act.

A person buying or selling securities or otherwise dealing with the securities market as a 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 and such other intermediary who may be associated with securities market immediately before the establishment of SEBI for which no registration certificate was necessary prior to such establishment, may continue to do so for a period of three months from such establishment or, if he has made an application for such registration within the said period of three months, till the disposal of such application.

Also no depository, participant, custodian of securities, foreign institutional investor, credit rating agency or any other intermediary associated with the securities market as SEBI may by notification in this behalf specify, shall buy or sell or deal in securities except under and in accordance with the conditions of a certificate of registration obtained from SEBI in accordance with the regulations made under this Act.

No person shall sponsor or cause to be sponsored or carry on or cause to be carried 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.

Every application for registration would in such manner and on payment of such fees as may be determined by regulations. The Board may, by order, suspend or cancel a certificate of registration in such manner as may be determined by regulations. However no such order shall be made unless the person concerned has been given a reasonable opportunity of being heard.

Chapter VA of the Act deals with prohibition of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control.

Section 12A of the Act provides that no person shall directly or indirectly:

- (a) use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations made thereunder;
- (b) employ any device, scheme or artifice to defraud in connection with issue or

dealing in securities which are listed or proposed to be listed on a recognized stock exchange;

- (c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognized stock exchange, in contravention of the provisions of this Act or the rules or the regulations made thereunder;
- (d) engage in insider trading;
- (e) deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations made thereunder;
- (f) acquire control of any company or securities more than the percentage of equity share capital of a company whose securities are listed or proposed to be listed on a recognized stock exchange in contravention of the regulations made under this Act.

Finance, Accounts and Audit of SEBI

Chapter VI of the Act provides for Finance, Accounts and Audit of SEBI.

The Central Government may, after due appropriation made by Parliament by law in this behalf, make to SEBI grants of such sums of money as the Central Government may think fit for being utilised for the purposes of this Act. There shall be constituted a fund to be called the Securities and Exchange Board of India General Fund and there shall be credited 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 under Section 11 and the expenses on objects and for purposes authorised by this Act.

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 at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by SEBI to the Comptroller and Auditor General of India. The Comptroller and Auditor General of India and any other person appointed by him in connection with the audit of the accounts of the Board shall have the same rights and privileges and authority in connection with such audit as the Comptroller and Auditor General generally has in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of SEBI. The accounts of SEBI as certified by the Comptroller and Auditor General of India or any other person appointed by him in this behalf together with the audit report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of

Parliament.

Penalties for Failures

Chapter VIA of SEBI Act, 1992, contains Section 15A to 15J which deals with penalties which can be imposed under the Act for various failures, defaults, non-disclosure and other offences.

It may be recalled that 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(a) 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.

Section 15A lays down that if any person who is required under SEBI Act or any rules or regulations made thereunder:

- (a) to furnish any document, return or report to the Board, fails to furnish the same, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.
- (b) to file any return or furnish any information, books or other documents within the time specified therefor in the regulations, fails to file return or furnish the same within the time specified therefor in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.
- (c) to maintain books of accounts or records, fails to maintain the same, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

Section 15B lays down that if any person who is registered as an Intermediary and is required under this Act or any rules or regulations made thereunder, to enter into an agreement with his client, fails to enter into such agreement, he shall be liable to pay a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

Section 15C lays down that if any listed company or any person who is registered as an Intermediary, after having been called upon by SEBI in writing to redress the grievances of Investor, fails to redress such grievances within the time specified by SEBI, such company or intermediary shall be liable to pay a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

Penalties for Default

Section 15D and 15F provide for penalties for default.

Section 15D lays down that in case of mutual funds, if any person who is:

- (a) required under this Act or any rules or regulations made thereunder to obtain

a certificate of registration from SEBI for sponsoring or carrying on any collective investment scheme, including mutual funds, sponsors or carries on any collective investment scheme, including mutual funds, without obtaining such certificate of registration, he shall be liable to a penalty of one lakh rupees for each day during which he sponsors or carries on any such collective investment scheme, including mutual funds, or one crore rupees, whichever is less;

- (b) registered with SEBI as a collective investment scheme, including mutual funds, for sponsoring or carrying on any investment scheme, fails to comply with the terms and conditions of certificate of registration, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (c) registered with SEBI as a collective investment scheme, including mutual funds, fails to make an application for listing of its schemes as provided for in the regulations governing such listing, he shall be liable to penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (d) registered as a collective investment scheme, including mutual funds, fails to dispatch unit certificates of any scheme in the manner provided in the regulation governing such despatch, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (e) registered as a collective investment scheme, including mutual funds, fails to refund the application monies paid by the investors within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (f) registered as a collective investment scheme, including mutual funds, fails to invest money collected by such collective investment schemes in the manner or within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Section 15E lays down that where any asset management company of a mutual fund registered under SEBI Act fails to comply with any of the regulation providing for restrictions on the activities of such company, it shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Section 15F provides penalties for default in case of stock brokers. As per the Section, if any person registered as a stock broker under SEBI Act -

- (a) fails to issue contract notes in the form and in the manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty not exceeding five times the amount for which the contract note was required to be issued by that broker;
- (b) fails to deliver any security or fails to make payment of the amount due to the investor in the manner within the period specified in the regulations, he shall

be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;

- (c) charges an amount of brokerage which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty of one lakh rupees or five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

Penalty for Insider Trading

Section 15G lays down that if any insider:

- (i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price sensitive information; or
- (ii) communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or
- (iii) counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price sensitive information,

he shall be liable to a penalty of 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

Section 15H lays down that if any person fails to:

- (i) disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate; or
- (ii) make such a public announcement to acquire shares at a minimum price, he shall be liable to a penalty not exceeding five lakh rupees;
- (iii) make a public offer by sending letter of offer to the shareholders who sold their shares pursuant to letter of offer,

he shall be liable to a penalty of twenty five crore rupees or three times the amount of profits made out of insider trading; whichever is higher.

Section 15H provides that if a person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty of twenty five crore rupees or three times the amount of profits made out of such practices, whichever is higher.

Penalty for contravention

Whoever fails to comply with any provision of this Act, the rules or regulations made or directions issued by SEBI thereunder for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.

Adjudications

Section 15-I & J deal with SEBI's power to adjudicate and factors to be taken into

account by the adjudicating officer.

- (1) For the purpose of adjudging under sections 15A, 15B, 15C, 15D, 15E, 15F, 15G, 15H, 15HA and 15HB, SEBI appoints any of its officers not below the rank of Division Chief to be 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.
- (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 in the opinion of the adjudicating officer, 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.

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.

	<p>What is the penalty for a person involved in insider trading?</p> <p>A person shall be liable to a penalty of twenty five crore rupees or three times the amount of profits made out of insider trading; whichever is higher.</p>
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Securities Appellate Tribunal

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.

As per Section 15K, the Central Government is empowered to establish by notifications one or more Appellate Tribunals, to be known as the Securities Appellate Tribunals to exercise the jurisdiction, power and authorities conferred on such Tribunal by SEBI Act or under the Act or any other law for the time being in force. The Central Government has set up a tribunal at Mumbai.

According to Section 15L, which deals with the composition of the Tribunal, the Securities Appellate Tribunals shall consist of a Presiding Officer and two other members to be appointed by the Central Government by notification.

Section 15M prescribes that a person shall not be qualified for appointment as

the Presiding Officer of Securities Appellate Tribunals unless he is a sitting or retired Judge of the Supreme Court or a sitting or retired Chief Justice of a High Court. It has also been prescribed that the presiding officer of the Securities Appellate Tribunal shall be appointed by the Central Government in consultation with chief justice of India or his nominee. A person shall not be qualified for appointment as a member of Securities Appellate Tribunal unless he is a person of ability, integrity and standing who has shown capacity in dealing with problems relating to securities market and has qualification and experience of corporate law, securities laws, finance, economics or accountancy.

A member of SEBI or any person holding a post at senior management level at SEBI cannot be appointed as presiding officer or member of Securities Appellate Tribunal during his service or tenure as such with SEBI or within two years from the date on which he ceases to hold office as such in SEBI.

Section 15N lays down that the Presiding Officer and every other member of Securities Appellate Tribunal shall hold office for a term of five years from the date he enters upon his office and is eligible for reappointment.

It has also been provided that the person attaining the age of sixty eight years cannot hold office as the presiding officer of Securities Appellate Tribunal. Also a person who has attained the age of sixty two years cannot hold office as member of Securities Appellate Tribunal.

Section 15-O lays down that the salary and allowances payable to and the other terms and conditions of service (including pension, gratuity and other retirement benefits) of, the Presiding Officer and other members of a Securities Appellate Tribunal are such as may be prescribed. It has also been provided that neither the salary and allowances nor the other terms and conditions of service of the said Presiding Officer and other members of the Securities Appellate Tribunal shall be varied to their disadvantage after appointment.

	<p>What is the composition of Securities Appellate Tribunal?</p>
<p>The Securities Appellate Tribunals shall consist of a Presiding Officer and two other members to be appointed by the Central Government by notification.</p>	

Filling up of Vacancies

Any vacancy, for reasons other than temporary absence, any vacancy occurs in the office of the presiding officer or any other member of a Securities Appellate Tribunal, shall be filled by the Central Government in accordance with the provisions of the Act. The proceedings may be continued before the Securities Appellate Tribunal from the stage at which the vacancy is filled.

Resignation and Removal

The presiding officer or any other member may resign his office, by notice in writing under his hand addressed to the Central Government. The presiding officer or the member would continue to hold office until:

- (a) the expiry of three months from the date of receipt of such notice, or

- (b) a person duly appointed as his successor enters upon his office, or
- (c) the expiry of his term of office,

whichever is earliest, unless the Central Government has permitted him to relinquish his office sooner.

The Presiding Officer or a member of a Securities Appellate Tribunal shall not be removed from his office except by an order by the Central Government on the ground of proved misbehaviour or incapacity after an inquiry made by a Judge of the Supreme Court, in which the Presiding Officer or member of Securities Appellate Tribunal concerned has been informed of the charges against him and given a reasonable opportunity of being heard in respect of these charges. The Central Government by rules regulate the procedure for the investigation of misbehaviour or incapacity of the presiding officer or the member.

Section 15R makes it clear that no order of the Central Government appointing any person as the Presiding Officer of a Securities Appellate Tribunal shall be called in question in any manner, and no Act or proceeding before a Securities Appellate Tribunal shall be called in question in any manner on the ground merely of any defect in the constitution of a Securities Appellate Tribunal.

Staff of Securities Appellate Tribunal

Central Government shall provide the Securities Appellate Tribunal with such officers and employees as Government may think fit. Officers and employees shall discharge their functions under general superintendence of the presiding officer. The salaries and allowances and other conditions of service of the officers and employees of Securities Appellate Tribunal would be prescribed.

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 under sub-section (1) 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.

Provided that 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.

Procedure of Securities Appellate Tribunal

As regards the procedure and powers of Securities Appellate Tribunal, Section 15U lays down that 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.

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.

Limitation

As per the section 15W, the provisions of the Limitations Act, 1963 shall apply to an appeal made to Securities Appellate Tribunal.

Public Servants

As per section 15X, the Presiding Officer and other officers and employees of Securities Appellate Tribunal shall be deemed to be public servants within the meaning of Section 21 of the Indian Penal Code.

Jurisdiction of Civil Court

Section 15Y lays down that no civil court has jurisdiction to entertain any suit or proceeding in respect of any matter which an Adjudicating Officer appointed under this Act or a Securities Appellate Tribunal under this Act is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

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.

What is the time period for filing an appeal with SAT and Supreme Court?



- In case of filing appeal with SAT: Within 45 days from the date of order of the copy made by SEBI or adjudicating officer.
- In case of filing appeal with Supreme Court: Within 60 days from the date of communication of the decision or order of SAT.

Powers of Central Government

(a) To issue directions

Section 16 empowers Central Government to issue directions in writing to SEBI on questions of policy as it may deem fit from time to time. However the Central Government shall as far as practicable, give an opportunity to SEBI to express its views before any such directions is given by the Central Government. The

decision of the Central Government as to whether a question is one of policy or not shall be final.

(b) To Supersede the Board

Section 17 lays down that if at any time the Central Government is of opinion that:

- (a) on account of grave emergency, SEBI is unable to discharge the functions and duties imposed on it by or under the provisions of this Act; or
- (b) SEBI has persistently made default in complying with any direction issued by the Central Government under this Act or in the discharge of the functions and duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of SEBI or the administration of SEBI has deteriorated; or
- (c) circumstances exist which render it necessary in the public interest so to do,

it may, by notification, supersede SEBI for such period, not exceeding six months, as may be specified in the notification.

Upon the publication of the notification, it will have the following effects:

- (a) all the members shall, as from the date of supersession, vacate their offices as such;
- (b) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of SEBI, shall until SEBI is reconstituted under sub-section (3), be exercised and discharged by such person or persons as the Central Government may direct; and
- (c) all property owned or controlled by SEBI shall, until the Board is reconstituted, vest in the Central Government.

On the expiration of the period of supersession specified in the notification, the Central Government may reconstitute the Board by a fresh appointment and in such case any person or persons who vacated their offices because of supersession shall not be deemed disqualified for appointment.

Returns and Reports

As per Section 18, SEBI is required to furnish to the Central Government at such time and in such form and manner as may be prescribed or as the Central Government may direct, such returns and statements and such particulars in regard to any proposed or existing programme for the promotion and development of the securities market, as the Central Government may from time to time require.

SEBI shall within ninety days after the end of each financial year submit to the Central Government a report in such form, as may be prescribed, giving a true and full account of its activities, policy and programmes during the previous financial year and a copy of the report, as soon as may be after it is received, shall be laid down before each House of Parliament.

Delegation of Powers

In accordance with Section 19 of SEBI Act, SEBI may, by general or special

order in writing delegate to any member, officer of the Board or any other person subject to such conditions, if any as may be specified in the order, such of its powers and functions under the Act as it may deem necessary.

Appeal to the Central Government

Section 20 of the Act provides that any person aggrieved by an order of SEBI made under this Act or the rules or regulations made thereunder, may prefer an appeal to the Central Government within such time as may be prescribed. The appeal shall not be admitted if it is preferred after the expiry of the period prescribed therefor. However if the appellant satisfies the Central Government that he had sufficient cause for not preferring the appeal within the prescribed period.

Every appeal made under this section shall be made in prescribed form and shall be accompanied by a copy of the order appealed against by such fees as may be prescribed.

The procedure for disposing of an appeal shall be such as may be prescribed and the appellant shall be given a reasonable opportunity of being heard.

Bar of Jurisdiction

Section 20A lays down that no order passed by SEBI or the adjudicating officer under this Act shall be appealable except as provided in section 15T or section 20 and no civil court shall have jurisdiction in respect of any matter which the Board (or the adjudicating officer) is empowered by, or under, this Act to pass any order and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any order passed by SEBI or the adjudicating officer by, or under, SEBI Act.

Public Servants

Section 22 of the Act provides that all members, officers and other employees of SEBI while acting or purporting to act in pursuance of any of the provisions of the Act shall be deemed to be public servants within the meaning of Section 21 of the Indian Penal Code.

Section 23 provides that no suit, prosecution or other legal proceedings shall lie against the Central Government or SEBI or any officer of the Central Government or any member, officer or other employee of SEBI for anything which is in good faith done or intended to be done under this Act or the rules or regulations made thereunder.

Offences and Punishments

Section 24, 26 and 27 deal with offences.

Section 24 lays down that:

- (1) Without prejudice to any award of penalty by the Adjudicating Officer under SEBI Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations made thereunder, he shall be punishable with imprisonment for a term which may extend to ten years or with fine which may extend to twenty five crore rupees or with both.

- (2) If any person fails to pay the penalty imposed by the Adjudicating Officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years or with fine which may extend to twenty-five crore rupees or with both.

Composition of certain offences

Section 24A provides any offence punishable under this Act, not being an offence punishable with imprisonment only or with imprisonment and also with fine, may before or after the institutions of any proceeding, be compounded by a Securities Appellate Tribunal or a Court before which such proceedings are pending.

Power to grant immunity

As per Section 24B of the Act, the Central Government may on the recommendations by SEBI, if satisfied that any person who is alleged to have violated any of the provisions of this Act or the rules or regulations made thereunder has made a full and true disclosures in respect of alleged violations, grant to such persons, subject to conditions as it may think fit, immunity from prosecution for any offence under this Act with respect to the alleged violation.

However no such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity. It has also been provided that recommendations of SEBI shall not be binding upon the Central Government. However, an immunity granted to a person can be withdrawn by the Central Government, if it is satisfied such person had, in the course of the proceedings not complied with the condition on which the immunity was granted or had given false evidence. Such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention. He shall also become liable to the imposition of any penalty under this Act to which such person would have been liable had not such immunity been granted.

Section 26 lays down that:

- (1) No court shall take cognizance of any offence punishable under this Act or any rules or regulations made thereunder, save on a complaint made by SEBI.
- (2) No court inferior to that of a Court of Session shall try any offence punishable under this Act.

Section 27 on offences by company lays down that:

- (1) Where an offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly;

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the

offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

- (2) Notwithstanding anything contained in above, where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. Here 'Company' means any body corporate and includes a firm or other association of individuals; and 'director', in relation to a firm, means a partner in the firm.

Power to make Rules

Section 29 empowers the Central Government to make rules for carrying out the purposes of this Act. Such rules may provide for all or any of the following matters, namely:

- (a) the term of office and other conditions of service of the Chairman and the members of SEBI;
- (b) the additional functions that may be performed by SEBI under section 11 of the Act;
- (c) the manner in which the accounts of SEBI shall be maintained under section 15;
- (d) the manner of inquiry by adjudicating officer;
- (e) the salaries and allowances and other terms and conditions of service of the Presiding Officers, members and other officers and employees of the Securities Appellate Tribunal;
- (f) the procedure for the investigation of misbehaviour or incapacity of the Presiding Officers or other members of the Securities Appellate Tribunal;
- (g) the form in which an appeal may be filed before the Securities Appellate Tribunal and the fees payable in respect of such appeal;
- (h) the form and the manner in which returns and report to be made to the Central Government under section 18;
- (i) any other matter which is to be, or may be, prescribed, or in respect of which provision is to be, or may be, made by rules.

Power to make Regulations

Section 30 empowers SEBI by notification to make regulations consistent with this Act and the rules made thereunder to carry out the purposes of this Act.

Such regulations may provide for all or any of the following matters, namely:

- (a) the times and places of meetings of SEBI and the procedure to be followed at such meetings including quorum necessary for the transaction of business;
- (b) the terms and other conditions of service of officers and employees of SEBI;

- (c) the matters relating to issue of capital, transfer of securities and other matters incidental thereto and the manner in which such matters shall be disclosed by the companies under section 11A.
- (d) the conditions subject to which certificate of registration is to be issued, the amount of fee to be paid for certificate of registration and the manner of suspension or cancellation of certificate of registration.

Rules, Regulations to be laid before the Parliament

Section 31 lays down that every rule and every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rules or regulation.

Section 32 lays down that the provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

II. SEBI ANNUAL REPORT

The Central Government notified SEBI (Annual Report) Rules 1994, on 7th April, 1994 in exercise of its powers under section 18(2) read with section 29 of SEBI Act, 1992.

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 students are advised to look at latest SEBI Annual Report, which is available on SEBI's website: www.sebi.gov.in**

The form of the annual report is divided into four parts. Part I deals with policies and programmes to be reviewed in respect of the general, economic, environmental and the investment climate, primary and secondary markets, mutual funds, intermediaries, foreign institutional investment, other activities and programmes having a bearing on the working of the Securities Market and finally an assessment and prospects of the times ahead.

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, namely:

- (a) Regulation of business in Stock Exchanges including trading and settlement

practices;

- (b) Registration and regulation of various intermediaries in the securities market including suspension, cancellation of registrations etc.
- (c) Registration and regulation of working of collective investment schemes and mutual funds including suspension and cancellation of registrations etc.
- (d) Promotion and regulation of self regulatory organisations (SROs);
- (e) Fraudulent and unfair trade practices and steps taken by SEBI to prevent recurrences;
- (f) Investors education and training of intermediaries;
- (g) Prohibition of insider trading and steps initiated to curb such practices;
- (h) Substantial acquisition of shares and takeovers;
- (i) Information obtained, inspection undertaken, inquiries conducted and results of audits of stock exchanges, intermediaries and SROs by SEBI;
- (j) Delegated powers and functions under the SCR Act, 1956;
- (k) Fees and other charges collected by SEBI;
- (l) Research and studies conducted by SEBI;
- (m) Other functions carried out by SEBI on Securities Market.

Part IV of the annual report contains detail of the organisational matter of SEBI.

III. SEBI'S ANNUAL ACCOUNTS

SEBI (Form of Annual Statement of Accounts and Records) Rules, 1994 were notified by the Central Government on 20th May, 1994 in consultation with Comptroller and Auditor General of India, in exercise of the powers conferred by Section 15(1) read with Section 29 of SEBI Act, 1992. Rule 3 prescribes that at the expiration of a period of 12 months ending with 31st March every year, SEBI shall prepare with reference to that period, a balance sheet, income and expenditure account and receipts and payments account as on the last working day of that period respectively in the forms - Form A, Form B and Form C respectively.

Rules 4 and 5 prescribe that SEBI shall preserve these statements for a minimum period of five years and that they shall be signed by the Chairman and an officer authorised by SEBI.

The accounts of SEBI shall be audited by the Comptroller & Auditor General of India (C&AG) and SEBI shall pay the C&AG for the services rendered. The C&AG or his authorised persons shall have the same rights, privileges and authority in connection with such audit as the C&AG has in connection with audit of government accounts and in particular shall have the right to demand the production of books, accounts, connected vouchers and documents and papers and to inspect any of the offices of SEBI. The accounts of SEBI as certified by the C&AG together with the audit report shall be forwarded annually to the Central Government who shall cause the same to be laid before each House of Parliament.

IV. SECURITIES APPELLATE TRIBUNAL (PROCEDURE) RULES, 2000

In exercise of the powers conferred by section 29 read with section 15T and 15U

of the Securities and Exchange Board of India Act, 1992 the Central Government notified Securities Appellate Tribunal (Procedure) Rules, 2000.

Limitation for Filing Appeal

Rule 3 dealing with Limitation for filing appeal requires every appeal to be filed within a period of forty five days from the date on which a copy of the order against which the appeal is filed, is received by the appellant. However, Appellate Tribunal has been empowered to entertain an appeal after the expiry of the said period of forty five days if it is satisfied that there was sufficient cause for not filing it within that period.

Procedure for Filing Appeal

Rule 4 requires a memorandum of appeal to be presented in the prescribed Form by any aggrieved person in the registry of the Appellate Tribunal within whose jurisdiction, his case falls or be sent by registered post addressed to the Registrar. A memorandum of appeal sent by post shall be deemed to have been presented in the registry on the day it was received in the registry.

Sittings of Appellate Tribunal

Rule 5 dealing with settings of Appellate Tribunal requires the Tribunal to hold its sitting either at a place where its office is situated or at such other place falling within its jurisdiction, as it may deem fit by the Appellate Tribunal. In the case of temporary absence of the Presiding Officer, Government may authorize one of the two other Members to preside over the sitting of the Tribunal either at a place where its office is situated or at such other place falling within its jurisdiction as it may deem fit by the Appellate Tribunal.

Fees and Documents to accompany Memorandum Appeal

Rule 9 lays down that every memorandum of appeal to be accompanied with a fee and such fee may be remitted in the form of crossed demand draft drawn on any nationalised bank in favour of "the Registrar, Securities Appellate Tribunal" payable at the station where the registry is located.

The amount of fee payable in respect of appeal against adjudication orders made under Chapter VI A of the Act has been prescribed as given below :

	<i>Amount of penalty imposed</i>	<i>Amount of fees payable</i>
1.	Less than rupees ten thousand	Rs. 500
2.	Rupees ten thousand or more but less than one lakh	Rs. 1,200
3.	Rupees one lakh or more	Rs. 1,200 plus Rs. 500 for every additional one lakh of penalty or fraction thereof, subject to a maximum of Rs. 1,50,000

Amount of fee payable in respect of any other appeal against an order of the Board under the Act shall be rupees five thousand only.

Rule 10 requires every memorandum of appeal filed to set forth concisely under distinct heads, the grounds of such appeal without any argument or narrative, and such ground shall be numbered consecutively. Separate memorandum of appeal is not required to seek interim order or direction if in the memorandum of appeal, the same is prayed for.

Rule 11 provides that every memorandum of appeal shall be in five copies and shall be accompanied with copies of the order, at least one of which shall be certified copy, against which the appeal is filed. Where a party is represented by authorised representative, a copy of the authorisation to act as the authorised representative and the written consent thereto by such authorised representative, shall be appended to the appeal. Rule 12 makes it clear that a memorandum of appeal shall not seek relief or reliefs against more than one order unless the reliefs prayed for are consequential.

Appeal to be in writing

Rule 7 requires every appeal, application, reply, representation or any document filed before the Appellate Tribunal to be typewritten, cyclostyled or printed neatly and legibly on one side of the good quality paper of foolscap size in double space and separate sheets to be stitched together and every page to be consecutively numbered and filed in five sets in a paper book along with an empty file size envelope bearing full address of the respondent and in case the respondents are more than one, then sufficient number of extra paper books together with empty file size envelope bearing full addresses of each respondent shall be furnished by the appellant.

Presentation and scrutiny of memorandum of appeal

Rule 8 which deals with presentation and Scrutiny of memorandum of appeal requires the Registrar to endorse on every appeal the date on which it is presented or deemed to have been presented and to sign endorsement. If, on scrutiny, the appeal is found to be in order, it shall be duly registered and given a serial number. If an appeal on scrutiny is found to be defective and the defect noticed is formal in nature, the Registrar may allow the appellant to rectify the same in his presence and if the said defect is not formal in nature, the Registrar may allow the appellant such time to rectify the defect as he may deem fit. If the appeal has been sent by post and found to be defective, the Registrar may communicate the defects to the appellant and allow the appellant such time to rectify the defect as he may deem fit. In case the appellant fails to rectify the defect within the time allowed in sub-rule (3), the Registrar may by order and for reasons to be recorded in writing, decline to register such memorandum of appeal and communicate the order to the appellant within seven days thereof. An appeal against the order of the Registrar is required to be made within fifteen days of receiving of such order to the Presiding Officer or in his temporary absence, to the Member authorized whose decision thereon shall be final.

Notice of appeal to the respondent and Filing of Reply

Rule 13 requires the Registrar to serve on the respondent a copy of the memorandum of appeal and paper book as soon as they are registered in the registry, by hand delivery, or by Registered Post or Speed Post. The respondent may file five complete sets containing the reply to the appeal along with documents in a paper book form with the registry within one month of the service of the notice on him

of the filing of the memorandum of appeal. The Appellate Tribunal may, in its discretion, on application by the respondent allow the filing of reply after the expiry of the period of one month. Every reply, application or written representation filed before the Appellate Tribunal should be verified in the prescribed manner. A copy of every application, reply, document or written material filed by the respondent before the Appellate Tribunal shall be forthwith served on the appellant, by the respondent.

Hearing of Appeal

The Appellate Tribunal shall notify the parties the date of hearing of the appeal in such manner as the Presiding Officer may by general or special order direct. On the day fixed or on any other day to which the hearing may be adjourned, the appellant shall be heard in support of the appeal. The Securities Appellate Tribunal shall, then, if necessary, hear the Board or its authorised representative against the appeal, and in such case the appellant shall be entitled to reply. During the course of the hearing of appeal the written arguments could be supplemented by time-bound oral arguments. However, in the case of temporary absence of the Presiding Officer or of the Member authorized by the Government under sub-rule (2) of rule 5, the Presiding Officer can authorize the other Member present on that day to hear the Board or authorized representative against the appeal.

In case the appellant does not appear in person or through an authorised representative when the appeal is called for hearing, the Securities Appellate Tribunal may dispose of the appeal on merits. However, where an appeal has been disposed of as aforesaid and the appellant appears afterwards and satisfies the Securities Appellate Tribunal that there was sufficient cause for his not appearance, when the appeal was called for hearing, the Securities Appellate Tribunal shall make an order setting aside the ex-parte order and restore the appeal.

Dress Code

Rule 17 dealing with dress regulations for Presiding Officer, Members and the representatives of the parties provides that the dress for the Presiding Officer shall be white or striped or black pant with blackcoat over white shirt and band or buttoned up black cut and band. The dress for two other Members shall be white or striped or black pant with black coat over white shirt and black tie or a buttoned-up black coat. In the case of female Presiding Officer, the dress shall be black coat over white saree.

Every authorised representative, other than a relative or regular employee of the party shall appear before the Appellate Tribunal in his professional dress if any, and if there is no such dress, a male, in a suit or buttoned-up coat over a pant or national dress that is a long buttoned up coat on dhoti or churridar pyjama, and a female, in a coat over white or any other sober coloured saree or in any other sober dress. All other persons appearing before the Appellate Tribunal are required to be properly dressed.

Order of the Appellate Tribunal

Every order of the Appellate Tribunal shall be pronounced in the sitting of the Appellate Tribunal by the Presiding Officer or in case of the temporary absence of the Presiding Officer, by the authorized Member and powers be signed and dated by the Presiding Officer. The Presiding Officer has to pass interim orders or injunctions,

subject to reasons to be recorded in writing, which it considers necessary in the interest of justice.

In terms of Rule 19 the orders of the Appellate Tribunal, as are deemed fit for publication in any authoritative report or the press may be released for such publication on such terms and conditions as the Presiding Officer may lay down. Under Rule 20, a certified copy of every order passed by the Appellate Tribunal shall be communicated to SEBI, the Adjudicating Officer and to the parties, as the case may be. **Students are advised to refer to SAT cases which are available on SEBI website www.sebi.gov.in.**

Inspection of Records and Copies Thereof

Rule 22 which deals with fee for inspection of records and copies thereof prescribes a fee of rupees twenty, for every hour or part thereof of inspection subject to a minimum of rupees one hundred for inspecting the records of a pending appeal by a party thereto. Similarly a fee of rupees five for a folio or part thereof not involving typing and a fee of rupees ten for a folio or part thereof involving typing of statement and figures has been prescribed for providing copies of the records of an appeal, to a party thereto.

Working hours of the Appellate Tribunal

Rule 23 prescribes that the office of the Appellate Tribunal shall observe such public and other holidays as observed by the offices of the Central Government in the locality where the office of the Appellate Tribunal is situated. The Appellate Tribunal shall, subject to any other order made by the Presiding Officer, remain open on the working days from 10.00 AM to 6.00 PM. But no work, unless of an urgent nature, shall be admitted after 4.30 PM on any working day. The sitting hours of the Appellate Tribunal shall ordinarily be from 10.30 AM to 1.00 PM and 2.00 PM to 5.00 PM, subject to any order made by the Presiding Officer.

Functions and Duties of the Registrar

Rule 25 and 26 deals with functions of Registrar. Rule 25 provides for general functions and Rule 26 provides for additional functions and duties of Registrars. Rule 25 provides that the Registrar shall discharge his functions under general superintendence of the Presiding Officer or in the temporary absence of the Presiding Officer, the authorized member. He shall discharge such other functions as are assigned to him under these rules by the Presiding Officer or in the temporary absence of the Presiding Officer, by the Member authorized by a separate order in writing. He shall have the custody of the records of the Appellate Tribunal. The official seal of the Appellate Tribunal shall be kept in the custody of the Registrar. However, subject to any general or special direction by the Presiding Officer, or in the temporary absence of the Presiding Officer, authorized member, the official seal of the Appellate Tribunal shall not be affixed to any order, summons or other process save under the authority in writing from the Registrar. The official seal of the Appellate Tribunal shall not be affixed to any certified copy issued by the Appellate Tribunal, save under the authority in writing of the Registrar.

Rule 26 provides for Additional functions and duties of Registrar. In addition to the functions and duties assigned in the rules, the Registrar shall have the following functions and duties subject to any general or special orders of the Presiding Officer

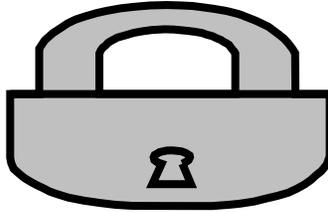
namely:

- (1) to receive all appeals, replies and other documents;
- (2) to decide all questions arising out of the scrutiny of the appeals before they are registered;
- (3) to require any appeal presented to the Appellate Tribunal to be amended in accordance with the rules;
- (4) subject to the directions of the Presiding Officer to fix date of hearing of the appeals or other proceedings and issue notices thereof;
- (5) direct any formal amendment of records;
- (6) to order grant of copies of documents to parties to proceedings;
- (7) to grant leave to inspect the record of the Appellate Tribunal;
- (8) dispose of all matters relating to the service of notices or other processes, application for the issue of fresh notice or for extending the time for or ordering a particular method of service on a respondent including a substituted service by publication of the notice by way of advertisement in the newspapers;
- (9) to requisition records from the custody of any court or other authority.

LESSON ROUND UP



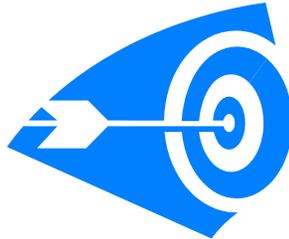
- The Securities Market refers to the markets for those financial instruments/ claims/obligations that are commonly and readily transferable by sale.
- The Securities Market has two inter-dependent and inseparable segments, the new issues (primary) market and the stock (secondary) market.
- The primary market provides the channel for sale of new securities, while the secondary market deals in securities previously issued.
- The four main legislations governing the securities market are: the SEBI Act, 1992; the Companies Act, 1956; the Securities Contracts (Regulation) Act, 1956 and the Depositories Act, 1996.
- SEBI has twin objectives of protecting the interests of the investors in securities and to promote the development of, and to regulate the securities markets by such measures as it thinks fit.
- The SEBI Act, 1992 empowers for appellate remedies against SEBI's order or penalties by establishing Securities Appellate Tribunal.
- Any person aggrieved by any decision or order of the SAT can file an appeal to Supreme Court.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Briefly discuss the evolution, growth and functions of financial system in India.
2. Explain the role of securities market in economic growth.
3. Discuss the various powers and functions of the Securities and Exchange Board of India.
4. Explain the role of SEBI in strengthening regulatory framework and fostering investor confidence.
5. Enumerate the various penalties which can be imposed under SEBI Act, 1992 for various failures, defaults, non-disclosure and other offences.
6. Explain the procedure for Appeal to the Securities Appellate Tribunal.
7. Discuss the various powers of the Central Government under SEBI Act, 1992.
8. Explain the functions and duties of the Registrar under the Securities Appellate Tribunal (Procedure) Rules, 2000.

STUDY II
SECURITIES MARKET REFORMS AND DEVELOPMENT



LEARNING OBJECTIVES

The study will enable the students to understand

- Developments in regulatory framework related to Securities Markets in chronological order
- Security Market Reforms and Development since 1997-98 till date
- Various new concepts introduced since 1992 such as dematerialization of shares, book building, buy-back of shares, reforms on disclosure requirements etc.
- Secondary market reforms such as rolling settlement, circuit breakers, price band and introduction of derivatives into India etc.

INTRODUCTION

In the planned economy concept, there were more controls and restrictions than the concept of development to support growth of the capital market in India. Some provisions of the Companies Act, MRTP Act, Capital Issues (Control) Act controlled the free regime of the market. The pricing of securities for issue was also subject to controls and regulations.

Since 1991, the scenario changed significantly with the initiation of economic and financial reforms by the Government. As a natural corollary of the liberalisation and globalisation, the Indian Capital Market has undergone a sea change in terms of innovations, growth and de-regulation. A list of series of various major policy reforms and development in the securities market are as under:

January 1992 to March 1996*

- The Securities and Exchange Board of India, set up in 1988 under an administrative arrangement, given statutory powers with the enactment of SEBI Act, 1992
- Capital Issues (Control) Act, 1947 repealed and the Office of Controller of

* Compiled on the basis of Annual Reports of the SEBI. The chapter has been developed to apprise the students with the yearwise developments in the Capital Market. For updated position of various developments, the students are advised to read this study lesson in conjunction with latest developments on the subject.

Capital Issues abolished; control over price and premium of shares removed. Companies now free to raise funds from securities markets after filing letter of offer with SEBI

- SEBI introduces regulations for primary and secondary market intermediaries, bringing them within the regulatory framework
- New reforms by SEBI in the primary market include improved disclosure standards, introduction of prudential norms and simplification of issue procedures. Companies required to disclose all material facts and specific risk factors associated with their projects while making public issues.
- Disclosure norms further strengthened by introducing cash flow statements
- Listing agreements of stock exchanges amended to require listed companies to furnish annual statement to the stock exchanges showing variations between financial projections and projected utilisation of funds in the offer document and at actuals, to enable shareholders to make comparisons between performance and promises
- New issue procedures introduced - partial book building for institutional investors - aimed at reducing costs of issue
- SEBI introduces a code of advertisement for public issues for ensuring fair and truthful disclosures
- The power to regulate stock exchanges delegated to SEBI by the government
- SEBI reconstitutes the governing boards of the stock exchanges, introduces capital adequacy norms for brokers and issues rules for making the client/broker relationship more transparent, in particular, segregating client and broker accounts
- Over the Counter Exchange of India (OTC) set up with computerised on line screen based nation-wide electronic trading and rolling settlement
- National Stock Exchange of India (NSE) set up as a stock exchange with computerised on line screen based nation- wide electronic trading
- The Stock Exchange, Mumbai (BSE) introduces on line screen based trading
- Capital adequacy requirement for brokers introduced
- System of mark to market margins introduced on the stock exchanges
- "Revised carry forward" system introduced in place of "badla"
- National Securities Clearing Corporation Limited set up by the NSE
- SEBI frames regulations for mutual funds. Private mutual funds permitted and several such funds have already been set up. All mutual funds allowed to apply for firm allotment in public issues - also aimed at reducing issue costs
- SEBI introduces regulations governing substantial acquisition of shares and take-overs and lays down the conditions under which disclosures and mandatory public offers are to be made to the shareholders
- Indian companies permitted to access international capital markets through Euroissues

- Foreign Direct Investment allowed in stock broking, asset management companies, merchant banking and other non-bank finance companies
- Foreign Institutional Investors (FIIs) allowed access to Indian capital markets on registration with SEBI
- Guidelines for Offshore Venture Capital Funds announced by the government
- SEBI strengthens surveillance mechanisms in SEBI and directs all stock exchanges to have separate surveillance departments
- SEBI strengthens enforcement of its regulations. Begins the process of prosecuting companies for mis-statements, issues show cause notices to merchant bankers, ensures refunds of application money in several issues on account of mis-statements in the prospectus

During 1997-98

- SEBI advised stock exchanges to set up either Trade Guarantee Fund or Settlement Guarantee Fund to eliminate counterparty risk.
- Upper limit for gross exposure of member brokers of stock exchanges was fixed at 20 times the base minimum capital and additional capital of the member broker.
- SEBI appointed Chandratre Committee on delisting of securities which recommended exchanges to collect listing fees from the companies for three year period in advance. Besides, the companies opting for voluntary delisting should mandatorily provide an exit route to investors by offering buy-back facility to them. These recommendations were accepted and suitable directions were issued to the stock exchanges.
- As on March 31, 1998, 20 stock exchanges in the country, accounting for almost 99.8 per cent of the total all-India turnover, had shifted to on-line screen based trading.
- Rolling settlement of T+5 was made mandatory in the exchanges where trading in dematerialised securities was available since January 15, 1998.
- SEBI appointed J. R. Varma Committee on Modified Carry Forward System which recommended a margin of 10 per cent on carry forward trades instead of earlier 15 per cent, enhancing the over all limit of carry forward trades by a broker to Rs 20 crore from the earlier limit of Rs 7.5 crore, removal of scripwise sub-limits on carry forward positions and removal of limit of Rs 10 crore for badla financier. The recommendations were accepted and suitable directions issued to stock exchanges.
- Brokers were permitted to warehouse trades for firm orders of the Institutional clients.
- SEBI appointed a committee under the chairmanship of Shri G. P. Gupta to study the concept of market making and to revive the institution of market makers. The recommendations are awaited.
- R. Chandrasekharan committee had recommended adequate safety and

security features for security certification. The action for its implementation has been initiated.

- All stock exchanges were required to strengthen their Investor Protection Fund and Investor Services Fund. The Stock exchanges were advised to provide a special facility for attending investor complaints and dummy terminal for showing the on-line trades.
- SEBI appointed L. C. Gupta Committee which recommended the introduction of derivatives trading in order to provide the facility of hedging in the most cost-efficient way against market risk, and accordingly action for its implementation was initiated.
- Settlement of trades in the depository was made compulsory from January 15, 1998 in selected scrips for institutional investors namely domestic FIs, Banks, Mutual Funds and FII's having a minimum portfolio of securities of Rs 10 crore.
- SEBI appointed Working Group on Dematerialisation which recommended that securities in dematerialised form should be treated as 'good delivery' in the physical segment with effect from April 6, 1998. Accordingly, action for implementation was initiated.
- The recognition of the Saurashtra-Kutch and Jaipur Stock Exchanges were further renewed for a period of one year.
- The Governing Board of Magadh Stock Exchange was superceeded on account of its working.
- The stock exchanges were permitted to expand their trading terminals to those cities where no other stock exchange was located subject to compliance with certain conditions. As for the cities where a stock exchange already existed, the exchanges seeking expansion were required to enter into a MoU with the concerned stock exchanges. Accordingly, the Stock Exchange, Mumbai (BSE) was permitted to expand outside Mumbai. Similar permissions were also granted to stock exchanges at Pune, Kolkata and Rajkot subject to fulfilment of certain conditions by them.
- The Capital Stock Exchange Kerala Limited and the Inter-Connected Stock Exchange of India were granted "in-principle" recognition subject to compliance with certain conditions.
- 151 brokers from the 22 stock exchanges across the country were inspected.
- There was a steep increase in registration of sub-brokers from 1798 to 3760 i.e. by 109 per cent.
- SEBI permitted unlisted infrastructure companies making a public issue of pure debt instruments/convertible debt instrument and municipal corporations from the requirements of Rule 19(2)(b) of Securities (Contract) Regulation Rules, 1957, allowing them to list their debt instruments on the stock exchanges without the requirement for equity being listed first.
- The facility of book-building was extended to the entire issue size for issuer companies which propose to make an issue of capital of and above Rs. 100 crore.

- A Committee was set up to examine the draft regulations on Credit Rating Agencies prepared by SEBI and to recommend suitable modifications.
- Amendments were made to SEBI (Merchant Bankers) Regulations 1992. Only body corporates were allowed to function as merchant bankers.
- Multiple categories of merchant bankers viz. Category II, III and IV were abolished and henceforth there would be only one category of merchant bankers, i.e. Category I Merchant Banker. This new entity shall undertake only those activities which are related to securities market including issue management activity and which do not require registration/have been granted exemption from registration as NBFC from the RBI. However, such entities shall have to seek separate registration if they wish to act as underwriter or portfolio manager. That is, Merchant Bankers would now require separate registration to act as underwriters as well as portfolio managers.
- Merchant Bankers were prohibited from carrying on fund-based activities other than those related exclusively to the capital market.
- SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 have been amended to provide for an arms length relationship between the issuer and the Registrar to the Issue.
- SEBI appointed a Committee under the Chairmanship of Dr S.A. Dave to draft the Regulations on Collective Investment Schemes. Until the Regulations were notified, the provisions of Section 12(1)(B) of SEBI Act prohibited any new scheme to be sponsored or further fund to be raised by the existing collective investment scheme. Further, SEBI stipulated that all existing schemes would continue to mobilise funds only after obtaining a rating from any of the recognised Credit Rating Agencies. It was decided that all advertisements by existing collective investment schemes would adhere to the advertisement code prescribed by SEBI.
- The Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 were amended to address certain issues that are important for investor protection.
- Aggregate investments by a mutual fund in listed or to be listed securities of group companies of the sponsor would not exceed 25 per cent of the net assets of all schemes of the fund.
- Securities transactions with associate brokers would not exceed 5 per cent of the quarterly business done by the mutual fund.
- Unitholders' approval would no longer be required for rollover of schemes and for converting close-ended schemes into open-ended ones, provided the unitholders were given the option to redeem their holdings in full at NAV based prices.
- Independent trustees who are not associated with the sponsor shall now constitute two-thirds of the Board of Trustees instead of earlier provision of 50 per cent.
- SEBI gave an option to the issuers to fix the minimum marketable lot on the basis of offer price subject to the condition that the marketable lot shall not be more than 100 shares.

- A Committee was set up under the Chairmanship of Mr P.K. Kaul to recommend the manner of discharge of responsibilities by the trustees as laid down in regulation 18 of SEBI (Mutual Funds) Regulations, 1996. The report of the Committee is awaited.
- SEBI set up a working group to work out the modalities and guidelines for investment by domestic mutual funds in overseas markets.
- SEBI regulations for merchant bankers, stock brokers, registrars to an issue, portfolio managers, underwriters, debenture trustees, bankers to an issue, custodian of securities, depositories, venture capital funds were amended to specifically include the concept of "fit and proper person" in their eligibility criteria that an applicant should be a fit and proper person.
- SEBI appointed Justice D.R. Dhanuka Committee which submitted its interim recommendations in respect of working draft of the Companies Bill, 1997.
- SEBI (Annual Report) Rules has been amended to such that SEBI shall submit Annual Report to the Central Government within 90 days after the end of each Financial Year instead of 60 days.

During 1998-99

Dematerialisation of Securities

- To eliminate the risks associated with trading in physical securities such as delay in transfer, bad delivery, theft, fake and forged shares, several new, and far reaching initiatives were taken by SEBI to accelerate dematerialisation and electronic book entry transfer of securities
- Compulsory trading in dematerialised form introduced for the first time for all investors in a phased manner in shares of selected companies which are most actively traded
- the list of companies whose shares are to be compulsorily traded in dematerialised form by institutional investors expanded to cover almost all the actively traded shares accounting for more than 90 per cent of the trading volume
- the Central Depository Services Ltd., a new depository promoted by the BSE and a few commercial banks granted certificate of commencement of business
- the market lots abolished for shares of companies compulsorily traded in dematerialised form by all investors
- the facility of selling small quantities of shares in the physical form of either 500 in number or Rs.25000 in value being introduced in the stock exchanges, to help investors having small holdings to dispose off their holdings easily.

Derivatives Trading

- To provide the facility of hedging and enhance the liquidity in the market, the committee appointed by SEBI on derivatives recommended phased introduction of trading in derivative products beginning with trading in stock index futures, accepted by SEBI. The introduction of derivatives is awaiting the amendment of SCR Act.

- The recommendations of the J.R. Verma Committee for risk containment measures for derivative trading including margin system accepted by SEBI.

Buy-back of Securities

- To help increase the liquidity in the securities and to enable companies to enhance the wealth of shareholders, the facility of buy-back of securities by listed companies introduced for the first time.

Par Value of Shares

- To give the flexibility to the companies to issue shares at any amount and to extend free pricing to its logical conclusion and to benefit the investors, the current requirement for issuing shares with a fixed par value of Rs.10 or Rs.100 abolished for companies whose shares are dematerialised.

Employees Stock Option Scheme

- To provide incentives to employees, the J.R. Verma Committee was constituted by SEBI to formulate the Guidelines for Employee Stock Options and Employee Stock Purchase Scheme. The Board has considered and accepted the recommendations of the Committee and the Guidelines are being issued.

Facilitating the Development of Infrastructure

- To facilitate increased raising of funds by infrastructure companies, SEBI granted several relaxations and exemptions from the existing requirements. These are given below:
 - Exemption from fulfilling eligibility norms.
 - Exemption from meeting profitability norms for free pricing of issues –subject to fulfillment of certain conditions.
 - Exemption from the requirement of offering at least 25 per cent of securities to public.
 - Exemption from the requirement of the minimum number of 5 shareholders for every Rs.1 lakh of capital issued.
 - Exemption from the requirement of minimum subscription of 90 per cent of public offer.
 - Relaxation from requirement of minimum financial participation by appraising agency – a minimum participation of 5 per cent of the project cost can be made either jointly or severally by the specified institutions, irrespective whether they have appraised the project or not.

Continuing Disclosures

- To improve the continuing disclosure standards for companies for quicker dissemination of information to investors, quarterly disclosure of financial results by listed companies made mandatory for the first time by SEBI through the amendment of the listing agreement, thus taking India to the select list of countries with similar continuing disclosure requirement.

- Continuing disclosures further enhanced by the introduction of the requirement of immediate disclosure of any material event in a company having a bearing on the performance of the company and price sensitive information.

Credit Rating Agencies

- To strengthen the credibility of the ratings of credit rating agencies and enhance the transparency in their reporting and information system, the recommendations of SEBI appointed Committee accepted.

Collective Investment Schemes

- To protect the interest of investors in Collective Investment Schemes and in accordance with the mandate given by the Government, SEBI initiated the process of framing the regulations for collective investment schemes. To protect the interest of the investors, in the interim period, SEBI took several measures with a two pronged approach to discipline and take action against erring entities and at the same time to educate the investors about the risks associated with investing in unregulated schemes. The action taken by SEBI included issuing show cause notices to defaulting entities, initiating court proceedings to obtain appropriate relief in the interest of the investors, conducting a special audit of the books of accounts of the larger entities, making credit rating mandatory for existing schemes, disseminating information to the investors through the issue of press releases/public notices etc.

Relaxation of Norms for IPOs

- To help lower issue cost and time for making public issues and also to simplify procedures, the ceiling of issue size of Rs.100 crore for book-building reduced to Rs.25 crore.
- To bring down the cost involved in public issues, SEBI modified the requirement of mandatory collection centres. The minimum number of collection centres for an issue of capital shall be – (a) the four metropolitan centres and (b) such centres where the stock exchanges are located in the region in which the registered office of the company is situated.
- To encourage the mobilisation of capital by new companies, the entry norms for IPOs further relaxed by substituting the requirement of actual payment of dividend in three out of five preceding years, with the ability to pay dividend as demonstrated by distributable profits in accordance with the provisions of the Companies Act in at least three out of five preceding years.
- To improve the liquidity and to encourage entrepreneurs to raise capital through public issues, the requirement of the lock-in period of promoters' contribution in full reduced to only 20% of the total capital of the company.
- To help investors make informed investment decisions, credit rating by approved credit rating agencies made mandatory for all public and rights issues of debt instruments irrespective of their maturity or conversion period as against exemption granted for 18 months.

- To facilitate floatation of issues by public and private sector banks, relaxation made in the Disclosure and Investor Protection guidelines of SEBI for the issue of capital, subject to the approval of the issue price by the RBI, as banks are under the regulatory purview of RBI.

Secondary Market Transparency

- To enhance the transparency in the secondary market, automated screen based trading which was introduced in 20 stock exchanges extended to the remaining 3 more stock exchanges to achieve 100 per cent coverage of automated trading.
- To enhance transparency of negotiated deals, stock exchanges directed to ensure that all negotiated deals result in delivery and deals of value of Rs.25 lakh or volume of 10,000 shares are reported on the screens within 15 minutes of transaction and disseminated to the market.
- To increase the competitiveness in the market and prevent market abuse, the facility of "all or one" available in the trading system of the stock exchanges was abolished.

Increase in Market Access

- To increase market access for investors across the country, the Stock Exchange Mumbai and the National Stock Exchange (NSE) further expanded their terminals through VSAT to cover more than 250 cities and towns.
- To increase the access of Indian securities market to NRIs, OCBs and FIIs, the Indian stock exchanges permitted to set up their trading terminals overseas subject to regulatory requirements of the host countries.

Mutual Funds

- In order to strengthen the disclosure by mutual funds, standard offer document and abridged offer document introduced .
- Several mutual funds directed by SEBI to honour their commitment to the investors in assured return schemes thus benefiting millions of investors. By the end of March 31, 1999 the total amount paid to investors was Rs.1350 crore.
- To ensure that the Trustees discharge their responsibilities more effectively, the report of SEBI-appointed Committee under the chairmanship of Shri P.K. Kaul, former Cabinet Secretary submitted to SEBI.

Market Safety and Risk Containment Measures

- To ensure that settlements take place without failure and to reduce counter party risk, 10 major and medium stock exchanges have set up trade / settlement guarantee funds measuring an increase of 6 exchanges with an amount of Rs.1000 crore .
- To protect market integrity especially under conditions of abnormal price movement and to contain extreme volatility, margin system strengthened by SEBI in consultation with the stock exchanges by introducing additional

volatility margin, incremental margin for carry forward transaction and concentration margin coupled with reduction of daily price bands from 10 per cent to 8 per cent and abolition of weekly price bands.

Monitoring, Surveillance and Effective Prevention of Market Manipulation

- To help ensure real time monitoring of price movements and broker positions and to generate real time alerts, 4 major and medium sized stock exchanges implemented the first phase of the Stock Watch System.
- Several enforcement actions taken against intermediaries for various violations of the provisions of SEBI Act and rules and regulations and also for market manipulation and unfair trade practices.

Consolidation of Smaller Stock Exchanges

- To help sustain the activities of smaller stock exchanges, the Inter Connected Stock Exchange of India set up by 14 regional stock exchanges, commenced trading operations in a limited way.

Foreign Institutional Investors

- FIIs permitted to directly participate in the public offers in takeover and buyback offer of companies.
- Procedural simplification introduced for registration and operations of the FIIs and the Sub-accounts.

Takeovers and Substantial Acquisition of Shares

- To further protect the interest of investors in takeovers and to enhance equity, fairness and transparency in takeover transactions, the interim recommendations of the reconstituted Committee under the chairmanship of Justice P.N. Bhagwati, former Chief Justice of India accepted.
- The threshold limit for mandatory public offer increased from 10 per cent to 15 per cent of the voting rights of a company.
- The creeping acquisition limit raised from the earlier level of 2 per cent to 5 per cent of the voting rights and also made applicable to persons holding above 51 per cent of voting rights up to 75 per cent.

During 1999-2000

Streamlining of the Disclosure and Investor Protection Guidelines

- The entry point norms for Initial Public Offer (IPO) which form a part of the Disclosure and Investor Protection Guidelines (DIP) relaxed for companies in the Information Technology (IT) sector to enable these companies to list their shares by making public offer of 10 per cent of post issue capital instead of 25 per cent for other sectors, subject to requirements of minimum number of 20 lakh securities and minimum net offer value of Rs.30 crore. This will encourage IT companies to come to the market.
- The requirement of "ability to pay dividend" substituted for "actual payment of dividend", in the entry point norms for public offers. This will further strengthen the guidelines.

- The DIP guidelines made common for all Initial Public Offers (IPOs) made common in the wake of abolishing of the concept of fixed par value. This will help streamline the guidelines.

Employee Stock Options Scheme

- The revised guidelines for employees stocks options schemes based on recommendations of committee appointed by SEBI under J. R. Varma were implemented.

Book-Building

- The issuers given the option to build either by 90 per cent of the net offer to the public or 75 per cent of the net offer to the public. The balance issue to be offered to the public at the fixed price determined through book-building exercise. This procedure is in line with the international practices and will aid price discovery and streamline the process of book-building.
- The 15 per cent reservation for individual investors bidding up to 10 marketable lots, merged with 10 per cent at fixed price offer. This will further streamline the process of book-building.

Credit Rating Agencies (CRAs)

- The regulations for CRAs notified. This will bring the CRAs under a regulatory framework for the first time.

Collective Investment Schemes (CIS)

- The Securities Law (Amendment) Bill, 1999 was passed by the Parliament facilitating the regulation of Collective Investment Schemes (CIS) and expanding the definition of securities to include units of CIS. This will help SEBI to regulate the CIS and protect the interest of investors in these schemes.
- Several other measures earlier taken by SEBI to protect investors included:
 - the issue of advertisements to warn investors of danger of investing in unregulated CIS and to notify all CIS that their registration of all CIS with SEBI is mandatory and
 - allowing the launching of new CIS schemes only after obtaining the rating from a CRA.

Market Making

- Following the acceptance of the recommendations of the Committee on Market Making appointed by SEBI, guidelines were issued to the stock exchanges to allow brokers to take up market making activity in shares of a company where the average number of trades is more than 50 and the value of trade on daily basis is more than Rs.10 lakh.

Marketing Initial Public Offer (IPO) through Secondary Market

- The facility of marketing IPOs through the use of the available infrastructure of stock exchanges permitted by SEBI to be introduced by the stock

exchanges. This will help reduce issue and distribution costs for public issues, reduce delays and speed up allotment.

Internet Trading

- Internet trading under order routing system permitted for the first time in a limited way through registered stock brokers on behalf of clients for execution of trades on recognized stock exchanges. This will further modernize the trading system.

Negotiated Deals

- The long prevalent system of negotiated deals on the stock exchanges (i.e. any transaction which either has a value of Rs 25 lakh / the traded volume is not less than 10,000 shares) which were non transparent and had become the source of much abuse was abolished by SEBI, and guidelines issued by SEBI permitting such deals only if they are executed on the on the screen on the price and order matching system of the exchanges, like any other deal. This will introduce transparency and price discovery in negotiated deals and protect better the investors.

Rolling Settlement

- Phased programme of T+5 rolling settlement introduced for the first time, in 10 scrips from January 10, 2000, and another 34 scrips from March 21, 2000 after shortlisting the scrips on the basis of the criteria that these scrips should be on the list for compulsory dematerialised trading and have a daily turn over of about Rs 1 crore and above. This important measure will increase the efficiency of market microstructure

Measures For Safety And Stability In Stock Market

- The existing margin system further refined and strengthened to enhance the safety of the market.

Dematerialisation of Shares

- The list of scrips to be traded compulsorily in dematerialised form by institutional investors increased in phases to 462 by the end of the financial year and further announcement made for increasing the list to 985 by June 26, 2000; a similar list of scrips for all investors increased to 260 by the end of the year and announced to be increased to 579 by June 26, 2000.
- Procedures for processing of dematerialised requests and opening of accounts for beneficial owners by the depository participants streamlined and facility of simultaneous transfer and dematerialisation introduced.
- Share transfer agents allowed to act as depository participants.
- The ceiling on the value of the portfolio of securities held in custody by the broker depository participants increased to 100 times the net worth of the broker.
- No delivery period for scrips under compulsory dematerialised form by all investors reduced to one week.

- Additional measures taken to enhance the safety standards of the depository system.
- Trading of new IPOs compulsorily in de-materialised form by all investors immediately upon listing.

Corporate Governance

- A Committee was appointed by SEBI under the chairmanship of Shri Kumar Mangalam Birla, member SEBI Board, to enhance the standard of corporate governance. The draft Report of the Committee was widely circulated and deliberated. The recommendations were accepted by SEBI Board and implemented by SEBI through the amendment of the listing agreement of the stock exchanges. The recommendations applicable first to all the listed companies which are included either in group A of the BSE and in S&P CNX Nifty index as on January 1, 2000 to be completed by March 31, 2001 and in the subsequent years to other companies in a phased manner. This will substantially enhance the standard of corporate governance in India.

Financial Disclosure

- The cash flow statement as per the listing agreement required to be mandatorily prepared in accordance with the relevant accounting standard.
- Additional disclosures to be made in the unaudited financial quarterly results of the companies to make these more transparent and meaningful.
- Limited review by auditors for half-yearly results.
- Prior intimation about Board Meeting at which declaration of dividend is considered to be made at least seven days in advance.
- Announcement by the companies on dividend, rights etc. to be made only after the close of the market hours to avoid excessive volatility in stock prices.

Listing of debt before equity

- Listing of debt securities relating to infrastructure and municipal corporation allowed before equity, subject to the condition that the debt instrument is rated not below a minimum rating of A or equivalent thereof.

Foreign Institutional Investors (FIIs)

- FIIs allowed to directly participate in the public offer in takeover and buy-back offer of companies.
- Foreign corporate or high networth individual investors allowed to invest as sub-account to widen the base of FIIs provided provident investment does not exceed 5 per cent of total issued capital of company.

Mutual Funds

- Investment by Mutual Funds in the equity shares or equity related instruments of a single company in a single scheme restricted to 10 per cent

of the NAV of the scheme and investment in index schemes to 15 per cent of NAV of the scheme to allow for diversification of investments by mutual funds. The limits can be extended to 25 per cent of the NAV of the scheme with the prior approval of the board of the asset management company and board of trustees.

- Investment in unlisted shares by mutual funds not to exceed of 10 per cent of the NAV of a scheme, in case of close ended scheme and 5 per cent of the NAV of the scheme in case of open-ended schemes.
- Investments by mutual funds in debt instruments issued by a single issuer which are rated not below investment grade restricted to 15 per cent of a scheme, but could be extended to 20 per cent with the prior approval of the boards of the asset management company and trustees. Investment in un-rated debt instrument of a single issuer in a scheme restricted to 10 per cent of the NAV of the scheme which could be increased to 25 per cent of NAV subject to approval of the boards of the asset management company and trustees.
- Following the recommendations of the P.K. Kaul Committee which were accepted by SEBI Board , the trustees of mutual funds required to file the details of his transaction relating to buying and selling of securities with the mutual fund on a quarterly basis and due diligence is required to be carried out by the trustees in fulfilment of the various obligations as required under the regulations.

Venture Capital Funds

- The recommendations of the Committee appointed by SEBI under the chairmanship of Shri Chandrashekhar, for developing the venture capital industry, were accepted by SEBI Board. These recommendations would go a long way in helping the growth of venture capital in India.

During 2000-01

Streamlining of the Disclosure and Investor Protection Guidelines

- To ensure availability of adequate information to investors, the guidelines issued to companies to disclose the details of utilization and deployment of unutilized part of promoter's contribution, firm allotment and reservation in their balance sheet. Similar requirements also specified in case of monies accrued to the company as a result of a preferential issue. Companies required to indicate the purpose for which such monies are utilised and the form in which such unutilised monies have been invested.
- To address apprehensions about an overly optimistic future performance by the company, no forecast or projections relating to financial performance of the issuer company to be given in the offer document.

Book-building

To further strengthen the book-building and to rationalise the existing provisions of book-building guidelines and to introduce greater transparency in the book-building

process, following guidelines issued

- 100 percent one stage book-building permitted with bidding centres at all cities having stock exchanges.
- The provision of 75 percent of the issue to be offered through book-building of which:
 - 60 percent to be allocated to institutional investors such as banks/FIIs and other financial institutions and at least 15 percent to be distributed on proportionate basis to non-institutional investors applying for more than 1000 shares and
 - The remaining 25 percent of shares to be available to small investors.

Entry Norms and Book Building

Book building process further used to strengthen and streamline the entry point norms for public issues and to help investors make better judgement of quality and price of the issue on the assumption that QIBs who would be subscribing first to the offer under the book building have ability to assess the quality of the investment and their investment decision would effectively amount to a market appraisal of the quality and price of the issue.

- Issuers not having net-worth of Rs. 1 crore and distributable profits in 3 out of the immediately preceding 5 years or proposing to raise more than 5 times its pre-issue net worth, required to make issues to be compulsorily through book-building route offering 60 percent to Qualified Institutional Buyers (QIBs).
- Institutional investors under the category of QIBs like banks, FIIs, mutual funds and other financial institutions to be allocated not more than 60 percent of the book-built portion.

Preferential Allotment Disclosures and Lock-in

- To safeguard investors' interest, guidelines on preferential allotment modified requiring companies to include detailed disclosures in the explanatory statement in the notice for the general meeting or AGM of the shareholders. viz. objective of the issue and intention of promoters, directors, key management persons, shareholding pattern etc.
- Lock-in period of one year from the date of allotment stipulated for instruments allotted on preferential basis to any person including promoters/promoter group except for such allotments which involve share swap for acquisitions.

Promoters Contribution and Lock-In

- To ensure promoters' association and commitment to company and to enhance investors' confidence in public issues of unlisted companies, the minimum promoters contribution of 20 percent for unlisted companies required to be locked-in for 3 years and the balance of the entire pre-IPO capital to be locked in for 1 year from the date of commencement of commercial production or the date of allotment in the public issue which ever is later.

IPOs in Dematerialised Mode

- To eliminate the problems relating to loss of allotment letters, share certificates, etc., and to induce the investors to opt for allotment of dematerialised shares, the trading for all IPOs in dematerialised form made compulsory with an option available to the investors for physical shares.

Guidelines for Issue of Debt Instruments

- To help the development of debt market and to provide a wider variety of debt instruments SEBI (Disclosure and Investor Protection) Guidelines, 2000 amended to allow issuers to issue unsecured/subordinated debt instruments with maturity of less than 18 months in the nature of mezzanine capital.

Public Issues Through Stock Exchange Mechanism

- To reduce issue costs as well as time taken in public issues, guidelines issued for offering securities in public issues through the stock exchange mechanism, giving the issuers the option to issue securities through the on-line system of the stock exchange or through the existing banking channel.

Allotment Procedure

- To speed up the listing process, in-principle approval from the stock exchanges for listing of securities required to be obtained by the lead merchant banker within 15 days of filing of the offer document with the stock exchange.
- To ensure speedier completion of the issue process, and to minimize the risks associated with volatile markets, the time for finalising allotment reduced from 30 to 15 days in book-built issues and the period between finalisation of basis of allotment and listing reduced to 7 working days to impart quicker liquidity to the investments made in primary issues.
- To ensure that investors get the shares/refund orders quickly, the despatch of share certificates/refund orders/cancel stock invest and demat credit required to be completed within two working days of finalisation of the basis of allotment, in place of present requirement of 30 days.
- To further simplify the present allotment procedure, market lots replaced with simple proportionate allotment to the applicants in the respective categories. To prevent fractional allotments and allotments of miniscule value, the minimum allotment to be higher of the following: a) one share or b) smallest integral number of shares that have a value of Rs. 1000/- calculated on the basis of issue price.

Relaxation of Minimum Offer to Public

- To encourage companies in the new economy while ensuring good quality issues with sufficient stock available for trading:
 - Indian companies in information technology, media, entertainment and telecom sectors permitted to access the markets with a minimum offer of 10 per cent of post-issue capital to the public subject to a minimum offering of 20 lakh shares for the amount of not less than Rs.50 crore. This relaxation subsequently extended to all companies with the same

conditions and the issue size increased from Rs. 50 crore to Rs. 100 crore.

- The restriction of minimum public issue size of Rs. 25 crore in case of an IPO through book-building removed for all companies.

Listing of Debt Before Equity

- The present facility of listing of debt securities of infrastructure companies and municipal corporations without having listed their equity, extended to all companies subject to investment grade credit rating, promoters' contribution of 20 per cent, three years lock-in, maintaining same standard of continuing disclosures, no partly paid-up shares/ other securities, and book-building option, etc.

Financial Disclosures Requirements for Issuers and Other Entities

To strengthen the financial disclosures norms for the listed entities:

- The unaudited financial quarterly results of the companies made more transparent and meaningful, additional disclosure norms prescribed and half-yearly results subjected to a "limited review" by the auditors,
- The issuers required to prepare cash flow statement referred to in the listing agreement in accordance with relevant accounting standard,
- The issuers required to disclose materially significant transactions, i.e., transactions of the company of material nature, with its promoters, the directors or the management, their subsidiaries or relatives, etc. which may have potential conflict with the interests of issuers at large,
- The public disclosure of details of non-compliance, penalties, strictures imposed by the stock exchange or SEBI or any matter of company related to the capital market during the last three years required; and separate disclosure for all material on non-recurring/abnormal income/gain and expenditure/loss and effect of all changes in accounting practices affecting the profits materially,
- All stock exchanges and subsidiaries of stock exchanges, clearing corporations advised to post their annual accounts in their respective websites, besides making available a copy of their annual accounts to investors, intermediaries and general public.
- Valuation methods standardised for net asset value of mutual funds for debt securities, thinly traded and non-traded debt and equities.
- The ICAI issued accounting standards for consolidation of accounts, segment reporting, related party transactions, deferred tax liability.
- These standards will be mandatory for all listed companies as per the phased programme of corporate governance issued by SEBI.

Corporate Governance

- The recommendations of the Kumar Mangalam Birla Committee on corporate governance in relation to listing agreement entered into by the companies with the stock exchanges implemented.

- According to the recommendations of the Accounting Standards Committee, the companies required to immediately disclose all material information simultaneously to all the stock exchanges where the securities of the company are listed.
- The regional stock exchanges required to disseminate the information to all stock exchanges where the securities of the company are listed or traded .
- Further, any material event arising out of decisions taken in the board meetings regarding announcement of results, dividends, bonus, rights etc. are to be furnished to the stock exchanges within fifteen minutes of the closure of the board meetings.
- The companies to report extent of compliance of corporate governance in their Annual Reports.
- The stock exchanges directed to monitor corporate governance compliance on quarterly basis.

Continuous Listing

- Guidelines issued to all listed companies to maintain a minimum level of non-promoter holding on a continuous basis as a measure of investor protection as it would ensure availability of floating stocks.

Rolling Settlement

- Rolling settlement which was first introduced voluntarily from January 1998 on all scrips included in the demat segment and then compulsorily to 163 scrips to be expanded to 414 scrips by covering additional 251 scrips from July 2, 2001 following the announcement made by the Government on March 13, 2001 in Parliament.
- The list of additional 251 scrips to include all scrips having the facility of ALBM/BLESS or MCFS in any stock exchange. In addition if there is any scrip which is included in the BSE 200 scrip but not covered by the above list also to be included in the compulsory rolling settlement on a nation-wide basis.
- All deferral products cease to be available from July 2, 2001 except for the limited purpose of liquidating the outstanding positions till September 3, 2001. However liquidation of outstanding deferral positions as of the date of announcement of SEBI decision to take place by September 3, 2001.
- Simultaneously exchanges permitted to introduce stock options from July 2, 2001.

Risk Containment Measures:

(A) Rationalisation and strengthening of Margin System

- Margins of 10 per cent made applicable for exposures up to Rs. 20 crore and 15 per cent made applicable for exposures exceeding Rs. 20 crore and up to Rs.40 crore or a uniform rate of 12.5 per cent margin made applicable under MCFS and ALBM.

- Price band for 200 scrips and scrips under compulsory rolling settlement, was relaxed to 16 per cent.
- Scrip limit in carry-forward position in Modified Carry-Forward System (MCFS) or the trade position in Automated Lending and Borrowing Mechanism (ALBM) was fixed at Rs 5 crore per scrip per member in account period and also in rolling settlement, and the exposure limit was fixed at Rs. 4 crore per broker.
- No volatility margin in compulsory rolling settlement system.
- Cash component to be minimum at 30 per cent of the total margin, to be deposited by the broker.
- To encourage delivery based transactions, the margins to be provided only in the shape of bank guarantees and cash component need not be insisted.
- Several measures taken following the events in the stock market in March 2001.

(B) Price Band:

To further strengthen the risk management system the following measures adopted:

- The price bands initially placed at 8 per cent such that once a scrip touched the 8 percent price band in either direction, the trading in that scrip to be restricted upto the price band for half an hour, and thereafter, the price band to be further relaxed by 4 percent in the direction in which the price moved to touch the ceiling .
- The relaxation of the price band could only be done at BSE or NSE. The other exchanges to relax the price band (by 4 percent) only after such relaxation is applied at BSE or NSE.
- Subsequently, the price band was relaxed by further 8 per cent for 200 actively traded scrips jointly decided by BSE and NSE.
- Following the events in the securities markets in March 2001 all transactions to be backed by delivery unless the sale transaction has been preceded by a purchase position of at least an equivalent amount in the name of the same client in the same or any other exchanges. This restriction was temporary, to be removed depending on the condition of the market.

Mandatory Client Code

- To help establish the identity of buyers and sellers of securities and to improve and facilitate market surveillance, the client code made mandatory at the brokers' level operating on all the stock exchanges.
- The unique client code also to be introduced across exchanges.

Abolition of No - Delivery Period

- No-delivery period of seven days abolished for companies whose securities are traded in the compulsory dematerialised mode.

Code of Ethics for Directors and Functionaries of Stock Exchanges

- Code of ethics' for directors and functionaries of stock exchanges introduced to raise the professional and ethical standards of exchanges and their functionaries and also to avoid conflict of interest, and promote market integrity.

Delivery Versus Payment (DVP)

- To bridge the gap between pay-in and pay-out of securities and funds, the DVP Committee set up to look into the mechanism for efficient payment and delivery system for securities and funds simultaneously. The recommendations of the committee awaited.

Trading and Settlement of Securities in Dematerialised Form

- To protect the interest of investors and enhance the safety of the dematerialisation process, additional safeguards introduced. Directives issued to depositories/depository participants to standardize the account opening procedure and to maintain the list of account holders. Additional guidelines also issued for proper verification of the debit instruction slips .
- To enhance the efficiency of the dematerialisation process and to prevent any possible misuse of pool account balances, directives issued to the depositories and depository participants, to reduce the pool account balances, to restrict the use of pool account balances only for effecting deliveries in the particular settlement and to levy penal charges for failure to reduce the pool account balances after the stipulated period.

Derivatives Trading

- To provide liquidity to the market and to enable market to absorb larger shocks for a small change in the prices, the derivatives trading was approved in June 2000 first in index futures contracts, both at NSE and BSE.
- Derivative products were expanded subsequently to include options on indices and thereafter to options on individual stocks.
- The risk containment measures for exchange traded index futures contracts outlined by SEBI under the framework consistent with the risk management guidelines. The exchanges are free to adopt any risk management model available globally.

Internet Trading

- To provide benefits to investors as an added advantage of convenience, transparency and real time trading, the internet based trading allowed through order routing system which will route client orders to exchange trading systems for execution of trades on the stock exchanges.

Securities Lending Scheme

- To facilitate smooth securities settlement, the schemes of ALBM and BLESS transactions of NSE and BSE, respectively, as generic products.

Investor Education

- A Working group appointed on investor education which recommended

application of information booklets on dematerialisation, secondary and primary market operations, imparting education on radio and television.

Mutual Funds

- A common format prescribed for all Mutual Fund schemes to disclose their entire portfolios on half yearly basis so that the investors can get meaningful information on the deployment of funds. Mutual Funds also required to disclose the investment in various types of instruments and percentage of investment in each scrip to the total NAV, illiquid and non performing assets, investment in derivatives and in ADRs and GDRs.
- To bring about transparency in the investment decisions, and ensure due diligence of the AMCs in their investment of public funds, all the AMCs directed to maintain records in support of each investment decision which would indicate the data, the facts and other related opinion leading to an investment decision.
- Further the AMCs required to record the basis for taking individual scrip-wise investment decision in equity and debt securities and report its compliance in their periodical reports to the trustees. After checking its compliance through independent auditors or internal/statutory auditors, the trustees required to report to SEBI in their half-yearly reports.
- To enable the investors to make informed investment decisions guidelines issued to mutual funds to fully revise and update offer document and memorandum atleast once in two years.
- Mutual funds also required to:
 - bring uniformity in disclosures of various categories of advertisements, with a view to ensure consistency and comparability across schemes of various mutual funds,
 - reduce initial offer period from a maximum of 45 days to 30 days,
 - despatch statements of account once the minimum subscription amount specified in the offer document is received even before the closure of the issue,
 - invest in mortgaged backed securities of investment grade by Credit Rating Agency,
 - identify and make provisions for the non-performing assets (NPAs), according to criteria for classification of NPAs and treatment of income accrued on NPAs and to disclose NPAs in half yearly portfolio reports,
 - disclose information in a revised format on unit capital, reserves, performance in terms of dividend and rise / fall in NAV during the half year period, annualized yields over the last 1, 3, 5 years in addition to percentage of management fees, percentage of recurring expenses to Net Assets, investment made in associate companies and payment made to associate companies for their services, details of large holdings etc. since their operation
 - declare their NAVs and sale/repurchase prices of all schemes updated

daily on regular basis on the AMFI web site by 8:00 p.m. and declare NAVs of their close-ended schemes on every Wednesday

- To give operational flexibility, mutual funds also allowed to constitute committees who can approve proposals for investment in unrated debt instruments after being approved by the AMC board and the trustees

Foreign Institutional Investors (FIIs)

- To avoid discrimination between Indian and foreign fund managers, SEBI (Foreign Institutional Investors) Regulations, 1995 amended on February 29, 2000 to permit domestic fund managers to also manage foreign funds.
- To facilitate investment by FIIs, foreign corporate bodies and foreign individuals permitted to invest upto 5 per cent of the total issued capital of the company.
- To further facilitate the foreign inflows the FIIs and sub-accounts permitted to invest in commercial papers
- To facilitate disinvestment in holding by FIIs which did not desire to renew registration, SEBI (Foreign Institutional Investors) Regulations, 1995 amended.

Venture Capital Funds (VCFs)

- To facilitate automatic transfer of shares from Venture Capital Funds or Foreign Venture Capital Investors to promoters of a venture capital undertaking, exemption granted from applicability of Open Offer requirements based on the recommendations of Shri K B Chandrasekhar Committee on Venture Capital.

During 2001-02

Issue Procedures

- To reduce the time period involved between closure of the issue and listing of securities, the companies were advised to ensure that details regarding the application and application monies received from the investors investing in the issue of a body corporate and the final certificate should be furnished to the Registrar to the Issue, the lead manager and the body corporate, before the expiry of 7 working days after the date of closure of issue.

SEBI (Disclosure and Investor Protection) Guidelines Amended

- To make the price discovery more broad based, the State Industrial Development Corporations and Foreign Venture Capital Investors registered with SEBI were permitted to be eligible to participate in public issues through the book-building route as Qualified Institutional Buyers (QIBs).

Book-Building

- To introduce the facility of 100 percent book-building for companies making a public issue, SEBI approved certain modifications in the book-building guidelines with effect from December 01, 2001.

Buy-back of Securities

- To enhance transparency and disclosures on buy-back of securities, SEBI issued guidelines that:
 - The companies shall be required to give prior notice of atleast 7 days to the stock exchanges about the Board meetings at which the proposal for buy-back of Securities is to be considered.
 - The companies shall be required to intimate the stock exchanges within 15 minutes after the board meeting about the decision on Buy-Back of Securities. The stock exchanges were advised to incorporate the above amendments in the Listing Agreement with immediate effect and confirm the same.

Issue of Debt Securities

- To make possible the issue of debt securities without the issue of equity and listing thereof, for unlisted companies desirous of making an issue of non-convertible debt securities (NCDS), SEBI (Disclosure and Investor Protection) guidelines were amended.

Underwriting

- To ensure the success of book-building issues, underwriting was made mandatory with the exception of 60 per cent of the net offer to public which has to be allotted to Qualified Institutional Buyers (QIBs).

Public Offer Clause Amended

- Through the Government Notification, Clause (b) to sub-rule (2) of Rule 19 of the SC(R) Rules, 1957 was amended providing for public offer at least 10 per cent instead of 25 per cent subject to certain conditions and the sector-wise exemptions were withdrawn.

Bankers to Issue

- To reduce the time period involved between closure of an issue and listing of securities, all Bankers to Issues were advised that details regarding application and application monies received from investors investing in the issue of a body corporate and final certificate are furnished to Bankers to the Issue, the Lead manager and Body corporate, before the expiry of 7 working days after the date of closure. Further, SEBI (Bankers to an Issue) Rules and Regulations, 1994 were amended through incorporation of a new Regulation 16A.

Deferral Products in Rolling Settlement and Uniform Settlement Cycle

- To provide adequate time for unwinding the positions for the securities market, SEBI took the following transitional measures:
 - All outstanding deferred positions as on May 14, 2001, were compulsorily liquidated by September 03, 2001.
 - Any additional deferred positions taken on or after May 15, 2001, in addition to the above were compulsorily liquidated by July 02, 2001.

- No new deferred positions were permitted from July 02, 2001 onwards.
- The exchanges were asked to monitor the positions of their members, phased liquidation of their positions between July 02, 2001 to September 03, 2001.
- Liquidation of outstanding positions as on July 02, 2001, was allowed only for the approved deferral products in the rolling settlement.

Rolling Settlement and Shortening of Settlement Cycle

- To enhance the efficiency of the secondary market, rolling settlement was introduced for additional 251 scrips from July 02, 2001 bringing the total number of scrips under rolling settlement to 414. The stocks, which were not under compulsory rolling settlement from July 02, 2001, were traded under compulsory rolling settlement with effect from January 02, 2002. It was also decided to further shorten the settlement cycle to T+3 for all listed securities from April 1, 2002.

Index-based market-wide circuit breaker in compulsory rolling settlement

- To bring about a co-ordinated trading halt in all equity and equity derivative markets nationwide, SEBI implemented an index-based market-wide circuit breaker system, applied at three stages of the index movement either way at 10 per cent, 15 per cent and 20 per cent with effect from July 02, 2001.

Margin based on VaR.

- To contain the risk associated with scrips in compulsory rolling settlement, the 99 per cent VaR based Margin System was introduced from July 02, 2001 as under:
 - Scrip-wise VaR and index-based VaR calculation by the exchanges for additional 251 scrips included in compulsory rolling settlement from July 02, 2001 and 15 scrips having the facility of CNS, CFRS, ALBRS and BLESS.
 - In addition to the above, additional level of margin was imposed to address the 1 per cent of the cases to supplement VaR based margins.
 - Additional 12 per cent margin imposed to address 1 per cent of the cases.
 - The VaR calculations based either on BSE Sensex or S & P CNX Nifty and other exchanges may calculate their own VaR or follow BSE or NSE pattern.
 - The VaR based margin capped at 100 per cent.
 - The VaR based margin calculated by the exchange at the end of the day to be used for the purpose of margin calculations for the transactions carried out next day.
 - The VaR based margin to be collected on T+1 basis.
 - In addition to margin calculated on VaR basis, exchanges to collect mark-to-market margin.

- Exchanges to impose additional margin on scrips whenever necessary to contain the risk in the market.

Withdrawal of restriction on short sales

- To facilitate short selling, all restrictions which were temporarily imposed were removed. SEBI withdrew the restrictions on short sales with effect from July 02, 2001.

Securities Lending Scheme, 1997

- To facilitate the use of stock lending following the introduction of rolling settlement in 414 scrips from July 2, 2001 and the ban on all deferral products such as ALBM/BLESS/MCFS/CNS, the restrictions on the Securities Lending Scheme, 1997 were withdrawn.

Scrip-wise price bands

- To introduce scrip-wise price band, SEBI decided that in addition to the market-wide index based circuit filters, there would be individual scrip-wise price bands of 20 per cent either way, for all scrips in the compulsory rolling settlement except for the scrips on which derivatives products are available or scrips included in indices on which derivatives products are available. While in the rest of the scrips that are not in compulsory rolling settlement, the existing price bands would continue to apply.
- Further post-September 11, 2001, as a temporary measure for market stability, a price band of 10 per cent was introduced on all shares on which derivative products are available.

Risk containment measures for Stock Option

- To reduce the risk in trading of Options on Stocks, SEBI implemented the following measures on the basis of the framework consistent with the risk management guidelines recommended by the L.C. Gupta Committee. Also, the exchanges were allowed to decide whether they want to adopt any of the risk management models available globally or else may like to develop their own models for risk management.
- The Stock Option Contracts to be traded on the derivative exchange/ segments shall have prior approval of SEBI. The Contract should comply with the disclosure requirements, if any, laid down by SEBI.
- The exchange to introduce Premium Settled American Style Stock Options, which shall be settled in cash at exercise, for an initial period of six months, thereafter, the Stock Options, at exercise, shall be settled by delivery.
- The Stock Option Contract to have a minimum contract size of Rs. 2 lakh at the time of its introduction in the market.
- The Stock Option contract to have a maximum maturity of 12 months and shall have a minimum of 3 strikes (in the money, near the money and out of the money).
- The initial margin requirements to be based on worst case of loss of a portfolio of an individual client to cover 99 per cent VaR over a one day horizon. The initial margin requirement shall be netted at level of individual

client and it shall be on gross basis at the level of Trading/Clearing Member. The initial margin requirement for the proprietary position of Trading/Clearing member shall also be on net basis.

- A portfolio based margining approach to be adopted which will take an integrated view of the risk involved in the portfolio of each individual client comprising of his positions in derivative contracts.
- Exchanges to disclose scrip-wise deliverable positions grossed across clients for that day's trading session in the specified format.

Unique client code

- To allocate ID to their investor clients, all brokers were directed through the stock exchanges to provide a unique ID to every investor. It was made mandatory for all brokers to use unique client codes for all clients. For this purpose, brokers were advised to collect and maintain in their back office the Permanent Account Number (PAN) allotted by Income Tax Department for all their clients. Sub-brokers will similarly maintain for their clients. Where an individual client does not have PAN number, such a client shall be required to give a declaration to that effect.
- For FIIs, (where FII, itself is the investing entity) and their sub-accounts, SEBI registration number of FIIs and sub-account to be used until the PAN No. is allotted.
- For tax paying body corporate, the unique registration number issued by the relevant regulatory authority to be used till the time the PAN is allotted.
- The stock exchanges to be required to maintain a database of client details submitted by brokers. Historical records of all quarterly submissions shall be maintained for a period of seven years by the exchanges.

Amendment to the Listing Agreement

- To enhance the level of continuous disclosure by the listed companies in the light of new Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI), SEBI decided to amend the Listing Agreement to incorporate the segment reporting, *accounting* for taxes on income, Consolidated Financial Results, Consolidated Financial Statements, Related Party Disclosures and Compliance with Accounting Standards.

Single Stock futures and the Risk Containment Measures

- To further develop the derivative market and to increase the availability of products, futures on 31 stocks, in which options contracts had been permitted by SEBI was introduced.
- As risk containment measures, SEBI adopted the existing risk management framework in the derivative market for Single Stock Futures.
- A portfolio based margining was adopted taking into account an integrated view of the risk involved in the portfolio of each individual client comprising of his positions in all derivative contracts i.e. Index Futures, Index Option, Stock Options and Single Stock Futures.

Demutualisation of the Stock Exchanges

- To remove the influence of brokers in the functioning of stock exchanges, SEBI decided that no broker member of the stock exchanges shall be an office bearer of an exchange or hold the position of President, Vice President, Treasurer etc. and amendment to the Rules, Articles, Bye-laws of the stock exchanges were in the process of being amended.

FII's Trading in all exchange traded derivative contracts

- To permit FII's to trade in all exchange traded derivative contracts, SEBI prescribed position limits for trading by FII's and their sub-accounts. The FII's were also permitted by the RBI to trade in all exchange derivative contracts subject to the prescribed position limit for them and their sub-accounts. They are also required to comply with the procedure of trading, settlement and reporting as prescribed by the derivative exchange/clearing house/clearing corporation from time to time.

Trading and Settlement in Dematerialised Securities

- To facilitate the settlement, SEBI prescribed the compulsory dematerialised trading by companies through connectivity with both the depositories. If the companies fail to establish connectivity with both the depositories from the due date, the trading will be on the "Trade for Trade" settlement window of the exchanges from the following settlement period.

Takeovers

- SEBI amended the Take-over Regulations to facilitate disinvestment of government shareholding in the listed Public Sector Undertakings.
- SEBI increased the creeping acquisition limit available for consolidation of existing holdings from 5 per cent to 10 per cent which would be available upto September 30, 2002, subject to review.

Mutual Funds

- To provide investors with meaningful information about the operations of the mutual fund schemes and to help them in taking well informed investment decision; SEBI revised and simplified the present format for un-audited half-yearly results. The mutual funds were asked to disclose performance in terms of rise/fall in NAV, yield, investment made in associate companies, details of large holding etc.
- All Mutual Funds were directed to post their half-yearly results in the prescribed format on their web sites and for investors the same may be displayed on AMFI web site before the expiry of one month from the close of each half-year.
- To make the monitoring more broad based, the Mutual Funds were required to disclose the portfolios on their web sites in the prescribed format before the expiry of one month from close of each half-year and a copy of the portfolio is required to be filed with SEBI at the time of submission of half-yearly results.

- To provide the investors objective analysis of the performance of the mutual funds schemes in comparison with the rise & fall in the securities market, the mutual funds were advised to disclose benchmark indices.
- To ensure that all personal securities transactions are conducted consistent with the Mutual Funds guidelines and in such manner so as to avoid any actual or potential conflict of interest or any abuse of an individual's position of trust and responsibility, SEBI issued detailed guidelines for investment/trading in securities by employees of AMCs and mutual fund trustee companies. Further more, Boards of AMCs and trustees are required to review the compliance of guidelines periodically.
- SEBI decided that mutual funds should disclose large unit holdings in the scheme, which are above 25 percent of the NAV. The information on the number of such investors and total holdings by them in percentage terms, shall be disclosed in the allotment letters after the initial public offerings and also in the annual and the half-yearly results.
- To implement the regulations in regard to independent functioning, SEBI decided that relatives of sponsors or directors of sponsor companies or relatives of associate directors of the AMCs and Trustee Companies should be considered as associate directors. The nominees of the companies who are stakeholders in the Sponsor Company or AMC shall be considered as associate directors. Further, a person who is an "associate" in accordance with definition in the regulations cannot be appointed as independent director even after he ceases to be an "associate" unless a cooling off period of three years has elapsed from the date of his disassociation.
- To bring uniformity in calculation of NAVs and to have proper valuation of Government Securities, all mutual funds were advised to use the prices for government securities released by an authorised agency.

Investment in Foreign Securities by Mutual Funds

- To broaden the avenues for investments, Mutual Funds as per the Union Budget 2002-03 proposals, were permitted to make investments in foreign debt securities including government securities in the countries with fully convertible currencies, short term as well as long term debt instruments with highest rating (foreign currency credit rating) by accredited/registered credit rating agencies. The mutual funds may also invest in units/securities issued by overseas mutual funds or unit trusts, which invests in aforesaid securities or are rated and registered with overseas regulators.

During 2002-03

- Implementation of T+3 rolling settlement for all listed securities across the exchanges from April 2, 2002 to move T+2 on April 1, 2003.
- Introduction of scientific model for risk management, based on VaR.
- Introduction of Electronic Data Information Filing And Retrieval (EDIFAR) System to facilitate electronic filing of certain documents/statements by the listed companies and their immediate disclosure to the market participants.
- Launch of Securities Market Awareness Campaign.

- Introduction of rating corporate governance on the principles of wealth creation, wealth management and wealth sharing.
- Introduction of Straight Through Processing (STP) for the securities transaction.
- Implementation of a comprehensive risk management system for Mutual Funds.
- Introduction of the Dual fungibility of ADRs and GDRs.
- Establishment of the Central Listing Authority (CLA).
- Issuance of necessary guidelines/circulars for Corporatization and Demutualization of stock exchanges.
- Introduction of the trading of Government Securities on the Stock Exchanges.
- Posting all the orders passed by the Securities Appellate Tribunal (SAT) and the Board on SEBI website, to bring in regulatory transparency.
- Introducing the consultative process on policy formulation by putting all reports of committees and draft regulations on SEBI website for seeking comments, suggestions and opinions from public.
- Issuance of guidelines on Delisting of Securities from the Stock Exchanges.
- Establishment of inter-depository transfer through on-line connectivity between CDSL and NSDL.
- Review and amendment of the following regulations and guidelines – a measure of regulatory proactiveness
 - SEBI (Insider Trading) Regulations, 1992
 - SEBI (Underwriters) Regulations, 1993
 - SEBI (Debenture Trustees) Regulations, 1993
 - SEBI (Portfolio Managers) Regulations, 1993
 - SEBI (Foreign Institutional Investors) Regulations, 1995
 - SEBI (Mutual Fund) Regulations, 1996
 - SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997
 - SEBI (Employee Stock Option Scheme & Employee Stock Purchase Scheme) Guidelines, 1999.
 - SEBI (Credit Rating Agencies) Regulations, 1999
 - SEBI (Issue of Sweat Equity) Regulations, 2002
 - SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002.
- Announcement of Accounting Standards and disclosure practices of the Indian companies by ICAI in consultation with SEBI in accordance with International Accounting Standards.
- Expansion of the derivatives products basket.

- Introduction of benchmarking of all the Mutual Funds Schemes to facilitate the understanding of the investors about the performance of the funds.
- Introduction of nomination facility for the unit holders of mutual funds.
- Simplification of documentation procedure for FII registration and reduction of registration fee for FIIs.
- Memoranda of Understanding (MoUs) for co-operation and information sharing were signed with international regulators like Securities and Finance Commission of Mauritius and Securities and Exchange Commission of Sri Lanka.

During 2003-04

Issue Norms

In order to ensure the high quality of issuers accessing the primary securities market, SEBI has introduced an additional criteria of net tangible assets, minimum number of allottees in public issue and profitability.

Disclosure Requirements

With a view to making Indian primary market more disclosure based and comparable with international standards, amendments have been made to the Guidelines to add additional disclosures in the offer documents. The offer documents should contain information relating to financial statements as per the Indian Accounting Standards.

Amendments in Book Building Guidelines

In order to make price discovery process more realistic, immune from artificial demand and more responsive to market expectations, the companies have been provided with some flexibility in the indication of price band either movable or fixed floor price in the Red Herring Prospectus. Qualified institutional buyers (QIBs) have been prohibited from withdrawing their bids after the closure of bidding.

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.

Central Listing Authority

The Central Listing Authority has been set up with Shri M. N. Venkatachalaiah, former Chief Justice of India as its President. The aim of CLA is to ensure uniform and standard practices for listing the securities on stock exchanges.

Margin Trading

With a view to providing greater liquidity in the secondary securities market, SEBI has allowed corporate brokers with a net worth of at least Rs.3 crore to extend margin trading facility to their clients in the cash segment of stock exchanges.

The brokers may use their own funds or borrow from scheduled commercial banks or NBFCs regulated by RBI but the total indebtedness for this purpose should not exceed five times the net worth.

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.

Secondary Market for Corporate Debt Securities

With a view to providing greater transparency and protecting the interests of investors in debt securities, SEBI has prescribed new guidelines for regulating private placement of debt securities issued by the corporates.

Full disclosure (initial and continuing) as per Companies Act, 1956, SEBI (DIP) Guidelines, 2000 and Listing Agreement are to be made by the companies.

Credit rating of debt securities, appointment of debenture trustees, separate Listing Agreement, frequent furnishing of periodical reports to SEBI etc. have been made mandatory to enhance the protection of investors in debt instruments.

Central Database of Market Participants

With a view to promoting up-to-date information about all market participants, SEBI has made it mandatory for every intermediary, to make an application for allotment of unique identification numbers for itself and for its related persons, under the SEBI (Central Database of Market Participants) Regulations, 2003).

This will be made mandatory for investors and companies at a later date.

Additional Continual Disclosures

With a view to providing further transparency and mitigating impacts of rumours and speculation, the brokers have been advised to disclose the details of bulk deals. Stock exchanges were advised to amend Clause 41 of the Listing Agreement to make it mandatory for the listed companies to publish the number of investor complaints received, disposed of, unresolved alongwith their quarterly results.

Enhance Market Safety and Reduce Credit Risk

Clearing and settlement cycle time has been further contracted to T+2 with effect from April 1, 2003 and this measure is expected to result in faster settlement, higher safety and lower settlement risk in the Indian capital market.

Mutual Funds

With a view to strengthening the position, specifying accountability and protecting the interest of investors, SEBI has defined the roles of Chief Executive Officer and Fund Manager of mutual funds.

Regulatory practices should be fair to all concerned in the market place. In order to enhance fairness, a uniform cut-off time for calculating and applying NAVs, both for subscriptions and redemptions have been prescribed.

Skewed holdings in mutual funds schemes may lead to distortion. To avoid any distortion in the unit holding pattern and its impact, minimum number of investors in a scheme has been prescribed. Further, it has been specified that no single investor should hold more than 25 per cent of the corpus of any scheme/plan.

Opportunities for investing have been widened for mutual funds by allowing them to invest in derivative securities. They have also been permitted to invest up to 10 per cent of the net assets as on January 31 of each year in foreign securities with the limit of minimum US \$ 5 million and maximum of US \$ 50 million.

Derivatives Contracts Trading

To make Indian capital market more efficient and world class, new products have been permitted. Interest rate futures contracts were introduced in June 2003 and futures and options contracts on sectoral indices have been introduced in August 2003.

FII and NRI have been permitted to invest in all exchange traded derivative contracts.

Exchange traded derivatives contracts on a notional 10 year Government bond have been allowed for trading.

Stock brokers have been allowed to trade in commodity derivatives.

Foreign Institutional Investors (FIIs)

To strengthen the "know your client" regime and in the interest of greater efficiency of the market, it has been made mandatory for the FIIs, to report issuance/renewal/cancellation/redemption of off-shore derivatives instruments against underlying Indian securities. Issuance of such derivatives has been limited only to regulated entities.

FIIs have been allowed to participate in de-listing offers to afford an exit opportunity. They have also been allowed to participate in sponsored ADR/ GDR programmes.

FIIs have also been permitted to participate in divestment by the Government in listed companies.

With a view to making markets more competitive and compliant, SEBI has brought in the following new regulations:

- SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003
- SEBI (Ombudsman) Regulations, 2003
- SEBI (Central Listing Authority) Regulations, 2003
- SEBI (Central Database for Market Participants) Regulations, 2003
- SEBI (Self Regulatory Organizations) Regulations, 2004
- SEBI (Criteria For Fit and Proper Person) Regulations, 2004

As a measure of regulatory pro-activeness, the existing regulations were reviewed and the following amendment to regulations were notified:

- SEBI (Foreign Institutional Investors) (Amendment) Regulations, 2003
- SEBI (Mutual Funds) (Amendment) Regulations, 2003

- SEBI (Depositories and Participants) (Amendment) Regulations, 2003
- SEBI (Debenture Trustees) (Amendment) Regulations, 2003
- SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2003
- SEBI (Issue of Sweat Equity)(Amendment) Regulations, 2003
- SEBI (Stock Brokers and Sub-Brokers) (Amendment) Regulations, 2003
- SEBI (Stock Brokers and Sub-Brokers) (Second Amendment) Regulations, 2003
- SEBI (Procedure for Holding Enquiry and Imposing Penalty) (Amendment) Regulations, 2003
- SEBI (Ombudsman)(Amendment) Regulations, 2003
- SEBI (Foreign Institutional Investors) (Amendment) Regulations, 2004

During 2004-05

Allocation of Shares to Retail Individual Investors

- Allocation of shares to retail individual investors has been increased from 25 per cent to 35 per cent of the total issue of securities in case of book-built issues. The retail individual investor has been redefined as one who applies or bids for securities of or for a value not exceeding Rs. 1 lakh, as against the earlier limit of Rs. 50,000.

Issue Advertisement

- The SEBI Disclosure and Investor Protection (DIP) Guidelines, 2000 were amended in order to ensure better readability of the issue advertisements appearing on television and to reduce the cost incurred in publishing pre-issue advertisements. The pre-issue advertisement which was mandatory for all public issues (fixed and book-built) should now contain minimum details.

Introduction of Shelf Prospectus

- The facility of shelf prospectus was introduced for public sector banks, scheduled banks and public financial institutions. They can file a draft shelf prospectus in the first instance disclosing the aggregate amount they intend to raise through various tranches. Any amount of over-subscription can be retained by the issuer in each tranche subject to the overall limit set for the year.

Green Shoe Option

- With an objective to widen the facility of Green Shoe Option, the SEBI (DIP) Guidelines, 2000 were amended to make it available in case of all public issues, viz., initial public offerings, follow-on offerings, public issues either through book building or fixed price route. All pre-IPO shareholders (including promoters) in case of IPOs and pre-issue shareholders holding more than 5 per cent shares (including promoters) in case of follow-on offerings can lend their shares for the purpose of green shoe option.

Issue Norms

- The SEBI (DIP) Guidelines, 2000 on issue norms were amended to provide for a floor face value of Re. 1 per share in order to restrict the pre-IPO splitting of shares. The face value has to be necessarily Rs. 10 per share for issue price below Rs. 500 and in cases where the issue price is Rs. 500 or more, the issuer companies can fix the face value below Rs. 10 per share.
- The definition of the minimum application lot has been changed from Rs. 2,000 to a band of Rs. 5,000-Rs. 7,000. The applications can be made in multiples of such value.
- The DIP Guidelines for preferential allotment were amended to: (a) restrict sale of shares by shareholders who are allotted shares on preferential basis; (b) impose lock-in period on pre-preferential shareholding from the relevant date till six months after the date of allotment; (c) reduce the period for allotment from 30 to 15 days; and (d) facilitate corporate debt restructuring.

Corporate Governance

- To improve the standards of corporate governance, SEBI amended Clause 49 of the Listing Agreement. The major changes in the new Clause 49 include amendments/additions to provisions relating to definition of independent directors, strengthening the responsibilities of audit committees, improving quality of financial disclosures, including those pertaining to related party transactions and proceeds from public/rights/preferential issues, requiring Boards to adopt formal code of conduct, requiring CEO/CFO certification of financial statements and improving disclosures to shareholders. Certain non-mandatory clauses like whistle blower policy and restriction of the term of independent directors have also been included.
- The implementation schedule of the amended Clause 49 which was initially proposed to be effective from April 1, 2005 for listed companies has been extended to December 31, 2005.

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.

Rationalisation of Dematerialisation Charges

- The existing structure of dematerialisation charges has been rationalized to provide benefits to investors. With effect from February 1, 2005, certain charges paid by investors were removed which include charges towards opening of a Beneficiary Owner (BO) account, credit of securities into BO account and custody charge for BO account opened on or after February 1, 2005. With effect from April 1, 2005, the custody charges are not levied on any investor.

IndoNext

- The first phase of BSE IndoNext trading platform was inaugurated by the Honourable Finance Minister on January 7, 2005 to provide for a nation-wide trading platform for the small and medium enterprises (SMEs).

Implementation of STP

- Mandatory processing of all institutional trades executed on the stock exchanges through the Straight Through Processing (STP) was introduced with effect from July 1, 2004. This was in continuation of the efforts made by SEBI to ensure the inter-operability between the STP Service Providers through the setting up of STP Centralised Hub.

SEBI (STP Centralised Hub and STP Service Providers) Guidelines, 2004

- In order to regulate the STP service, SEBI (STP Centralised Hub and STP Service Providers) Guidelines, 2004 which also prescribed the model agreement between the STP centralized hub and the STP service providers. The STP Guidelines prescribe the eligibility criteria and conditions of approval, obligations and responsibilities and code of conduct for the STP centralized hub and the STP service providers.
- In consonance with the internationally accepted ISO 15022 messaging standards, standardized transaction work flow and messaging format for the STP system in India was specified by SEBI.

Derivatives

- In order to encourage the trading and clearing members of stock exchanges to use infrastructure of special electronic fund transfer (SEFT) facility as laid down by RBI to the extent possible, the members are now given a choice to opt for payment of mark-to-market margins, either before the start of trading next day *i.e.*, on T day, or on the next day *i.e.*, T+1. In case the members opt to pay mark-to-market margin on T day, no scaling up of initial margin would be applicable.
- Units of money market mutual funds and units of gilt funds were permitted to be accepted towards cash equivalent as part of the liquid assets of a clearing member.
- The eligibility criteria for indices on which futures and options are permitted to be introduced was modified to encourage the introduction of derivatives contracts on sectoral indices.

Foreign Institutional Investors (FIIs)

- The Union Government announced, within an overall External Commercial Borrowing (ECB) ceiling of US\$ 9 billion, a sub-ceiling of US\$ 1.75 billion for FII investment in dated Government securities and Treasury Bills, both under 100 per cent debt route and normal 70:30 route. Further, a cumulative sub-ceiling of US\$ 500 million for FII investment in corporate debt was announced over and above the sub-ceiling of US\$ 1.75 billion. Both the sub-ceilings are separate and not fungible.
- FII position limits in the equity index derivative contracts were revised. Accordingly, FII position limit in all index options and futures contracts on a particular underlying index shall be Rs. 250 crore (separately for futures and options) or 15 per cent of the total open interest of the market in index futures and index options, whichever is higher per exchange.

- The frequency of reporting of offshore derivative instruments by registered foreign institutional investors has been made monthly.
- The mutual funds and FIs have been advised to enter the Unique Client Code (UCC) pertaining to the parent entity at the order entry level and enter the UCCs for their individual schemes/sub-accounts on the post-closing session.

SMILE Task Force

- A Securities Markets Infrastructure Leveraging Expert Task Force (SMILE Task Force) was constituted by SEBI to carry out a thorough 'health check' on the securities markets infrastructure encompassing all segments of the markets (viz. equities, debt, derivatives, fund products) and covering all market participants such as exchanges, trading platforms, clearing and settlement systems, payment systems, depositories, issue houses (registrars) and other intermediaries. The Task Force has submitted reports on "Infrastructure and Process Flow for the Primary Market" and "Infrastructure and Process Flows for Enhancing Distribution Reach in the Mutual Fund Industry". The Reports are under consideration of SEBI for implementation.

MoU Signed with Overseas Regulators

- Securities and Exchange Board of India (SEBI) signed a Memorandum of Understanding (MoU) with United States Commodity Futures Trading Commission (CFTC) at Washington on April 28, 2004. This is the sixth MoU that SEBI had signed with its international counterparts for strengthening communication channels and establishing a framework for assistance and mutual co-operation between the two organizations.

In order to fine-tune the regulatory requirements, regulations amended during 2004-05 are as follows:

- SEBI (Venture Capital Funds) (Amendment) Regulations, 2004.
- SEBI (Foreign Venture Capital Investors) (Amendment) Regulations, 2004.
- SEBI (Central Database of Market Participants) (Amendment) Regulations, 2004.
- SEBI (Portfolio Managers) (Amendment) Regulations, 2004.
- SEBI (Depositories and Participants) (Amendment) Regulations, 2004.
- SEBI (Buy-back of Securities) (Amendment) Regulations, 2004.
- SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) (Amendment) Regulations, 2004.
- SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2004.
- SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) (Second Amendment) Regulations, 2004.
- SEBI (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2004.

- SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) (Third Amendment) Regulations, 2004.

Amendments to the existing laws entail a detailed procedure. Pending amendment to existing laws, regulatory pro-activeness was reflected through the following set of notifications:

- Notification under Sub-Regulation (1) of Regulation 6 of Securities and Exchange Board of India (Central Database of Market Participants) Regulations.
- Notification under Sub-Regulation (2) of Regulation 6 of Securities and Exchange Board of India (Central Database of Market Participants) Regulations.
- Notification under Sub-Regulation (1) and (3) of Regulation 6 of Securities and Exchange Board of India (Central Database of Market Participants) Regulations.
- Notification under Sub-Regulation (1) of Regulation 5A of Securities and Exchange Board of India (Central Database of Market Participants) Regulations.
- Notification under Sub-Regulation (1) of Regulation 4 and Sub-Regulation (1) and (2) of Regulation 6 of Securities and Exchange Board of India (Central Database of Market Participants) Regulations.

During 2005-06

I. Primary Securities Market

Specific Allocation for Mutual Funds

- Within the category of Qualified Institutional Buyers (QIBs), there was no specific allocation for any group in case of book built issues. In order to increase the retail participation through mutual funds, SEBI introduced a specific allocation of 5 per cent within the QIB category with effect from September 19, 2005. The mutual funds are also eligible for allotment from the balance available for the QIB category.

Proportionate Allotment to QIBs

- In an effort to provide level playing field and also to prevent misuse of discretion exercised by the merchant bankers in the process of allocation of shares, it was decided that the allotment to QIBs shall also be made on a proportional basis.

Margin Requirement for QIBs

- Although, there was no regulatory stipulation as regards the proportion of margin to be collected from the subscribers to a public issue, in practice, 100 per cent margin was collected from the non-institutional investors while the institutional investors did not give any margin. As a move towards level playing field, SEBI introduced a 10 per cent margin on QIB bids.

ECS Facility for Public Issue Refunds

- In order to ensure faster and hassle-free refunds, it was decided to extend the facility of electronic transfer of funds to public issue refunds, initially at 15 centers where clearing houses are managed by RBI.

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.

Introduction of Optional Grading of IPO

- With a view to assisting the investors, particularly the retail investors, SEBI has given in-principle approval for grading of IPOs by the rating agencies at the option of the issuers. SEBI will not certify the assessment made by the rating agencies.

Rationalisation of Disclosure Requirements for the Listed Companies

- Under the Listing Agreement, a listed company is required to make continuous disclosures to the stock exchanges. In order to rationalise the disclosure requirements, it was decided to do away with the repetitive disclosures in case of rights issues and public issues by the listed companies which have a satisfactory track record of filing periodic returns with the stock exchanges and have a comprehensive mechanism for satisfactory redressal of investor grievances.

Abridged Letter of Offer

- In order to bring uniformity in the practice of making available abridged offer documents, it was decided to permit an issuer company making a rights issue, to despatch an abridged letter of offer which shall contain disclosures as required to be given in the case of an abridged prospectus.

Disclosure of Issue Price

- In case of a fixed price issue, a company is required to disclose the issue price or the price band in the offer document filed with SEBI. In order to provide flexibility, it was decided to allow a listed company to fix and disclose the issue price in case of a rights issue any time prior to fixing of the record date in consultation with the designated stock exchange, and in case of public issue through fixed price route, at any time prior to filing of prospectus with the Registrar of Companies.

Further Issue of Shares

- Further issue of capital by a company, after filing a draft offer document with SEBI, was prohibited till the listing of shares that are referred to in the offer document. In order to facilitate additional resource mobilisation, a company has been permitted to issue further shares, provided full disclosures as regards the total capital to be raised from such further issues are made in the draft offer document.

Corporate Governance of Listed Companies

- Under Clause 49 of the Listing Agreement, listed companies were advised to comply with the revised guidelines on corporate governance, including appointment of the independent directors. Initially the compliance date was April 1, 2005, which was subsequently extended to December 31, 2005. Without further extension of the deadline, a few clarifications were given in January 2006 relating to maximum gap between two Board meetings, sitting fees of the non-executive directors and certification on internal control system by the CEO/CFO.

II. Secondary Securities Market

Separate Window for Execution of Block Deals

- In order to facilitate execution of large trades without impacting the market, the stock exchanges were allowed to provide a separate trading window for block deals subject to certain conditions. BSE and NSE activated this window with effect from November 14, 2005.

Review of Dematerialisation Charges

- In order to enable an investor, who is not satisfied with the services of a DP, to shift his Beneficiary Owner (BO) account to another DP, SEBI advised the depositories/DPs not to levy any charges when a BO transfers all his securities lying in his account to another branch of the same DP or to another DP of the same depository or another depository, provided the BO accounts at the transferee DP and at transferor DP are one and the same.

Activation of ISINs of Initial Public Offerings (IPOs)

- There is a time gap of about four to five days between the crediting of securities to a Beneficiary Owner's account and the commencement of trading. The time gap was utilised by a few investors to indulge in offmarket trades prior to the commencement of trading. In order to prevent such transactions, SEBI advised depositories that, in case of IPOs, the ISINs of securities should be activated only on the date of commencement of trading on the stock exchanges.

SEBI (Central Database of Market Participants) Regulations, 2003

- Following recommendations of the Jagdish Capoor Committee, it was decided to resume registration under the MAPIN regulations in phases and obtain the Unique Identification Number (UIN) with biometric impression for a trade order value of Rs. 5 lakh and above. For trade order of value less than Rs. 5 lakh, a choice is given to the investors (natural persons) to provide either the Permanent Account Number (PAN) of the Income Tax Department or UIN obtained under MAPIN. Pending implementation of the above decision, PAN has been made compulsory for all categories of investors for opening a demat account with effect from April 1, 2006. The existing demat account holders are required to submit details of PAN by September 30, 2006.

Discontinuation of Hand Delivery Bargains/Delivery versus Payment

- In order to streamline the settlement system, consistent with IOSCO recommendations, transactions executed on the stock exchanges would be necessarily settled through the clearing corporation/clearing house of the stock exchanges. The earlier practice of Hand Delivery Bargains/Delivery versus Payment (DvP) was discontinued with effect from September 19, 2005.

Guidelines for Issuing Electronic Contract Notes

- In order to provide further safeguard to the issuance of contract notes, additional conditions were prescribed such as sending of Electronic Contract Notes (ECNs) to a designated e-mail ID and retention of acknowledgements of receipt/proof of delivery only to such clients who have consented for the same. Wherever the ECNs have not been delivered or have been rejected by the e-mail ID of the client, the broker is obligated to send the physical contract note(s) within the stipulated time under the extant SEBI guidelines.

Shifting of Securities from Trade-for-Trade Segment to Rolling Settlement

- On the basis of information as regards connectivity of companies provided by the depositories, stock exchanges were advised to shift the shares of certain companies from trade-for-trade segment to rolling settlement subject to their having at least 50 per cent of non-promoter holdings in demat mode as per Clause 35 of the Listing Agreement.

Committee to Study the Future of Regional Stock Exchanges

- A Committee was set up under the Chairmanship of Shri G. Anantharaman, Whole Time Member, SEBI to review and examine the future of the Regional Stock Exchanges (RSEs) - post-demutualisation. According to the terms of reference, the Committee has to deliberate and advise on the future role of RSEs, manner of dealing with assets in the event of withdrawal of recognition and the process of divestment of shareholding.

Policy Initiatives for Derivatives

- Based on the recommendations of the Secondary Market Advisory Committee, the trading member position limit for stock based derivatives has been revised.
- Derivatives can be introduced on stocks of large companies undergoing corporate restructuring on the first day of listing subject to certain conditions.

Corporatisation and Demutualisation (C and D) of Stock Exchanges

- In order to expedite the Corporatisation and Demutualisation of stock exchanges, SEBI approved and notified the C and D schemes of 19 stock exchanges during 2005-06. The NSE and OTCEI have been exempted from submitting the C and D schemes as they were already notified as corporatised and demutualised stock exchanges vide notification dated March 23, 2005 and September 15, 2005, respectively.

III. Mutual Funds

Gold Exchange Traded Funds in India

- Pursuant to the announcement made by the Honourable Finance Minister in his Budget Speech for 2005-06, SEBI appointed a Committee for the introduction of Gold Exchange Traded Fund (GETF) in India. Based on the recommendations of the said Committee, the SEBI (Mutual Funds) Regulations, 1996 were amended and notification was issued on January 12, 2006 permitting mutual funds to introduce GETFs in India subject to certain investment restrictions.

Minimum Number of Investors in Scheme(s)/Plan(s) of Mutual Funds

- According to the SEBI Guidelines dated December 12, 2003, every mutual fund scheme should have a minimum of 20 investors and holding of a single investor should not be more than 25 per cent of the corpus. SEBI clarified that this stipulation is applicable at the portfolio level. Moreover, if there is a breach of 25 per cent limit by an investor over the quarter, a rebalancing period of one month would be allowed.

Unique Client Code (UCC) for Mutual Fund Scheme(s)/Plan(s)

- In order to facilitate the unit holders to claim tax benefit associated with the payment of Securities Transaction Tax (STT), it was decided to allow mutual funds to share the unique client code of their schemes/plans with their unit holders.

Investments in ADRs, GDRs and Foreign Securities by Mutual Funds

- Mutual funds were permitted to invest in ADRs, GDRs and foreign securities. In case disclosures to this effect were not made in the offer document, all mutual funds were advised to send a written communication to the investors about the proposed investment.

Review of Time Limit for Updating NAV on AMFI Website

- In view of the difficulties faced by mutual funds, the time limit for uploading the net asset value (NAV) on the AMFI website was extended from 8 p.m. to 9 p.m.

Venture Capital Funds

- The Venture Capital Funds were allowed to invest in securities of foreign companies subject to the conditions stipulated by RBI and SEBI from time to time.

IV. Foreign Institutional Investors (FIIs)

FII Investment in Debt Securities

- The outstanding limit for FII investment in debt securities for 2006-07 has been revised upward by the Government within the overall limit of External Commercial Borrowings (ECBs). While such limit for Government Securities (including Treasury Bills) was raised from US \$ 1.75 billion to US \$ 2.00 billion, the same for the corporate debt had been increased from US \$ 0.5

billion to US \$ 1.5 billion. The sub-ceilings continued to remain separate and not fungible.

V. Corporate Restructuring

Takeovers

- In order to provide flexibility to corporate restructuring, SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 is being amended which include, *inter alia*, removal of restrictions on market purchases and preferential allotments. The outgoing shareholders can sell entire stake to the incoming acquirer in case of takeover. However, if the target company's minimum public shareholding falls below the prescribed minimum, the restoration should take place through a framework provided by the revised Clause 40A of the Listing Agreement.

Delisting of Securities

- In order to simplify the existing framework, the SEBI (Delisting of Securities) Guidelines, 2003 were amended, making it possible for stock exchanges to delist the shares of errant companies which are not complying with the Listing Agreement.

VI. Regulatory Amendments

- In order to fine-tune the regulatory requirements, following regulations were amended during 2005-06:
- SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) (Amendment) Regulations, 2005.
- SEBI (Mutual Funds) (Amendment) Regulations, 2006.
- SEBI (Custodian of Securities) (Amendment) Regulations, 2006.
- SEBI (Venture Capital Funds) (Amendment) Regulations, 2006.

During 2006-07

I. Primary Securities Market

Continuous Listing Requirement: Minimum Level of Public Shareholding

To enable a minimum level of public shareholding, listed companies will now be required to maintain minimum level of public shareholding at 25 per cent of the total shares issued for continued listing on stock exchanges. Exemptions are provided to companies which are required to maintain at least 10 per cent but less than 25 per cent in accordance with the Rule 19 (2) (b) of the Securities Contracts (Regulation) Rules, 1957 and to companies that have two crore or more number of listed shares, and market capitalisation of Rs. 1,000 crore or more.

Optional IPO Grading

SEBI framed Guidelines relating to disclosure of grading of the Initial Public Offer (IPO) by issuer companies who may want to opt for grading of their IPOs by the rating agencies. If the issuer companies opt for grading, then they are required to disclose the grades, including the unaccepted ones, in the prospectus.

Guidelines for Issue of Indian Depository Receipts (IDRs)

SEBI issued Guidelines on disclosures and related requirements for companies desirous of issuing IDRs in India. SEBI also prescribed the listing agreement for entities issuing IDRs.

Qualified Institutions' Placement (QIP)

SEBI issued directions for the issuing companies, relating to Qualified Institutions' Placement, to pave the path for a fast and cost-effective way of raising resources from Indian securities market.

Corporate Bond Market – Launch of Reporting Platform

SEBI directed, both BSE and NSE, to introduce a trade reporting platform for corporate bonds.

Common Platform for Electronic Filing and Dissemination of Information Relating to Listed Companies

At the instance of SEBI, BSE and NSE jointly launched a common portal www.corpfiling.co.in on January 01, 2007, for dissemination of filings made by companies listed on these exchanges, in terms of the listing agreement.

II. Secondary Securities Market

Value at Risk (VaR) Margining in Cash Market

It was decided to update the applicable VaR margins in the cash market at least five times in a day instead of only at the end of the trading day and then apply it to the open positions for the subsequent trading day, as practised in the derivatives market.

Mandatory Requirement of PAN for Trading in the Cash Market

In order to further strengthen Know Your Client (KYC) norms in the cash market and to generate a reliable audit trail, PAN was made mandatory for all transactions in the cash market with effect from January 01, 2007.

Mandatory Requirement of PAN for Opening and Operating Demat Accounts

PAN was made mandatory for all demat accounts, opened after April 01, 2006, pertaining to all categories including minors, trusts, foreign corporate bodies, banks, corporates, FIIs, and NRIs. For demat accounts that existed prior to April 01, 2006, time for furnishing and verification of PAN card details was extended upto December 31, 2006.

Standing Committee for Addressing Problems in Computerised Trading

The stock exchanges were advised to set up Standing Committees to investigate the problems in computerised trading system, such as, hanging, slowdown, breakdown, and any other problem. The matter would be referred to respective Standing Committee, even if, the duration of disruption is less than five minutes.

Dissemination of Tariff/Charge Structure of Depository Participants (DPs)

Following the representations made by investors, on different charge/tariff

structure of various DPs, it was decided that the DPs will immediately inform respective depositories, about any change in charge/tariff structure. The depositories were directed to display charge/tariff structure of various DPs on their websites to help investors in taking informed decisions.

Safeguards to Address the Transfer of Securities of the Investors

A large number of representations were received from investors relating to transfer of securities from Beneficiary Owners' (BOs) Account without proper authorisation. Accordingly, the DPs were instructed to put in place adequate safeguards.

Policy Initiatives for Derivatives

Procedure for re-introduction of derivatives contracts and modified position limits were reviewed by the Secondary Market Advisory Committee (SMAC). Further, based on a decision taken by SEBI Board, Derivatives Market Review Committee was set up to carry out a comprehensive review of developments and to suggest future directions for derivatives market in India.

Corporatisation and Demutualisation (C & D) of Stock Exchanges

SEBI notified Securities Contracts (Regulation) (Manner of Increasing and Maintaining Public Shareholding in Recognised Stock Exchanges) Regulations, 2006 on November 13, 2006, whereby the recognised stock exchanges were directed to ensure that at least 51 per cent of its equity share capital is held by public, either by fresh issue of equity shares to the public, through issue of prospectus or through (i) offer for sale, (ii) placement of shares to institutions, (iii) issue of equity shares on private placement, and (iv) any combination of the above.

III. Mutual Funds

Rationalisation of Initial Issue Expenses and Dividend Distribution Procedures

To contain frequent churning in mutual fund schemes, close-ended schemes were permitted to charge initial issue expenses to the scheme while open-ended schemes can charge only entry load for the purpose of meeting the expenses connected with sales and distribution of schemes. Dividend distribution procedures were also specified by SEBI. Notice to be issued to public within one calendar day of the decision by the trustees on dividend distribution.

Undertaking from Trustees for New Scheme Offer Document

To address concerns regarding launch of similar products, mutual fund trustees were directed to certify that the scheme approved by them is a new product and it is not a minor modification of existing scheme/product.

Investment in ADRs/GDRs/Foreign Securities and Overseas Exchange Traded Funds (ETFs)

Following the Finance Bill 2006-07 and subsequent raising of limit by RBI, the maximum ceiling for individual mutual funds to invest in ADRs/GDRs issued by Indian companies, equity of overseas companies listed on recognised stock exchanges overseas and rated debt securities was raised from USD 50 million to USD 100

million. Subsequently, the limit was further raised to USD 150 million. Mutual funds were also advised to appoint a dedicated fund manager for making such investments.

Introduction of Capital Protection Oriented Schemes

SEBI (Mutual Funds) Regulations, 1996 were amended to permit launch of Capital Protection Oriented schemes.

Uniform Cut-off Timing for Applicability of Net Asset Value (NAV)

Following the various systemic changes made by RBI in money market the cut-off timings for applicability of NAV, in case of purchases and redemptions of liquid schemes, were revised.

Dispatch of Statement of Accounts

SEBI directed mutual funds to dispatch the statement of accounts to the unit holders under Systematic Investment Plan (SIP) / Systematic Transfer Plan (STP) / Systematic Withdrawal Plan (SWP) once every quarter ending March, June, September and December, within 10 working days of the end of the respective quarter. SEBI also advised mutual funds to provide statement of accounts to the unit holders, who have not transacted during the last six months, to ensure better information dissemination.

Launch of Gold Exchange Traded Funds (GETFs)

SEBI amended SEBI (Mutual Funds) Regulations, 1996 to specify the methodology for valuation of gold for the purpose of GETFs. Accordingly, the gold held by a GETF scheme shall be valued at the AM fixing price of London Bullion Market Association (LBMA) in US dollars per troy ounce for gold having a fineness of 995.0 parts per thousand, subject to prescribed adjustments. Two GETF schemes were launched during the year, offering investors better diversification opportunity.

Real Estate Mutual Fund

SEBI Board approved the draft guidelines for Real Estate Mutual Funds (REMFs). REMF means a scheme of a mutual fund which has investment objective to invest directly or indirectly in real estate property and shall be governed by the provisions and guidelines under SEBI (Mutual Funds) Regulations.

IV. Foreign Institutional Investors (FIIs)

Investment in Debt Securities

The investment limit for FIIs in Government Securities (including Treasury Bills) was raised from USD 2 billion to USD 2.6 billion by RBI. The list of eligible investment categories of FIIs was enlarged to allow more participation in Indian securities market.

V. Regulatory Developments

The following rules were rescinded during 2006-07:

- SEBI Intermediary Rules (Stock Brokers and Sub-brokers, 1992; Merchant Bankers, 1992; Underwriters, 1993; Portfolio Managers, 1993; Debenture Trustees, 1993; Registrars to an Issue and Share Transfer Agents, 1993 and Bankers to an Issue, 1994).

- Amendment to SEBI (Procedure for Holding Inquiry and Imposing Penalty by Adjudicating Officer) Amendment Rules, 1995, to provide for appointment of presenting officer by SEBI in adjudication proceedings.

The following Regulations were framed during 2006-07:

- SC(R) (Manner of Increasing and Maintaining Public Shareholding in Recognised Stock Exchanges) Regulations, 2006
- SEBI (Regulatory Fee on Stock Exchanges) Regulations, 2006

During 2007-08

I. Primary Securities Market

(A) Introduction of Fast Track Issues (FTIs)

Fast Track issues has been introduced 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 on satisfying certain specified requirements to make Fast Track Issues (FTIs).

(B) Amendments To Equity Listing Agreement

1. Insertion of New Clause 43A

New Clause 43A has been added to the listing agreement, requiring the companies to file deviations in the use of public issue proceeds and to appoint monitoring agency to monitor utilisation of proceeds etc.

2. Clause 49

Clause 49(sub Clause (II)(D) and (IV)(D) has been amended covering the following:

- (a) The issuer company is required to place the monitoring report in respect of utilisation of issue proceeds filed with it by monitoring agency before the Audit Committee.
- (b) The issuer company shall be required to inform material deviations in the utilisation of issue proceeds to the stock exchange.
- (c) The issuer company is required to make the material deviations/ adverse comments of the Audit Committee/Monitoring Agency public thorough advertisement in news papers.

3. Insertion of New clause 52

- (a) SEBI has decided to phase out EDIFAR gradually in view of a new portal viz. Corporate Filing and Dissemination System (CFDS) put in place jointly by BSE and NSE at the URL www.corpfilling.co.in.
- (b) Accordingly the listed companies are required to file information with the stock exchange only through CFDS.
- (c) The compliance officer, appointed under Clause 47(a) and the company shall be responsible for ensuring the correctness, authenticity and comprehensiveness of the information, statements

and reports filed under this clause and also for ensuring that such information is in conformity with the applicable laws and listing agreement. [Clause 52(1)(b)]

(C) Grading of IPO has been made mandatory.

II. Secondary Securities Market

(A) Short selling and securities lending and borrowing

In order to provide a mechanism for borrowing of securities to enable settlement of securities sold short, it has also been decided to put in place a full-fledged securities lending and borrowing (SLB) scheme for all market participants in the Indian securities market under the over-all framework of "Securities Lending Scheme, 1997"

(B) Introduction of mini derivative (Futures & Options) contract on Index (Sensex & Nifty)

Mini derivative contract on Index (Sensex and Nifty) with a minimum contract size of Rs. 1 lakh at the time is introduced.

(C) PAN has been made as the sole identification number for all transactions in the securities market.

III. Mutual Funds

- Waiver of load for direct applications
- No entry load will be charged for direct applications received by the Asset Management Company (AMC) i.e. applications received through internet, submitted to AMC or collection centre/Investor Service Centre that are not routed through any distributor/agent/broker.

IV. Regulatory Developments

- (A) Guidelines for consent orders for considering request for composition of offences has been introduced.
- (B) Securities and Exchange Board of India (Certification of Associated Persons in the Securities Markets) Regulations, 2007 introduced.

During 2008-09

Primary Market

The amendments to the SEBI (Disclosure and Investor Protection) Guidelines, 2000 included the following:

- Regulatory Stipulation on an unlisted company making an IPO to compulsorily list the securities being issued through IPO on stock exchanges having nationwide terminals.
- Introduction of concept of anchor investors in Public issues through Book Building.
- Introduction of a supplementary process of applying in public issues, viz., the "applications supported by blocked amount" (ASBA) process for IPO applications to ensure that the funds are debited from the investors' accounts

only upon confirmed allotment of securities and only to the extent of allotment made to the investor. The ASBA process was also extended to rights issues.

- Timeline for completion of bonus issues by listed companies stipulated at 15 days from the date of approval by the board of directors of the issuer (in case shareholders' approval is not required) and at 60 days from the date of meeting of the board of directors wherein the bonus was announced subject to shareholders' approval.
- Abolition of No delivery period for all types of Corporate Actions in respect of the scrips which are traded in Compulsory demat mode.
- Expansion of the eligibility criteria for listed companies desirous of making Qualified Institutional Placement (QIP) to cover companies, which have been listed during the preceding one year pursuant to approved scheme(s) of merger/ demerger/ arrangement entered into with companies which have been listed for more than one year in such stock exchange(s).
- Modification in the pricing guidelines for QIP through change in the floor price formula and definition of relevant date and extending these guidelines to preferential allotment to QIBs, provided that the number of QIB allottees in such preferential allotment does not exceed five.
- The lock-in period of shares in preferential allotment, pursuant to exercise of warrants to be the full lock-in period of one year or three years, as the case may be, from the date of allotment of such shares.
- Permission to a listed company to make a combined offering of Non-Convertible Debentures (NCDs) with warrants through the QIP mechanism. NCDs and warrants issued pursuant to a combined offering can be listed and traded separately. The minimum contract value for trading of NCDs/ warrants was set at Rs.1 lakh.
- A simplified listing agreement for debt securities prescribed.
- A Simplified listing agreements for Indian Depository Receipts was introduced.
- 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.
- Grading of IPO has been made mandatory. 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 securities in India.
- Existing format to submit information pertaining to the activities by RTI/STA has been modified. The Registrar to Issue /Share transfer agents to submit the quarterly reports to SEBI in electric form only and the submission of such reports in hard copy shall be dispensed with.
- The issuer making an initial public offer permitted to announce the floor price

or price band after the date of registration of the Red Herring Prospectus with the Registrar of companies, at least two working days before the issue opening date.

- Listing of following securities by a listed issuer relaxed from the requirement of Rule 19(2)(b):
 - (i) Equity shares with differential rights as to dividend, voting or otherwise offered through rights or bonus issue.
 - (ii) Warrants issued along with Non Convertible Debentures through Qualified Institutions Placement.
- SEBI made it mandatory on the part of promoters (including promoter group) to disclose the details of pledge of shares held by them in listed entities promoted by them.

Equity Listing Agreement

Clause 5A – Uniform procedure prescribed for dealing with unclaimed shares providing for:

- (a) Creation of demat suspense account
- (b) Crediting of corporate benefits which is accruing on unclaimed shares such as bonus, split, etc.
- (c) Details of shareholding of individual allottee and the allottee's account shall be credited as and when he/she approaches.

Clause 16, 19 – Reduction in timelines for rights issues like the notice period required for calling a board meeting of the issuer to consider the rights issue; and the period stipulated for completion of allotment and commencement of listing and trading of the shares so issued. SEBI has reduced the current timelines, related to Right Issue as follows:

- Notice period for Board Meeting from 7 working days to 2 working days
- Notice period for record Date from 15/21/30 days to 7 working days
- Issue Period from Minimum 30 days to Minimum 15 days to maximum 30 days Minimum 15 days to maximum 30 days
- Completion of Post issue from 42 days to 15 days

Clause 20A – All listed companies have been required to declare their dividend on per share basis only.

Clause 24 – A listed/unlisted company which are getting merged have been required to appoint an independent merchant banker for giving a fairness opinion on the valuation done by the valuers to safeguard the interest of shareholders.

Clause 28A – A Listing Company can not issue shares in any manner which may confer on any person, superior rights as to voting or dividend vis-à-vis the rights on equity shares that are already listed.

Clause 35 – The format for reporting the shareholding pattern shall include details of shares pledged by promoters and promoter group entities, as specified.

Clause 41 – SEBI has modified clause 41 in order to bring more efficiency in the disclosure of financial results like amending:

- (i) The time limit for submission and publication of financial results to the stock exchange.
- (ii) Limited review to be placed before the Board of Directors.
- (iii) Submission of limited review report in case of last quarter.

Clause 43A – New Clause 43A has been added to the listing agreement, requiring the companies:

- to file deviations in the use of public issue proceeds
- to appoint monitoring agency to monitor utilization of proceeds etc.

Clause 49 – If the non-executive chairman is a promoter or is related to promoters or persons occupying management positions at the board level or at one level below the board, at least one- half of the board of the company should consist of Independent Director.

- The minimum age for Independent Directors shall be 21 years.
- The gap between resignation/removal of an Independent Director and appointment of another Independent Director in his place shall not exceed 180 days. However, this provision is not applicable to companies who fulfill the minimum requirement of Independent Director.
- Disclosures of relationship between directors inter-se shall be made in the Annual Report, notice of appointment of a director, prospectus and letter of offer.
- The issuer company is required to
 - (i) Place the monitoring report in respect of utilization of issue proceeds filed with it by monitoring agency before the Audit Committee.
 - (ii) Inform material deviations in the utilization of issue proceeds to the stock exchange.
 - (iii) Make the material deviations/adverse comments of the Audit Committee.
- Non-Mandatory provisions has been introduced if the Independent director has the requisite qualifications and experience which would be use to the company and which, in the opinion of the company would enable him to contribute effectively to the company in his capacity as an Independent Director.

Clause 52 – SEBI has decided to phase out EDIFAR gradually in view of a new portal viz. Corporate Filing and Dissemination System (CFDS) put in place jointly by BSE and NSE at the URL www.corpfiling.co.in. Accordingly the listed companies are required to file information with the stock exchange only through CFDS. The compliance officer, appointed under Clause 47(a) and the company shall be

responsible for ensuring the correctness, authenticity and comprehensiveness of the information, statements and reports filed under this clause and also for ensuring that such information is in conformity with the applicable laws and listing agreement. [Clause 52(1)(b)]

Secondary Market

The salient policy initiatives concerning the secondary market segment were:

- The broad framework for short selling and securities lending and borrowing (SLB) scheme for all market participants was operationalized with effect from April 21, 2008. The key modifications made to SLB Scheme included an increase in tenure for SLB to 30 days from 7 days, extending the time for SLB session to the normal trade timings of 9:55 am to 3:30 pm, and allowing margins in SLB in the form of cash and cash equivalents.
- Margining of institutional trades was made mandatory with effect from April 21, 2008 and collection of margins from institutional investors on a T+1 basis.
- Direct Market Access facility was introduced for institutional investors, allowing brokers to offer clients direct access to the exchange trading system through the broker's infrastructure without manual intervention by the broker, subject to proper risk management of clients by the broker.
- The cross margining facility was extended to all market participants for offsetting positions in cash and derivatives market.
- The Securities Contracts –Manner of Increasing and Maintaining Public Share holding in recognized stock exchanges” (MIMPS) Regulation 2006 was amended to allow six categories of shareholders namely, public financial institutions, stock exchanges, depositories, clearing corporations, banks and insurance companies to hold directly or indirectly up to 15 per cent of the paid-up equity share capital of the concerned stock exchange. Any shareholder other than the aforesaid six categories of investors can hold directly or indirectly not more than 5 per cent of the paidup equity share capital of a stock exchange.
- Approval was granted to NSE and BSE for operational zing the exchange traded currency derivatives segment; and MCX Stock Exchange Ltd. was recognized as a stock exchange for a period of one year commencing on September 16, 2008 for operationalizing the exchange traded currency derivatives segment only.
- Broad guidelines were approved for providing an exit option to regional stock exchanges whose recognition is withdrawn and/or renewal of recognition is refused by SEBI and those exchanges that are desirous of surrendering their recognition.
- Framework for recognition and supervision of stock exchanges/platforms of stock exchanges for small and medium enterprises was specified by SEBI.
- A director, nominated by an institution as its representative on the Board of Directors, is eligible to participate in the ESOS of the company subject to

certain conditions. Accounting Treatment prescribed by SEBI, for options brought in line with the accounting treatment provided by ICAI.

- SEBI notified the SEBI (Intermediaries) Regulation, 2008 for putting in place a comprehensive regulation applicable to all intermediaries. The registration process has been simplified. The fit and proper criteria has been modified to make it principle based. Apart from specifying common code of conduct, the registration granted to intermediaries was made permanent subject to the compliance of the SEBI Act, regulations, updation of relevant disclosures and payment of fees. Procedure for action in case of default and manner of suspension or cancellation of certificate has been simplified to shorten the time faced by the parties without compromising with the right of reasonable opportunity to be heard. The procedure for surrender of certificate has been simplified.
- In terms of an amendment to the SEBI (Depositories and Participants) Regulations, 1996, the requirement of the depositories to ensure payments before effecting the transfer in the demat system was dispensed with, as the Depositories Act did not cast an obligation on the depositories to ensure that payment had been made in respect of transfer of security.
- An amendment to SEBI (Portfolio Managers) Regulations, 1993 on August 11, 2008 relaxed the criteria for considering the application for registration as portfolio manager and increased the net worth for carrying portfolio management service from Rs. 50 lakh to Rs. 2 crore.
- The SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 was amended on August 11, 2008 for facilitating the trading in currency derivatives on the platform of stock exchanges.
- The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 was amended on October 30, 2008. It was clarified that no acquirer, who together with persons acting in concert with him held 55 per cent or more but less than 75 per cent of the shares or voting rights in a target company, should acquire either by himself or through persons acting in concert with him any additional shares entitling him to exercise voting rights unless he made public announcement in accordance with the regulations.
- SEBI notified the SEBI (Investor Protection and Education Fund) Regulations, 2009, with a view to strengthening its activities for investor protection. The Fund shall be used for the protection of investors and promotion of investor education and awareness, in ways like:-
 - (a) educational activities including seminars, training, research and publications, aimed at investors;
 - (b) awareness programmes through media - print, electronic, aimed at investors;
 - (c) funding investor education and awareness activities of investors' associations recognized by the Board;
 - (d) aiding investors' associations recognized by the Board (SEBI) to undertake legal proceedings in the interest of investors in securities that are listed or proposed to be listed.

- The Government notified the Rules for the Delisting Framework. The delisting Rules inter- alia provide grounds for voluntary as also compulsory delisting.
- Securities and Exchange Board of India (SEBI) notified the SEBI (Delisting of Equity Shares) Regulations, 2009.

Mutual Funds

Some of the important initiatives relating to mutual funds were:

- Allow existing mutual fund schemes to engage in short selling of securities as well as lending and borrowing of securities after making additional disclosures including risk factors in the Scheme Information Document.
- SEBI guidelines for parking of funds in short term deposits of scheduled commercial banks were not to apply to term deposits placed as margins for trading in cash and derivatives market.
- The aggregate ceiling for overseas investments by mutual funds was enhanced from US\$ 5 billion to US\$ 7 billion.
- The amendments to the SEBI (Mutual Funds) Regulations, 1996 with regard to Real Estate Mutual Funds included the following:
 - Sponsors seeking to set up new mutual funds, for launching only real estate mutual fund schemes, shall be carrying on business in real estate for a period not less than five years. They shall also fulfill all other eligibility criteria applicable for sponsoring a mutual fund.
 - An existing mutual fund may launch a real estate mutual fund scheme if it has an adequate number of key personnel and directors having adequate experience in real estate.
 - A real estate mutual fund scheme is required to be close-ended and its units shall be listed on a recognized stock exchange.
 - A real estate mutual fund shall invest at least 35 per cent of the net assets of the scheme directly in real estate assets.
 - The AMC, its directors, the trustees and the real estate valuer shall ensure that the valuation of assets held by a real estate mutual fund scheme is done in good faith in accordance with the norms specified.
 - In order to bring about uniformity in the contents of Abridged Scheme-wise Annual Report prepared by the mutual funds, a new format was prescribed.
 - It was decided that in case of large applications for purchase of income/ debt oriented schemes other than liquid fund schemes with amount equal to or more than Rs. 1 crore, the closing NAV of the day on which the funds were available for utilization would be applicable.
 - The units under close-ended schemes are required to be mandatorily listed. It was stipulated that a close-ended debt scheme shall invest only in such securities which mature on or before the date of the maturity of the scheme.

- It was decided in October 2008 to enhance on a case to case basis the prescribed borrowing limit of mutual funds to 40 per cent of the net assets for a period of six months to enable them to meet the redemption requests in an orderly manner.
- It was mandated that liquid fund schemes and plans should make investment in/purchase debt and money market securities with maturity up to 182 days only w.e.f. February 1, 2009 and in such instruments with maturity up to 91 days only w.e.f May 1, 2009.
- Asset management companies are required to disclose on their respective websites the portfolio of debt-oriented close-ended and interval schemes/plans as on the last day of a month, on or before the third working day of the succeeding month.

Foreign Institutional Investment

- The eligible categories of the Foreign Institutional Investor (FII) applicants were expanded to allow for NRI-owned investment managers to register as FIIs subject to the condition that they did not invest their proprietary funds.
- It was decided to do away with the quantitative restrictions imposed on Overseas Derivative Instrument (ODI) issuance capabilities and restrictions on ODIs on derivatives with effect from October 7, 2008.
- In June 2008, the limit for investments in debt by the FIIs in the government securities was increased from US\$ 3.2 billion to US\$ 5 billion and in corporate debt from US\$ 1.5 billion to US\$ 3 billion. The corporate bond investment limits were further increased to US\$ 6 billion in October 2008 and to US\$ 15 billion in January 2009.
- The restriction on investment of FIIs in the ratio of 70:30 in equity and debt respectively was done away with.

Corporate Debt Market

- In order to facilitate development of a vibrant primary market for corporate bonds in India, SEBI notified "Issue and Listing of Debt Securities Regulations" on June 6, 2008 to provide for simplified regulatory framework for issuance and listing of non-convertible debt securities (excluding bonds issued by the Government) issued by any company, public sector undertaking or statutory corporation. The new regulations prescribe rationalized disclosure norms for public and private placements, reduction of timelines involved during draft prospectus stage, enhanced responsibilities of merchant bankers for exercising due diligence, etc.
- SEBI set up a Standing Advisory Committee named "Corporate Bonds and Securitisation Advisory Committee" (CoBoSAC) under the chairmanship of Dr R.H. Patil for making recommendations to SEBI from time to time regarding the market for corporate bonds and securitized debt instruments.

During 2009 – till date***Primary Securities Market***

- Introduction of Pure Auction Method in further Public Offerings leading to allotment on priority basis and at differential prices.
- Introduction of Concept of Anchor Investors in Public Offerings.
- Rationalisation of Regulatory Framework for issuance of Indian Depository Receipts (IDRs).
- Rationalisation of Disclosure Requirements for further public issues and rights issues by listed entities.
- Introduction of ASBA as a supplementary facility to retail individual investors.
- SEBI Disclosure and Investor Protection Guidelines (DIP Guidelines) governing public offerings were replaced by the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations).
- Uniform Procedure for dealing with Unclaimed Shares.
- Listing of Securities Issued through IPO on at least One Stock Exchange with Nationwide Trading Terminals.
- Prohibition on Issuance of Shares with Superior Rights as to voting or dividend *vis-à-vis* the rights on equity shares that are already listed.
- Disclosure of Details of the Allottees in the Qualified Institutional Placements (QIP) and Shareholding Pattern of Issuer Companies.
- Introduction of Uniform Margin Payment for all Categories of Investors in Public Issues.

Secondary Securities Market

- Trading Hours on Stock Exchanges: With a view to align Indian markets with those of the international markets to facilitate assimilation of any economic information that may flow in from other global markets, permit the stock exchanges to set their trading hours (in the cash and derivatives segments) are between 9 am and 5 pm,
- Submission of copy of PAN mandatory for transfer of shares in Physical Form for securities market transactions and off-market/private transactions involving transfer of shares in physical form of listed companies.
- Comprehensive Risk Management Framework for the Cash Market
- Disclosure of Investor Complaints and Arbitration Details on Stock Exchange Website based on the feedback received from investors and their associations to bring in more transparency in the grievance redressal available in the stock exchanges.
- Stock exchanges shall disclose the details of complaints lodged by clients/investors against trading members and companies listed in the exchange, on their website including details pertaining to arbitration and penal action against the trading members.

- Depositories shall disclose the details of complaints lodged by beneficiary owners (BO's)/investors against depository participants (DPs) on their website including details pertaining to arbitration and penal action against the DPs.
- Tenure of contracts in Securities Lending and Borrowing (SLB) increasing upto maximum period of 12 months from a contract period of 30 days.
- Introduction of Concept of Authorised Persons.
- Enhanced Transparency in Dealing between a Client and Stock Broker and Strengthening of Know Your Client (KYC) Norms.
- In-person Verification of Clients shall be carried out by the staff of the stock brokers in case of trading account and by the staff of the depository participant (DP) in case of beneficial owner (BO) account.
- Mandated a half yearly internal audit for credit rating agencies to be conducted by Company Secretaries, Chartered Accountants or Cost and Management Accountants who are in practice and who do not have any conflict of interest with the CRA.
- Stock exchanges to introduce derivatives on Volatility Indexes which have a suitable track record.

Corporate Debt Market

- Issue of Simplified Listing Agreement for Debt Securities.
- The issue of debt securities, convertible, either partially or fully or optionally into listed or unlisted equity, are guided by the disclosure norms in terms of the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009.
- Clearing and Settlement Mechanism for Corporate Bonds Settlement of bond trades through the clearing corporations which are subsidiaries of NSE and BSE.

Mutual Funds

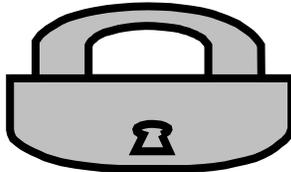
- Issuance of Guidelines for Investment by Mutual Funds in IDRs
- Money Market Instruments brought under the Investment Limits. Mutual Funds (Second Amendment) Regulations, 2009 prescribed that no mutual fund schemes can invest more than 30 percent of their assets in money market instruments of an issuer. However, such limit shall not be applicable for investments in Government securities, treasury bills and collateralised borrowing and lending obligations.
- Debt securities are valued by Mutual Funds in terms of spread indicated by specified rating agencies.
- Transparency in Payment of Commission and Load Structure.

LESSON ROUND UP



- As a natural corollary of the liberalization and globalization, the Indian Capital Market has undergone a sea change in terms of innovations, growth and deregulation.
- New reforms by SEBI in the primary market include improved disclosure standards, introduction of prudential norms and simplification of issue procedures.
- SEBI has brought various rules and regulations for control of primary and secondary market.
- New issue procedures were introduced.
- Compulsory trading in dematerialized form introduced.
- Facility of buy-back of securities by listed companies introduced.
- Internet trading under order routing system permitted.
- Various derivative products were introduced and expanded.

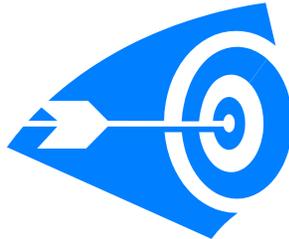
SELF TEST QUESTIONS



(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Enumerate the major reforms Indian capital markets have undergone during the recent past.
2. Discuss the salient features of capital market reforms in India.
3. Discuss the various initiatives taken by SEBI to improve transparency in Secondary market.
4. Briefly explain the policy initiatives taken by SEBI for developing capital market infrastructure in India.
5. "Indian Capital market has undergone sea change in terms of innovations, growth and deregulation" – Discuss.

STUDY III
MONEY MARKET



LEARNING OBJECTIVES

The Study will enable the students to understand

- Concept of money market
- Difference between money market and capital market
- Call money market and Short-term Deposit market
- Various money market instruments
- Types & features of Government Securities
- Bill Rediscounting
- Money Market Mutual funds
- Concept & features of Treasury bills
- Guidelines for issuance of Commercial Paper.

INTRODUCTION

Money market is a very important segment of the Indian financial system. It 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. Excess funds are deployed in the money market, which in turn are availed of to meet temporary shortages of cash and other obligations. Money market provides access to providers and users of short-term funds to fulfill their borrowings and investment requirements at an efficient market clearing price. It performs the crucial role of providing an equilibrating mechanism to even out short-term liquidity and in the process, facilitating the conduct of monetary policy. Short-term surpluses and deficits are evened out. The money market is the major mechanism through which the Reserve Bank influences liquidity and the general level of interest rates. The Bank's interventions to influence liquidity serve as a signaling-device for other segments of the financial system.

The money market is 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.

Though there are a few types of players in money market, the role and the level of participation by each type of player differs greatly.

Government is an active player in the money market and in most economies, it constitutes the biggest borrower of this market. Both, Government Securities or G-Secs and Treasury-Bills or T-Bills are securities issued by RBI on behalf of the Government of India to meet the latter's borrowing for financing fiscal deficit. Apart from functioning as a merchant banker to the government, the central bank also regulates the money market and issues guidelines to govern the money market operations.

Another dominant player in the money market is the banking industry. Banks mobilize deposits and utilize the same for credit accommodation. However, banks are not allowed to use the entire amount for extending credit. In order to promote certain prudential norms for healthy banking practices, most of the developed economies require all banks to maintain minimum liquid and cash reserves. As such, banks are required to ensure that these reserve requirements are met before directing on their credit plans. If banks fall short of these statutory reserve requirements, they can raise the same from the money market since it is a short-term deficit.

Moreover, financial institutions also undertake lending and borrowing of short-term funds. Due to the large volumes these FIs transact in, they do have a significant impact on the money market.

Corporates also transact in the money market mostly to raise short-term funds for meeting their working capital requirements.

Other institutional players like mutual funds (MFs), Foreign institutional investors (FIIs) etc. also transact in money market. However, the level of participation of these players varies largely depending on the regulations. For instance, the level of participation of the FIIs in the Indian money market is restricted to investment in government securities only.

I. FEATURES OF MONEY MARKET

The money market is a wholesale market. The volumes are very large and generally transactions are settled on a daily basis. Trading in the money market is conducted over the telephone, followed by written confirmation from both the borrowers and lenders.

There are a large number of participants in the money market: commercial banks, mutual funds, investment institutions, financial institutions and finally the Reserve Bank of India. The bank's operations ensure that the liquidity and short-term interest rates are maintained at levels consistent with the objective of maintaining price and exchange rate stability. The Central bank occupies a strategic position in the money market. The money market can obtain funds from the central bank either by borrowing or through sale of securities. The bank influences liquidity and interest rates by open market operations, REPO transactions changes in Bank Rate, Cash Reserve Requirements and by regulating access to its accommodation. A well-developed money market

contributes to an effective implementation of the monetary policy. It provides:

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.

II. MONEY MARKET Vs. CAPITAL MARKET

The money market possesses different operational features as compared to capital market. It deals with raising and deployment of funds for short duration while the capital market deals with long-term funding. The money market provides the institutional source for providing working capital to the industry, while the capital market offers long-term capital for financing fixed assets.

The money market operates as a wholesale market and has a number of inter-related sub-markets such as the call market, the bill market, the treasury bill market, the commercial paper market, the certificate of deposits market etc. The volume of transaction in money market is very large and varied and skilled professional operators are required to ensure successful operations. Due to its flexibility, money market trading is mostly done on telephone with written confirmation from both borrowers and lenders being sent immediately thereafter. The transactions are supposed to be on "same day settlement" basis.

As stated earlier, commercial banks, financial intermediaries, large corporates and the Reserve Bank of India (RBI) are the major constituents of Indian Money Market. RBI as the residual source of funds in the country plays a key role and holds strategic importance in the money market. RBI is able to expand or contract the liquidity in the market through different instruments such as Statutory Liquidity Ratio (SLR), Current Liquidity Ratio (CLR) etc. Thus RBI policy controls the availability and the cost of credit in the economy.

Money Market Vs. Capital Market



- Money Market deals with Short Term funding whereas Capital Market deals with Long Term funding.
- Money Market provides working capital to industry but Capital Market offers long term capital for financing fixed assets.
- Money Market is a whole sale debt market whereas Capital Market works through equity market.

III. GROWTH OF MONEY MARKET

The organisation and structure of the money market has undergone a sea change in the last decade in India. This was accompanied by a growth in quantitative terms also.

Upto 1987 the money market consisted of 6 facets:

1. Call Money Market;
2. Inter Bank Term Deposit/Loan Market;
3. The Participation Certificate Market;
4. Commercial Bills Market;
5. Treasury Bills Market; and
6. Inter-corporate Market.

The market had 3 main deficiencies:

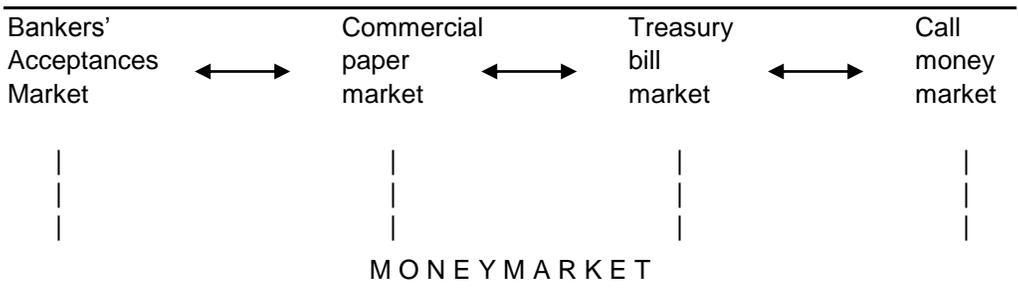
1. It had a very narrow base with RBI, Banks, LIC and UTI as the only participants lending funds while the borrowers were large in number;
2. There were few money market instruments. The participation certificate became extinct during 1980s;
3. The interest rates were not market determined but were controlled by either RBI or by a voluntary agreement between the participants through the Indian Banks Association (IBA).

To set right these deficiencies the Chakravarthy Committee (1985) and the Vaghul Committee (1987) offered many useful suggestions and their implementation has widened and deepened the market considerably by increasing the number of participants and instruments and introducing market determined rates as compared to the then existing administered interest rates.

An additional feature was the creation of an active secondary market for money market instrument to have greater liquidity. For this purpose the Discount and Finance House of India Limited (DFHI) was formed as an autonomous financial intermediary in April, 1988 to smoothen the short-term liquidity imbalances and to develop an active secondary market for the instruments of the money market. The DFHI plays the role of a market maker in money market instruments. In the relaxation of the regulatory framework and the arrival of the new instruments and the new players, DFHI occupies a key role in ushering in a more active de-regulated money market.

IV. STRUCTURE AND INSTITUTIONAL DEVELOPMENT

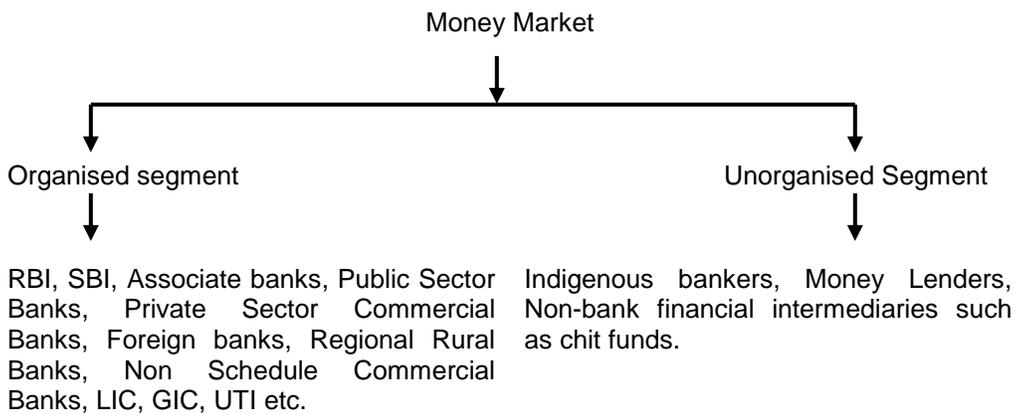
The following diagram depicts the important segments and inter-relation in the money market:



The Indian Money Market consists of both organised and unorganised segments. In the unorganised segment interest rates are much higher than in the organised segment.

The organised segment consists of the 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, UTI etc.

The unorganised segment essentially consists of indigenous bankers, money lenders and other non-bank financial intermediaries such as Chit Funds. For these institutions there is no clear cut demarcation between short-term and long-term and between a genuine trade bill and mere financial accommodation. The share of the unorganised sector in providing trade finance has greatly diminished after the Bank Nationalisation and expansion of Nationalised Banks reach into the length and breadth of the country.



V. MONEY MARKET INSTRUMENTS

Just as any other financial market, money market also involves transfer of funds in exchange of financial assets and due to the nature of the money market, the instruments used in it represent short-term claims. It is important to note that the money market instruments do not include any equities. Money market instruments mainly include Government securities, securities issued by Banking sector and securities issued by private sector. A brief discussion of various money market instruments has been given below:

1. Government Securities

All funds raised by the government from the money market are through the issue of securities by the RBI. Thus, T-Bills and Government dated securities are all issued by the RBI on behalf of the government.

Government securities(G-secs) are sovereign securities which are issued by the Reserve Bank of India on behalf of Government of India,in lieu of the Central Government's market borrowing programme. The term Government Securities

includes: Central Government Securities, State Government Securities, and Treasury bills. Being risk free securities, they set the benchmark for the interest rates of the other money market instruments.

The Central Government borrows funds to finance its 'fiscal deficit'. The market borrowing of the Central Government is raised through the issue of dated securities and 364 days treasury bills either by auction or by floatation of loans.

In addition to the above, treasury bills of 91 days are issued for managing the temporary cash mismatches of the Government. These do not form part of the borrowing programme of the Central Government.

Types of Government Securities

Government Securities are of the following types:

Dated Securities

Dated Securities are generally fixed maturity and fixed coupon securities usually carrying semi-annual coupon. These are called dated securities because these are identified by their date of maturity and the coupon, e.g., 11.03% GOI 2012 is a Central Government security maturing in 2012, which carries a coupon of 11.03% payable half yearly. The key features of these securities are:

- (a) They are issued at face value.
- (b) Coupon or interest rate is fixed at the time of issuance, and remains constant till redemption of the security.
- (c) The tenor of the security is also fixed.
- (d) Interest/Coupon payment is made on a half yearly basis on its face value.
- (e) The security is redeemed at par (face value) on its maturity date.

Zero Coupon bonds

Zero Coupon bonds are bonds issued at discount to face value and redeemed at par. These were issued first on January 19, 1994 and were followed by two subsequent issues in 1994-95 and 1995-96 respectively. The key features of these securities are:

- (a) They are issued at a discount to the face value.
- (b) The tenor of the security is fixed.
- (c) The securities do not carry any coupon or interest rate. The difference between the issue price (discounted price) and face value is the return on this security.
- (d) The security is redeemed at par (face value) on its maturity date.

Partly Paid Stock

Partly Paid Stock is stock where payment of principal amount is made in installments over a given time frame. It meets the needs of investors with regular flow of funds and the need of Government when it does not need funds immediately. The first issue of such stock of eight year maturity was made on November 15, 1994 for

Rs. 2000 crore. Such stocks have been issued a few more times thereafter. The key features of these securities are:

- (a) They are issued at face value, but this amount is paid in installments over a specified period.
- (b) Coupon or interest rate is fixed at the time of issuance, and remains constant till redemption of the security.
- (c) The tenor of the security is also fixed.
- (d) Interest/Coupon payment is made on a half yearly basis on its face value.
- (e) The security is redeemed at par (face value) on its maturity date.

Floating Rate Bonds

Floating Rate Bonds are bonds with variable interest rate with a fixed percentage over a benchmark rate. There may be a cap and a floor rate attached thereby fixing a maximum and minimum interest rate payable on it. Floating rate bonds of four year maturity were first issued on September 29, 1995, followed by another issue on December 5, 1995. Recently RBI issued a floating rate bond, the coupon of which is benchmarked against average yield on 364 Days Treasury Bills for last six months. The coupon is reset every six months. The key features of these securities are:

- (a) They are issued at face value.
- (b) Coupon or interest rate is fixed as a percentage over a predefined benchmark rate at the time of issuance. The benchmark rate may be Treasury bill rate, bank rate etc.
- (c) Though the benchmark does not change, the rate of interest may vary according to the change in the benchmark rate till redemption of the security.
- (d) The tenor of the security is also fixed.
- (e) Interest/Coupon payment is made on a half yearly basis on its face value.
- (f) The security is redeemed at par (face value) on its maturity date.

Bonds with Call/Put Option

First time in the history of Government Securities market RBI issued a bond with call and put option this year. This bond is due for redemption in 2012 and carries a coupon of 6.72%. However the bond has call and put option after five years i.e. in year 2007. In other words it means that holder of bond can sell back (put option) bond to Government in 2007 or Government can buy back (call option) bond from holder in 2007. This bond has been priced in line with 5 year bonds.

Capital Indexed Bonds

Capital Indexed Bonds are bonds where interest rate is a fixed percentage over the wholesale price index. These provide investors with an effective hedge against inflation. These bonds were floated on December 29, 1997 on tap basis. They were of five year maturity with a coupon rate of 6 per cent over the wholesale price index.

The principal redemption is linked to the Wholesale Price Index. The key features of these securities are:

- (a) They are issued at face value.
- (b) Coupon or interest rate is fixed as a percentage over the wholesale price index at the time of issuance. Therefore the actual amount of interest paid varies according to the change in the Wholesale Price Index.
- (c) The tenor of the security is fixed.
- (d) Interest/Coupon payment is made on a half yearly basis on its face value.
- (e) The principal redemption is linked to the Wholesale Price Index.

Features of Government Securities

(i) Nomenclature

The coupon rate and year of maturity identifies the government security.

Example: 12.25% GOI 2008 indicates the following:

12.25% is the coupon rate, GOI denotes Government of India, which is the borrower, 2008 is the year of maturity.

(ii) Eligibility

All entities registered in India like banks, financial institutions, Primary Dealers, firms, companies, corporate bodies, partnership firms, institutions, mutual funds, Foreign Institutional Investors, State Governments, Provident Funds, trusts, research organisations, Nepal Rashtra bank and even individuals are eligible to purchase Government Securities.

(iii) Availability

Government securities are highly liquid instruments available both in the primary and secondary market. They can be purchased from Primary Dealers. PNB Gilts Ltd., is a leading Primary Dealer in the government securities market, and is actively involved in the trading of government securities.

(iv) Forms of Issuance of Government Securities

Banks, Primary Dealers and Financial Institutions have been allowed to hold these securities with the Public Debt Office of Reserve Bank of India in dematerialized form in accounts known as Subsidiary General Ledger (SGL) Accounts. Entities having a Gilt Account with Banks or Primary Dealers can hold these securities with them in dematerialized form.

In addition government securities can also be held in dematerialized form in demat accounts maintained with the Depository Participants of NSDL.

(v) Minimum Amount

In terms of RBI regulations, government dated securities can be purchased for a minimum amount of Rs. 10,000/-only. Treasury bills can be purchased for a minimum

amount of Rs. 25,000/- only and in multiples thereof. State Government Securities can be purchased for a minimum amount of Rs 1,000/- only.

(vi) Repayment

Government securities are repaid at par on the expiry of their tenor. The different repayment methods are as follows:

- (i) For SGL account holders, the maturity proceeds would be credited to their current accounts with the Reserve Bank of India.
- (ii) For Gilt Account Holders, the Bank/Primary Dealers, would receive the maturity proceeds and they would pay the Gilt Account Holders.
- (iii) For entities having a demat account with NSDL, the maturity proceeds would be collected by their DP's and they in turn would pay the demat Account Holders.

(vii) Day Count

For government dated securities and state government securities the day count is taken as 360 days for a year and 30 days for every completed month. However for Treasury bills it is 365 days for a year.

Example: A client purchases 7.40% GOI 2012 for face value of Rs. 10 lacs @ Rs.101.80, i.e. the client pays Rs.101.80 for every unit of government security having a face value of Rs. 100/- The settlement is due on October 3, 2002. What is the amount to be paid by the client?

The security is 7.40% GOI 2012 for which the interest payment dates are 3rd May, and 3rd November every year.

The last interest payment date for the current year is 3rd May 2002. The calculation would be made as follows:

Face value of Rs. 10 lacs. @ Rs.101.80%.

Therefore the principal amount payable is Rs.10 lacs \times 101.80% =10,18,000

Last interest payment date was May 3, 2002 and settlement date is October 3, 2002. Therefore the interest has to be paid for 150 days (including 3rd May, and excluding October 3, 2002). (28 days of May, including 3rd May, up to 30th May + 30 days of June, July, August and September + 2 days of October). Since the settlement is on October 3, 2002, that date is excluded.

$$\text{Interest payable} = \frac{10 \text{ lacs} \times 7.40\% \times 150}{360 \times 100} = \text{Rs.}30833.33$$

Total amount payable by client =10,18,000+30833.33=Rs. 10,48,833.33

Benefits of Investing in Government Securities

- (i) No tax deducted at source
- (ii) Additional Income Tax benefit u/s 80L of the Income Tax Act for Individuals

- (iii) Qualifies for SLR purpose
- (iv) Zero default risk being sovereign paper
- (v) Highly liquid
- (vi) Transparency in transactions and simplified settlement procedures through CSDL/NSDL

Methods of Issuance of Government Securities

Government securities are issued by various methods, which are as follows:

(a) Auctions

Auctions for government securities are either yield based or price based. In an yield based auction, the Reserve Bank of India announces the issue size (or notified amount) and the tenor of the paper to be auctioned. The bidders submit bids in terms of the yield at which they are ready to buy the security. In a price based auction, the Reserve Bank of India announces the issue size (or notified amount), the tenor of the paper to be auctioned, as well as the coupon rate. The bidders submit bids in terms of the price. This method of auction is normally used in case of reissue of existing government securities.

Method of auction: There are following two methods of auction:

- (i) *Uniform price Based or Dutch Auction* procedure is used in auctions of dated government securities. The bids are accepted at the same prices as decided in the cut off.
- (ii) *Multiple/variable Price Based or French Auction* procedure is used in auctions of Government dated securities and treasury bills. Bids are accepted at different prices/yields quoted in the individual bids.

Bids: Bids are to be submitted in terms of yields to maturity/prices as announced at the time of auction.

Cut off yield is the rate at which bids are accepted. Bids at yields higher than the cut-off yield is rejected and those lower than the cut-off are accepted. The cut-off yield is set as the coupon rate for the security. Bidders who have bid at lower than the cut-off yield pay a premium on the security, since the auction is a multiple price auction.

Cut off price: It is the minimum price accepted for the security. Bids at prices lower than the cut-off are rejected and at higher than the cut-off are accepted. Coupon rate for the security remains unchanged. Bidders who have bid at higher than the cut-off price pay a premium on the security, thereby getting a lower yield. Price based auctions lead to finer price discovery than yield based auctions.

Notified amount: The amount of security to be issued is 'notified' prior to the auction date, for information of the public.

The Reserve Bank of India (RBI) may participate as a non-competitor in the auctions. The unsubscribed portion devolves on RBI or on the Primary Dealers if the auction has been underwritten by PDs. The devolvement is at the cut-off price/ yield.



Underwriting in Auctions. For the purpose of auctions, bids are invited from the Primary Dealers one day before the auction wherein they indicate the amount to be underwritten by them and the underwriting fee expected by them. The auction committee of Reserve Bank of India examines the bids and based on the market conditions, takes a decision in respect of the amount to be underwritten and the fee to be paid to the underwriters. Underwriting fee is paid at the rates bid by PDs, for the underwriting which has been accepted. In case of the auction being fully subscribed, the underwriters do not have to subscribe to the issue necessarily unless they have bid for it. If there is a devolvement, the successful bids put in by the Primary Dealers are set-off against the amount underwritten by them while deciding the amount of devolvement.

(b) On-tap issue

This is a reissue of existing Government securities having pre-determined yields/prices by Reserve Bank of India. After the initial primary auction of a security, the issue remains open to further subscription by the investors as and when considered appropriate by RBI. The period for which the issue is kept open may be time specific or volume specific. The coupon rate, the interest dates and the date of maturity remain the same as determined in the initial primary auction. Reserve Bank of India may sell government securities through on tap issue at lower or higher prices than the prevailing market prices. Such an action on the part of the Reserve Bank of India leads to a realignment of the market prices of government securities. Tap stock provides an opportunity to unsuccessful bidders in auctions to acquire the security at the market determined rate.

(c) Fixed coupon issue

Government Securities may also be issued for a notified amount at a fixed coupon. Most State Development Loans or State Government Securities are issued on this basis.

(d) Private Placement

The Central Government may also privately place government securities with Reserve Bank of India. This is usually done when the Ways and Means Advance (WMA) is near the sanctioned limit and the market conditions are not conducive to an issue. The issue is priced at market related yields. Reserve Bank of India may later offload these securities to the market through Open Market Operations (OMO).

After having auctioned a loan whereby the coupon rate has been arrived at and if still the government feels the need for funds for similar tenure, it may privately place an amount with the Reserve Bank of India. RBI in turn may decide upon further selling of the security so purchased under the Open Market Operations window albeit at a different yield.

(e) Open Market Operations (OMO)

Government securities that are privately placed with the Reserve Bank of India are sold in the market through open market operations of the Reserve Bank of India. The yield at which these securities are sold may differ from the yield at which they were privately placed with Reserve Bank of India. Open market operations are used by the Reserve Bank of India to infuse or suck liquidity from the system. Whenever the Reserve Bank of India wishes to infuse the liquidity in the system, it purchases

government securities from the market, and whenever it wishes to suck out the liquidity from the system, it sells government securities in the market.

2. Money at Call and Short Notice

Money at call is outright money. Money at short notice is for a maturity of or up to 14 days. Money for higher maturity is known as inter-bank deposits. The participants are banks and all India financial institutions as permitted by RBI. From April 1991, corporates with minimum lendable resources of Rs.20 crores for transaction have also been permitted to lend in the market through the DFHI. Mumbai is the single most important centre and other centres are Kolkata, Delhi, Chennai, Ahmedabad and Bangalore.

The market is an over-the-telephone market. Non-bank participants act as lenders only. Banks borrow for a variety of reasons to maintain their CRR, to meet heavy payments (e.g. withdrawals by customers for payment of taxes), to adjust their maturity mismatch etc. There are days of heavy borrowings on these occasion. Consequently, depending upon supply, interest rates show wide fluctuations. Corporate treasury management is not as sophisticated as in industrialised countries and through the cash credit system transfer their liquidity management to their banker who in turn resort to the call money market.

3. Bills Rediscounting

Bill-financing seller drawing a bill of exchange and the buyer accepting it, thereafter the seller discounting it with, say, a bank, is an important device for fund raising in advanced countries. The bills are liquidated on maturity. Hundies (an indigenous form of bill of exchange) have been popular in India, too. But there has been a general reluctance on the part of buyers to commit themselves to payments on maturity. Hence, bill finance has not been popular, official incentives and coercions notwithstanding. In case of borrowers having working capital limits of Rs.5 crores and above, at least 25% of the aggregate limits for financing inland credit sales should be by way of bill finance. In addition, banks have a facility to rediscount the bills with the RBI and other approved institutions like LIC, GIC, UTI, ICICI, IFCI, DFHI etc.

4. Inter-Bank Participation (IBP)

This instrument emerged in the '70s but became almost defunct in the '80s. Vaghul Committee suggested its revival for the purpose of removing imbalances which effected the maturity mix of banks assets. Two types of IBP are allowed to be issued by banks as per RBI guidelines:

- (a) on risk sharing basis
- (b) without risk sharing

These instruments are used by Scheduled Commercial Banks other than Regional Rural Banks. IBP with sharing is issued for 91 to 180 days in respect of advances classified under health-code status. In connection with corporate lending, the lender bank shares the losses with borrower banks. The rate of interest is mutually determined by the issuing bank and the participating bank.

IBP without risk sharing can have a tenor of 90 days only. The issuing banks show participation as borrowing, while the participating banks show it as advances to

banks. The IBP scheme is advantageous as it is more flexible for access compare to the regular consortium tie up.

However, IBP has not become very popular because it is not transferable and there is absence of the ceiling on interest rate. Further, there is no provision for premature redemption/advance payment of the certificate after a minimum lock-in period.

5. Money Market Mutual Funds (MMMFs)

When savers switch their savings from banks to capital markets in search of higher returns and capital appreciation, there arises the institution of mutual funds - collecting small savings of a large number of savers, and investing them in capital market instruments, using their professional expertise, superior capability and economies of scale. They seek to provide safety, liquidity and return. Money market is an avenue for obtaining higher returns on short term funds. But the operators are large institutions and deals are in large amounts for beyond the capacity of money. The concept of a mutual fund in relation to a capital market can naturally be extended to money market. Hence, the coming up of money market mutual funds. The concept has been worked in the USA and other advanced countries. MMMFs industry is very well developed in USA. In the 1980s, the capital markets were in an uncertain phase yields on the US Government short term securities were high, but the minimum amounts required by them were high. For example \$10,000 to buy a treasury bill. In the circumstances, MMMFs industry developed quite fast. Historically, the MMMFs was introduced in 1971 by Bruce Bent and Henry Brown of the Wall street.

In India, the decision to promote MMMFs was announced by RBI while unveiling its credit policy in April, 1991. A task force on MMMFs was set up under the chairmanship of D Basu in September, 1991. It was required to evolve guidelines, for establishing these funds, devise formats of negotiable instruments to be used, investment policies, etc. Its recommendations formed the basis of the guidelines issued by RBI in April, 1992.

SEBI amended the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 which provides that no mutual fund scheme shall invest more than thirty percent of its net assets in money market instruments of an issuer. However, such limit shall not be applicable for investments in Government securities, treasury bills and collateralized borrowing and lending obligations.

6. Call Money Market and Short-term Deposit Market

The formation and operations of Discount and Finance House of India (DFHI) led to enhanced activities in this market segment. DFHI was allowed to borrow, lend and also arrange funds. With a view to improve the equilibrium of the market without steep raise in the rates, the interest rates in the call money market was partly freed by the announcement of RBI that DFHI would operate outside the purview of the provisions of the ceiling rates fixed by the Indian Banks Association

The inter bank rates both on call money and short-term deposits were freed and deregulated from May, 1989. In May, 1990 GIC, IDBI, NABARD etc. were included as participants for the purpose of lending in the market and bring about great integration among the different segments of the market. In October, 1990 participants in the

Commercial Bill market were also similarly permitted as lenders. Again in April, 1991, Institutions and mutual funds with bulk lendable resources were allowed access by RBI to the call money market through DFHI. All bank subsidiaries were allowed to set up money market mutual funds.

A minimum size of Rs. 20 crores for each transaction was stipulated while permitting the participation of the corporates in the call money market. Additionally, the lender was required to offer an undertaking that he had no outstandings against loans taken from the banking sector. The borrowers were essentially the banks. In this scenario the DFHI plays a vital role in stabilising the call and short-term deposit rates through larger turnover and smaller spread. Private mutual funds were also allowed to participate in the market as lenders from April, 1995.

DFHI ascertains from the prospective lenders and borrowers the money available and needed and exchanges a deal settlement advise with them indicating the negotiated interest rates applicable to them. When DFHI borrows, a call deposit receipt is issued to the lender against a cheque drawn on RBI for the amount lent. If DFHI lends, it issues to the RBI a cheque representing the amount lent to the borrower against the call deposit receipt.

The call rates are very volatile as they are determined by the interaction of demand and supply of funds in the market. This volatility mainly arises out of the conditionalities regarding the maintenance of Cash Reserve Ratio (CRR) by the banks. When banks borrow large amounts during tight liquidity periods to fulfil their CRR requirements, the rates are pushed up and after these needs are met the rates come down. During busy season (October-March) there will be a great demand for credit in the market and consequently the interest rates are higher.

Two call rates exist in India, i.e. Inter-bank call rate and the lending rate of DFHI. In 1989 when the rates were first deregulated there was an initial upsurge, but the market flattened at an average rate of around 10 to 15% and this continued till 1990. In 1991 in the wake of a financial crisis in the market, the rates went up to 38%. After the CRR and the SLR were slashed and loan resources increased as a follow up of the Narasimham's Committee Report, the call rates came down steeply to 5 to 6% in 1993. Again in 1994 there was sharp increase to around 100%. The DFHI rate has also been fluctuating like the inter bank rate and is slightly higher than the latter.

The following are the additional factors contributing to the volatility:

1. periodical large borrowings to meet CRR requirements of banks.
2. certain banks operate excessive credit beyond their permissible limits to meet structural disequilibrium of resources versus needs.
3. call rates increase steeply when institutional lenders and corporates withdraw huge amounts for tax payments etc.
4. call rates go up also when there is less-liquidity in the money market investments for want of buyers for Government securities, units, public sector bonds etc. in which funds are invested.

RBI has made efforts to reduce the volatility by different measures and brought about stability in the rates. There is now a compulsion for banks to match liquidity

with maturity. RBI uses CRR as a critical variable in the operation of the call money market.

7. Treasury Bills

Treasury Bills are money market instruments 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, the lowest risk category instruments are the treasury bills.

RBI issues these at a prefixed day and a fixed amount.

These are four types of treasury bills.

- (a) 14-day Tbill-maturity is in 14 days. Its auction is on every Friday of every week. The notified amount for this auction is Rs. 100 crores.
- (b) 91-day Tbill-maturity is in 91 days. Its auction is on every Friday of every week. The notified amount for this auction is Rs. 100 crores.
- (c) 182-day Tbill-maturity is in 182 days. Its auction is on every alternate Wednesday (which is not a reporting week). The notified amount for this auction is Rs. 100 crores.
- (d) 364-Day Tbill-maturity is in 364 days. Its auction is on every alternate Wednesday (which is a reporting week). The notified amount for this auction is Rs. 500 crores.

A considerable part of the government's borrowings happen through Tbills of various maturities. Based on the bids received at the auctions, RBI decides the cut off yield and accepts all bids below this yield.

The usual investors in these instruments are banks who invest not only to part their short-term surpluses but also since it forms part of their SLR investments, insurance companies and FIs. FIs so far have not been allowed to invest in this instrument.

These T-bills which are issued at a discount can be traded in the market. Most of the time, unless the investor requests specifically, they are issued not as securities but as entries in the Subsidiary General Ledger (SGL) which is maintained by RBI. The transactions cost on Tbill are non-existent and trading is considerably high in each bill, immediately after its issue and immediately before its redemption.

The yield on T-bills is dependent on the rates prevalent on other investment avenues open for investors. Low yield on T-bills, generally a result of high liquidity in banking system as indicated by low call rates, would divert the funds from this market to other markets. This would be particularly so, if banks already hold the minimum stipulated amount (SLR) in government paper.

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.

Features of Treasury Bills

(a) Form

The treasury bills are issued in the form of promissory note in physical form or by credit to Subsidiary General Ledger (SGL) account or Gilt account in dematerialised form.

(b) Minimum Amount of Bids

Bids for treasury bills are to be made for a minimum amount of Rs 25000/- only and in multiples thereof.

(c) Eligibility

All entities registered in India like banks, financial institutions, Primary Dealers, firms, companies, corporate bodies, partnership firms, institutions, mutual funds, Foreign Institutional Investors, State Governments, Provident Funds, trusts, research organisations, Nepal Rashtra bank and even individuals are eligible to bid and purchase Treasury bills.

(d) Repayment

The treasury bills are repaid at par on the expiry of their tenor at the office of the Reserve Bank of India.

(e) Availability

All the treasury Bills are highly liquid instruments available both in the primary and secondary market.

(f) Day Count

For treasury bills the day count is taken as 365 days for a year.

(g) Yield Calculation

The yield of a Treasury Bill is calculated as per the following formula:

$$Y = \frac{(100 - P) \times 365 \times 100}{P \times D}$$

Wherein Y = Discounted yield
 P = Price
 D = Days to maturity

Example

A cooperative bank wishes to buy 91 Days Treasury Bill Maturing on Dec. 6, 2006 on Oct. 12, 2006. The rate quoted by seller is Rs. 99.1489 per Rs. 100 face values. The YTM can be calculated as following:

The days to maturity of Treasury bill are 55 (October – 20 days, November – 30 days and December – 5 days)

$$\text{YTM} = (100 - 99.1489) \times 365 \times 100 / (99.1489 \times 55) = 5.70\%$$

Similarly if the YTM is quoted by the seller price can be calculated by inputting the price in above formula.

Primary Market

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

Salient Features of the Auction Technique:

- (a) The auction of treasury bills is done only at Reserve Bank of India, Mumbai.
- (b) Bids are to be submitted on NDS by 2:30 PM on Wednesday. If Wednesday happens to be a holiday then bids are to submitted on Tuesday.
- (c) Bids are submitted in terms of price per Rs 100. For example, a bid for 91-day Treasury bill auction could be for Rs 97.50.
- (d) Auction committee of Reserve Bank of India decides the cut-off price and results are announced on the same day.
- (e) Bids above the cut-off price receive full allotment; bids at cut-off price may receive full or partial allotment and bids below the cut-off price are rejected.

Types of Auctions

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. This method is followed in the case of 364 days treasury bills and is valid only for competitive bidders.
- *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. This method is applicable in the case of 91 days treasury bills only. The system of Dutch auction has been done away with by the RBI wef 08.12.2002 for the 91 day treasury T Bill.

What is Dutch auction?

When all the bids accepted are equal to or above the cut off price it is known as Dutch Auction.

What is French Auction?

When all the bids accepted at the cut off level it is known as French Auction.



Secondary Market & Palyers

The major participants in the secondary market are scheduled banks, financial Institutions, Primary dealers, mutual funds, insurance companies and corporate treasuries. Other entities like cooperative and regional rural banks, educational and religious trusts etc. have also begun investing their short term funds in treasury bills.

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.

Treasury Bills - An Effective Cash Management Product

Treasury Bills are very useful instruments to deploy short term surpluses depending upon the availability and requirement. Even funds which are kept in current accounts can be deployed in treasury bills to maximise returns. Banks do not pay any interest on fixed deposits of less than 15 days, or balances maintained in current accounts, whereas treasury bills can be purchased for any number of days depending on the requirements. This helps in deployment of idle funds for very short periods as well. Further, since every week there is a 91 days treasury bills maturing and every fortnight a 364 days treasury bills maturing, one can purchase treasury bills of different maturities as per requirements so as to match with the respective outflow of funds. At times when the liquidity in the economy is tight, the returns on treasury bills are much higher as compared to bank deposits even for longer term. Besides, better yields and availability for very short tenors, another important advantage of treasury bills over bank deposits is that the surplus cash can be invested depending upon the staggered requirements.

Example

Suppose party A has a surplus cash of Rs. 200 crore to be deployed in a project. However, it does not require the funds at one go but requires them at different points of time as detailed below:

Funds Available as on 1.1.2009	Rs. 200 crore
Deployment in a project	Rs. 200 crore
As per the requirements	
06.1.2009	Rs. 50 crore
13.1.2009	Rs. 20 crore
02.2.2009	Rs. 30 crore
08.2.2009	Rs. 100 crore

Out of the above funds and the requirement schedule, the party has following two options for effective cash management of funds:

Option I

Invest the cash not required within 15 days in bank deposits

The party can invest a total of Rs. 130 crore only, since the balance Rs. 70 crores is required within the first 15 days. Assuming a rate of return of 6% paid on

bank deposits for a period of 31 to 45 days, the interest earned by the company works out to Rs. 76 lacs approximately.

Option II

Invest in Treasury Bills of various maturities depending on the funds requirements

The party can invest the entire Rs. 200 crore in treasury bills as treasury bills of even less than 15 days maturity are also available. The return to the party by this deal works out to around Rs. 125 lacs, assuming returns on Treasury Bills in the range of 8% to 9% for the above periods.

Portfolio Management Strategies

Strategies for managing a portfolio can broadly be classified as active or passive strategies:

Buy And Hold: A buy and hold strategy can be described as a passive strategy since the Treasury bills once purchased, would be held till its maturity. The salient features of this strategy are:

- (a) Return is fixed or locked in at the time of investment itself.
- (b) The exposure to price variations due to secondary market fluctuations is eliminated.
- (c) There is no risk of default on maturity.

Buy and Trade

This strategy can also be described as an active market strategy. The returns on this strategy are higher than the buy and hold strategy as the yield can be optimised by actively trading the treasury bills in the secondary market before maturity.

8. Certificates of Deposits

Certificates of Deposit (CDs) is a negotiable money market instrument and issued in dematerialised form or as a 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.

Eligibility

CDs can be issued by (i) scheduled commercial banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs); and (ii) select all-India Financial Institutions that have been permitted by RBI to raise short-term resources within the umbrella limit fixed by RBI.

Aggregate Amount

Banks have the freedom to issue CDs depending on their requirements. A FI may issue CDs within the overall umbrella limit fixed by RBI, i.e., issue of CD together with other instruments viz., term money, term deposits, commercial papers and intercorporate deposits should not exceed 100 per cent of its net owned funds, as per the latest audited balance sheet.

Minimum Size of Issue and Denominations

Minimum amount of a CD should be Rs.1 lakh i.e., the minimum deposit that could be accepted from a single subscriber should not be less than Rs. 1 lakh and in the multiples of Rs. 1 lakh thereafter. CDs can be issued to individuals, corporations, companies, trusts, funds, associations, etc. Non-Resident Indians (NRIs) may also subscribe to CDs, but only on non-repatriable basis which should be clearly stated on the Certificate. Such CDs cannot be endorsed to another NRI in the secondary market.

Maturity

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.

Discount/Coupon Rate

CDs may be issued at a discount on face value. Banks/FIs are also allowed to issue CDs on floating rate basis provided the methodology of compiling the floating rate is objective, transparent and market based. The issuing bank/FI is free to determine the discount/coupon rate. The interest rate on floating rate CDs would have to be reset periodically in accordance with a pre-determined formula that indicates the spread over a transparent benchmark.

Reserve Requirements

Banks have to maintain the appropriate reserve requirements, i.e., cash reserve ratio (CRR) and statutory liquidity ratio (SLR), on the issue price of the CDs.

Transferability

Physical CDs are freely transferable by endorsement and delivery. Demat CDs can be transferred as per the procedure applicable to other demat securities. There is no lock-in period for the CDs. Banks/FIs cannot grant loans against CDs. Furthermore, they cannot buy-back their own CDs before maturity.

Trades in CDs

All OTC trades in CDs shall be reported within 15 minutes of the trade on the FIMMDA reporting platform.

Format of CDs

Banks/FIs should issue CDs only in the dematerialised form. However, according to the Depositories Act, 1996, investors have the option to seek certificate in physical form.

Accordingly, if investor insists on physical certificate, the bank/FI may inform to Monetary Policy Department, Reserve Bank of India, Central Office, Fort, Mumbai - 400 001 about such instances separately. Further, **issuance of CD will attract stamp duty**. There will be no grace period for repayment of CDs. If the maturity date

happens to be holiday, the issuing bank should make payment on the immediate preceding working day. Banks/FIs may, therefore, so fix the period of deposit that the maturity date does not coincide with a holiday to avoid loss of discount / interest rate.

Security Aspect

Since physical CDs are freely transferable by endorsement and delivery, it will be necessary for banks to see that the certificates are printed on good quality security paper and necessary precautions are taken to guard against tempering with the document. They should be signed by two or more authorized signatories.

Payment of Certificate

Since CDs are transferable, the physical certificate may be presented for payment by the last holder. The question of liability on account of any defect in the chain of endorsements may arise. It is, therefore, desirable that banks take necessary precautions and make payment only by a crossed cheque. Those who deal in these CDs may also be suitably cautioned. The holders of dematted CDs will approach their respective depository participants (DPs) and have to give transfer/delivery instructions to transfer the demat security represented by the specific ISIN to the 'CD Redemption Account' maintained by the issuer. The holder should also communicate to the issuer by a letter/fax enclosing the copy of the delivery instruction it had given to its DP and intimate the place at which the payment is requested to facilitate prompt payment. Upon receipt of the Demat credit of CDs in the "CD Redemption Account", the issuer, on maturity date, would arrange to repay to holder/transferor by way of Banker's cheque/high value cheque, etc.

Issue of Duplicate Certificates

In case of the loss of physical CD certificates, duplicate certificates can be issued after compliance of the following:

- (a) A notice is required to be given in at least one local newspaper,
- (b) Lapse of a reasonable period (say 15 days) from the date of the notice in the newspaper; and
- (c) Execution of an indemnity bond by the investor to the satisfaction of the issuer of CD.

The duplicate certificate should only be issued in physical form. No fresh stamping is, required as a duplicate certificate is issued against the original lost CD. The duplicate CD should clearly state that the CD is a Duplicate one stating the original value date, due date, and the date of issue (as "Duplicate issued on _____").

Accounting

Banks/FIs may account the issue price under the Head "CDs issued" and show it under deposits. Accounting entries towards discount will be made as in the case of "cash certificates". Banks/FIs should maintain a register of CDs issued with complete particulars.

9. Inter-Corporate Deposits

Apart from CPs, 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 funds surplus corporates to lend to other corporates. Also the better-rated corporates can borrow from the banking system and lend in this market. As the cost of funds for a corporate is much higher than a bank, the rates in this market are higher than those in the other markets. ICDs are unsecured, and hence the risk inherent is high. The ICD market is not well organised with very little information available publicly about transaction details.

10. 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 date and encashed by the seller or may be endorsed to a third party in payment of dues owing to the latter. But the most common method 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).

The volume of bills both inland and foreign, which are discounted accounted for about 20% of the total scheduled commercial bank credit. Over the years this percentage is coming down. The Reserve Bank has been attempting to develop a market for commercial bills. The bill market scheme was introduced in 1942 and a new scheme called Bill Rediscount Scheme with several new features was introduced in November, 1970. Under the latter scheme the RBI rediscount bills at the bank rates or at rates specified by it at its discretion. Since the rediscounting facility has been made restrictive, it is generally available on a discretionary basis.

The difficulties which stand in the way of bill market development are, the incidence of stamp duty, shortage of stamp paper, reluctance of buyers to accept bills, predominance of cash credit system of lending and the administrative work involved in handling documents of title to goods. To be freely negotiable and marketable, the bills should be first class bills i.e. those accepted by companies having good reputation. Alternatively, the bills accepted by companies should be co-accepted by banks as a kind of guarantee. In the absence of these criteria, bill market has not developed in India as the volume of first class bills is very small.

11. 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 enabling highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors. Subsequently, primary dealers, satellite dealers and all-India financial institutions were also permitted to issue CP to enable them to meet their short-term funding requirements for their operations. Guidelines for issue of CP are presently governed by various directives issued by the Reserve Bank of India, as amended from time to time. The guidelines for issue of CP incorporating all the amendments issued till date is given below:

In these guidelines, unless the context otherwise requires:

- (a) “banks” or “banking company” means a banking company as defined in clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949) or a “corresponding new bank”, “State Bank of India” or “subsidiary bank” as defined in clause (da), clause (nc) and clause (nd) respectively thereof and includes a “co-operative bank” as defined in clause (cci) of Section 5 read with Section 56 of that Act.
- (b) “scheduled bank” means a bank included in the Second Schedule of the Reserve Bank of India Act, 1934.
- (c) “All-India Financial Institutions (FIs)” means those financial institutions which have been permitted specifically by the Reserve Bank of India to raise resources by way of Term Money, Term Deposits, Certificates of Deposit, Commercial Paper and Inter-Corporate Deposits, where applicable, within umbrella limit.
- (d) “Primary Dealer” means a non-banking financial company which holds a valid letter of authorization as a Primary Dealer issued by the Reserve Bank, in terms of the “Guidelines for Primary Dealers in Government Securities Market” dated March 29, 1995, as amended from time to time.
- (e) “corporate” or “company” means a company as defined in Section 451(aa) of the Reserve Bank of India Act, 1934 but does not include a company which is being wound up under any law for the time being in force.
- (f) “non-banking company” means a company other than banking company.
- (g) “non-banking financial company” means a company as defined in Section 451(f) of the Reserve Bank of India Act, 1934.
- (h) “working capital limit” means the aggregate limits, including those by way of purchase/discount of bills sanctioned by one or more banks/FIs for meeting the working capital requirements.
- (i) “Tangible net worth” means the paid-up capital plus free reserves (including balances in the share premium account, capital and debentures redemption reserves and any other reserve not being created for repayment of any future liability or for depreciation in assets or for bad debts or reserve created by revaluation of assets) as per the latest audited balance sheet of the company, as reduced by the amount of accumulated balance of loss, balance of deferred revenue expenditure, as also other intangible assets.

Issue of Commercial Paper

Corporates and primary dealers (PDs), and the all-India financial institutions (FIs) that have been permitted to raise short-term resources under the umbrella limit fixed by Reserve Bank of India are eligible to issue CP.

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) company has been sanctioned working capital limit by bank/s or all-India financial institution/s; and
- (c) the borrowal account of the company is classified as a Standard Asset by the financing bank/s / institution/s.

Rating Requirement

All eligible participants shall obtain the credit rating for issuance of Commercial Paper from either the Credit Rating Information Services of India Ltd. (CRISIL) or the Investment Information and Credit Rating Agency of India Ltd. (ICRA) or the Credit Analysis and Research Ltd. (CARE) or the FITCH Ratings India Pvt. Ltd. or such other credit rating agencies as may be specified by the Reserve Bank of India from time to time, for the purpose. The minimum credit rating shall be P-2 of CRISIL or such equivalent rating by other agencies. The issuers shall ensure at the time of issuance of CP that the rating so obtained is current and has not fallen due for review.

Maturity

CP can be issued for maturities between a minimum of 7 days and a maximum 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.

Denominations

CP can be issued in denominations of Rs.5 lakh or multiples thereof. Amount invested by a single investor should not be less than Rs.5 lakh (face value).

Limits and the Amount of Issue of CP

CP can be issued as a "stand alone" product. The aggregate amount of CP from an issuer shall be within the limit as approved by its Board of Directors or the quantum indicated by the Credit Rating Agency for the specified rating, whichever is lower. Banks and FIs will, however, have the flexibility to fix working capital limits duly taking into account the resource pattern of companies financing including CPs. An FI can issue CP within the overall umbrella limit fixed by the RBI i.e., issue of CP together with other instruments viz., term money borrowings, term deposits, certificates of deposit and intercorporate deposits should not exceed 100 per cent of its net owned funds, as per the latest audited balance sheet. The total amount of CP proposed to be issued should be raised within a period of two weeks from the date on which the issuer opens the issue for subscription. CP may be issued on a single date or in parts on different dates provided that in the latter case, each CP shall have the same maturity date. Every issue of CP including renewal should be treated as a fresh issue.

Issuing & Paying Agent (IPA)

Only a scheduled bank can act as an IPA for issuance of CP.

Investment in CP

CP may be issued to and held by individuals, banking companies, other corporate bodies registered or incorporated in India and unincorporated bodies, Non-

Resident Indians (NRIs) and Foreign Institutional Investors (FIIs). However, investment by FIIs would be within the limits set for their investments by Securities and Exchange Board of India (SEBI).

Mode of Issuance

CP can be issued either in the form of a promissory note or in a dematerialized form through any of the depositories approved by and registered with SEBI. CP will be issued at a discount to face value as may be determined by the issuer. No issuer shall have the issue of CP underwritten or co-accepted.

Preference for Dematerialisation

While option is available to both issuers and subscribers to issue/hold CP in dematerialised or physical form, issuers and subscribers are encouraged to prefer exclusive reliance on dematerialized form of issue/holding. However, with effect from June 30, 2001, banks, FIs and PDs are required to make fresh investments and hold CP only in dematerialised form.

Payment of CP

The initial investor in CP shall pay the discounted value of the CP by means of a crossed account payee cheque to the account of the issuer through IPA. On maturity of CP, when the CP is held in physical form, the holder of the CP shall present the instrument for payment to the issuer through the IPA. However, when the CP is held in demat form, the holder of the CP will have to get it redeemed through the depository and receive payment from the IPA.

Stand-by Facility

In view of CP being a 'stand alone' product, it would not be obligatory in any manner on the part of the banks and FIs to provide stand-by facility to the issuers of CP. Banks and FIs have, however, the flexibility to provide for a CP issue, credit enhancement by way of stand-by assistance/credit, back-stop facility etc. based on their commercial judgement, subject to prudential norms as applicable and with specific approval of their Boards.

Non-bank entities including corporates may also provide unconditional and irrevocable guarantee for credit enhancement for CP issue provided:

- (i) the issuer fulfils the eligibility criteria prescribed for issuance of CP;
- (ii) the guarantor has a credit rating at least one notch higher than the issuer given by an approved credit rating agency; and
- (iii) the offer document for CP properly discloses the net worth of the guarantor company, the names of the companies to which the guarantor has issued similar guarantees, the extent of the guarantees offered by the guarantor company, and the conditions under which the guarantee will be invoked.

Procedure for Issuance

Every issuer must appoint an Issuing and Paying Agent (IPA) for issuance of CP. The issuer should disclose to the potential investors its financial position as per the

standard market practice. After the exchange of deal confirmation between the investor and the issuer, issuing company shall issue physical certificates to the investor or arrange for crediting the CP to the investor's account with a depository. Investors shall be given a copy of IPA certificate to the effect that the issuer has a valid agreement with the IPA and documents are in order.

Role and Responsibilities

The role and responsibilities of issuer, IPA and credit rating agency (CRA) are set out below:

(a) Issuer

With the simplification in the procedures for CP issuance, issuers would now have more flexibility. Issuers would, however, have to ensure that the guidelines and procedures laid down for CP issuance are strictly adhered to.

(b) Issuing and Paying Agent (IPA)

Only a Scheduled Bank can act as an IPA for issuance of CP.

- (i) IPA would ensure that issuer has the minimum credit rating as stipulated by the RBI and amount mobilised through issuance of CP is within the quantum indicated by CRA for the specified rating or as approved by its Board of Directors, whichever is lower.
- (ii) IPA has to verify all the documents submitted by the issuer viz., copy of board resolution, signatures of authorised executants (when CP in physical form) and issue a certificate that documents are in order. It should also certify that it has a valid agreement with the issuer.
- (iii) Certified copies of original documents verified by the IPA should be held in the custody of IPA.
- (iv) All schedule commercial banks, acting as an IPA will report about every CP issue to Chief General manager, RBI within three days from the date of completion of the issue.
- (v) IPAs which are Negotiated Dealing System (NDS) member, should report the details of CP issue on NDS platform within two days from the date of completion of the issue.
- (vi) Additionally all scheduled banks acting as an IPA should submit the date pertaining to CP issuances on the Online Returns Filing System (ORFS) module within two days from the date of issuance of CP. This reporting is in addition to the reporting on NDS platform till ORFS module stabilizes after which reporting on NDS can be discontinued.

(c) Credit Rating Agency (CRA)

- (i) Code of Conduct prescribed by the SEBI for CRAs for undertaking rating of capital market instruments shall be applicable to them (CRAs) for rating CP.
- (ii) Further, the credit rating agency would henceforth have the discretion to determine the validity period of the rating depending upon its perception

about the strength of the issuer. Accordingly, CRA shall at the time of rating, clearly indicate the date when the rating is due for review.

- (iii) While the CRAs can decide the validity period of credit rating, they would have to closely monitor the rating assigned to issuers vis-a-vis their track record at regular intervals and would be required to make their revision in the ratings of public through their publications and website.

Documentation Procedure

Fixed Income Money Market and Derivatives Association of India (FIMMDA) may prescribe, in consultation with the RBI, for operational flexibility and smooth functioning of CP market, any standardised procedure and documentation that are to be followed by the participants, in consonance with the international best practices. For this Issuer/IPAs are required to refer to the detailed guidelines issued in this regard. Violation of these guidelines will attract penalties and may also include debarment of the entity from the CP market.

Defaults in CP market

In order to monitor defaults in redemption of CP, scheduled banks which act as IPAs, are advised to immediately report, on occurrence, full particulars of defaults in repayment of CPs to the Financial Markets Department, Reserve Bank of India.

Non-applicability of Certain Other Directions

Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 does not apply to any non-banking financial company (NBFC) insofar as it relates to acceptance of deposit by issuance of CP, in accordance with the Guidelines.

12. Gilt-edged (Government) Securities

These securities are issued by Governments such as Central and State Governments, Semi-Government Authorities, City Corporations, Municipalities, Port Trust, State Electricity Boards, Metropolitan Authorities, Housing Boards and Large Financial Institutions. They are held by RBI and are eligible to be reckoned for the purpose of SLR of the banks. Though they are long dated securities, they are in great demand as banks have to buy/sell them for maintaining the level of Net Demand and Time Liabilities (NDTL) as on the last day (Friday) of the second preceding fortnight. Being a security issued by the sovereign government, they are considered the most secured financial instruments which guarantees both safety of the capital and the income.

Considering their liquidity and safety, the rate of interest is lower but it is payable half-yearly. These securities are issued by the Public Debt Office (PDO) of the RBI. Unlike T-Bills they are not auctioned, their issues are notified a few days before opening for subscription and offer is kept open for two to three days. The budgeted amount is collected through a number of tranches over the period of a year. This helps avoidance of flooding of the market with securities. The issues are mostly mopped up by institutional investors. When these securities are announced for issue RBI suspends the sale of existing loans till the closure of the subscription to the new issues of gilt-edged securities. The government has a right to retain excess subscriptions upto 10% over and above the notified limit. Applications for the

securities are received at the offices of the RBI and SBI generally during the slack season, when there is no acute demand for funds outside.

The process of issue and redemption of bill rated securities is a continuous one. Because of their continuous availability they are called tap-stocks. In most cases redemptions on the stipulated date will be meager as redemption can take place from time to time, as and when the investor opts for it. Redemption can also take place in the form of exchange or conversion of the existing securities for new ones. Grooming of the market and switching are the other operations resorted to by RBI. While grooming means acquiring securities nearing maturity to facilitate redemption and making available a variety of loans to broaden the gilt-edged market. On the other hand, switching means purchasing one security against the sale of another security instead of outright sale of the new one. These are called open operations in the secondary market.

When RBI refunds cash or issues new securities it is called primary market operations in Government securities. RBI buys the securities mostly in switch operations and rarely for cash. The purchase is made by RBI from out of the surplus funds of IDBI, Exim Bank and NABARD under special arrangements. Switch operations are helpful to the banks and financial institutions in improving the yields on their investments in Government Securities. The RBI fixes annual quota based on the size of each bank for its switch transactions.

As the buyers are banks, insurance companies and Employees Provident Funds which are statutorily required to invest in Gilt-edged Securities, the market for them continues to be captive in nature. A buy-back service is offered by RBI for the Government Securities at prices quoted in the rate lists that RBI publishes from time to time. These rates help the banks to obtain the yield in alignment with the coupon rates of the new Central Securities. The facility to substitute one security for another in their portfolio of SLR is provided by RBI to the banks.

No forward market exists for transactions in the securities but the repo transactions exist in the inter-bank market offering an opportunity to place odd amounts of cash for any period of time and in any eligible security. The risk of default is reduced as the investment is fully collateralised.

Banks opt for repo transactions in Government securities to avail three benefits:

- (a) The borrowing by a bank in the call money market increases its CRR and SLR liabilities. But when a repo transaction is undertaken it is shown in the bank books as an outright sale of securities and hence not reflected in the level of Net Demand and Time Liabilities (NDTL). The CRR and SLR liabilities therefore, are unaffected.
- (b) Some times to make speculative profits, banks sell or buy repos but this is risky in as much as the price movements may not go as expected.
- (c) Some banks manage to sell and buy SLR securities as part of liquidity adjustments, taking into account the rates they would get through the repo and the new coupon rate that they expect and how soon they can realise it.

What is Repo Transaction?



Repo means an instrument for borrowing funds by selling securities of the Central Government or a State Government or of such securities of a local authority as may be specified in this behalf by the Central Government or foreign securities, with an agreement to repurchase the said securities on a mutually agreed future date at an agreed price which includes interest for the fund borrowed.

For short term Government Securities there is no attractive and effective secondary market as such securities (other than T- Bills) are not issued regularly. As and when they are issued their yields are fixed at below market rates. Consequently, profits can rarely be made either through switch transactions or occasional ready forwards. As the budget deficits are generally large requiring massive financing, open market operations in the primary market dominate the scene limiting the short-term operations in the secondary market. However, in the recent past, secondary market is being actively developed by different means for Government securities.

LESSON ROUND UP

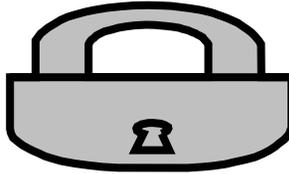


- Money market is a very important segment of the Indian financial system. It is the market for dealing in monetary assets of short-term nature.
- There are a large number of participants in the money market: commercial banks, mutual funds, investment institutions, financial institutions and the Regulatory Authority.
- The money market possesses different operational features as compared to capital market. It deals with raising and deployment of funds for short duration while the capital market deals with long-term funding.
- The money market operates as a wholesale market and has a number of inter-related sub-markets such as the call market, the bill market, the treasury bill market, the commercial paper market, the certificate of deposits market etc.
- Money market instruments mainly include Government securities, securities issued by Banking sector and securities issued by private sector.
- All funds raised by the government from the money market are through the issue of securities by the RBI.
- Methods of Issuance of Government Securities are (a) Auctions (b) On-tap issue (c) Fixed coupon issue (d) Private Placement (e) Open Market Operations (OMO)

- Money at call is outright money. Money at short notice is for a maturity of or up to 14 days.

- Treasury Bills are money market instruments to finance the short term requirements of the Government of India.
- Certificates of Deposit (CDs) is a negotiable money market instrument and is issued in dematerialised form or as a Usance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period.
- Commercial bills are basically negotiable instruments accepted by buyers for goods or services obtained by them on credit.
- 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 enabling highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors.
- Gilt-edged (Government) Securities are issued by Governments such as Central and State Governments, Semi-Government Authorities, City Corporations, Municipalities, Port Trust, State Electricity Boards, Metropolitan Authorities, Housing Boards and Large Financial Institutions.

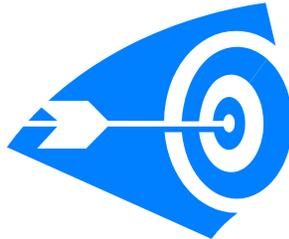
SELF TEST QUESTIONS



(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. "Money market is very important segment of Indian Financial System". Comment and discuss various features of money market.
2. Discuss various types of government securities and benefits of investing in government securities.
3. Explain Treasury Bills as an effective Cash Management product and state how yield of Treasury Bill is calculated.
4. Briefly discuss the guidelines for issue of commercial paper.
5. Discuss the role and responsibilities of issuer, issuing and paying agent and credit rating agency in issuance of commercial paper.
6. Write a short note on Gilt edged Securities Market.

STUDY IV
CAPITAL MARKET INSTRUMENTS



LEARNING OBJECTIVES

The study will enable the students to understand

- Classification of instruments
- Preference shares and its various kinds
- Tracking stocks
- Sweat Equity shares
- Foreign Currency Convertible Bonds/Global Depository Receipts
- Indian Depository Receipts
- Derivatives
- Hedge Funds, Exchange Traded Funds, Fund of Funds & Gold Exchange Traded Funds

INTRODUCTION

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, whereunder the company has to issue the security. Investor preferences vary with their attitude towards risk, and their investment goals and investment horizon. The tax liability of the investor too effects the choice of investment media. The firm on the other hand, is affected by the debt-equity ratio permissible, SEBI Regulations on issue of capital, and the formalities to be complied with while raising an issue. 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. The corporate sector and financial/investment institutions have been issuing new instruments to attract investors. However, the range of instruments used is still very narrow. Convertible debenture is the most popular instrument in the current scenario to raise funds from the markets. The attraction for the instrument for both the corporate sector and the investor lies in—(a) the investor gets a reasonable return during the initial years, followed by equity participation on conversion, and (b) the issue involves lower post-tax cost of capital, thereby entailing a lesser strain on liquidity.

CLASSIFICATION OF 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, non convertible debentures with equity warrants, partly convertible debentures, partly convertible debentures with Khokha (buy-back arrangement), Optionally convertible debenture, warrants convertible into debentures or shares, secured premium notes with warrants etc.



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

The salient features of various financial instruments available in the financial markets have been discussed in the study material. Money market instruments have already been discussed in the chapter 'Money Market' and the salient features of instruments available in securities markets are discussed below:

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 are member of the company and have voting rights. A company may issue shares with differential rights as to voting, payment of dividend etc.

Equity capital and further issues of equity capital by a company are generally based on the condition that they will rank *pari passu* alongwith the earlier issued share capital in all respects. However, as regards dividend declared by the company such additional capital shall be entitled to dividend ratably for the period commencing from the date of issue to the last day of the accounting year, unless otherwise specified in the articles or in the terms of the issue.

Important characteristics of equity shares are given below:

1. Equity shares, other than non-voting shares, have voting rights at all general meetings of the company. These votes have the affect of the controlling the management of the company.
2. Equity shares have the right to share the profits of the company in the form of dividend (cash) and bonus shares. However even equity shareholders cannot demand declaration of dividend by the company which is left to the discretion of the Board of Directors.
3. When the company is wound up, payment towards the equity share capital

will be made to the respective shareholders only after payment of the claims of all the creditors and the preference share capital.

4. Equity share holders enjoy different rights as members such as:
 - (a) right of pre-emption in the matter of fresh issue of capital (Section 81)
 - (b) right to apply to the court to set aside variations of their rights to their detriment (Section 107)
 - (c) right to receive a copy of the statutory report before the holding of the statutory meeting by public companies (Section 165)
 - (d) right to apply to Central Government to call for the Annual General Meeting, if the company fails to call such a meeting (Section 167)
 - (e) right to apply to Company Law Board for calling for an extra-ordinary general meeting of the company (Section 186)
 - (f) right to receive annual accounts along with the auditors report, directors report and other information (Section 210, 217 & 219).

[The rights mentioned at 4(b), 4(c), 4(d), 4(e) and 4(f) are also available to the preference shareholders. The right of pre-emption in the matter of fresh issue of capital is available only to the equity shareholders vide Section 81(1)(a)].

Equity shareholders, other than non-voting shares are entitled to voting rights in all matters, whereas preference shareholders are entitled to voting rights if the assured dividend to which they are entitled has been in arrears for a specified period. In the normal course where there is no dividend in arrears to be paid to them they have no voting rights except in a class meeting convened for preference share holders for specific purposes.

Shares with Differential Voting Rights

The Central Government notified Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 vide GSR No. 167(E) dated 9th March, 2001.

Rules 3 of the Rules enables companies limited by shares to issue shares with differential rights as to dividend, voting or otherwise, subject to fulfilment of certain conditions. The conditions are required to be fulfilled at the time of issue of equity shares with differential rights for the simple reason that these are the conditions subject to which a company may issue shares with differential rights. The conditions are :

1. The company has distributable profits in terms of section 205 of the Companies Act, 1956 for preceding three financial years preceding the year in which it was decided to issue such shares.
2. The company has not defaulted in filing annual accounts and annual returns for three financial years immediately preceding the financial year of the year in which it was decided to issue such share. The period of three financial years prescribed above shall be reduced proportionately in the case of companies, which are in existence for less than three financial years. In cases where the default has been condoned by the prescribed authority, it

shall be deemed, for the purpose of this clause that the company had not defaulted in filing of the documents. In other words, the condition does not apply to companies, which have made good the default.

3. The company has not failed to repay its deposits or interest thereon on due date or redeem its debentures on due date or pay dividend.

The above two conditions are similar to the provisions of section 274(1)(g) disqualifying a director under that section.

4. The Articles of Association of the company authorizes the issue of shares with differential voting rights. Where the articles of association of a company do not authorize issue of such shares, then a special resolution under section 31 of the Act shall be passed in the general meeting to suitably alter the articles.
5. The company has not been convicted of any offence arising under, Securities Exchange Board of India Act, 1992; Securities Contracts (Regulation) Act, 1956. Foreign Exchange Management Act, 1999. All the above rules are stringent, for they prohibit companies having defaulted/ convicted, as the case may be, in the specified areas once in a lifetime. The clause, however, does not cover the offences under Companies Act, 1956.
6. The company has not defaulted in meeting investors' grievances. The definition of "meeting" of investors' grievances is not clear. In true sense, it means satisfaction of investor or doing the rightful thing, which will reach the logical end. One may say that replying investors may amount to meeting investor's grievance. This argument seems justifiable in cases where the investors do not respond by submitting necessary information/ documents, whereby the cases remains pending at their end.
7. The company has obtained the approval of shareholders in general meeting by passing resolution as required under the provision of sub-clause (a) of sub-section (1) of section 94 read with sub-section (2) of the said section.

This rule requires companies to obtain approval of the shareholders in the general meeting by passing resolution under section 94(1)(a) for increase in share capital by issuing new shares. However, such resolution is not required in cases where a company does not issue new shares with differential rights, but varies the rights of the existing equity shares to include an element of difference in rights attached to those shares, subject to compliance with the conditions prescribed under sections 106 and 107 and the provisions in the articles of association of the company.

The opening words of Rule 3 namely, "Every company limited by shares may issue with..." do not supersede the provisions of sections 106 and 107 and do not, thereby, require companies to issue fresh shares with differential rights. Sections 106 and 107 deal with the shares of different classes of shares. Therefore, a company having equity share capital may have two classes of shares e.g. — A class equity shares and B class equity shares. Further, section 94(1)(a) deals with increase in share capital by issue of new shares only. However, there is a room for debate on this issue.

8. The listed public company has obtained the approval of shareholders through postal ballot. One will have to carry out necessary procedures under the Rules governing Postal Ballot.
9. The notice of the meeting at which resolution is proposed to be passed is accompanied by an explanatory statement stating—
 - (a) the rate of voting rights which the equity share capital with differential voting right shall carry (differential voting right here includes right to voting, dividend or otherwise);
 - (b) the scale or in proportion to which the rights of such class or type of shares will vary (the particulars of the differential right shall be provided for);
 - (c) the company shall not convert its equity capital with voting rights into equity share capital with differential voting rights and the shares with differential voting rights into equity share capital with voting rights (however, one may take shelter under Sections 106 and 107 as explained above);
 - (d) the shares with differential voting rights shall not exceed 25% of the total share capital issued; (this clause limits the quantum of shares that may be issued with differential rights). The limit could have been restricted to paid-up capital rather than issued capital.
 Clauses (c) and (d) of Rule 9 of the Rules, could have been bifurcated into sub-rules stipulating conditions, rather than requiring companies to make them a part of the explanatory statement;
 - (e) that a member of the company holding any equity share with differential right shall be entitled to bonus shares, right shares of the same class;
 - (f) the holders of the equity shares with differential right shall enjoy all other rights to which the holder is entitled to excepting the differential right as indicated in (a) above.

The holders of the equity shares with differential voting rights shall enjoy all other rights to which the holder is entitled to excepting the differential right.

Rule 4 of the Rules requires every company referred to in rule 3 to maintain a register as required under section 150 of the Companies Act containing the particulars of differential rights to which the holder is entitled.

As per section 2(46A) a share with differential rights means a share that is issued with differential rights in accordance with the provisions of section 86 of the Act. The equity shares with differential rights include equity shares with differential rights as to—(a) voting; (b) dividend; and (c) otherwise.

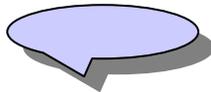
Neither the Act nor the Rules define the term—"otherwise", which may include any other right attached to equity shares.

Clause 28A of the Listing Agreement, however provides that a listed company cannot issue shares in any manner which may confer on any person, superior rights as to voting or dividend vis-à-vis the rights on equity shares which are already listed.

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 priority 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.

The following kinds of preference shares are dealt with by the companies:



- cumulative preference shares
- non-cumulative preference shares
- convertible preference shares
- redeemable preference shares
- irredeemable preference shares
- participating preference share
- non participating preference shares

Cumulative preference shares

In the case of this type of share the dividend payable every year becomes a first claim while declaring dividend by the company. In case 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. Such arrears of preference dividend will be carried forward and paid out of the profits of the subsequent years, before payment of equity dividend. However, 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

In the case of these shares, dividend does not accumulate. If there are no profits or the profits are inadequate in any year, the shares are not entitled to any dividend for that year. Unless there is a specific provision in the Articles of Association of the company, the preference shareholders have no right to participate in the surplus profits or in the surplus assets in a winding up. They are entitled to payment of the declared preference dividend in any particular year and to the repayment of their preference capital in the event of winding up before payment to the equity shareholders.

Convertible preference shares

If 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 or right, 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. These shares are

some times referred to as quasi equity shares in common parlance. Companies may even charge a premium as part of the terms of conversion of preference shares, as they do sometimes while converting debentures into equity shares.

Redeemable preference shares

If the articles of a company so authorise, redeemable preference shares can be issued. This is in contrast to the principle that the company normally can not redeem or buy back its own shares vide Section 77 of the Act, except by following the procedure for reduction of capital and getting the sanction of the High Court in pursuance of Sections 100 to 104 or of Section 402. With effect from 31st October, 1998 a new Section 77A was inserted in the Act empowering companies to purchase its own securities under certain circumstances and subject to certain conditions.

Section 80 regulates the redemption of redeemable preference shares as follows:

1. The partly paid shares, if any, must be made fully paid up.
2. The shares are to be redeemed only out of the profits of the company, which would otherwise be available for distribution of dividend or out of the proceeds of a fresh issue of shares made for the purpose.
3. The premium, if any payable, on redemption should be provided for out of the profits of the company or its security premium account.
4. Where redemption is made out of profits, a sum equal to the nominal value of the shares redeemed, must be transferred to a capital redemption reserve account which can be utilised only to pay up unissued shares of the company to be issued as fully paid bonus shares.

With effect from 1st March, 1997 a new sub-section 5A was inserted under section 80 laying down that no company limited by shares shall issue any preference shares which is irredeemable or is redeemable after the expiry of a period of 20 years from the date of its issue.

Irredeemable preference shares

If the terms of issue provide that the preference shares are not redeemable except on the happening of certain specified events which may not happen for an indefinite period such as winding up, these shares are called irredeemable preference shares. Issue of irredeemable preference shares was permitted till the amendment of the Act by introduction of Section 80A with effect from 15th June, 1988 (This was further amended by sub-section 5A with effect from 1st March, 1997). As per the 1988 amendment all preference shares existing on 15th June, 1988 which were not redeemable within 10 years from the date of the issue and had not been redeemed on or before 15th June, 1998 were to be compulsorily redeemed by the company on the due date of redemption or within a period not exceeding 10 years from 15th June, 1988. Where a company was not in a position to redeem any shares within the period aforesaid and to pay the dividend thereon, the company might with the consent of Company Law Board on a petition made by it in this behalf, issue further redeemable shares equal to the amounts due including the dividend thereon in respect of unredeemed preference shares. On the issue of such further redeemable preference shares, the unredeemed shares shall be deemed to have been redeemed.

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. Subject to provision in the terms of issue these shares can be entitled to participate in the surplus profits left, after payment of dividend to the preference and the equity shareholders to the extent provided therein. Subject to provisions in the terms of issue such preference shares can be entitled even to bonus shares.

Non participating preference shares

Unless the terms of issue indicate specifically otherwise, all preference shares are to be regarded as non-participating preference shares.

Debentures

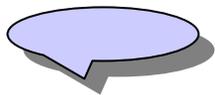
Section 2(12) of the Companies Act, 1956 defines debentures as follows:

“Debenture includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not.”

Debenture is a document evidencing a debt or acknowledging it and any document which fulfills either of these conditions is a debenture. The important features of a debenture are:

1. It is issued by a company as a certificate of indebtedness.
2. It usually indicates the date of redemption and also provides for the repayment of principal and payment of interest at specified date or dates.
3. It usually creates a charge on the undertaking or the assets of the company. In such a case the lenders of money to the company enjoy better protection as secured creditors, i.e. if the company does not pay interest or repay principal amount, the lenders may either directly or through the debenture trustees bring action against the company to realise their dues by sale of the assets/undertaking earmarked as security for the debt.

Debentures are issued in the following forms:



- Naked or unsecured debentures.
- Secured debentures.
- Redeemable debentures.
- Perpetual debentures.
- Bearer debentures.
- Registered debentures.

Their features are as follows:

- (a) *Naked or unsecured debentures*: Debentures of this kind do not carry any charge on the assets of the company. The holders of such debentures do not therefore have the right to attach particular property by way of security as to repayment of principal or interest.
- (b) *Secured debentures*: 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. The mortgage may be one duly registered in the formal way or one which is secured by the deposit of title deeds in case of urgency.
- (c) *Redeemable debentures*: Debentures that are redeemable on expiry of certain period are called redeemable debentures. Such debentures after redemption can be reissued in accordance with the provisions of Section 121 of the Companies Act, 1956.
- (d) *Perpetual debentures*: If the debentures are issued subject to redemption on the happening of specified events which may not happen for an indefinite period, e.g. winding up, they are called perpetual debentures.
- (e) *Bearer debentures*: Such debentures are payable to bearer and are transferable by mere delivery. 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. A bonafide transferee for value is not affected by the defect in the title of the transferor.
- (f) *Registered debentures*: 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 debentureholders maintained as per Section 152 of the Companies Act, 1956.

Based on convertibility, debentures can be classified under three categories:

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

1. *Fully Convertible Debentures (FCDs)*: These are converted into equity shares of the company with or without premium as per the terms of the issue, on the expiry of specified period or periods. If the conversion is to take place at or after eighteen months from the date of allotment but before 36 months, the conversion is optional on the part of the debenture holders in terms of SEBI ICDR Regulations. Interest will be payable on these debentures upto the date of conversion as per transfer issue.

2. *Non Convertible Debentures (NCDs)*: These debentures do not carry the option of conversion into equity shares and are therefore redeemed on the expiry of the specified period or periods.

3. *Partly Convertible Debentures (PCDs)*: These may consist of two kinds namely - convertible and non-convertible. The convertible portion is to be converted into equity shares at the expiry of specified period. However, the non convertible portion

is redeemed at the expiry of the stipulated period. If the conversion takes place at or after 18 months, the conversion is optional at the discretion of the debenture holder.

Basic features of convertible debentures

1. Debentures are issued for cash at par.
2. They are converted into specified or unspecified number of equity shares at the end of the specified period. The ratio at which the convertible debentures are exchanged for equity shares is known as conversion price or conversion ratio which is worked out by dividing the face value of a convertible debenture by its conversion price. For instance if the face value of a convertible debenture is Rs.100 and it is convertible into two equity shares, the conversion price is Rs.50 and the conversion ratio is 2. The difference between the conversion price and the face value of the equity share is called conversion premium.
3. Convertible debentures may be fully or partly convertible. In case it is fully convertible the entire face value is converted into equity shares on expiry of the stipulated period. If partly convertible, the convertible portion is converted into equity shares on expiry of the specified period and the non convertible portion is redeemed at the expiry of certain period.
4. Conversion into equity shares may take place in one or more stages at the end of specified period or periods in the case of fully or partly convertible debentures.
5. If one or more parts of the debentures are convertible after 18 months, a company should get a credit rating done by a credit rating agency approved by SEBI. Fresh rating is required if debentures are rolled over.
6. Earlier upto July, 1991 the Controller of capital issues had imposed a maximum interest rate of 14% per annum payable on convertible debentures for non FERA, non MRTP companies and 12.5% per annum in other cases. However from 1st August, 1991 interest rates of debentures were deregulated and companies were allowed to pay interest at rates they considered reasonable.
7. Convertible debentures of public companies are listed on the stock exchanges to assure liquidity to the holders. However, even today debt instruments are not actively traded in Indian stock exchanges.

Advantages of convertible debentures

The advantages of convertible debentures to the company are—

1. Capitalisation of interest cost till the date of commissioning of the project is allowed in accordance with accounting principle. If the conversion of the debentures is duly linked with the commissioning of the project the entire interest cost can be capitalised, without charging the interest to profit & loss account and pulling down the profits of the company.
2. Convertible debentures carry lower interest as compared to the rate charged by the Banks and Financial Institutions.

3. From the point of view of the debt equity ratio the convertible part of the debentures is treated as equity by financial institutions. The company is thus enabled to have a high degree of flexibility in financing its future projects.
4. Equity capital gets increased after each conversion, facilitating easier servicing of equity by payment of dividend.
5. Tax benefits are higher as interest on debentures is allowed as a deduction in computation of taxable income of the company. Additionally a company having a proven track record and future earning potential will be able to reasonable premium at the time of conversion. This will result in reducing the servicing cost of equity.
6. This is a popular form of financing in companies as the interest rates are cheaper than those charged by Financial Institutions on term loans.
7. In the case of term loans from FIs and Banks they usually impose many conditions on management including placing their representative on the board. In the case of convertible debentures there is thus a greater degree of autonomy for the companies.

The advantages of the convertible debentures to the investors are -

1. The investor is assured of a fixed return by way of interest on the debentures till conversion. On conversion into equity the investor becomes entitled to receive dividend declared on equity shares. The advantage to the investor is that he receives a fixed return on his investment by way of interest even during the gestation period and project implementation period.
2. As price of equity shares tends to rise on completion of the project of the company, the investor gets value appreciation on his investment, if converted into equity.
3. In most cases, debentures carry security with a charge on all or a part of movable/immovable properties of the company. This assures prompt payment of principal and interest by invoking the assistance of a debenture trustee. However in terms of SEBI Regulations where the debentures have a maturity period of 18 months or less it is mandatory for the company to create security on the debentures.
4. A fair amount of liquidity is enjoyed by convertible debentures listed on the stock exchanges depending on the track record of the companies. Even if debentures are not traded as actively as equity shares, convertible debentures of good companies command reasonable liquidity. Where a debenture has several parts, each part of the convertible debentures can be traded separately or in full on the stock exchanges.
5. The following options are available to the investor who has bought convertible debentures issued in several parts:
 - (a) To sell all the parts immediately on allotment;
 - (b) To sell one or more parts and retain other or others till conversion and to obtain equity shares for retention or sale.

The distinctions between fully convertible and partly convertible debentures are—

<i>Characteristics</i>	<i>Partly convertible debentures</i>	<i>Fully convertible debentures</i>
Suitability	Better suited for companies with established track record	Better suited for companies without established track record
Capital base	Relatively lower equity capital on conversion of debentures	Higher equity capital on conversion of debentures
Flexibility in financing	Favourable debt equity ratio	Highly favourable debt equity ratio
Classification for debt-equity ratio computation	Convertible portion classified as 'equity' and non-convertible portion as 'debt'	Classified as equity for debt-equity computation
Popularity	Not so popular with investors	Highly popular with investors
Servicing of equity	Relatively lesser burden of equity servicing	Higher burden of servicing of equity

In the case of partly convertible debentures, debenture redemption reserve has to be created for 50% of the face value of the non-convertible portion. The facility of buy-back is also permissible in respect of non-convertible portion of debentures.

In contrast no reserve for debenture redemption is required for fully convertible debentures nor buy-back arrangements are permissible.

Detachable warrants issued alongwith both convertible and non convertible debentures afford many advantages.

The warrant entitles the debenture holders to get equity shares specified in the warrants on expiry of a certain period at a price not exceeding the cap price mentioned in the warrant. Equity warrant is commonly issued with non convertible debentures to brighten their marketability. Warrants attached to convertible debentures and equity shares make the latter hot cakes in the market. The warrant is a negotiable instrument which is easily tradable if listed on the stock exchange.

Convertible bonds are issued in developed capital markets with a conversional price well above the current market price per share. The pricing is generally higher by 15% to 20% than the current price of the shares in the market. The investor has the option to avoid the conversion, if the market price of the security falls below the conversion price. The timing of the conversion also can be kept flexible by the company.

In view of the attraction offered by equity warrant, companies issue them by private placement without employing the services of brokers/sub-brokers etc.

In the case of issues made to the market, wider disposal of equity reduces the risk of takeover bids. The management can buy these shares gradually through intermediaries observing SEBI regulations.

Sometimes companies issue *zero interest fully convertible debentures*. In this case, investors are not paid any interest till the date of conversion or upto the notified date, after which they are converted into shares. For the investor the investment amount is lower and cost of conversion also is less. Further this helps them as a means of tax planning since interest which is otherwise taxable is not paid. The capital appreciation at the time of conversion is treated as capital gains where tax rate is less. Companies also prefer this instrument because they are able to avoid payment of interest.

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. The holder has an option to sell back the SPN to the company at par value after the lock in period. If the holder exercises this option, no interest/premium is paid on redemption. In case the holder keeps it further, he is repaid the principal amount along with the additional interest/premium on redemption in installments as per the terms of issue. The conversion of detachable warrants into equity has to be done within the specified time. TISCO took the lead in July, 1992 by making a mega rights issue of equity shares and secured premium notes aggregating to Rs.1,212 crores.

The terms of the SPN were so formulated that the return on investment was treated as capital gain and not regular income. Consequently, the rate of tax applicable was lower.

Equity Shares with Detachable Warrants

Essar Gujarat, Ranbaxy and Reliance issued this type of instrument. The holder of the warrant is eligible to apply for the specified number of shares on the appointed date at the pre-determined 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. Reliance has used this method.

Deep Discount Bond

IDBI and SIDBI had issued this instrument. For a deep discount price of Rs.2,700/- in IDBI the investor got a bond with the face value of Rs.1,00,000. The bond appreciates to its face value over the maturity period of 25 years. Alternatively, the investor can withdraw from the investment periodically after 5 years. The capital appreciation is charged to tax at capital gains rate which is lower than normal income tax rate. The deep discount bond is considered a safe, solid and liquid instrument and assigned the best rating by CRISIL.

Fully Convertible Debentures with Interest (Optional)

In this case there is no interest payment involved say for the first 6 months. Then the holder can exercise option and apply for securities at a premium without paying additional amount. However interest will be payable at a determined rate from the date of first conversion to second/final conversion and in lieu thereof equity shares are issued.

Partly convertible debentures can also be issued with similar or modified features as indicated above.

Fully Convertible Cumulative Preference Share (Equipref)

This instrument is in two parts A & B. Part A is convertible into equity shares automatically and compulsorily on the date of allotment without any application by the allottee, and Part B is redeemed at par/converted into equity after a lock in period at the option of the investor, at a price 30% lower than the average market price. The dividend is given only for part B shares.

Upon conversion of each part, the face value stands reduced proportionately on the date of conversion.

Sweat Equity Shares

Sweat equity share is a instrument permitted to be issued by specified Indian companies, under Section 79A of Companies Act, 1956 inserted by Companies (Amendment) Act, 1999 w.e.f. 31st October, 1998. According to this section a public company may issue sweat equity shares of a class of shares already issued if the following conditions are fulfilled:

- (a) The issue of sweat equity share is authorised by a special resolution passed by the company in the general meeting.
- (b) The resolution specifies the number of shares, current market price, consideration if any and the class or classes of directors or employees to whom such equity shares are to be issued.
- (c) Not less than one year has elapsed at the date of the issue, since the date on which the company was entitled to commence business.
- (d) The sweat equity shares of a company whose equity shares are listed on a recognised stock exchange are issued in accordance with the regulations made by SEBI in this regard.

However, in the case of a company whose equity shares are not listed on any recognised stock exchange, the sweat equity shares are to be issued in accordance with the guidelines as may be prescribed.

The expression "company" means company incorporated, formed and registered under the Companies Act, 1956, and includes its subsidiary company incorporated in a Country outside India.

All the limitations, restrictions and provisions relating to equity shares are also applicable to such sweat equity shares issued under the new Section 79A.

Sweat equity shares can be issued by the company to employees or directors at a discount or for consideration other than cash, for providing know how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

It may be noted that the intellectual property right, know how or value additions arise as of now mainly in the case of Information Technology related companies and Pharmaceutical companies. Categories of industries which are eligible to issue sweat equity shares have not been indicated by the Government either in the Act or otherwise.

The term "sweat equity" indicates equity issued to directors and long time employees who have toiled from the inception of the company to build it with a brand image and thus contributed significantly by their efforts in this direction.

Since these shares are issued at a discount or for consideration other than cash, the company will generally select those employees and directors as per norms approved by the Board of Directors, based on the know how provided or intellectual property rights created and given for value additions made by such directors and employees to the company.

Tracking Stocks

Dr. J.J. Irani Expert Committee constituted by the Government to make recommendation on the Concept Paper on Company Law has recommended in its report for the introduction of 'Tracking Stocks' in the Indian Capital Market.

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.

A tracking stock is a special type of stock issued by a publicly held company to track the value of one segment of that company. By issuing a tracking stock, the different segments of the company can be valued differently by investors. Tracking stocks are generally issued by a parent company in order to create a financial vehicle that tracks the performance of a particular division or subsidiary. When a parent company issues a tracking stock, all revenues and expenses of the applicable division are separated from the parent company's financial statements and bound to the tracking stock. Often this is done to separate a high-growth division from large losses shown by the financial statements of the parent company. The parent company and its shareholders, however, still control operations of the subsidiary.

Tracking stock carries dividend rights tied to the performance of a targeted division without transferring ownership or control over divisional assets. In contrast to a spin-off or an equity carve-out, the parent retains full control, allowing it to enjoy any operating synergies, or economies of scale in administration or finance.

Shareholders of tracking stocks have a financial interest only in that unit or division of the company. Unlike the common stock of the company itself, a tracking stock usually has limited or no voting rights. In the event of a company's liquidation, tracking stock shareholders typically do not have a legal claim on the company's

assets. If a tracking stock pays dividends, the amounts paid depends on the performance of the business unit or division. But not all tracking stocks pay dividends.

A company has many good reasons to issue a tracking stock for one of its subsidiaries (as opposed to spinning it off to shareholders).

- (i) First, the company keeps control over the subsidiary (although they don't get all the profit), but all revenues and expenses of the division are separated from the parent company's financial statements and attributed to tracking stock. This is often done to separate a high growth division with large losses from the financial statements of the parent company.
- (ii) Second, they might be able to lower their costs of obtaining capital by getting a better credit rating
- (iii) Third, the businesses can share marketing, administrative support functions, etc.
- (iv) Finally, if the tracking stock shoots up, the parent company can make acquisitions and pay in stock of subsidiary instead of cash.

When a tracking stock is issued, the company can choose to sell it to the markets (i.e., via an initial public offering) or to distribute new shares to existing shareholders. Either way, the newly tracked business segment gets a longer lease, but can still run back to the parent company in tough times.

Advantages of Tracking Stock

A key advantage of tracking stock is that it offers divisional managers a degree of decision-making authority that might otherwise be unattainable, given top management's reluctance to dilute its control over the division's assets. The practical effect should be to enhance job satisfaction for divisional managers, thus reducing retention risk and also increasing the company's responsiveness to changing market conditions. Also, investors have more direct access to the specific businesses of the parent, which can be highly useful in the case of a diversified company. Another possible reason for the growing popularity of trackers is that trackers allow mainstream companies to exploit the dual stock market pricing between conventional and high-tech or Internet businesses. By creating tracked business units, conventional businesses too can benefit from the pricing frenzy.

Disadvantages of Tracking Stock

For investors, tracking stocks can be of a mixed bag. Like regular stocks, tracking stockholders are entitled to dividends paid out by the subsidiaries issuing the tracking stock. Yet the holders of tracking stocks do not have ownership in the company, instead, at-times tracking stock shareholders vote on issues affecting the corporate parent, not the subsidiary whose stocks they own. Another downside is the fact that the board of directors of the tracking-stock subsidiary is often put in place by the parent company and is not elected by tracking stock shareholders, which would cause conflicts of interests.

The tracking stocks are highly skeptical also. Shareholders have limited voting rights, if any, and they cannot elect their own boards. Moreover, if the parent company falls on hard times, conflict could develop between the shareholders of a tracked division, especially if it continues to do well, and the shareholders of the

parent company. The potential for such conflict could affect the performance of the tracking stock.

Another important drawback with tracking stock is that it can dramatically increase the potential for conflict and litigation over accounting policy. It is because the owners of the tracking stock have rights only over dividends, and dividend payouts are driven by the recognition of divisional profits, the arguments over profit recognition are almost sure to arise whenever tracking stock investors are disappointed in their returns. They will surely be tempted to accuse corporate management of adopting policies that deliberately understate their profits.

Disaster Bonds

These are issued by companies and institutions to share the risk and expand the capital to link investors return with the size of insurer losses. The bigger the losses, the smaller the return and vice-versa. The coupon rate and the principal of the bonds are decided by the occurrence of the casualty of disaster and by the possibility of borrowers defaults.

Option Bonds

This instrument covers those cumulative and non-cumulative bonds where interest is payable on maturity or periodically and redemption premium is offered to attract investors.

Easy Exit Bonds

This instrument covers both bonds which provide liquidity and an easy exit route to the investor by way of redemption or buy back where investors can get ready encashment in case of need to withdraw before maturity.

Pay in Kind Bonds

This refers to bonds wherein interest for the first three to five years is paid through issue of additional bonds, which are called baby bonds as they are derived from parent bond.

Split Coupon Debentures

This instrument is issued at a discounted price and interest accrues in the first two years for subsequent payment in cash. This instrument helps better management of cash outflows in a new project depending upon cash generating capacity.

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.

Some of the above instruments have been used selectively by companies and institutions recently to raise funds.

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.

In structuring a coupon note issue, a conventional current coupon bond is sold to the investor. The streams of coupon payments are stripped away and the principal amount of bond is sold as a deep discount bond. The gain to the investor is difference between the purchase price and the par value. The coupon streams are sold like zero coupon bonds where the investor pays discount for it and receives the payment at a lower rate.

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. Depending on the prospects of the project during the conversion period, the lender may exercise either of the options. The fixed interest rate debenture may have certain additional features including higher rate of interest distinct from the original debt instrument.

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. This instrument is beneficial to the investors in periods of falling interest rates when the holder can exercise the debt warrant option and hold additional debt at, interest rates above market rates.

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. The interest rate is computed on the date of take down at the then prevailing private placement rates, using a formula based on the index such as the 182 days treasury bill yield rates. These instruments are beneficial to a company in a high interest rate environment, if the interest rates are expected to decline between the date of commitment and the date of takedown.

Stepped Coupon Bonds

Under stepped coupon bonds, the interest rate is stepped up or down during the tenure of the bond. The main advantage to the investor is the attraction of higher rate of interest in case of general rise in interest rates.

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. For example, equity shares or debentures may be issued with two warrants - one warrant giving right to the purchaser to be allotted one equity share at the end of a certain period and another warrant with a debt or preference share option.

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.

This instrument encourages long term investor participation in the scheme by favourable review of interest rates 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. These notes provide for level payments for time intervals during the term of the note, with periodic interest adjustments tied to an index, and adjustments to the principal balance to reflect the difference between the portion of the payment allocable to interest and the amount of floating rate interest actually incurred. Maximum limits on upward adjustments to principal are specified at the outset to protect the lender from runaway floating exposure. The level pay note has the advantage to the issuer of having a predictable level of debt service for a period of years, thereby avoiding the uncertainties of floating debt on cash flows during that time.

Industrial Revenue Bonds

Industrial revenue bonds are issued by financial institutions in connection with the development or purchase of industrial facilities. These may become attractive if certain income-tax and wealth-tax concessions are offered.

The bond proceeds could be used to purchase or a construct facilities which are subsequently leased or sold to the company. The institution acts as a conduit of funds between the lenders and the company in order to take advantage of tax benefits enjoyed by the institutions.

Commodity Bonds

Commodity bonds are bonds issued to share the risk and profitability of future commodity prices with the investor. For example, petro bonds, silver bonds, gold bonds and coal bonds.

A petro bond may carry a fixed rate of interest with part of the face value of the bonds denominated in barrels of oil. There would be a floor in the face value of the bond. In view of the upside profit potential in oil prices, the interest rate could be lower than the market rate of interest. These bonds may be issued for decontrolled items.

Participating Preference Shares

These are quasi equities and can be issued by companies to bolster the net worth without dilution of management control. They are similar in all respects to non voting equity shares except for preference over equity in the event of winding up. The face value of the share may be Rs.10 or Rs.100. The coupon rate may be linked into equity dividend. These shares will have the right to fully participate in the profits of the company and also be eligible for bonus shares. These are irredeemable in nature and hence an amendment to Section 80 of the Companies Act is necessary to enable the issue of such shares.

They are issued to risk averse investors interested in a steady return.

Participating Debentures

These debentures are profit sharing debentures which are unsecured with a right to participate in the profits of companies. These debentures can be issued up to a maximum of 50% of the voting equity shares. They shall have a maturity period of 3-10 years, and shall be listed separately on the stock exchanges.

These instruments are suited for high growth oriented existing dividend paying companies and may be issued by companies with a track record of dividend payment in the last two years and in 4 out of 5 or in 5 out of 7 previous years.

These debentures may be offered to all classes of investors including NRIs and foreigners. The investors in these instruments may also be given entitlement in right and bonus issues.

Third Party Convertible Debentures

These are debt instruments with warrant attached which gives an option to subscribe to the equity shares of another company at a price lower than the market price. These are similar to convertible debentures with warrant option except that these debentures give an option to the investor to subscribe for shares in another company. The coupon rates on these debentures are lower than pure debt in view of the warrant option. The debentures are secured and can be issued to all classes of investors. These instruments are suitable for high profile companies raising resources for greenfield projects.

Possible variations of the instruments are detachable equity coupons and debentures with equity coupons.

Convertible Debentures Redeemable at Premium

These are convertible debentures issued at face value with a put option to the investor to resell the debentures to the issuer at a premium on a future date. The face value of the debentures is higher than the market value of the equity shares into which they are to be converted.

The pricing of the debenture is a very vital factor to the issuer, since the value of the debentures is fixed higher than the market value of the equity shares into which they are to be converted. Accordingly, the issuer is able to lower the financing cost by raising debentures at a high price and lower coupon rate as compared to convertible debenture redeemable at par.

If the price of the underlying equity shares does not rise sufficiently to make conversion attractive to the investor, he may exercise his put option and sell the debentures to the issuer at a premium.

The investor is not required to pay any tax on conversion of debentures into equity shares. The investor stands to gain if there is a rise in price of the equity shares.

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. There is a commitment from the loan originator and/or intermediary institution to ensure a minimum yield on maturity.

Features of Assets to be Securitised

The assets to be securitised shall have the following features:

- (a) The cash flows generated from the assets should be received periodically in accordance with a pre-determined schedule.
- (b) The actual cash flows generated from the assets should be predictable.
- (c) The assets should be large in number and total value to be issued in securitised form.
- (d) The assets should be sufficiently similar in nature to enable pooling of their cash flows.
- (e) The assets should be marketable.

Types of Asset backed Securities: There are two types of asset backed securities. In the first type, the investors have an interest in the underlying assets, usually through a special purpose trust. These are known as 'Unitisation' in UK and 'Pass through Securities' in USA.

The second type is where a special purpose vehicle, usually a company issues negotiable securities whose value is derived from and secured by the assets held by the vehicle. These are known as 'securitisation' in UK and 'asset backed securities' in USA.

Advantages of Asset backed Securities to Issuer:

- (a) The issuer can generate cash from the assets immediately enabling funds to be redeployed in other projects.
- (b) The issuer may be able to improve balance sheet ratios by excluding the original assets and the securities created by the assets from the balance sheet by suitable structuring of the transaction.

Advantages of Asset backed Securities to Investor.

These instruments have a relatively low credit risk since the securities are backed by good quality collateral and offer a higher yield than Government securities.

Carrot and Stick Bond

Another variation of the above instrument is the 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. Finally, the spot yield curve can be better constructed based on the real yields.

Inflation risk: A nominal bond is exposed to high inflation risk. This is the risk that inflation will increase, leading to increase in interest rate. Essentially then, inflation risk is a sub-component of interest rate risk. A capital indexed bonds lowers the interest rate risk by neutralising the inflation risk.

The effectiveness of the hedge will, however, depend on the appropriateness of the inflation index. The purpose of issuing capital indexed bonds will not be fully served if the RBI were to use the Wholesale Price Index (WPI) or the Retail Price Index (RPI) as the index for inflation. The reason is that these indices do not adequately capture inflation as it affects the investors, especially the retail class.

If banks are protected against inflation risk, they may, perhaps, pass on the benefits in the form of higher interest rate to the retail investors. That, in turn, provides retail investors a higher cushion against inflation risk. In such cases, more the inflation index is aligned to price levels affecting retail consumption, better the hedge.

Inflation expectation: Investors buy bonds by postponing their current consumption. There is, therefore, a trade-off between investment and consumption. To make an intelligent decision between these two states of nature, investors need an indicator to measure inflation expectations. At present, due to lack of adequate measures, we assume that inflation expectation is the same as current inflation. If actual inflation were higher in the future, the investment decision may be unattractive. It is, therefore, important to proxy inflation expectation. A capital indexed bond helps in this regard.

If the RBI were to issue capital indexed bonds across the yield curve, we will have real yields for each maturity sector. We already have nominal yields as well for these sectors. The difference between the nominal and the real yields is a proxy for inflation expectation.

Moreover, the RBI also proposes to introduce STRIPs. Such instruments will make more sense on real interest-bearing bonds than the nominal ones.

Debt for Equity Swap

These instruments give an offer to the debt holders to exchange the debt for equity shares of the company.

The issuers offering debt for equity swaps are interested in increasing equity capital by improving their debt-equity ratios and enhancing their debt issuing capacity. They reduce their interest burden and replace it with dividend burden which is payable at the discretion of the issuer. However, the issuer faces the risk of dilution of earnings per share by a sharp rise in the equity. In addition, dividends are not tax deductible.

From the investors point of view, there is potential gain from rise in the value of the equity shares. The potential rise in price of equity shares may or may not materialise.

Variations of this instrument are mortgage backed securities that split the monthly payment from underlying mortgages into two parts - each receiving a specified portion of the principal payments and a different specified portion of the interest payments.

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 advantages 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.

The investor gains in the event of appreciation in the value of the equity shares. Even if the appreciation does not materialise, the investor has the benefit of a steady stream of implied income. If the instrument is issued with put option, the investor can resell the securities to the investor.

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. After getting approval from the Ministry of Finance and completing other formalities, a company issues rupee denominated shares in the name of depository which delivers these shares to its local custodian bank, the holder on records, thus depository. The depository then issues dollar denominated depository receipts (or GDR) against the shares registered with it. Generally one GDR is equivalent to one or more (rupee denominated) shares. It is traded like any other dollar denominated security in the foreign markets, in addition to equity financing (as GDR represents equity) over debt financing. GDR issue also possesses merits like less issue formalities, less administrative works as regards dividend payment, information dissemination, annual general meeting etc. as the issuer deal only with a single shareholder, the depository; easy availability of foreign exchange and no foreign exchange risk. Besides issuing companies, foreign investors especially FIIs also get advantage of investing in the Indian companies without getting registration with SEBI, relief from cumbersome settlement and delivery procedures, adequate liquidity (as GDR is as liquid as the shares of the company in its home market) and generally higher returns. In fact, GDR holders enjoy all economic benefits of the underlying shares but has none of the corporate rights like right to vote.

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. Euro Convertible Bonds are usually issued as unsecured obligation of the borrowers. FCCBs represent equity linked debt security which can be converted into

shares or into depository receipts. The investors of FCCBs has the option to convert it into equity normally in accordance with pre-determined formula and sometimes also at a pre-determined exchange rate. The investor also has the option to retain the bond. The FCCBs by virtue of convertibility offers to issuer a privilege of lower interest cost than that of similar non convertible debt instrument. By issuing these bonds, a company can also avoid any dilution in earnings per share that a further issue of equity might cause whereas such a security still can be traded on the basis of underlying equity value. The agreement providing for the issuance of FCCBs normally carry less restrictive covenants as they relate to the issuer. Further, FCCBs can be marketed conveniently and the issuer company can expect that the number of its shares will not increase until investors see improved earnings and prices for its common stock. Like GDRs, FCCBs are also freely tradeable and the issuer has no control over the transfer mechanism and cannot be even aware of ultimate beneficiary. The Finance Ministry vide Notification dated 20.6.1994 stated that w.e.f. this date FCCBs will be considered an approved instrument of accessing external commercial borrowings. The terms and conditions normally applicable to commercial borrowing would be binding on convertible bonds. This would include restrictions on end-use, import of capital goods and minimum maturity for bonds. Priority for accessibility to this facility would be given to firms with good forex earnings record or potential.

The following are some of the special features of FCCBs:

- (1) Convertible Euro Bonds are similar to Convertible Bonds as issued in domestic capital markets since they give the investor the right to convert the fixed interest bond into equity shares or common stock of the issuing company.
- (2) The Bonds themselves have fixed rate of interest which is lower than coupons or straight bonds of comparable terms.
- (3) The conversion rights stipulate that the bondholder may convert the bond into ordinary shares, either on a series of given dates or at any time between specified dates in the future. The price at which the shares may be purchased through such conversion provisions are specified at the time the convertible bonds are issued.
- (4) Convertible bonds are attractive to the issuer because they are available to the investor at a cost less than that of the alternative fixed interest debt instruments. For the investor, convertible bonds offer an opportunity to participate in the capital growth of a company. He receives a fixed income from the bonds for as long as he holds them but stands to make a capital gain by converting the bonds to equity, provided that by the conversion date, the price of the shares has risen higher than the fixed conversion price. On the other hand, if the share price fails to rise, or falls, the risk is limited by the income return available from the fixed interest feature of the bond.
- (5) Convertible bonds thus offer a mixture of the attributes of fixed interest and equity investments. They have a higher yield than equities but have the potential of capital gain while the risk of capital loss is limited by the ability to hold to maturity. They provide a fixed return coupled with possible capital appreciation although the price of convertible bonds is more volatile than for

straight bonds, being influenced by the share price of the issuing company, as well as by yields in the international fixed interest market.

- (6) Convertible Euro bonds offer an additional advantage to the investor which is not available with convertible domestic bonds. They may be issued in a currency that differs from the currency in which the shares of the company are denominated. In the last three or four years the Japanese companies, in particular, have issued convertible bonds denominated in US dollars and Deutschmark of Swiss Francs but with options to convert into shares of the borrowing company, denominated in yen. Such issues give the bondholders the opportunity to participate in the Japanese stock market as well as the option to diversify the currency risk.
- (7) Convertible bonds are normally issued with fixed exchange rate clauses specifying the rates at which the bonds may be converted into ordinary shares of the issuer. The investor's decision of whether to opt for conversion or hold convertible bonds is, therefore greatly influenced by relative exchange rate movements.

Indian Depository Receipts

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. "Domestic Depository" means custodian of securities registered with SEBI and authorised 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 after having obtained permission from Ministry of Finance for doing such business in India.

The Central Government vide its powers conferred by clause (a) of sub-section (1) of section 642 read with section 605A of the Companies Act, 1956, notified Companies (Issue of Indian Depository Receipts) Rules, 2004. These rules are applicable only to those companies incorporated outside India, whether they have or have not established any place of business in India. Chapter X of SEBI (ICDR) Regulations, 2009 deal with issue of Indian Depository Receipts. The regulations given in this Chapter are in addition to the provisions of the Companies Rules. Every issuer of an IDR has to comply with the conditions stipulated in the listing agreement for IDRs issued by SEBI.

Derivatives

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. A brief detail of futures and options are given as under:

Futures

Futures is 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. The idea behind financial futures contract is to transfer future changes in security prices from one party in the contract to the other. It offers a means to manage risk in participating financial market. Futures basically transfer value rather than create it. It is a means for reducing risk or assuming risk in the hope of profit. Every futures contract entered into has two side willing buyer and a willing seller. If one side of contract makes a profit, the other side must make a loss. All futures market participants taken together can neither lose nor gain, the futures market is a zero sum game.

For successful futures, two types of participants i.e. hedgers and speculators are essential. Financial futures contracts may be of various types such as: -

- Interest Rate Futures
- Treasury Bill Futures
- Euro-Dollar Futures
- Treasury Bond Futures
- Stock Index Futures
- Currency Futures.

However, future prices reflect demand and supply conditions in future market. As in other markets, an increase or decrease in supply lowers or increases the prices of instruments for future delivery.

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. An option contract comprises of its type a put or call, underlying security or commodity expiry date, strike price at which it may be exercised. Options are generally described by the nature of underlying commodity. An option on common stock is said to be stock option; an option on a bond, a bond option; an option on a foreign currency, a currency option, an option on future contract, a future option; and so on. The specified price at which the underlying commodity may be bought (in the case of call) or sold (in the case of put) is called exercise price or the striking price of the option. To buy or sell the underlying commodity pursuant to option contract is to exercise the option. Most of the option may be exercised at any time, upto and including the expiration date.

The buyer of an option pays the option writer (seller) an amount of money called the option premium or option price. In return, the buyer receives the privilege, but not the obligation, of buying (in the case of call) or selling (in the case of a put) the underlying commodity for the exercise price. In the case of a call option, if the price of the commodity exceeds the exercise price, the call option is said to be in the money and the call option buyer could exercise the option, thereby earning the difference between the two prices-the exercise value or intrinsic value. On the other hand, if the price of the commodity is below the exercise price, the call option is out-of the money and will not be exercised, its intrinsic value is zero. In the case of a put option, if the price of the commodity is below the exercise price, the put option is said to be in-the-

money. The put option buyer could exercise the option to earn the difference between the exercise price and the price of the commodity. A put option is said to be out of the money when the commodity price exceed the exercise price.

Option provide investors with the opportunity to hedge investments in the underlying shares and share portfolios and can thus reduce the overall risk related to the investments significantly.

Mini contracts on derivatives

Mini derivative contract on Index (Sensex and Nifty) with a minimum contract size of Rs. 1 lakh at the time was being introduced by SEBI.

Mini Derivative contracts on sensex

Bombay Stock Exchange offers *mini* Futures and Options contracts on the leading Indian equity Index 'SENSEX ' for retail investors to participate in the ever growing Derivatives market.

Mini Derivative contracts on Nifty

Mini derivative (futures and options) contracts on S&P CNX Nifty index was introduced for trading in F&O segment w.e.f. January 1, 2008 by National Stock Exchange.

Hedge Funds*

1.1 Defining the Hedge Fund

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.

The term can also be defined by considering the characteristics most commonly associated with hedge funds. Usually, hedge funds:

- are organized as private investment partnerships or offshore investment corporations;
- use a wide variety of trading strategies involving position-taking in a range of markets;
- employ as assortment of trading techniques and instruments, often including short-selling, derivatives and leverage;
- pay performance fees to their managers; and
- have an investor base comprising wealthy individuals and institutions and relatively high minimum investment limit (set at US \$100,000 or higher for most funds).

* Excerpts from SEBI Report on "Policy Options Permitting Foreign Hedge to Access Indian Securities Market". The Report was released by SEBI for public comments on 24.05.2004.

1.2 Hedge Fund and Other Pooled Investment Vehicles

Hedge funds are sometimes called as 'rich man's mutual fund'. In addition, other unregistered investment pools, such as venture capital funds, private equity funds and commodity pools, are sometimes referred to as hedge funds. Although all of these investment vehicles are similar in that they accept investors' money and generally invest it on a collective basis, they also have characteristics that distinguish them from hedge funds.

1.2.1 Mutual Fund or Registered Investment Companies

In many ways, hedge funds are similar to mutual funds. Both entities issue units or securities to investors, hold pools of securities to diversify investment, have professional asset manager and may, at times, have similar investment strategies. At the same time, they also differ in a number of ways. Mutual funds are registered with securities markets regulator and are subject to the provisions of the relevant regulations such as, offer/issue of units/securities, disclosure and reporting requirement, valuation for the purpose of computation of NAV, conflict of interest issue and limit leverage. Hedge funds are not required to be registered and therefore, are not subject to similar regulatory provisions.

1.2.2 Private Equity Fund

A private equity fund, like a hedge fund, is an unregistered investment vehicle in which investors pool money to invest. Private equity funds concentrate their investments in unregistered (and typically illiquid) securities. Both private equity funds and US based hedge funds are typically organized as limited partnerships (LLP). Like hedge funds, private equity funds also rely on the exemption from registration of the offer and sale of their securities. The investors in private equity funds and hedge funds typically include high net worth individuals and families, pension funds, endowments, banks and insurance companies. Private equity funds, however, differ from hedge funds in terms of the manner in which contribution to the investment pool is made by the investors. Private equity investors typically commit to invest a certain amount of money with the fund over the life of the fund, and make their contributions in response to "capital calls" from the fund's general partner. Private equity funds are long term investments, provide for liquidation at the end of the term specified in the fund's governing documents and offer little, if any, opportunities for investors to redeem their investments. A private equity fund may distribute cash to its investors when it sells its portfolio investment, or it may distribute the securities of a portfolio company.

1.2.3 Venture Capital Fund

Venture capital pools are similar to hedge funds or private equity; they attract the same class of investors. Venture capital funds, however, invest in the start-up or early stages of a company. Unlike hedge fund advisors, general partners of venture capital funds often play an active role in the companies in which the funds invest. In contrast to a hedge fund, which may hold an investment in a portfolio security for an indefinite period based on market events and conditions, a venture capital fund typically seeks to liquidate its investment once the value of the company increases above the value of the investments.

1.2.4 Commodity Pool

Commodity pools are investment trusts, syndicates or similar enterprises that are operated for the purpose of trading commodity futures. The investment concentration in commodity futures distinguishes commodity pools from hedge funds.

1.3 Domestic and Offshore Hedge Fund

1.3.1 Domestic Hedge Fund

Domestic hedge funds are usually organized (in USA) as limited partnerships to accommodate investors that are subject to U.S. income taxation. The fund's sponsor typically is the general partner and investment adviser. Hedge funds may also take the form of limited liability companies (LLC) or business trusts. LLPs, LLCs and business trusts are generally not separately taxed and, as a result, income is taxed only at the level of the individual investors. Each of these firms also limits investors liability; LLCs offer the additional benefit of limited liability for fund advisors (general partners).

1.3.2 Offshore Hedge Fund

Offshore hedge funds are typically organized as corporations in countries such as the Cayman Islands, British Virgin Islands, the Bahamas, Panama, The Netherlands Antilles or Bermuda. Offshore funds generally attract investments of U.S. tax exempt entities, such as pension funds, charitable trusts, foundations and endowments, as well as non-U.S. residents. U.S. tax-exempt investors favour investments in offshore hedge funds because they may be subject to taxation if they invest in domestic limited partnership hedge funds.

1.4 Market Benefits of Hedge Funds

A Taxonomy of Hedge Fund Strategies

Strategy	Description
Directional Trading	Based upon speculation of market direction in multiple asset classes. Both model-based systems and subjective judgment are used to make trading decisions.
Relative Value	Focus on spread relationships between pricing components of financial assets. Market risk is kept to minimum and many managers use leverage to enhance returns.
Specialist Credit	Based around lending to credit sensitive issuers. Funds in this strategy conduct a high level of due diligence in order to identify relatively inexpensive securities.
Stock Selection	Combine long and short positions, primarily in equities, in order to exploit under and overvalued securities. Market exposure can vary substantially.

Hedge funds can provide benefits to financial markets by contributing to market efficiency and enhance liquidity. Many hedge fund advisors take speculative trading positions on behalf of their managed hedge funds based extensive research about the true value or future value of a security. They may also use short term trading strategies to exploit perceived mis-pricings of securities. Because securities markets are dynamic,

the result of such trading is that market prices of securities will move toward their true value. Trading on behalf of hedge funds can thus bring price information to the securities markets, which can translate into market price efficiency. Hedge funds also provide liquidity to the capital markets by participating in the market.

Hedge funds play an important role in a financial system where various risks are distributed across a variety of innovative financial instruments. They often assume risks by serving as ready counter parties to entities that wish to hedge risks. For example, hedge funds are buyers and sellers of certain derivatives, such as securitised financial instruments, that provide a mechanism for banks and other creditors to un-bundle the risks involved in real economic activity. By actively participating in the secondary market for these instruments, hedge funds can help such entities to reduce or manage their own risks because a portion of the financial risks are shifted to investors in the form of these tradable financial instruments. By reallocating financial risks, this market activity provides the added benefit of lowering the financing costs shouldered by other sectors of the economy. The absence of hedge funds from these markets could lead to fewer risk management choices and a higher cost of capital. Hedge fund can also serve as an important risk management tool for investors by providing valuable portfolio diversification. Hedge fund strategies are typically designed to protect investment principal. Hedge funds frequently use investment instruments (e.g. derivatives) and techniques (e.g. short selling) to hedge against market risk and construct a conservative investment portfolio – one designed to preserve wealth.

In addition, hedge funds investment performance can exhibit low correlation to that of traditional investments in the equity and fixed income markets. Institutional investors have used hedge funds to diversify their investments based on this historic low correlation with overall market activity.

Exchange Traded Funds (ETFs)*

Exchange traded funds (ETFs) are a new variety of mutual fund that first became available in 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.

In short, they are similar to index mutual funds but are traded more like a stock. As their name implies, Exchange Traded Funds represent a basket of securities that are traded on an exchange. As with all investment products, exchange traded funds have their share of advantages and disadvantages.

<i>Advantages of Exchange Traded Funds</i>	<i>Disadvantages of Exchange Traded Funds</i>
ETFs can be bought and sold throughout the trading day, allowing for intraday trading - which is rare with mutual funds.	Commissions - like stocks, trading exchange traded funds are an extra cost.
Traders have the ability to short or buy ETFs on margin.	Only institutions and the extremely wealthy can deal directly with the ETF. Companies must buy through a broker.

* Extracts from SEBI Annual Report 2002-2003.

<p>Low annual expenses rival the cheapest mutual funds.</p>	<p>Unlike mutual funds, ETFs don't necessarily trade at the net asset values of their underlying holdings, meaning an ETF could potentially trade above or below the value of the underlying portfolios.</p>
<p>Tax efficiency - due to SEC regulations, ETF tend to beat out mutual funds when it comes to tax efficiency (if it is a non-taxable account then they are equal).</p>	<p>Slippage - as with stocks, there is a bid-ask spread, meaning you might buy the ETF for 15 1/8 but can only sell it for 15 (which is basically a hidden charge).</p>

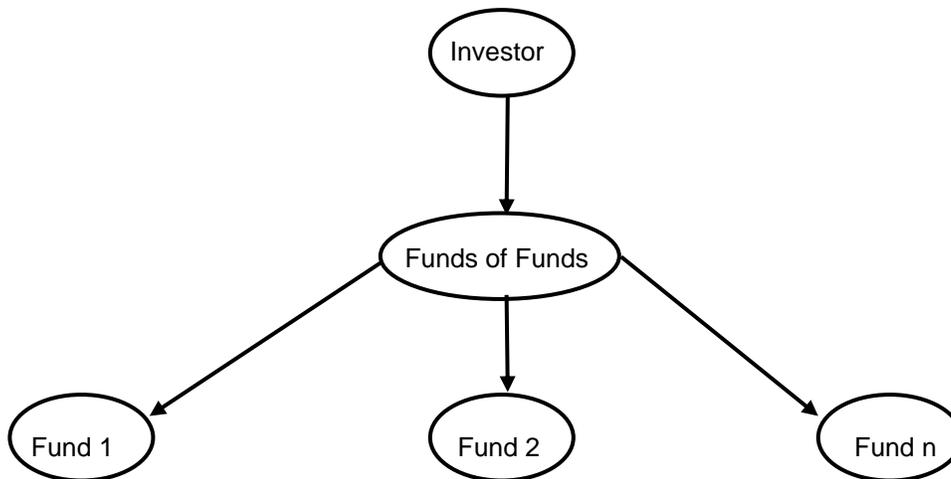
Fund of Funds (FoFs)

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. Depending on the investment style of the fund managers, fund of funds schemes can be broadly classified into:

Sector specific funds: Such type of funds invest in different sectors of the economy and thus hedge themselves against the under performance of any sector by taking the advantage from the rise in another sector.

Asset allocation funds: These funds diversify investment by holding several different asset classes at the same time. By varying the stocks to bonds proportion, the fund endeavors to endow the investors, with an appropriate asset allocation in different stages of their lives. They are also known as life cycle funds.

A Typical Fund of Funds



The various benefits of fund of funds scheme are presented below.

Diversification: As a fund of funds invests in the schemes of other funds, it provides a greater degree of diversification.

Uncomplicated: Instead of investing in different stocks/units of mutual funds and keeping a track record of all of them, it will be much easier to invest in and track only one fund, which in turn invests in other mutual funds.

Cheap: While entering into the capital markets it is difficult to diversify because of limited funds. Fund of funds provide an opportunity to go for diversification with comparatively limited amounts.

Risk: Investors can trim down the risk by choosing this route. Because of diversification, even if one stock/scheme is not performing well risk level comes down.

Expertise of Various Managers: As in the case of schemes of mutual funds, fund of funds scheme also work under the due diligence of a fund manager. This gives the scheme additional expertise as compared to other mutual funds schemes. These schemes also provide access to information which may be difficult to obtain for an investor on a case by case basis.

However, just like any other investment, fund of funds is not free from shortcomings. Few of the disadvantages are specified below.

1. **Additional Fees:** The more diversified the fund is, the greater the likelihood that the investor will incur an incentive fee on one or more of the constituent managers, regardless of overall FoF performance.¹
2. **Associated Risks:** Risks associated with all the underlying funds get added at this level. Following are the type of risks associated with fund of funds scheme.
 - **Management Risks:** Every fund manager has a particular style of diversification. This diversification style will be in perfect correlation with the number of managers involved. The views of a manager may be altogether different from the market. As pointed out by Harry Kat that once a fund of funds reached a certain number of managers, adding more flattens the returns curve and diversifies away alpha.
 - **Operational Risks:** Due diligence of a scheme in itself gives rise to operational risks. Continuous monitoring is required for knowing about performance of the funds, any possibility of a fraud and to know about the investment style of the funds and any desirable or undesirable changes in it.
 - **Qualitative Risks:** These include risks associated with the management environment of the fund such as organizational structure, infrastructure, investment process, operational issues etc.

Realizing the benefits of the scheme and the potential of the Indian mutual fund industry SEBI had decided to allow fund of funds from May 29, 2003.

¹ Brown, Stephen J., Goetzmann, William N. and Liang, Bing "Fees on Fees in Fund of Funds", Working Paper 9464, National Bureau of Economic Research, January 2003.

Regulations in India

The fund of funds scheme was introduced in the Indian market by making suitable amendments in SEBI (Mutual Funds) (Amendment) Regulations, 2003.

Gold Exchange Traded Funds

SEBI (Mutual Funds) (Amendment) Regulations dated January 24, 2006 permitted introduction of Gold Exchange Traded Fund schemes by Mutual Fund. Gold Exchange Traded Fund (GETF) schemes are permitted to invest primarily in

- (a) Gold
- (b) Gold related instruments i.e. such instruments having gold as underlying, as are specified by SEBI from time to time.

A gold exchange traded fund scheme is subject to the following investment restrictions:

- (a) the initial issue expenses in respect of any such scheme should not exceed six percent of the funds raised under that scheme;
- (b) the funds of any such scheme should be invested only in gold or gold related instruments in accordance with its investment objective, except to the extent necessary to meet the liquidity requirements for honouring repurchases or redemptions, as disclosed in the offer document; and
- (c) pending deployment of funds in accordance with clause (b), the mutual fund may invest such funds in short term deposits of scheduled commercial banks.”

1. Valuation

Since physical gold and other permitted instruments linked to gold are denominated in gold tonnage, it will be valued based on the market price of gold in the domestic market and will be marked to market on a daily basis. The market price of gold in the domestic market on any business day would be arrived at as under:

Domestic price of gold = (London Bullion Market Association AM fixing in US\$/ounce X conversion factor for converting ounce into kg for 0.995 fineness X rate for US\$ into INR) + custom duty for import of gold + sales tax/octroi and other levies applicable.

The Trustees reserve the right to change the source (centre) for determining the exchange rate. The AMC should record in writing the reason for change in the source for determining the exchange rate.

2. Determination of Net Asset Value

NAV of units under the Scheme would be calculated as shown below:

$$\text{NAV (Rs.)} = \frac{\text{Market or Fair Value of Scheme's investments} + \text{Current Assets} - \text{Current Liabilities and Provision}}{\text{No of Units outstanding under Scheme on the Valuation Date}}$$

The NAV shall be calculated up to four decimals.

3. *Recurring Expenses*

For a GETF, the limits applicable to equity schemes as specified in SEBI Regulations shall be applicable.

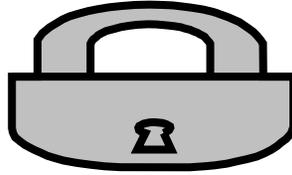
4. *Benchmark for GETF*

As there are no indices catering to the gold sector/securities linked to Gold, currently GETF shall be benchmarked against the price of Gold.

LESSON ROUND UP



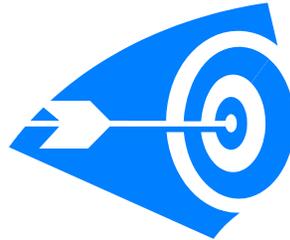
- Instruments can be classified into three categories viz. Pure, Hybrid and Derivatives.
- Share with differential rights means a share that is issued with differential rights in accordance with the provisions of section 86 of the Companies Act, 1956. The equity shares with differential rights include equity shares with differential rights as to—(a) voting; (b) dividend; and (c) otherwise.
- Owners of preference 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.
- Debenture is a document evidencing a debt or acknowledging it and any document which fulfills either of these conditions is a debenture.
- Debenture includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not.
- Sweat equity share is a instrument permitted to be issued by specified Indian companies, under Section 79A of Companies Act, 1956.
- 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.
- GDR 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.
- Derivatives are contracts which derive their values from the value of one or more of other assets (known as underlying assets).
- Futures is contract to buy or sell an underlying financial instrument at a specified future date at a price when the contract is entered.
- An option contract conveys the right to buy or sell a specific security or commodity at specified price within a specified period of time.
- Private equity fund is an unregistered investment vehicle in which investors pool money to invest.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. State and explain in brief about various new capital market instruments in Indian Securities Market.
2. Give a comparative view of various types of preference shares prevalent in the market.
3. Dwell upon the features and advantages of convertible debentures. Distinguish between fully and partly convertible debentures.
4. Discuss the various types of instruments used by Indian companies to raise capital from the International Market.
5. Define Hedge funds and explain its characteristics and benefits.
6. Write short notes on—
 - (a) Sweat Equity Shares
 - (b) Mortgage Backed Securities
 - (c) Derivatives
 - (d) Pure and Hybrid Instruments
 - (e) Exchange Traded Funds.

STUDY V
CREDIT RATING



LEARNING OBJECTIVES

The study will enable the students to understand

- Concept and uses of credit rating
- Important issues in credit rating
- Credit Rating Agencies, rating process and symbols
- Overview of SEBI (Credit Rating Agencies) Regulations, 1999
- Guidelines for Credit Rating Agencies
- Internal Audit of Credit Rating Agencies

INTRODUCTION

Credit rating, in general sense, 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.

'Encyclopedia of Banking & Finance' by Charles J. Woelfel states that a credit rating is a letter or number used by a mercantile or other agency in reports and credit rating books to denote the ability and disposition of various businesses (individual, proprietorship, partnership or corporation) to meet their financial obligations. It also states that ratings are used as a guide to the investment quality of bonds and stocks, based on security of principal and interest (or dividends), earning power, mortgage position, market history and marketability.



Credit ratings establish a link between risk and return. An investor or any other interested person uses the rating to assess the risk-level and compares the offered rate of return with his expected rate of return.

Credit rating is extremely important as it not only plays a role in investor protection but also benefits industry as a whole in terms of direct mobilisation of savings from individuals. Rating also provide a marketing tool to the company and its

investment bankers in placing company's debt obligations with a investor base that is aware of, and comfortable with, the level of risk. Ratings also encourage discipline amongst corporate borrowers to improve their financial structure and operating risks to obtain a better rating for their debt obligations and thereby lower the cost of borrowing. Companies those get a lower rating are forewarned, as it were and have the freedom, if they desire, to take steps on their financial or business risks and thereby improve their standing in the market.

The need for reliable information in channelisation of the resources to the most productive uses can hardly be overemphasized. Relevant and reliable information helps the investors to arrive at their investment decisions. These include offer documents of the issuers, research reports of market intermediaries and media reports. In the developed markets, credit rating agencies have also come to occupy a leading position as information providers alongwith rating of financial instruments. Particularly for the credit related opinions in respect of debt related instruments, such agencies offer independent opinions which are objective, well researched and credible.

During the great American depression years, high levels of default triggered the growth of credit rating as an essential input for the investors. The recognition for credit rating received a new impetus when Government Pension Funds, Insurance Companies etc. were directed not to invest in securities rated below a particular grade by credit rating agencies. This led to the growth in the awareness of credit rating as a primary tool of risk assessment.

The first Mercantile Credit Agency was established in New York in 1841. Its first rating guide was published in 1859 by Robert Dun. Another similar agency was set up by John Bradstreet which published its rating guide in 1857. These two agencies were merged to form Dun and Bradstreet in 1933 which acquired Moody's Investor Service in 1962. Moody's was founded by Moody in 1900. The other world renowned rating agency namely Standard and Poor was created in 1941 by merging the Standard Statistics Company and Poor's Publishing Company which had their origin earlier.

In India CRISIL (Credit Rating and Information Services (India) Limited) was set up as the first credit rating agency in 1987. This was followed by ICRA Limited (Investment Information and Credit Rating Agency of India Limited) in 1991 and CARE (Credit Analyses and Research Limited) in 1994 and then in 1999 Fitch Rating India Pvt. Ltd. and Brickwork Rating Pvt. Ltd. in 2008. Both these five credit rating agencies are registered with the Securities and Exchange Board of India.

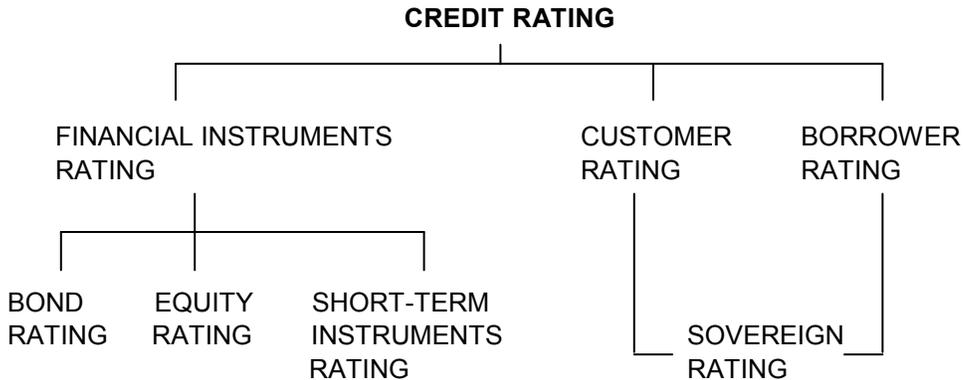
I. CONCEPT & OVERVIEW

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. To facilitate simple and easy understanding, credit rating is expressed in alphabetical or alphanumerical symbols.

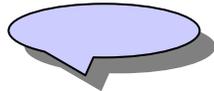
A rating is specific to a debt instrument and is intended to grade different such instruments in terms of credit risk and ability of the company to service the debt obligations as per terms of contract namely - principal as well as interest. A rating is neither a general purpose evaluation of a corporate entity, nor an over all assessment

of the credit risk likely to be involved in all the debts contracted or to be contracted by such entity.

Though credit rating is considered more relevant for gradation of debt securities, it can be applied for other purposes also. The diagram below depicts various types of credit ratings:



The various purposes for which credit rating is applied are:



- Long-term/Medium-term debt obligations such as debentures, bonds, preference shares or project finance debts are considered long-term and debts ranging from 1 to 3 years like fixed deposits are considered medium-term;
- Short-term debt obligations - the period involved is one year or less and cover money market instruments such as commercial paper, credit notes, cash certificates etc.;
- Equity Grading and Assessment, structured obligations, municipal bonds, mutual fund schemes, plantation schemes, real estate projects, infrastructure related debts, ADR, GDR issues, bank securities etc.

Credit rating does not bound the investor to decide whether to hold or sell an instrument as it does not take into consideration factors such as market prices, personal risk preferences and other consideration which may influence an investment decision. It does not create any fiduciary relationship between the rating agency and the user of the rating. A credit rating agency does not perform an audit but relies on information provided by the issuer and collected by the analysts from different sources hence it does not guarantee the completeness or accuracy of the information on which the rating is based.

In determining a rating, both qualitative and quantitative analysis are employed. The judgement is qualitative in nature and the role of the quantitative analysis is to help make the best possible overall qualitative judgement or opinion. The reliability of the rating depends on the validity of the criteria and the quality of analysis.

The quality of credit rating mainly depends upon and quality of the rating agency, rating elements also. The agency should have good reputation, personal competence, independence, qualified and experienced staff.

Uses of Credit Rating

Credit rating is useful to investors, issuers, intermediaries and regulators.

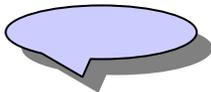
For Investors: The main purpose of credit rating is to communicate to the investors the relative ranking of the default loss probability for a given fixed income investment, in comparison with other rated instruments. In a way it is essentially an information service. In the absence of professional credit rating, the investor has to largely depend on his familiarity with the names of promoters or collaborators of a company issuing debt instruments. This is not a reliable method. Credit rating by skilled, competent and credible professionals eliminates or at least minimizes the role of name recognition and replaces it with a well researched and properly analysed opinions. This method provides a low cost supplement to investors. Large investors use information provided by rating agencies such as upgrades and downgrades and alter their portfolio mix by operating in the secondary market. Investors also use the industry reports, corporate reports, seminars and open access provided by the credit rating agencies.

For Issuers: The market places immense faith in opinion of credit rating agencies, hence the issuers also depend on their critical analysis. This enables the issuers of highly rated instruments to access the market even during adverse market conditions. Credit rating provides a basis for determining the additional return (over and above a risk free return) which investors must get in order to be compensated for the additional risk that they bear. The difference in price leads to significant cost savings in the case of highly rated instruments.

For Intermediaries: Rating is useful to Intermediaries such as merchant bankers for planning, pricing, underwriting and placement of the issues. Intermediaries like brokers and dealers in securities use rating as an input for monitoring risk exposures. Merchant bankers also use credit rating for pre-packaging issues by way of asset securitisation/structured obligations.

For Regulators: Regulatory authorities in different countries such as US, Australia and Japan have specified rules that restrict entry to the market of new issues rated below a particular grade, that stipulate different margin requirements for mortgage of rated and unrated instruments, that prohibit institutional investors for purchasing or holding instruments rated below a particular level and so on.

Factors for Success of a Rating System



- Credible and independent structure and procedures;
- Objectivity and impartiality of opinions;
- Analytical research, integrity and consistency;

- Professionalism and industry related expertise;
- Confidentiality;
- Timeliness of rating review and announcement of changes;
- Ability to reach wide range of investors by means of Press reports, print or electronic media and investor oriented research services.

Important Issues in Credit Rating

Investments and Speculative Grades: Securities rated below BBB' (S & P), Baa' (Moody's) are called non-investment grade or speculative grade or junk bonds. Rating agencies do not recommend or indicate the rating levels of instruments up to which one should or should not invest.

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. The frequency of surveillance may range between quarterly or yearly. A formal and extensive written review is taken at least once in an year but where some specific concern arises about the industry or the issuing entity, the review is taken up immediately. Where justified the rating agency may change the rating by upgradation or downgradation depending on the likely impact of changing circumstances on the debt servicing capability of the issuer. In other cases, the rating is retained at the same level.

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 analysed and decision is taken regarding the rating change. The credit watch listing may also specify positive or negative outlooks. It should be noted that being under credit watch does not necessarily mean that there would be a 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. Once the rating is assigned, it is communicated to the issuer, who is given an opportunity to make one request for a review, only in case fresh facts or clarifications become relevant. After these are considered, the final rating is assigned. In India, the issuer has the option of not accepting the assigned rate in which case the rating is not disclosed by the rating agency. However, if the rating is accepted, it comes under the surveillance process of the concerned agency.

Rating of Manufacturing Companies

The factors generally considered for rating of manufacturing companies are as under:

Industry Risk : It is defined as the strength of the industry within the economy and relativity to the economic trends. It is evaluated on the basis of factors like business cyclicality, earnings volatility, growth prospects, demand - supply projections, entry barriers and extent of competition and nature and extent of regulation.

Company's industry and market position: The company's sales position in its major fields and its historical background of its market position is analysed alongwith ability to sustain/increase market shares; brand strengths and position; price leadership and distribution and marketing strengths/weaknesses.

Operating efficiencies: Ability to control costs, productivity efficiencies relative to others, labour relationship, extent of forward and backward integration, access to raw materials/markets, and technology.

Accounting Quality: Financial statements are adjusted for non-standard accounting treatments. Overall evaluation of the accounting policies employed and the extent to which they understate or overstate financial performance and position. These include analysis of auditor's qualifications, revenue recognition, depreciation policy, inventory evaluation, funding for pension liabilities, undervalued assets etc.

Financial flexibility: Evaluation of the company's financing needs, plans and alternatives, its flexibility to accomplish its financing programmes under stress without damaging creditworthiness.

Earnings protection: The key measurements which indicate the basic long term earnings power of the company including return on capital, profit margins, earnings from various business segments, sources of future earnings growth, coverage ratios etc.

Financial leverage: Relative usage of debt and levels of debt appropriate to different types of businesses, utilisation of long and short term sources of funds, management of working capital.

Cash flow adequacy: It is the relationship of cash flows to leverage and the ability to internally meet all cash needs of the business. It measures the magnitude and variability of future cash flows relative to debt servicing obligations and other commitments such as group company funding, BIFR packages and contingent liabilities. This analysis goes into the inherent protective factors for expected cash flows of the company and the sensitivity of these cash flows to changes in variables like raw material costs and selling prices.

Management evaluation: The record of achievement in operations and financial results, strategic and financial planning, commitment, consistency and credibility, overall quality of management, line of succession, strength of middle management

and organisation structure and its linkage with the operating environment and management strategies.

Rating of Financial Services Companies

The rating methodology for non-banking financial services companies is based on CAMEL model encompassing, Capital adequacy, Asset quality, Management, Earnings and Liquidity. The nature and accessibility of funding sources is also considered.

Rating of Structured Obligations/Asset Securitisation

Structured borrowing arrangements are entered into by companies for various reasons. However, the most important one is that less credit worthy instruments or corporates are able to tap sources of funds at a more advantageous borrowing rate by offering a variety of credit enhancements.

The process of converting loans or receivables into negotiable instruments is known as securitisation. These negotiable instruments are then sold to investors', they are secured by the underlying assets and have other credit enhancements. Securitisation transforms illiquid assets like the renewable portfolio on the balance sheet of a lender into a marketable security.

The principal credit risk in asset backed financing is potential impairment of cash flows due to the assets becoming defaulting on repayments or turning into a loss. The main factors considered for credit rating are the overall risk profile and monitoring and collection procedures of the issuer; the quality of the assets being securitised; the process of selection of the asset pool to be securitised; the characteristics of the pool and the cash flows from it based on the past record of its behaviour. The possible credit loss and other deficiencies of the pool in terms of timing and quantum of cash flows are analysed and the extent and nature of credit enhancement is then determined.

Other important considerations in a securitisation transaction are the legal and tax structure and the ability and willingness of the services and trustee to manage and maintain control on assets and payment streams from them.

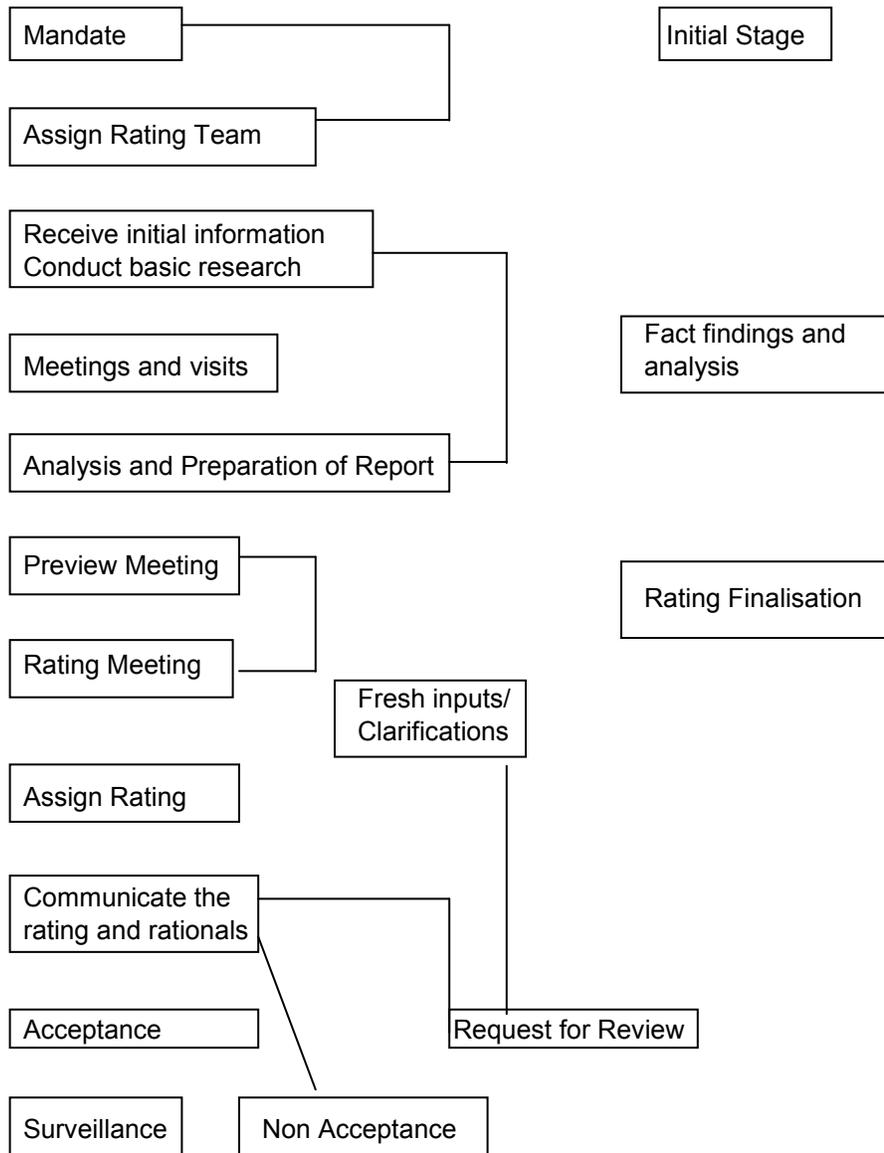
Rating Process

Rating process refers to the typical practices and procedures which a rating agency follows to gather information for evaluating the credit risk of specific issuers and issues, to analyse and conclude on the appropriate rating to monitor the credit quality of the rated issuer or security over time, deciding on timely changes in ratings, as and when companies' fundamentals change and to keep investors and the market players informed. All these are interrelated and on going processes. The general principals followed all over the world are the same. The rating agencies in India have adopted the methodology of the major international credit rating agencies.

As a sample we indicate ICRA's Rating Process in the the form of a flow chart

below:

**ICRA's Rating Process
An Overview**



The rating process begins with the receipt of a mandate from the issuer company. The next step is to form analytical teams with sectoral skills.

Information gathering/analysis

For the basic research, obtain credit related data, both statistical and qualitative, from a multitude of sources like annual reports, prospectus, industry/sectoral

economic data, government reports, news reports, discussions with industry/regulatory/other circles. Statistical data bases are developed over time to enable comparability across major issuer categories.

Meetings with Management

Meetings are held with key operating personnel of the company covering broadly the background, history, organisational structure, operating performance, financial management and topics of special relevance to the company's future. The central focus of all discussions is the same with analysts looking for information that will help them to understand the issuer's ability to generate cash from operations to meet debt obligations over the next several years. It is the management's opportunity to explain the company's business and financial strategies. Finally, a meeting with top management is held, where apart from corporate strategy and philosophy, key issues relevant to the rating are discussed. A plant visit with the major manufacturing/work centres and project sites is invariably undertaken.

In India, credit rating agencies do not undertake unsolicited ratings merely based on published information of the company. The quality of credit rating will greatly improve with privileged information obtained from the companies by credit rating agencies. It is possible to have two agencies to do the rating for a particular issue and the findings may even vary, because rating is a matter of perceptions. But generally the findings will not be varying widely.

The ratings can be published by the agency only after approval and with the permission of the issuer. Subsequent changes emerging out of the monitoring by the credit rating agency will be published even if such changes are not found acceptable to the issuers. The issuer may appeal on the findings of an agency. In such a case the agency will undertake a review and thereafter indicate its final decision. Unless the rating agency has over looked critical information at the first stage, chances of the rating being changed on appeal will be rare.

There is no system yet to rate the rating agency. Informed public opinion is the touch stone on which the rating companies are being assessed. The success of a rating agency is measured by the quality, consistency and integrity and the record of acceptance in the market. The rating is always about a particular issue and not generally about the issuer.

II. RATING SYMBOLS

Rating symbols are used in terms of alphabets. For preference shares the letters pf are prefixed to the debenture rating symbols and f prefixed for fixed deposits while P (prime) is prefixed to short-term instruments. Below are given some of the rating symbols used by various credit rating agencies.

A. Rating Symbols of CRISIL (Credit Rating Information Services of India Ltd.)

CRISIL Debenture Rating Symbols

(a) High Investment Grades

AAA (triple A)	Highest Safety - on timely payment of interest and principal.
AA (double A)	High Safety - regarding timely payment of Interest

and principal. This symbol shows minor variation from triple A.

(b) Investment Grades

A	Adequate safety - regarding timely payment of interest and principal subject to adverse impact arising out of changed circumstances.
BBB (triple B)	Moderate safety - regarding timely payment of interest and principal subject to variations caused by changing circumstances weakening the capacity.

(c) Speculative Grades

BB (double B)	Inadequate safety - regarding payment of timely interest and principal due to the comparative uncertainties faced by the issuer.
B	High risk - susceptible to default in payment of principal and interest due to adverse business or economic conditions affecting the issuer.
C	Substantial risk - Due to the presence of factors which make the issue vulnerable to default if unfavourable circumstances develop.
D	Default - default likely in payment of interest and maturity amount. Such debentures are extremely speculative and returns from them can be realised only on reorganisation or liquidation.

CRISIL has decided to include a new rating category called "not meaningful" (NM) for companies which have been referred to the Bureau for Industrial and Financial Re-construction (BIFR).

Note: CRISIL may apply + (plus) or – (minus) signs for ratings from AA to D to reflect comparative standing on a better or worse scale within the category.

CRISIL Fixed Deposit Rating Symbols

FAAA (F triple A)	Highest safety - indicates the degree of safety regarding timely payment of interest and principal is very strong.
FAA (F double A)	High safety - indicates the degree of safety regarding timely payment of interest and principal is strong.
FA	Adequate safety - indicates the degree of safety regarding timely payment of interest and principal is satisfactory. Changes in circumstances can affect such issues more than those in the higher rated categories.
FB	Inadequate safety - indicates inadequate safety of timely payment of interest and principal. Such issues are less susceptible to default than fixed deposits rating below this category, but the uncertainties that the issuer faces could lead to inadequate capacity to make timely interest and principal payments.

FC	High risk - indicates the degree of safety regarding timely payment of interest and principal is doubtful. Such issues have factors at present that make them vulnerable to default; adverse business or economic conditions would lead to lack of ability or willingness to pay interest or principal.
FD	Default - indicates the issuer is either in default or is expected to be in default upon maturity.

Note: CRISIL may apply + (plus) or – (minus) signs for rating from FAA to FC to indicate the relative position within the rating category of the company raising fixed deposits.

CRISIL's Rating for Short-term Instruments

P-1	This rating indicates that the degree of safety regarding timely payment on the instrument is very strong.
P-2	This rating indicates that the degree of safety regarding timely payment on the instrument is strong; however the relative degree of safety is lower than that for instruments rated — P —.
P-3	This rating indicates that the degree of safety regarding timely payment on the instrument is adequate, however, the instrument is more vulnerable to the adverse effects changing circumstances than an instrument rated in the two higher categories.
P-4	This rating indicates that the degree of safety regarding timely payment on the instrument is minimal and it is likely to be adversely affected by short-term adversity or less favourable conditions.
P-5	This rating indicates that the instrument is expected to be in default on maturity or is in default.

Note: CRISIL may apply + (plus) sign for rating from P-1 to P-3 to reflect a comparatively higher standing within the category.

CRISIL's Rating Symbols for Structured Obligations (SO)

Structured obligations ratings are based on the same scale (AAA to D) as CRISIL ratings for long-term instruments. However, reflecting the distinction of structured obligations from a debt instrument, structured obligations rating symbols are defined differently.

(1) High Investment Grades

AAA (SO) (Triple A) - Highest Safety - This rating indicates highest degree of certainty regarding timely payment of financial obligations on the instrument. Any adverse changes in circumstances are most unlikely to affect the payments on the instruments.

AA (SO) (Double A) - High safety - This rating indicates highest degree of certainty regarding timely payment of financial obligations on the instrument.

(2) Investment Grades

A (SO) - Adequate Safety - This rating indicates adequate degree of certainty regarding timely payment of financial obligations on the instrument. Changes in

circumstances can adversely affect such instruments more than those in the higher rated categories.

BBB (SO) (Triple B) - Moderate Safety - This rating indicates moderate degree of certainty regarding timely payment of financial obligations on the instrument. However, changing circumstances are more likely to lead to a weakened capacity to meet financial obligations than for instruments in higher rated categories.

(3) *Speculative Grades*

BB (SO) (Double B) - Inadequate Safety - This rating indicates inadequate degree of certainty regarding timely payment of financial obligations on the instrument. Such instruments are less susceptible to default than instruments rated below this category.

B (SO) - High Risk - This rating indicates high risk and greater susceptibility to default. Any adverse business or economic conditions would lead to lack of capability or willingness to meet financial obligations on time.

C (SO) - Substantial Risk - This rating indicates that the degree of certainty regarding timely payment of financial obligations is doubtful unless circumstances are favourable.

D (SO) - Default - This rating indicates that the obligor is in default or expected to be in default.

Note: CRISIL may apply + (plus) sign for rating from AA to C to reflect a comparatively higher standing within the category.

CRISIL's Rating Symbols for Real Estate Developers' Projects

Highest Ability: PA-1: Projects rated PA-1 indicate highest ability of the developer to specify and build to agreed quality levels and transfer clear title within stipulated time schedules.

High Ability: PA-2: Projects rated PA-2 indicate that the developers' ability to build the project to specified quality levels, time schedules and transfer clear title is high.

Adequate Ability: PA-3: Projects rated PA-3 indicate adequate ability of the developer to build to reasonable quality levels and time schedules and transfer clear title for the present. However, changing circumstances are likely to adversely affect these projects more than those in the higher rated categories.

Inadequate Ability: PA-4: Projects rated PA-4 indicate that the developers ability to build to specified quality levels and adhere to time schedules is inadequate. Uncertainties facing the project could result in inability and/or unwillingness to complete projects.

Inability: PA-5: Projects rated PA-5 indicate inability of the developer to complete projects or transfer clear title.

Note: CRISIL may apply + (plus) sign for rating from P-1 to P-3 to reflect a comparatively higher standing within the category.

CRISIL Foreign Structured Obligations (FSO) Rating Scales

CRISIL has developed a framework for rating the debt obligations of Indian corporates supported by credit enhancements extended by entities based outside the

country. The issues considered inter alia include the credit worthiness of the offshore entity, the nature and structure of the credit enhancement mechanism to ensure timely payments on rated debt obligations and regulatory issues as regards the transfer risk. CRISIL would notch up the standalone credit ratings of these Indian issuers depending on all these factors.

CRISIL ratings of Foreign Structured Obligations (FSO) factor the credit enhancement extended by an entity based outside the country. The ratings indicate the degree of certainty regarding timely payment of financial obligations on the instrument. These ratings have been assigned in the current regulatory framework as regards the transfer risk and any change therein could impact the ratings.

The credit enhancements could be in the form of guarantees, letters of credit, asset backing or other suitable structures. Due to the current regulatory controls on inward remittances, CRISIL would require suitable liquidity mechanisms to be in place for ensuring timely payment on due dates.

Foreign Structured Obligations ratings are based on the same scale (AAA through D) as CRISIL ratings for long-term instruments. Foreign Structured Obligations ratings symbols are defined below :

High Investment Grades

AAA(fso) (Triple A)*	Highest Safety - This rating indicates highest degree of certainty regarding timely payment of financial obligations on the instrument. Any adverse changes in circumstances are most unlikely to affect the payments on the instrument.
AA(fso) (Double A)*	Highest Safety - This rating indicates high degree of certainty regarding timely payment of financial obligations on the instrument. This instrument differs in safety, from "AAA(fso)" instruments only marginally.

Investment Grades

A(fso)*	Adequate Safety - This rating indicates adequate degree of certainty regarding timely payment of financial obligations on the instrument. Changes in circumstances can adversely affect such instruments. Changes in circumstances can adversely affect such instruments more than those in the higher rated categories.
BBB(fso) (Triple B)*	Moderate Safety - This rating indicates a moderate degree of certainty regarding timely payment of financial obligations on the instrument. However, changing circumstances are more likely to lead to a weakened capacity to meet financial obligations than for instruments in higher rated categories.

Speculative Grades

BB(fso) (Double B)*	Inadequate Safety - This rating indicates inadequate degree of certainty regarding timely payment of financial obligation on the instrument. Such instruments are less
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	susceptible to default than instruments rated below this category.
B(fso)	High Risk - This rating indicates high risk and greater susceptibility to default. Any adverse business or economic conditions would lead to lack of capability or willingness to meet financial obligations on time.
C(fso)	Substantial Risk - This rating indicates that the degree of certainty regarding timely payment of financial obligations is doubtful unless circumstances are favourable.
D(fso)	Default - This rating indicates that the obligation is in default or expected to default.

Note: The contents within Parenthesis are a guide to the pronunciation of the rating symbols.

CRISIL Rating Scale for Instrument Carrying Non-Credit Risk

AAAr (Triple A r) Highest Safety	Debentures rated AAAr are judged to offer highest safety of timely payment of interest and/ or principal. Though the circumstances providing this degree of safety are likely to change, such changes as can be envisaged are most unlikely to affect adversely the fundamentally strong position of such issues.
AAr (Double A r) High Safety	Debentures rated AAr are judged to offer high safety of timely payment of interest and/ or principal. They differ in safety from AAAr issues only marginally.
Ar (Single A r) Adequate Safety	Debentures rated Ar are judged to offer adequate safety of timely payment of interest and/ or principal; however, changes in circumstances can adversely affect such issues more than those in the higher rated categories.
BBBr (Triple B r) Moderate Safety	Debentures rated BBBr are judged to offer sufficient safety of timely payment of interest and/ or principal for the present; however, changing circumstances are more likely to lead to a weakened capacity to pay interest and repay principal than for debentures in higher rated categories.

Speculative Grades

BBr (Single B r) High Risk	Debentures rated BBr are judged to carry inadequate safety of timely payment of interest and/ or principal; while they are less susceptible to default than other speculative grade debentures in the immediate future, the uncertainties that the issuer faces could lead to inadequate capacity to make timely interest and principal payments.
Br (Single B r) High Risk	Debentures rated Br are judged to have greater susceptibility to default; while currently interest and/ or principal payments are met, adverse business or economic conditions would lead to lack of ability or willingness to pay interest or principal.

Cr (Single C r) Substantial Risk	Debentures rated Cr are judged to have factors present that make them vulnerable to default; timely payment of interest and/or principal is possible only if favourable circumstances continue.
Dr (Single D r) In Default	Debentures rated Dr are in default and in arrears of interest and/ or principal payments or are expected to default on maturity. Such debentures are extremely speculative and returns from these debentures may be realized only on reorganisation or liquidation.

Note:

- (1) CRISIL may apply "+" (plus) or "-" (minus) signs for ratings from AA to C to reflect comparative standing within the category.
- (2) The contents within parenthesis are a guide to the pronunciation of the rating symbols.
- (3) The 'r' symbol attached to the rating indicates that the instrument has an element of non-credit risk (such as market risk). The risk represented by the 'r' symbol would be specific for each instrument.
- (4) In situations where there is any arrangement for payment on the instrument by an obligor other than the issuer or any means of enhancing credit including arrangements such as guarantees, letters of credit, etc., CRISIL can add the structured obligations rating symbol '(so)' to this rating scale.

Credit Rating Scale for Financial Strength Ratings (FSR)

Ratings are broadly divided into two categories - Secure and Vulnerable. Rating categories from "AAA" to "BBB" are classified as 'secure' ratings and are used to indicate insurance companies whose financial capacity to meet policyholder obligations is sound. Rating categories from "BB" to "D" are classified as vulnerable ratings and are used to indicate insurance companies whose financial capacity to meet policyholder obligations is vulnerable to adverse economic and underwriting conditions.

The opinion does not take into account timeliness of payment or the likelihood of the use of a defense such as fraud to deny claims. For insurance companies with cross-border or multi-national operations, including those conducted by branch offices or subsidiaries, ratings do not take into account any potential that may exist for foreign exchange restrictions to prevent policy obligations from being met. Financial strength ratings do not refer to an insurance company's ability to meet non-policy obligations (i.e. debt contracts).

The ratings are not recommendations to purchase or discontinue a policy, contract or security issued by an insurance company nor are they guarantees of financial strength.

Secure Ratings

AAA	Reflects Highest Financial Strength to meet policyholder obligations. Though the circumstances providing this strength are
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likely to change, such changes as can be envisaged are most unlikely to affect adversely the fundamentally strong position.

AA	Reflects High Financial Strength to meet policyholder obligations. Companies in this category differ only marginally from the 'AAA' rated insurance companies.
A	Reflects Adequate Financial Strength to meet policyholder obligations. However, change in circumstances can adversely affect such companies more than those in the higher rated categories.
BBB	Reflects Moderate Financial Strength to meet policyholder obligations. However, changing circumstances are more likely to lead to a weakened capacity to meet policyholder obligations than the higher rated categories.

Vulnerable Ratings

BB	Reflects Inadequate Financial Strength to meet policyholder obligations. While companies rated in this category are less susceptible to default than other speculative grade companies in the immediate future, the uncertainties that they face could lead to inadequate capacity to meet their policyholder obligations.
B	Reflects Greater Susceptibility to default on policyholder obligations. While current obligations are met, adverse business or economic conditions would lead to lack of ability or willingness to meet policyholder obligations.
C	Vulnerable to default. Ability to meet policyholder obligations is possible only if favourable circumstances prevail.
D	In default. Current policyholder obligations are in default. Insurance companies rated "D" are extremely speculative and policyholder obligations may be realised only on reorganisation or liquidation.

Financial strength ratings from "AA" to "BB" may be modified by use of a plus (+) or minus (–) sign to show the relative standing of the insurance / reinsurance company within the rating categories.

CRISIL Bond Fund Rating Symbols

AAAf	The fund's portfolio holdings provide very strong protection against losses from credit defaults.
AAf	The fund's portfolio holdings provide strong protection against losses from credit defaults.
Af	The fund's portfolio holdings provide adequate protection against losses from credit defaults.
BBBf	The fund's portfolio holdings provide moderate protection against losses from credit defaults.

BBf	The fund's portfolio holdings provide uncertain protection against losses from credit defaults.
Cf	The fund's portfolio holdings have factors present which make them vulnerable to credit defaults.

CRISIL Rating Scales for Real estate Developers

DA1	Excellent. The developer's past track record in executing real estate projects as per specified quality levels and transferring clear title within stipulated time schedule is <i>excellent</i> .
DA2	Very Good. The developer's past track record in executing real estate projects as per specified quality levels and time schedules and transferring clear title, is <i>very good</i> .
DA3	Good. The developer's past track record in executing real estate projects as per specified quality levels and time schedules and transferring clear title, is <i>good</i> .
DA4	Unsatisfactory. The developer's past track record in executing real estate projects as per specified quality levels and time schedules and transferring clear title, is <i>unsatisfactory</i> .
DA5	Poor. The developer's past track record in executing real estate projects as per specified quality levels and time schedules and transferring clear title, is <i>poor</i> .

CRISIL Grading Scale for Governance and Value Creation

Level 1:	The capability of firms rated CRISIL GVC Level-1 with respect to wealth creation for all their stakeholders while adopting sound corporate governance practices is the highest.
Level 2:	The capability of firms rated CRISIL GVC Level-2 with respect to wealth creation for all their stakeholders while adopting sound corporate governance practices is high.
Level 3:	The capability of firms rated CRISIL GVC Level-3 with respect to wealth creation for all their stakeholders while adopting sound corporate governance practices is strong.
Level 4:	The capability of firms rated CRISIL GVC Level-4 with respect to wealth creation for all their stakeholders while adopting sound corporate governance practices is moderate.
Level 5:	The capability of firms rated CRISIL GVC Level-5 with respect to wealth creation for all their stakeholders while adopting sound corporate governance practices is adequate.

- Level 6: The capability of firms rated CRISIL GVC Level-6 with respect to wealth creation for all their stakeholders while adopting sound corporate governance practices is inadequate.
- Level 7: The capability of firms rated CRISIL GVC Level-7 with respect to wealth creation for all their stakeholders while adopting sound corporate governance practices is poor.
- Level 8: The capability of firms rated CRISIL GVC Level-8 with respect to wealth creation for all their stakeholders while adopting sound corporate governance practices is the lowest.

CRISIL Grading Scale for Healthcare Institutions

The grading scale for healthcare institutions will have two components. The first will be the hospital classification such as

- Nursing home
- General secondary care
- Specialty secondary care
- Single-specialty tertiary care
- Multi-specialty tertiary care

The second component of the grading scale will be the hospital's grading within that classification on a four-point scale. Thus, a typical grading could read - General secondary care hospital assigned Grade C or Nursing home assigned Grade B.

The hospital classification will be based on the number of specialties offered by the hospital. The definition for various grades, as envisaged currently, is given below:

- Grade A: Reflects Very Good Quality of delivered patient care. A healthcare institution graded in this category has facilities, equipment, manpower and service quality levels which are consistent with the highest standards in the Indian healthcare industry.
- Grade B: Reflects Good Quality of delivered patient care. A healthcare institution graded in this category has facilities, equipment, manpower and service quality levels which are consistent with high standards in the Indian healthcare industry, although these would be lower than healthcare quality levels in Grade A hospitals.
- Grade C: Reflects an Average Quality of delivered patient care. A healthcare institution graded in this category has facilities, equipment, manpower and service quality levels which are consistent with adequate standards in the Indian healthcare industry. Improvements in specific areas would be required for such hospitals to be eligible for a higher grade.
- Grade D: The grading reflects Poor Quality of delivered patient care. The healthcare institution graded in this category has facilities, equipment, manpower and service quality levels which are below

the average standards in the Indian healthcare industry. The grading indicates that quality standards would need to be set up in the institution and substantial improvements in patient care would be needed to obtain a higher grade.

A typical definition would read as follows:

CRISIL has classified the XYZ Hospital as a 'Speciality Secondary Care Hospital' and assigned a 'Grade B'. The grading reflects a Good Quality of delivered patient care. The healthcare institution graded in this category has facilities, equipment, manpower and service quality levels which are consistent with high standards in the Indian healthcare industry."

CRISIL Rating Symbols for Credit Assessments

1	<i>Very Strong Capacity</i> - This indicates that the capacity for timely payment of interest and principal is very strong.
2, 3, 4	<i>Strong Capacity</i> - This indicates that the capacity for timely payment of interest and principal is strong. However, the capacity is not as strong as for borrowers with Credit Assessment "1".
5, 6, 7	<i>Adequate Capacity</i> - This indicates that the capacity for timely payment of interest and principal is satisfactory. Changes in circumstances can affect the capacity of the borrower more than those in the stronger Credit Assessment categories.
8, 9, 10	<i>Inadequate Capacity</i> - This indicates inadequate capacity for timely payment of interest and principal. Such borrowers are less susceptible to default than borrowers with Credit Assessments below this category, but the uncertainties that the borrower faces could lead to inadequate capacity to make timely interest and principal payment.
11, 12, 13	<i>Poor Capacity</i> - This indicates that the capacity for timely payment of interest and principal is doubtful. Such borrowers face circumstances at present that make them vulnerable to default; adverse business or economic conditions would lead to lack of capacity to pay interest or principal.
14	<i>Default</i> - This indicates that the borrower is either in default or is expected to be in default upon maturity of the debt.

CRISIL Rating for Collective Investment Scheme

Investment Grade

Grade - I (High Certainty)	This rating indicates high certainty that the Collective Investment Scheme will provide the assured returns in the form of produce and/or cash.
Grade - II (Adequate Certainty)	This rating indicates adequate certainty that the Collective Investment Scheme will provide the assured returns in the form of produce and/or cash.

Grade - III (Moderate Certainty)	This rating indicates moderate certainty that the Collective Investment Scheme will provide the assured returns in the form of produce and/or cash.
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Non-Investment Grade

Grade - IV (Inadequate Certainty)	This rating indicates inadequate certainty that the Collective Investment Scheme will provide the assured returns in the form of produce and/or cash. Risk factors for the scheme are high and the scheme is prone to default.
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Grade - V (High Uncertainty)	This rating indicates high uncertainty that the Collective Investment Scheme will provide the assured returns in the form of produce and/or cash. Risk factors for the scheme are extremely high leading to high expectation of default on obligations.
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B. Rating Symbols of ICRA (Investment Information and Credit Rating Agency of India Ltd.)

Long-term including debentures, bonds and preference shares

LAAA	Highest Safety - indicates fundamentally strong position. Risk factors are negligible. There may be circumstances adversely affecting the degree of safety but such circumstances, as may be visualised, are not likely to affect the timely payment of principal and interest as per terms.
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LAA+ LAA LAA-	High Safety - Risk factors are modest and may vary slightly. The protective factors are strong and the prospect of timely payment of principal and interest as per terms under adverse circumstances, as may be visualised, differs from 'LAAA' only marginally.
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LA+ LA LA-	Adequate Safety - Risk factors are more variable and greater in periods of economic stress. The protective factors are average and any adverse change in circumstances, as may be visualised, may alter the fundamental as per terms.
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LBBB+ LBBB LBBB-	Moderate Safety - Considerable variability in risk factors. The protective factors are below average. Adverse changes in business/economic circumstances are likely to affect the timely payment of principal and interest as per terms.
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LBB+ LBB LBB-	Inadequate Safety - The timely payment of interest and principal are more likely to be affected by present or prospective changes in business/economic circumstances. The protective factors fluctuate in case of changes in economy/business conditions.
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LB+	Risk Prone - Risk factors indicate that obligations may not be met when due. The protective factors are narrow. Adverse changes in business/economic conditions could result in inability/unwillingness to service debts on time as per terms.
LB	
LB-	
LC+	Substantial Risk - There are inherent elements of risk and timely servicing of debts/obligations could be possible only in case of continued existence of favourable circumstances.
LC	
LC-	
LD	Default - Extremely speculative. Either already in default in payment of interest and/or principal as per terms or expected to default. Recovery is likely only in liquidation or re- organisation.

Medium-term including fixed deposit and fixed deposit programme

MAAA	High Safety - The prospect of timely servicing of interest and principal as per terms is the best.
MAA+	High Safety - The prospect of timely servicing of the interest and principal as per terms is high, but not as in MAAA rating.
MAA	
MAA-	
MA+	Adequate Safety - The prospect of timely servicing of the interest and principal is adequate. However debt servicing may be affected by adverse changes in the business/ economic conditions.
MA	
MA-	
MB+	Inadequate Safety - The timely payment of interest and principal are more likely to be affected by future uncertainties.
MB	
MB-	
MC+	Risk Prone - Susceptibility to default high. Adverse changes in business/economic conditions could result in inability/unwillingness to service debts on time and as per terms.
MC	
MC-	
MD	Default - Either already in default or expected to default.

Short-term debt including commercial paper

A1+	Highest Safety - The prospect of timely payment of debt/ obligation is the best.
A1	
A2+	High Safety - The relative safety is marginally lower than in <u>A</u> -1' rating.
A2	
A3+	Adequate Safety - The prospect of timely payment of interest and instalment is adequate, but any adverse changes in business/economic conditions may affect the fundamental strength.
A3	
A4+	Risk prone - The degree of safety is low. Likely to default in case of adverse changes in business/economic conditions.
A4	

A5 Default - Either already in default or expected to default. Inadequate capacity.

Note: The suffix of + (plus) sign or – (minus) may be used with the rating symbol to indicate the comparative position within the group covered by the symbol.

ICRA Rating Symbols For Debt Funds

The ICRA Rating Symbols for Credit Risk Rating of Debt Funds and their implications are as follows:

MfAAA	Indicates highest quality. The investment quality is of highest grade and is similar to that of fixed income obligations of highest safety.
mfAA+ mfAA mfAA-	Indicates high quality. The investment quality is of high grade and is similar to that of fixed income obligations of high safety.
mfA+ mfA mfA-	Indicates adequate quality. The investment quality is of upper medium grade and is similar to that of fixed income obligations of adequate safety.
mfBBB+ mfBBB mfBBB-	Indicates moderate quality. The investment quality is of medium grade and is similar to that of fixed income obligations of moderate safety.
mfBB+ mfBB mfBB-	Indicates inadequate quality. The investment quality is of low grade and is similar to that of fixed income obligations of inadequate safety.
mfB+ mfB mfB-	Indicates poor quality. The investment quality is of lowest grade and is similar to that of fixed income obligations that are risk prone.

The ICRA Rating Symbols for Market Risk Rating of Debt Funds and their implications are as follows:

M1	Indicates very low sensitivity to changing interest rates and other market conditions.
M2	Indicates low sensitivity to changing interest rates and other market conditions.
M3	Indicates moderate sensitivity to changing interest rates and other market conditions.
M4	Indicates high sensitivity to changing interest rates and other market conditions.
M5	Indicates very high sensitivity to changing interest rates and other market conditions.

Rating Scale for Insurance Companies

iAAA	Highest claims paying ability. Indicates fundamentally strong position. Prospect of meeting policyholder obligations is best.
iAA	High claims paying ability. Risk factors are modest and may vary slightly. Prospect of meeting policy holder obligations is high and differs from iAAA only marginally.
iA	Adequate claims paying ability. Prospect of meeting policyholder obligations is adequate. The risk factors are more variable and greater in periods of economic stress and adverse changes in business/ economic circumstances as may be visualised, may alter the fundamental strength.
iBBB	Moderate claims paying ability. The protective factors are below average and adverse changes in business/ economic circumstances are likely to affect the prospect of meeting policyholder obligations.
iBB	Inadequate claims paying ability. The protective factors fluctuate in case of changes in business/economic conditions and prospects of meeting policyholder obligations are more likely to be affected by such changes.
iB	Weak claims paying ability. Risk factors indicate that policyholders' obligations may not be met when due. Adverse changes in business/economic conditions could result in inability/unwillingness to service policyholder obligations.
iC	Lowest claims paying ability. Indicates fundamentally poor position. Such companies may often be in default on policyholder obligations and may be or likely to be placed under supervision of insurance regulators.

Equity grades

ICRA Equity Grade outstanding shows any outstanding Equity assigned by ICRA to the company. ICRA's equity grade comments upon the relative inherent quality of equity reflected by the earnings prospects, risk and financial strength associated with the specific company. ICRA's Equity Grading Scale is listed below.

ER1 A	Excellent Earnings Prospects; Low Risk
ER1 B	Excellent Earnings Prospects; Moderate Risk
ER1C	Excellent Earnings Prospects; High Risk
ER2A	Very Good Earnings Prospects; Low Risk
ER2B	Very Good Earnings Prospects; Moderate Risk
ER2C	Very Good Earnings Prospects; High Risk

ER3A	Good Earnings Prospects; Low Risk
ER3B	Good Earnings Prospects; Moderate Risk
ER3C	Good Earnings Prospects; High Risk
ER4A	Moderate Earnings Prospects; Low Risk
ER4B	Moderate Earnings Prospects; Moderate Risk
ER4C	Moderate Earnings Prospects; High Risk
ER5A	Weak Earnings Prospects; Low Risk
ER5B	Weak Earnings Prospects; Moderate Risk
ER5C	Weak Earnings Prospects; High Risk
ER6A	Poor Earnings Prospects; Low Risk
ER6B	Poor Earnings Prospects; Moderate Risk
ER6C	Poor Earnings Prospects; High Risk

ICRA-CIDC grading symbols for Project Owner

OR1	Very strong project promoter. The likelihood of good project management and adequacy of project finance are highest.
OR2+ OR2 OR2-	Strong project promoter. The likelihood of good project management and adequacy of project finance are high but not as high as OR1.
OR3+ OR3 OR3-	Moderate project promoter. The likelihood of good project management and adequacy of project finance are moderate. Adverse changes in the economic situation might prevent the owner from being able to financially close the project.
OR4+ OR4 OR4-	Inadequate project promoter. The likelihood of good project management and adequacy of project finance are inadequate. The project promoter has inadequate experience and/or financial strength in implementing projects.
OR5	Weak project promoter. The likelihood of good project management and adequacy of project finance are weak.

ICRA-CIDC grading symbols for the Project

PT1	Very strong project. The prospects of successful implementation of the project as per plan are highest. The project risk factors are lowest.
PT2+ PT2 PT2-	Strong project. The prospects of successful implementation of the project as per plan are high. The project risk factors are low.

PT3+	Moderate project. The prospects of successful implementation of the project as per plan are moderate. The project risk factors are moderate.
PT3	
PT3-	
PT4+	Inadequate project. The prospects of successful implementation of the project as per plan are inadequate. The project risk factors are high.
PT4	
PT4-	
PT5	Weak project. The prospects of successful implementation of the project as per plan are poor. The project risk factors are highest.

'P' RATING

The letter P in parenthesis after the rating symbol shall indicate that the debt instrument is being issued to raise resources by a new company for financing a new project and the rating assumes successful completion of the project.

During 1992, ICRA also launched two schemes of credit assessment and general assessment.

Rating Scale for Collective Investment Schemes

Investment Grades

CS 1	High Grade - Schemes rated CS 1 are considered to have high probability of achieving indicated returns. The protective factors are above average.
CS 2	Adequate Grade - Schemes rated CS 2 are considered to have adequate probability of achieving indicated returns. The risks associated with such schemes are higher than schemes rated as CS 1. The protective factors are average. Returns are susceptible to adverse changes in circumstances.
CS 3	Moderate Grade - Schemes rated CS3 are considered to have moderate probability of achieving indicated returns. The risks associated with such schemes are higher than schemes rated in the higher categories. The protective factors are below average. Adverse changes in circumstances are more likely to affect returns.

Speculative (Non-Investment) Grades

CS 4	Inadequate Grade - Schemes rated CS4 are considered to have inadequate probability of achieving indicated returns. The protective factors are weak. Such schemes are considered to have speculative characteristics.
CS 5	High risk - Schemes rated CS5 are considered to have very high risks. Such schemes are extremely speculative.

ICRA-CIDC grading symbols for Contractors

CR 1	Very strong contract execution capacity - The prospects of timely completion of projects without cost overruns are best and the ability to pay liquidated damages for non-conformance with contract is highest.
CR 2+ CR 2 CR-	Strong contract execution capacity - The prospects of timely completion of projects without cost overruns and the ability to pay liquidated damages for non-conformance are high but not as high as CR1.
CR 3+ CR 3 CR-	Moderate Contract execution capacity - The prospects of timely completion of projects without cost overruns and the ability to pay liquidated damages for non-conformance are moderate. Contract execution capacity can be affected moderately by changes in the construction sector prospects.
CR 4+ CR 4 CR-	Inadequate contract execution capacity - The prospects of timely completion of projects without cost overruns and the ability to pay liquidated damages for non-conformance are inadequate. Contract execution capacity can be affected severely by changes in the construction sector prospects.
CR 5	Weak contract execution capacity - The prospects of timely completion of projects without cost overruns and the ability to pay liquidated damages for non-conformance are poor.

ICRA-CIDC grading symbols for Consultants

CT 1	Very strong project engineering capacity - The prospects of good technical design and the ability to pay liquidated damages for non-conformance with contract are highest.
CT 2+ CT 2 CT 2-	Strong project engineering capacity - The prospects of good technical design and the ability to pay liquidated damages for non-conformance are high but not as high as CT1.
CT 3+ CT 3 CT 3-	Moderate project engineering capacity - The prospects of good technical design and the ability to pay liquidated damages for non-conformance are moderate.
CT 4+ CT 4 CT 4-	Inadequate project engineering capacity - The prospects of good technical design and the ability to pay liquidated damages for non-conformance are inadequate. The track record of the consultant in project designing is not impressive.
CT 5	Weak project engineering capacity - The prospects of good technical design and the ability to pay liquidated damages for non-conformance are poor. The consultant either has no track record or has a track record of design flaws and disputes with clients.

C. Rating Symbols of CARE (Credit Analysis and Research Ltd.)

Credit Rating of Debt instruments

Long /Medium -term instruments (NCD/FD/CD/SO/CPS/RPS/L)

<i>Symbols</i>	<i>Rating Definition</i>
CARE AAA	Instruments with this rating are considered to be of the best credit quality, offering highest safety for timely servicing of debt obligations. Such instruments carry minimal credit risk.
CARE AA	Instruments with this rating are considered to offer high safety for timely servicing of debt obligations. Such instruments carry very low credit risk.
CARE A	Instruments with this rating are considered to offer adequate safety for timely servicing of debt obligations. Such instruments carry low credit risk.
CARE BBB	Instruments with this rating are considered to offer moderate safety for timely servicing of debt obligations. Such instruments carry moderate credit risk.
CARE BB	Instruments with this rating are considered to offer inadequate safety for timely servicing of debt obligations. Such instruments carry high credit risk.
CARE B	Instruments with this rating are considered to offer low safety for timely servicing of debt obligations and carry very high credit risk. Such Instruments are susceptible to default.
CARE C	Instruments with this rating are considered to be having very high likelihood of default in the payment of interest and principal.
CARE D	Instruments with this rating are of the lowest category. They are either in default or are likely to be in default soon.
NCD	Non Convertible Debenture
FD	Fixed Deposit
CD	Certificate of Deposit
SO	Structured Obligations
CPS	Convertible Preference Shares
RPS	Redeemable Preference Shares

As instrument characteristics or debt management capability could cover a wide range of possible attributes whereas rating is expressed only in limited number of symbols, CARE assigns '+' or '-' signs to be shown after the assigned rating (wherever necessary) to indicate the relative position within the band covered by the rating symbol.

Short term instruments

<i>Symbols</i>	<i>Rating Definition</i>
PR1	Instruments with this rating would have strong capacity for timely payment of short-term debt obligations and carry lowest credit risk. Within this category, instruments with relatively better credit characteristics are assigned PR1+ rating.
PR2	Instruments with this rating would have adequate capacity for timely payment of short-term debt obligations and carry higher credit risk as compared to instruments rated higher.
PR3	Instruments with this rating would have moderate capacity for timely repayment of short term debt obligations at the time of rating and carry higher credit risk as compared to instruments rated higher.
PR4	Instruments with this rating would have inadequate capacity for timely payment of short-term debt obligations and carry very high credit risk. Such Instruments are susceptible to default.
PR5	The instrument is in default or is likely to be in default on maturity.

As instrument characteristics or debt management capability could cover a wide range of possible attributes whereas rating is expressed only in limited number of symbols, CARE assigns '+' or '-' signs to be shown after the assigned rating (wherever necessary) to indicate the relative position within the band covered by the rating symbol. Suffix (L) will be used for loans.

CARE's Rating Scale for Corporate Governance Rating (CGR)

CARE CGR 1:	In CARE's opinion, the bank has adopted corporate governance practices which would provide its stakeholders highest comfort on the degree of corporate governance. CARE's CGR rating is however not a certificate on statutory compliance and is not a recommendation to buy or sell securities issued by the entity.
CARE CGR 2:	In CARE's opinion, the bank has adopted corporate governance practices which would provide its stakeholders high level of comfort on the degree of corporate governance. CARE's CGR rating is however not a certificate on statutory compliance and is not a recommendation to buy or sell securities issued by the entity.
CARE CGR 3:	In CARE's opinion, the bank has adopted corporate governance practices which would provide its stakeholders adequate level of comfort on the degree of corporate governance. CARE's CGR rating is however not a certificate on statutory compliance and is not a recommendation to buy or sell securities issued by the entity.

- CARE CGR 4: In CARE's opinion, the bank has adopted corporate governance practices which would provide its stakeholders moderate level of comfort on the degree of corporate governance. CARE's CGR rating is however not a certificate on statutory compliance and is not a recommendation to buy or sell securities issued by the entity.
- CARE CGR 5: In CARE's opinion, the bank has adopted corporate governance practices which would provide its stakeholders inadequate level of comfort on the degree of corporate governance. CARE's CGR rating is however not a certificate on statutory compliance and is not a recommendation to buy or sell securities issued by the entity.
- CARE CGR 6: In CARE's opinion, the bank has adopted corporate governance practices which would provide its stakeholders poor level of comfort on the degree of corporate governance. CARE's CGR rating is however not a certificate on statutory compliance and is not a recommendation to buy or sell securities issued by the entity.

Issuer Rating

<i>Symbols</i>	<i>Definition</i>
CARE AAA (Is)	Issuers with this rating are considered to be of the best credit quality, offering highest safety of timely servicing of debt obligations. Such issuers carry minimal credit risk.
CARE AA (Is)	Issuers with this rating are considered to offer high safety for timely servicing of debt obligations. Such issuers carry very low credit risk.
CARE A (Is)	Issuers with this rating are considered to offer adequate safety for timely servicing of debt obligations. Such issuers carry low credit risk.
CARE BBB (Is)	Issuers with this rating are considered to offer moderate safety for timely servicing of debt obligations. Such issuers carry moderate credit risk.
CARE BB (Is)	Issuers with this rating are considered to offer inadequate safety for timely servicing of debt obligations. Such issuers carry high credit risk.
CARE B (Is)	Issuers with this rating are considered to offer low safety for timely servicing of debt obligations and carry very high credit risk. Such issuers are susceptible to default.
CARE C (Is)	Issuers with this rating are considered to be having very high likelihood of default in the payment of interest and principal

CARE D (Is) Issuers with this rating are of the lowest category. They are either in default or are likely to be in default soon.

Care's Issuer Rating (CIR) reflects the overall credit risk of the issuer. The rating scale has been aligned with the long term instruments rating scale ranging from AAA(Is) signifying 'Highest Safety' to D(Is) signifying 'Default'. 'Is' signifies 'Issuer Rating'

D. Rating Symbols of Fitch India

Long Term (12 months and above)

Investment Grade

<i>Rating</i>	<i>Definition</i>
AAA(ind)	<i>Highest credit quality.</i> 'AAA(ind)' ratings indicate the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for timely payment of financial commitments. This capacity is unlikely to be adversely affected by foreseeable events.
AA(ind)	<i>High credit quality.</i> 'AA(ind)' ratings indicate a low expectation of credit risk. They indicate strong capacity for timely payment of financial commitments. This capacity may vary slightly from time to time because of economic conditions.
A(ind)	<i>Adequate credit quality.</i> 'A(ind)' ratings indicate that there is currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.
BBB(ind)	<i>Moderate credit quality.</i> 'BBB(ind)' ratings indicate a moderate expectation of credit risk. The capacity for timely payment of financial commitments is considered sufficient, but adverse changes in circumstances and in economic conditions are more likely to impair this category. This is the lowest investment-grade category.

Speculative Grade

<i>Rating</i>	<i>Definition</i>
BB(ind)	<i>Speculative.</i> 'BB(ind)' ratings indicate a fairly weak credit risk. Payment of financial commitments is uncertain to some degree and capacity for timely repayment remains more vulnerable to adverse economic change over time.
B(ind)	<i>Highly Speculative.</i> 'B(ind)' ratings indicate a significantly weak credit risk. Payment of financial commitments may not be made when due. Capacity for timely repayment is contingent upon a sustained, favourable business and economic environment.

C(ind)	<i>High Default Risk.</i> 'C(ind)' ratings indicate imminent default. Capacity for meeting financial commitments is solely reliant upon sustained, favourable business or economic developments.
D(ind)	<i>Default.</i> 'D(ind)' ratings indicate default. Expected recovery values are highly speculative and cannot be estimated with any precision.

Term Deposits (Bank Deposits, Fixed Deposits)

Investment Grade

<i>Rating</i>	<i>Definition</i>
tAAA(ind)	<i>Highest credit quality.</i> Protection factors are very high. Capacity for timely payment of financial commitments is unlikely to be adversely affected by foreseeable events.
tAA(ind)	<i>High credit quality.</i> Protection factors are high. Capacity for timely payment of financial commitments may vary slightly from time to time because of economic conditions.
tA(ind)	<i>Adequate credit quality.</i> Protection factors are average. Capacity for timely payment of financial commitments may be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.

Speculative Grade

<i>Rating</i>	<i>Definition</i>
tB(ind)	<i>Speculative.</i> Protection factors are low. Capacity for timely repayment of financial commitments remains more vulnerable to adverse economic change over time.
tC(ind)	<i>High Default Risk.</i> Capacity for meeting financial commitments is solely reliant upon sustained, favourable business or economic developments.
tD(ind)	<i>Default.</i> Expected recovery values are highly speculative and cannot be estimated with any precision.

Short Term (less than 1 year)

<i>Rating</i>	<i>Definition</i>
F1(ind)	<i>Highest credit quality.</i> Indicates the strongest capacity for timely payment of financial commitments.
F2(ind)	<i>Good credit quality.</i> A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.
F3(ind)	<i>Fair credit quality.</i> The capacity for timely payment of financial commitments is adequate; however, near-term adverse changes could result in a reduction to non-investment grade.

- F4(ind) *Speculative.* Minimal capacity for timely payment of financial commitments, plus vulnerability to near-term adverse changes in financial and economic conditions.
- F5(ind) *Default.* Denotes actual or imminent payment default.

Notes:

- Within a band of rating symbols (from AA(ind) to B(ind)), the signs "+" (plus) or "-" (minus) denote relative position within the rating category.
- The symbol (CP), (CD), (ICD), or (PS) after the rating indicates that Commercial Paper, Certificate of Deposit, Intercorporate Deposit or Preference Share has been rated.
- The symbol (M) after the rating indicates that the market or non-credit risks of the debt instrument are not reflected in the rating.
- The symbol (SO) after the rating indicates "structured obligation". The rating of the structured debt programme may differ from the rating of the secured/unsecured debt obligation of the issuer.
- Ratings may be placed on Rating Watch to notify investors that there is a reasonable probability of a rating change and the likely direction of such change. These are designated as "Positive", indicating a potential upgrade, "Negative", for a potential downgrade, or "Evolving", if ratings may be raised, lowered or maintained.

Brickwork Rating Symbols for Long Term debt instruments

The long-term debt instruments' includes Bonds, Non Convertible Debentures, Certificate of Deposits, Fixed Deposits, Convertible Preference Shares, Redeemable Preference Shares and Structured Obligations, all with original maturity exceeding one year.

Investment Grade Ratings:

- BWR AAA
(BWR Triple A) Instruments with AAA' rating are considered to offer the Best credit quality, in terms of timely servicing of debt obligations.
- BWR AA
(BWR Double A) Instruments with AA' rating are considered to offer High credit quality.
- BWR A Instruments with A' rating are considered to offer Adequate credit quality.
- BWR BBB
(BWR Triple B) Instruments with this rating are considered to offer Moderate credit quality.

Speculative grade:

- BWR BB
(BWR Double B) Instruments with this rating are considered to offer Inadequate credit quality.

BWR B	Instruments with this rating are considered to offer Low credit quality.
BWR C	Instruments with this rating are considered to offer Very Low credit quality.
BWR D	Instruments with this rating are in Default or expected to Default.

*Note:***1. Not – Appropriate category (NA)**

Brickwork assigns Not-Appropriate NA to certain instruments when the existing ratings are of no relevance for the investors. It is also difficult to compute the probability of default such instruments which have a temporary protection from the regulators, courts or under the protection of bankruptcy laws in BIFR.

2. {+} (plus) {–} (minus) modifiers are used with BWR AA to BWR C. The modifiers reflect the comparative standing for the same rating category

3. Brickwork Ratings for Structured Obligation

The ratings of certain instruments and issuers could be enhanced using a support structure mechanism. The issuer could receive a guarantee from the Central Government or State Government or a large MNC Company, by domestic or international institution etc. Certain other securities could be asset backed – mortgage backed securities, cash margin, escrow mechanism car loan securitized paper, securities of trade receivables and credit card receivables etc. The structured obligations use similar long term rating scale from BWR AAA to BWR D with a suffix, "so". The rules of modifiers are also same as for the regular long term ratings.

4. Convertible Instruments

While Brickwork Ratings model is applicable for the debt instruments there are large number of debt instruments which also show certain equity characteristics. Such instruments are subject to credit risk and market risk as well as liquidity risk. Brickwork does not attempt to forecast variables like stock price and hence does not capture market risk adequately, To this extent ratings of such instruments are prone to subjectivity. Ratings with suffix symbol –e denote convertible features in such instruments.

Brickwork Rating Symbols for Short Term debt instruments**Short Term Instruments Rating Scale**

The Short Term debt instruments with original maturity up to one year.

BWR P1	Instruments with this rating are considered to offer Excellent credit quality
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BWR P2	Instruments with this rating are considered to offer High credit quality
BWR P3	Instruments with this rating are considered to offer Moderate credit quality
BWR P4	Instruments with this rating are considered to offer Low credit quality
BWR P5	Instruments with this rating are in Default or expected to Default

Note:

1. The modifier “+” is used only from P1 to P3 to reflect comparative higher stand within the categories. The mapping of long to short term ratings has been explained elsewhere in the criteria.

3. Brickwork Rating Symbols for issuer rating

BWR AAA (BWR Triple A)	Issuer with ‘AAA’ rating is considered to offer the BEST credit worthiness.
BWR AA (BWR Double A)	Issuer with ‘AA’ rating is considered to offer High credit worthiness.
BWR A	Issuer with ‘A’ rating is considered to offer Adequate credit worthiness.
BWR BBB (BWR Triple B)	Issuer with this rating is considered to offer Moderate credit worthiness.
BWR BB (BWR Double B)	Issuer with this rating is considered to offer Inadequate credit worthiness.
BWR B	Issuer with this rating is considered to offer Low credit worthiness.
BWR C	Issuer with this rating is considered to offer Very Low credit worthiness.
BWR D	Issuer with this rating is in Default or expected to Default.

Brickwork Rating Symbols for Corporate Governance

BWR CG 1	Quality of Corporate Governance is The BEST
BWR CG 2	Quality of Corporate Governance is EXCELLENT
BWR CG 3	Quality of Corporate Governance is HIGH
BWR CG 4	Quality of Corporate Governance is ADEQUATE
BWR CG 5	Quality of Corporate Governance is MODERATE

BWR CG 6	Quality of Corporate Governance is INADEQUATE
BWR CG 7	Quality of Corporate Governance is LOW
BWR CG 8	Quality of Corporate Governance is The LOWEST

Brickwork Rating Symbols for Insurance Companies

BWR In AAA	BEST financial capability to meet policyholders obligations
BWR In AA	HIGH financial capability to meet policyholders obligations
BWR In A	ADEQUATE financial capability to meet policyholders obligations
BWR In BBB	MODERATE financial capability to meet policyholders obligations
BWR In BB	INADEQUATE financial capability to meet policyholders obligations
BWR In B	LOW financial capability to meet policyholders obligations
BWR In C	VERY LOW financial capability to meet policyholders obligations
BWR In D	DEFAULT on current policy holder obligations
BWR MF C	VERY LOW credit quality of underlying Debt portfolio
BWR RP 5	LOW project implementation
BWR RD 4	INADEQUATE project implementation capability
BWR RD 5	LOW project implementation capability

III. 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 Rs.100 crore for the previous five years. CRAs would be required to have a minimum net worth of Rs. 5 crore. A CRA can not rate a security issued by its promoter. No Chairman, Director or Employee of the promoters shall be Chairman, Director or Employee of CRA or its rating committee. A CRA can not rate securities issued by any borrower, subsidiary, an associate promoter of CRA, if there are common Chairman, Directors and Employees between the CRA or its rating committee and these entities. A CRA can not rate a security issued by its associate or subsidiary if the CRA or its rating committee has a Chairman, Director or Employee who is also a Chairman, Director or Employee of any such entity. CRAs would have to carry out

periodic reviews of the ratings given during the lifetime of the rated instrument. 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. Issuers coming out with a public/rights issue of debt securities would be required to incorporate an undertaking in the offer documents promising necessary co-operation with the rating agency in providing true and adequate information.

Some of the important definitions in the Regulations are reproduced below:

- *Associate* – In relation to the Credit Rating Agency, associate includes a person—
 - (i) who directly or indirectly by himself or in combination with relatives, owns or controls shares carrying not less than 10% of the voting rights of the CRA, or
 - (ii) in respect of whom the CRA directly or indirectly by itself or in combination with other persons, owns or controls shares carrying not less than 10% of the voting rights, or
 - (iii) majority of the directors of which, own or control shares not less than 10% of the voting rights of the CRA, or
 - (iv) whose director, officer or employee is also a director, officer, employee of the CRA.
- *Client* – means any person whose securities are rated by a CRA.
- *Credit Rating 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.
- *Issuer* – means a person or a company whose securities are proposed to be rated by a CRA.
- *Networth* – means the aggregate value of the paid up equity capital and free reserves (excluding reserves created out of revaluation) reduced by the aggregate value of accumulated losses and deferred expenditure not written off including miscellaneous expenses not written off.
- *Rating* – means an opinion regarding securities expressed in the form of standard symbols or in any other standardised manner, assigned by a CRA and used by the issuer of such securities to comply with a requirement specified by these Regulations
- *Rating Committee* – means a committee constituted by a CRA to assign rating to a security

Registration of Credit Rating Agencies

Any person proposing to commence any activity as a credit rating agency should make an application to SEBI for the grant of a certificate of registration for the purpose. Any person, who before the said date carrying on any activity as a credit rating agency, should make an application to SEBI for the grant of a certificate within a period of three months from such date. However SEBI may, where it is of the

opinion that it is necessary to do so, for reasons to be recorded in writing, extend the said period upto a maximum of six months from such date. An application for the grant of a certificate should be made to SEBI accompanied by a non-refundable specified application fee. Any person who fails to make an application for the grant of a certificate within the period specified in that sub-regulation, ceases to carry on rating activity.

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 recognised 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

SEBI shall not consider an application for the grant of a certificate unless the applicant satisfies the following conditions, namely:

- (a) the applicant is set up and registered as a company under the Companies Act, 1956;
- (b) the applicant has, in its Memorandum of Association, specified rating activity as one of its main objects;
- (c) the applicant has a minimum net worth of rupees five crores.

However a credit rating agency existing at the commencement of these regulations, with a net worth of less than rupees five 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.

- (d) the applicant has adequate infrastructure, to enable it to provide rating services in accordance with the provisions of the Act and these regulations;
- (e) the applicant and the promoters of the applicant, referred to in this regulation have professional competence, financial soundness and general reputation of fairness and integrity in business transactions, to the satisfaction of SEBI;
- (f) 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;
- (g) 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;

- (h) the applicant has, in its employment, persons having adequate professional and other relevant experience to the satisfaction of the Board;
- (i) 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.
- (j) the applicant, in all other respects, is a fit and proper person for the grant of a certificate;
- (k) grant of certificate to the applicant is in the interest of investors and the securities market.

Application to conform to the requirements

Any application for a certificate, which is not complete in all respects or does not conform to the requirement or instructions as specified should be rejected by SEBI. However before rejecting any application, the applicant should be given an opportunity to remove, within thirty days of the date of receipt of relevant communication, from SEBI such objections as may be indicated by SEBI. It has been further provided that SEBI may on sufficient reason being shown, extend the time for removal of objections by such further time, not exceeding thirty days to enable the applicant to remove such objections.

Furnishing of information, clarification and personal representation

SEBI may require the applicant to furnish such further information or clarification as it consider necessary, for the purpose of processing of the application. SEBI if so desires, may ask the applicant or its authorised representative to appear before SEBI for personal representation in connection with the grant of a certificate.

Grant of Certificate

SEBI grants a certificate after getting satisfied that the applicant is eligible for the grant of a certificate of registration. The grant of certificate of registration should be subject to the payment of the specified registration fee in the manner prescribed.

Conditions of certificate

The certificate granted is subject to the condition that the credit rating agency should comply with the provisions of the Act, the regulations made thereunder and the guidelines, directives, circulars and instructions issued by SEBI from time to time on the subject of credit rating. The credit rating agency should forthwith inform SEBI in writing where any information or particulars furnished to SEBI by a credit rating agency is found to be false or misleading in any material particular; or has undergone change subsequently to its furnishing at the time of the application for a certificate. The period of validity of certificate of registration shall be three years.

Renewal of certificate

A credit rating agency, if it desires renewal of the certificate granted to it, should make to SEBI an application for the renewal of the certificate of registration. An application for renewal of certificate of registration shall be accompanied by a non-refundable application fee as prescribed in Second Schedule of the Regulations. Schedule II provides for the following fees:

Application fee	— Rs. 50,000/-
Registration fee for grant of certificate	— Rs. 5,00,000/-
Renewal fees	— Rs. 10,00,000/-

Such application should be made not less than three months before expiry of the period of validity of the certificate in the manner specified. The application for renewal should be accompanied by a renewal fee as specified and should be dealt in the same manner as if it were an application for the grant of a fresh certificate.

Procedure where certificate is not granted

SEBI may reject the application if after considering an application is of the opinion that a certificate should not be granted or renewed, after giving the applicant a reasonable opportunity of being heard. The decision of SEBI not to grant or not to renew the certificate should be communicated by SEBI to the applicant within a period of thirty days of such decision, stating the grounds of the decision. Any applicant aggrieved by the decision of SEBI rejecting his application may, within a period of thirty days from the date of receipt by him of the communication apply to SEBI in writing for re-consideration of such decision. Where an application for re-consideration is made, SEBI should consider the application and communicate to the applicant its decision in writing, as soon as may be.

Effect of refusal to grant certificate

An applicant whose application for the grant of a certificate has been rejected should not undertake any rating activity. An applicant whose application for the grant of a certificate has been rejected by SEBI, should on and from the date of the receipt of the communication ceases to carry on any rating activity. If SEBI is satisfied that it is in the interest of the investors, it may permit the credit rating agency to complete the rating assignments already entered into by it, during the pendency of the application or period of validity of the certificate. SEBI in order to protect the interests of investors, may issue directions with regard to the transfer of records, documents or reports relating to the activities of a credit rating agency, whose application for the grant or renewal of a certificate has been rejected and for this purpose also determine the terms and conditions of such appointment.

Code of Conduct

Every credit rating agency is required to abide by the Code of Conduct as per SEBI Regulations:

- (1) A credit rating agency in the conduct of its business should observe high standards of integrity and fairness in all its dealings with its clients.
- (2) A credit rating agency should fulfil its obligations in an ethical manner.

- (3) A credit rating agency should render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgement. It shall wherever necessary, disclose to the clients, possible sources of conflict of duties and interests, while providing unbiased services.
- (4) The credit rating agency should avoid any conflict of interest of any member of its rating committee participating in the rating analysis. Any potential conflict of interest shall be disclosed to the client.
- (5) A credit rating agency should not indulge in unfair competition nor they wear away client of any other rating agency on assurance of higher rating.
- (6) A credit rating agency should not make any exaggerated statement, whether oral or written, to the client either about its qualification or its capability to render certain services or its achievements in regard to services rendered to other clients.
- (7) A credit rating agency should always endeavour to ensure that all professional dealings are effected in a prompt and efficient manner.
- (8) A credit rating agency should not divulge to other clients, press or any other party any confidential information about its client, which has come to its knowledge, without making disclosure to the concerned person of the rated company/client.
- (9) A credit rating agency should not make untrue statement or suppress any material fact in any documents, reports, papers or information furnished to SEBI or to public or to stock exchange.
- (10) A credit rating agency should not generally and particularly in respect of issue of securities rated by it be a party—
 - (a) to creation of false market
 - (b) passing of price sensitive information to brokers, members of the stock exchanges, other players in the capital market or to any other person or take any other action which is unethical or unfair to the investors.
- (11) A credit rating agency should maintain an arm's length relationship between its credit rating activity and any other activity. A credit rating agency or any of his employees should not render directly or indirectly any investment advice about any security in the publicly accessible media, whether real-time or non-real time, unless a disclosure of his interest including long or short position in the said security has been made, while rendering such advice. In case an employee of the credit rating agency is rendering such advice, he should also disclose the interest of his dependent family members and the employer including their long or short in the said security, while rendering such advice.
- (12) A credit rating agency is required to abide by the provisions of the Act, regulations and circulars which may be applicable and relevant to the activities carried on by the credit rating agency.

Agreement with the client

Every credit rating agency is required to enter into a written agreement with each client whose securities it proposes to rate, and every such agreement should include

the following provisions, namely:

- (a) the rights and liabilities of each party in respect of the rating of securities shall be defined;
- (b) the fee to be charged by the credit rating agency shall be specified;
- (c) the client shall agree to a periodic review of the rating by the credit rating agency during the tenure of the rated instrument and to co-operate with the credit rating agency in order to enable the latter to arrive at, and maintain, a true and accurate rating of the clients' securities and shall in particular provide to the latter, true, adequate and timely information for the purpose;
- (d) the credit rating agency shall disclose to the client the rating assigned to the securities of the latter through regular methods of dissemination, irrespective of whether the rating is or is not accepted by the client;
- (e) the client shall agree to disclose the rating assigned to the client's listed securities by any credit rating agency during the last three years and any rating given in respect of the client's securities by any other credit rating agency, which has not been accepted by the client in the offer document;
- (f) the client shall agree to obtain a rating from at least two different rating agencies for any issue of debt securities whose size is equal to or exceeds, rupees one hundred crores.

Monitoring of ratings

Credit rating agency should during the lifetime of securities rated by it continuously monitor the rating of such securities. It should also disseminate information regarding newly assigned ratings, and changes in earlier rating promptly through press releases and websites, and, in the case of securities issued by listed companies, such information should also be provided simultaneously to the concerned to all the stock exchanges where the said securities are listed.

Procedure for review of rating

Every credit rating agency should carry out periodic review of all published ratings during the lifetime of the securities. If the client does not co-operate with the credit rating agency so as to enable the credit rating agency to comply with its obligations, the credit rating agency should carry out the review on the basis of the best available information.

However, it has been provided that if owing to such lack of co-operation, a rating has been based on the best available information, the credit rating agency should disclose to the investors the fact that the rating is so based. A credit rating agency should not withdraw a rating so long as the obligations under the security rated by it are outstanding, except where the company whose security is rated is wound up or merged or amalgamated with another company.

Internal Procedures to be framed

Credit rating agency should frame appropriate procedures and systems for monitoring the trading of securities by its employees in the securities of its clients, in

order to prevent contravention of SEBI (Insider Trading) Regulations, 1992; SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 2003; and other laws relevant to trading of securities.

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. It should also make available to the general public information relating to the rationale of the ratings, which shall cover an analysis of the various factors justifying a favourable assessment, as well as factors constituting a risk.

Submission of Information

In case any information is called by SEBI from a credit rating agency including any report relating to its activities, the credit rating agency is required to furnish such information to SEBI within a period specified or if no such period is specified, then within a reasonable time. It should also furnish to SEBI, copies of its balance sheet and profit and loss account at the close of each accounting period,

Every credit rating agency is required to comply with such guidelines, directives, circulars and instructions as issued by SEBI from time to time.

Appointment of Compliance Officer

It is under an obligation to appoint a compliance officer who will be responsible for monitoring the compliance of the Act, Rules and Regulations, notifications, guidelines, instructions etc issued by SEBI or the Central Government. The compliance officer should immediately and independently report to SEBI any non-compliance observed by him.

Maintenance of Books of Accounts Records, etc.

Credit rating agency should keep and maintain, for a minimum period of five years, the following books of accounts, records and documents, namely:

- (i) copy of its balance sheet, as on the end of each accounting period;
- (ii) a copy of its profit and loss account for each accounting period;
- (iii) a copy of the auditor's report on its accounts for each accounting period.
- (iv) a copy of the agreement entered into, with each client;
- (v) information supplied by each of the clients;
- (vi) correspondence with each client;
- (vii) ratings assigned to various securities including upgradation and down gradation (if any) of the ratings so assigned;
- (viii) rating notes considered by the rating committee;
- (ix) record of decisions of the rating committee;
- (x) letter assigning rating;

- (xi) particulars of fees charged for rating and such other records as SEBI may specify from time to time.

Credit rating agency is required to intimate to SEBI, the place where the books of account, records and documents required to be maintained under these regulations are being maintained.

Steps on auditor's report

Credit rating agency should within two month's from the date of the auditor's report, take steps to rectify the deficiencies if any, made out in the auditor's report, insofar as they relate to the activity of rating of securities.

Confidentiality

Every credit rating agency shall treat, as confidential, information supplied to it by the client and no credit rating agency shall disclose the same to any other person, except where such disclosure is required under any law.

Rating process

Credit rating agency should specify the rating process and file a copy of the same with SEBI for record and also file with SEBI any modifications or additions made therein from time to time. It should in all cases follow a proper rating process. Credit rating agency is required to have professional rating committees, comprising members who are adequately qualified and knowledgeable to assign a rating. All rating decisions, including the decisions regarding changes in rating, should be taken by the rating committee. Credit rating agency should be staffed by analysts qualified to carry out a rating assignment. Credit rating agency should inform SEBI about new rating instruments or symbols introduced by it. Credit rating agency, while rating a security should exercise due diligence in order to ensure that the rating given by the credit rating agency is fair and appropriate. A credit rating agency should not rate securities issued by it. Rating definition, as well as the structure for a particular rating product, should not be changed by a credit rating agency, without prior information to SEBI. A credit rating agency should disclose to the concerned stock exchange through press release and websites for general investors, the rating assigned to the securities of a client, after periodic review, including changes in rating, if any.

Securities issued by promoter

Credit rating agency shall not rate a security issued by its promoter. No credit rating agency should rate a security issued by an entity, which is a borrower of its promoter or a subsidiary of its promoter or an associate of its promoter, if there are common Chairman, Directors between credit rating agency and these entities, there are common employees, there are common Chairman, Directors, Employees on the rating committee. No credit rating agency should rate a security issued by its associate or subsidiary, if the credit rating agency or its rating committee has a Chairman, director or employee who is also a Chairman, director or employee of any such entity. However, these conditions do not apply to securities whose rating has been already done by a credit rating agency before the commencement of these regulations, and such securities may, subject to the provisions of the other Chapters of these regulations, continue to be rated, without the need to comply with the restrictions imposed by the regulations.

Procedure for inspection and investigation

SEBI can appoint one or more persons as inspecting officers, to undertake inspection or investigation of the books of account, records and documents of the credit rating agencies, for any of the purposes specified in the regulations. The purposes referred to in regulation should be to ascertain whether the books of account, records and documents are being maintained properly, to ascertain whether the provisions of the Act and these regulations are being complied with, to investigate into complaints received from investors, clients or any other person on any matter having a bearing on activities of the credit rating agency and in the interest of the securities market or in the interest of investors. The inspections ordered by SEBI should not ordinarily go into an examination of the appropriateness of the assigned ratings on the merits. Inspections to judge the appropriateness of the ratings may be ordered by SEBI, only in case of complaints which are serious in nature to be carried out either by the officers of SEBI or independent experts with relevant experience or combination of both.

Notice of inspection or investigation

SEBI shall give ten days written notice to the credit rating agency before ordering an inspection or investigation. SEBI in the interest of the investors may order in writing, direct that the inspection or investigation of the affairs of the credit rating agency to be taken up without such notice. During the course of an inspection or investigation, the credit rating agency against whom the inspection or investigation is being carried out should be bound to discharge all its obligations as provided in regulation.

Obligations of Credit Rating Agency

It should be the duty of credit rating agency whose affairs are being inspected or investigated, and of every director, officer or employee thereof, to produce to the inspecting or investigating officer such books, accounts and other documents in its or his custody or control and furnish him with such statements and information relating to its rating activities, as the inspecting officer may require within such reasonable period as may be specified by the officer. The credit rating agency should allow the inspecting officer to have reasonable access to the premises occupied by such credit rating agency or by any other person on its behalf and extend to the inspecting officer reasonable facility for examining any books, records, documents and computer data in the possession of the credit rating agency and to provide copies of documents or other materials which, in the opinion of the inspecting officer, are relevant for the purposes of the inspection or investigation, as the case may be. The inspecting officer, in the course of inspection or investigation, should be entitled to examine, or record the statements, of any officer, director or employee of the credit rating agency for the purposes connected with the inspection or investigation. Every director, officer or employee of the credit rating agency is bound to render to the inspecting officer all assistance in connection with the inspection or investigation which the inspecting officer may reasonably require.

The inspecting officer should as soon as possible, on completion of the inspection or investigation, submit a report to SEBI. However if directed to do so by SEBI, he may submit an interim report. SEBI after considering the inspection report

or the interim report referred to in regulation communicate the findings of the inspecting officer to the credit rating agency and give it a reasonable opportunity of being heard in the matter. SEBI may call upon the credit rating agency on receipt of the explanation, if any to take such measures as it may deem fit in the interest of the securities market and for due compliance with the provisions of the Act and the regulations.

Action in case of default

A credit rating agency which—

- (a) fails to comply with any condition subject to which a certificate has been granted;
- (b) contravenes any of the provisions of the Act or these regulations or any other regulations made under the Act; shall be dealt with in the manner provided under Chapter V of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

GUIDELINES FOR CREDIT RATING AGENCIES

Recent events in global financial system have underlined the pivotal role that credit ratings play. Effective use of credit ratings by the users is crucially dependent upon quality and quantity of disclosures made by the Credit Rating Agencies (CRAs). There have been widespread consultations on the issue both globally and within India and several documents have been prepared. In the wake of the above and in order to impart higher credibility to the processes and procedures associated with the credit rating, it has been decided, in consultation with the CRAs, to prescribe the following transparency and disclosure norms for them:

Rating Process

A CRA shall keep the following records in support of each credit rating and review / surveillance thereof:

- The important factors underlying the credit rating and sensitivity of such credit rating to changes in these factors;
- Summary of discussions with the issuer, its management, auditors and bankers which have a bearing on the credit rating;
- Decisions of the rating committee(s), including voting details and notes of dissent, if any, by any member of the rating committee, and
- If a quantitative model is a substantial component of the credit rating process, the rationale for any material difference between the credit rating implied by the model and the credit rating actually assigned.

These records should be maintained till five years after maturity of instruments and be made available to auditors and regulatory bodies when sought by them.

Default Studies

The CRA, should publish information about the historical default rates of CRA rating categories and whether the default rates of these categories have changed

over time, so that the public can understand the historical performance of each category and if and how rating categories have changed, and be able to draw quality comparisons among ratings given by different CRAs. The default rates shall be calculated in the following manner:

- One Year Default Rate is the weighted average of default rates of all possible 1 year static pools in the 5-year period.
- Cumulative Default Rate: The cumulative default rate (CDR) represents the likelihood of an entity that was rated at the beginning of any multi-year period defaulting at any time during the multi-year period. Three-year cumulative default rate shall be computed as: Three-year CDR for rating category X = No. of issuers which defaulted over the three-year period / No. of issuers outstanding at the beginning of the three-year period.

Here,

Static Pool:	Non-defaulted ratings that were outstanding at the beginning of any period
Default:	Non-payment of interest or principal amount in full on the pre-agreed date. A CRA shall recognize default at the first instance of delay in servicing of interest or principal on the rated debt instrument.
Default Rate:	The number of defaults among rated entities in the static pool as a percentage of the total number of entities in the static pool.
Averaging:	All averaging across static pools for default rate computations must be based on the weighted average method where the weights are the number of ratings in each static period

Dealing with Conflict of interest

A CRA shall formulate the policies and internal codes for dealing with the conflict of interests. A CRA shall ensure that its analysts do not participate in any kind of marketing and business development including negotiations of fees with the issuer whose securities are being rated, the employees' involved in the credit rating process and their dependants do not have ownership of the shares of the issuer and prompt review of the credit ratings of the securities as and when any of its employees joins the respective issuer.

Obligations in respect of Rating of Structured Finance Products

A CRA may undertake rating of structured finance products, namely, instruments/ pay-outs resulting from securitization transactions. In such cases, apart from following all the applicable requirements in case of non-structured ratings, the following additional requirements shall also be complied with:

- A CRA or its subsidiaries shall not provide consultancy or advisory services regarding the design of the structured finance instrument.

- The rating symbols shall clearly indicate that the ratings are for structured finance products.

Unsolicited Credit Ratings

In case of unsolicited credit ratings, i.e. the credit ratings not arising out of the agreement between a CRA and the issuer, credit rating symbol shall be accompanied by the word “UNSOLICITED” in the same font size. A CRA shall monitor and disclose credit rating during the life of the rated securities, as if it were a solicited rating.

Disclosures

In case of listed securities, the CRA shall also make disclosures to the stock exchanges as specified in the SEBI (Credit Ratings) Regulations, 1999. For ratings assigned and their periodic reviews, the CRA shall issue press releases which shall also be kept on their websites. Where a specific format has been prescribed, the disclosures shall be made in that format. A CRA shall make all the disclosures stipulated below on their websites:

- A CRA shall formulate and disclose its policies, methodology and procedures in detail regarding solicited and unsolicited credit ratings.
- A CRA shall disclose in the formats prescribed about details of new credit ratings assigned during last six-months; Movement of credit rating of all outstanding securities during the last six-months:
 - Movement of each credit rating,
 - Movement of each credit rating from investment grade to non investment grade and vice versa and
 - Movement of each credit rating that has moved by more than one notch
- The history of credit rating of all outstanding securities;
- On annual basis, the list of defaults separately for each rating category (e.g. AAA, AA, A, BBB, BB, B, C) This shall include the initial credit rating assigned by the CRA, month and year of initial rating, month and year of default, last credit rating assigned by the CRA before the issuer defaulted, comments of CRAs, if any.
- On annual basis, the average one-year and three-year cumulative default rates (based on weighted average), for the last 5 years, separately for each following category:
 - each credit rating category (e.g. AAA, AA, A, BBB, BB, B, C), separately;
 - structured instruments and non-structured instruments, separately
- A CRA shall disclose the general nature of its compensation arrangements with the issuers.
- A CRA shall disclose, in case of accepted ratings, its conflict of interest, if any, including the details of relationship – commercial or otherwise – between the issuer whose securities are being rated / any of its associate of such issuer and the CRA or its subsidiaries.

- A CRA shall disclose annually its total receipt from rating services and non-rating services, issuer wise percentage share of non-rating income of the CRA and its subsidiary to the total revenue of the CRA and its subsidiary from that issuer, and names of the rated issuers who along with their associate contribute 10% or more of total revenue of the CRA and its subsidiaries.
- While publishing the ratings of structured finance products and their movements, a CRA apart from following all the applicable requirements in case of non-structured ratings shall also disclose the track record of the originator and details of nature of underlying assets while assigning the credit rating. The track record shall include a brief description of the financials of the originator, rating migrations to speculative categories and defaults.
- A CRA shall also disclose at least once in every six months, the performance of the rated pool, i.e., collection efficiency, delinquencies. A CRA shall also provide a detailed description of the underlying pools including ageing, Credit enhancements such as liquidity supports, first and second loss guarantee provided shall also be disclosed.
- While publishing unsolicited ratings and their movements, a CRA apart from following all the applicable requirements in case of solicited ratings shall make the following disclosures:
 - the extent of participation by the issuer, its management, bankers and auditors in the credit rating process.
 - the information used and its source in arriving at and reviewing the credit rating.
- A CRA shall disclose annually all the unsolicited ratings carried out in the last three financial years; names of issuers, which were given, solicited rating in the last financial year.
- A CRA shall disclose its shareholding pattern as prescribed by stock exchanges for a listed company under clause 35 of Listing Agreement.
- A CRA shall disclose the compliance status of each provision of IOSCO code of conduct.

Implementation Schedule and Reporting

The half-yearly disclosures shall be made by the CRAs within 15 days from the end of the half-year (March / September). The yearly disclosures shall be made by the CRAs within 30 days from the end of the financial year.

A CRA can make additional disclosures other than those stipulated with the prior approval of its Board.

Internal Audit of Credit Rating Agency

SEBI has decided in consultation with the credit rating agencies (CRAs) to be undertaken an internal audit on a half yearly basis which is envisaged under Regulation 22 of the SEBI (Credit Rating Regulations), 1999 by Company Secretaries, Chartered Accountants, or Cost and Management Accountants who are

in practice and who do not have any conflict of interest with the CRA. It shall cover all aspects of CRA operations and procedures, including investor grievance redressal mechanism, compliance with the requirements stipulated in the SEBI Act, Rules and Regulations made thereunder, and guidelines issued by SEBI from time to time. The report shall state the methodology adopted, deficiencies observed, and consideration of response of the management on the deficiencies and also include a summary of operations and of the audit, covering the size of operations, number of transactions audited and the number of instances where violations/deviations were observed while making observations on the compliance of any regulatory requirement. The report shall comment on the adequacy of systems adopted by the CRA for compliance with the requirements of regulations and guidelines issued by SEBI and investor grievance redressal.

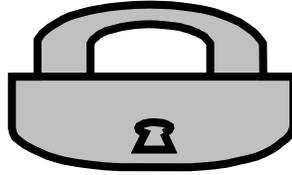
The time schedule for the internal audit shall be as under:

- The CRA shall receive the report of the internal audit within two months from the end of the half-year.
- The Board of Directors of the CRA shall consider the report and take steps to rectify the deficiencies, if any, and the CRA shall send an Action Taken Report to SEBI within next two months.

LESSON ROUND UP



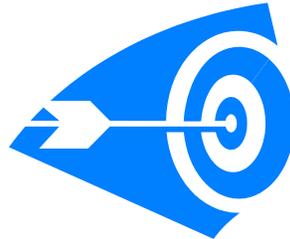
- Credit rating is the evaluation of the credit worthiness of an individual or of a business concern or of an instrument of a business based on relevant factors indicating ability and willingness to pay obligations as well as net worth.
- The main purpose of credit rating is to communicate to the investors the relative ranking of the default loss probability for a given fixed income investment, in comparison with other rated instruments.
- In India CRISIL (Credit Rating and Information Services (India) Limited) was set up as the first credit rating agency in 1987. This was followed by ICRA Limited (Investment Information and Credit Rating Agency of India Limited) in 1991 and CARE (Credit Analysis and Research Limited) in 1994, in 1999 Fitch Rating India Pvt. Ltd. and Brickwork Ratings Pvt. Ltd. in 2008. All these five credit rating agencies are registered with the Securities and Exchange Board of India.
- Credit Rating Agencies are regulated by SEBI (Credit Rating Agencies) Regulations, 1999.
- SEBI has also prescribed Transparency and Disclosure Norms (Guidelines) for Credit Rating Agencies.
- Practising Company Secretaries are authorized to undertake Internal Audit of CRAs.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What do you understand by credit rating? Name the Indian agencies involved in Credit Rating and also explain briefly their rating methodology.
 2. Explain major provisions of SEBI (Credit Rating Agencies) Regulations, 1999.
 3. Explain general obligations of Credit Rating Agencies under Chapter III of SEBI (Credit Rating Agencies) Regulations, 1999.
 4. Discuss the procedure relating to inspection and investigation of the credit rating agencies.
 5. Explain important uses of credit rating and factors contributing to the success of a rating system.
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STUDY VI
CAPITAL MARKET INTERMEDIARIES



LEARNING OBJECTIVES

The study will enable the students to understand

- Market intermediaries involved in the primary market
- Market intermediaries involved in the secondary market
- Overview of SEBI Regulations applicable to Primary and Secondary Market Intermediaries
- SEBI (Self Regulaory Organisations) Regulations, 2004
- SEBI (Intermediaries) Regulations, 2008

INTRODUCTION

Capital market intermediaries are a vital link between the regulators, issuers and investor. Any aberrations in the capital markets has presumably direct bearing on the intermediaries, their governance processes and practices which in turn affect the confidence of the markets. It is therefore necessary to ensure good governance practice of the intermediaries and also to have constant monitoring and surveillance on the acts of intermediaries. Securities and Exchange Board of India Act, 1992 was framed to provide for the establishment of a Board to protect the interest of investors in securities and to promote the development of and regulate the securities market and for matter connected therewith and incidental thereto.

As per Section 11 of SEBI Act, it is the duty of SEBI to register and regulate the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisors and such other intermediaries who may be associated with securities market in any manner.

SEBI has issued regulations in respect of each intermediary to ensure proper services to be rendered by them to the investors and the capital market.

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. The regulation is primarily principle based and some significant changes in the framework are given below:

1. Permanent Registration

Subject to compliance with the SEBI Act, regulations, updation of relevant disclosures and payment of fees registration shall be permanent.

2. Registration for multiple activities

The process for registration for undertaking multiple activities by the same intermediary has been simplified.

3. Registration Form- information divided into two parts

Part 1 of the form will be disclosed and available to the public and Part II will contain such information which will be retained with the Board as regulatory filing.

4. Fit and Proper person requirements

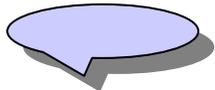
The criteria to determine whether the intermediary is a Fit and Proper person have been revised and are now principle based.

5. Suspension/Cancellation of certificate of registration

The manner of suspension/cancellation of any certificate granted to any person has been provided in the regulations. Consequently the SEBI (Procedure for holding enquiry by enquiry officer and imposing penalty) Regulations, 2002 has been repealed and SEBI (Intermediaries) Regulations, 2008 has taken place.

I. 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

1. MERCHANT BANKERS

SEBI has advised that merchant bankers shall undertake only those activities

which relate to securities market. These activities are:

- (a) Managing of public issue of securities;
- (b) Underwriting connected with the aforesaid public issue management business;
- (c) Managing/Advising on international offerings of debt/equity i.e. GDR, ADR, bonds and other instruments;
- (d) Private placement of securities;
- (e) Primary or satellite dealership of government securities;
- (f) Corporate advisory services related to securities market including takeovers, acquisition and disinvestment;
- (g) Stock broking;
- (h) Advisory services for projects;
- (i) Syndication of rupee term loans;
- (j) International financial advisory services.

The activities of the merchant bankers in the Indian capital market are regulated by SEBI (Merchant Bankers) Rules, 1992 and SEBI (Merchant Bankers) Regulations, 1992. While the rules were notified by the Central Government in exercise of the powers conferred by section 29 of SEBI Act, 1992, the regulations were notified by SEBI in exercise of the powers conferred by section 30 of SEBI Act, 1992 after approval of the Central Government. Both the rules and the regulations took effect on 22nd December, 1992 on their publication in the Gazette of India. Central Government vide its notification dated 07 September, 2006 has recinded the SEBI (Merchant Bankers) Rules, 1992. On the date of publication of this study material, the new Rules are yet to be notified.

SEBI (Merchant Bankers) Regulations, 1992



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 term issue means an offer of sale or purchase of securities by any body corporate, or by any other person or group of persons on its or his or their behalf, as the case may be, to or from the public or the holders of securities of such body corporate or person or group of persons through a merchant banker.

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 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.

- (a) the applicant shall be a body corporate other than a non-banking financial company as defined under clause(f) of section 45-I of the RBI Act, 1934;
- (b) the applicant has the necessary infrastructure like adequate office space, equipments and manpower to effectively discharge his activities;
- (c) the applicant has in his employment a minimum of two persons who have the experience to conduct the business of the merchant banker;
- (d) a person directly or indirectly connected with the applicant has not been granted registration by SEBI;
- (e) the applicant fulfills the capital adequacy requirement;
- (f) the applicant, his partner, director or principal officer is not involved in any litigation connected with the securities market which has an adverse bearing on the business of the applicant;
- (g) the applicant, his director, partner or principal officer has not at any time been convicted for any offence involving moral turpitude or has been found guilty of any offence;
- (h) the applicant has the professional qualification from an institution recognised by the Government in finance, law or business management;
- (i) the applicant is a fit and proper person;
- (j) grant of certificate to the applicant is in the interest of investors.

Capital adequacy

Regulation 7 prescribes that the capital adequacy requirement shall be a networth of not less than five crore rupees.

Networth means the sum of paid-up capital and free reserves of the applicant at the time of making application.

Regulation 8, 9, 9A and 10 deal with procedure for registration, renewal of certificate conditions of registration and procedure where registration is not granted.

Regulation 11 stipulate that on refusal of registration by SEBI, the applicant shall cease to carry on any activity as a merchant banker from the date of receipt of SEBI's refusal letter.

Regulation 12 provides for payment of fees and consequences of failure to pay annual fees. It provides that SEBI may suspend the registration certificate if merchant banker fails to pay fees.

General obligations and responsibilities of Merchant Banker

Chapter III of the Regulations containing Regulations 13 to 28 deal with general obligations and responsibilities of Merchant Bankers.

Regulation 13 stipulates that every merchant banker shall abide by the code of conduct which has been specified in Schedule III. The code of conduct as provided in the schedule is as under:

Code of Conduct for Merchant Bankers

1. A merchant banker shall make all efforts to protect the interests of investors.
2. A merchant banker shall maintain high standards of integrity, dignity and fairness in the conduct of its business.
3. A merchant banker shall fulfil its obligations in a prompt, ethical, and professional manner.
4. A merchant banker shall at all times exercise due diligence, ensure proper care and exercise independent professional judgement.
5. A merchant banker shall endeavour to ensure that—
 - (a) inquiries from investors are adequately dealt with;
 - (b) grievances of investors are redressed in a timely and appropriate manner;
 - (c) where a complaint is not remedied promptly, the investor is advised of any further steps which may be available to the investor under the regulatory system.
6. A merchant banker shall ensure that adequate disclosures are made to the investors in a timely manner in accordance with the applicable regulations and guidelines so as to enable them to make a balanced and informed decision.
7. A merchant banker shall endeavour to ensure that the investors are provided with true and adequate information without making any misleading or exaggerated claims or any misrepresentation and are made aware of the attendant risks before taking any investment decision.
8. A merchant banker shall endeavour to ensure that copies of the prospectus, offer document, letter of offer or any other related literature is made available to the investors at the time of issue or the offer.
9. A merchant banker shall not discriminate amongst its clients, save and except on ethical and commercial considerations.
10. A merchant banker shall not make any statement, either oral or written, which would misrepresent the services that the merchant banker is capable of performing for any client or has rendered to any client.
11. A merchant banker shall avoid conflict of interest and make adequate disclosure of its interest.
12. A merchant banker shall put in place a mechanism to resolve any conflict of interest situation that may arise in the conduct of its business or where any conflict of interest arises, shall take reasonable steps to resolve the same in an equitable manner.
13. A merchant banker shall make appropriate disclosure to the client of its possible source or potential areas of conflict of duties and interest while

acting as merchant banker which would impair its ability to render fair, objective and unbiased services.

14. A merchant banker shall always endeavour to render the best possible advice to the clients having regard to their needs.
15. A merchant banker shall not divulge to anybody either orally or in writing, directly or indirectly, any confidential information about its clients which has come to its knowledge, without taking prior permission of its clients, except where such disclosures are required to be made in compliance with any law for the time being in force.
16. A merchant banker shall ensure that any change in registration status/any penal action taken by the Board or any material change in the merchant banker's financial status, which may adversely affect the interests of clients/ investors is promptly informed to the clients and any business remaining outstanding is transferred to another registered intermediary in accordance with any instructions of the affected clients.
17. A merchant banker shall not indulge in any unfair competition, such as weaning away the clients on assurance of higher premium or advantageous offer price or which is likely to harm the interests of other merchant bankers or investors or is likely to place such other merchant bankers in a disadvantageous position while competing for or executing any assignment.
18. A merchant banker shall maintain arms length relationship between its merchant banking activity and any other activity.
19. A merchant banker shall have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients, investors and other registered entities from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.
20. A merchant banker shall not make untrue statement or suppress any material fact in any documents, reports or information furnished to the Board.
21. A merchant banker shall maintain an appropriate level of knowledge and competence and abide by the provisions of the Act, regulations made thereunder, circulars and guidelines, which may be applicable and relevant to the activities carried on by it. The merchant banker shall also comply with the award of the Ombudsman passed under the Securities and Exchange Board of India (Ombudsman) Regulations, 2003.
22. A merchant banker shall ensure that the Board is promptly informed about any action, legal proceedings, etc., initiated against it in respect of material breach or non-compliance by it, of any law, rules, regulations, directions of the Board or of any other regulatory body.
23. (a) A merchant banker or any of its employees shall not render, directly or indirectly, any investment advice about any security in any publicly accessible media, whether real-time or non-real-time, unless a disclosure of his interest including a long or short position, in the said security has been made, while rendering such advice.

- (b) In the event of an employee of the merchant banker rendering such advice, the merchant banker shall ensure that such employee shall also disclose the interests, if any, of himself, his dependent family members and the employer merchant banker, including their long or short position in the said security, while rendering such advice.
24. A merchant banker shall demarcate the responsibilities of the various intermediaries appointed by it clearly so as to avoid any conflict or confusion in their job description.
25. A merchant banker shall provide adequate freedom and powers to its compliance officer for the effective discharge of the compliance officer's duties.
26. A merchant banker shall develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in carrying out their duties. Such a code may extend to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance or resolution of conflict of interests, disclosure of shareholdings and interests, etc.
27. A merchant banker shall ensure that good corporate policies and corporate governance are in place.
28. A merchant banker shall ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed (including having relevant professional training or experience).
29. A merchant banker shall ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it in the conduct of its business, in respect of dealings in securities market.
30. A merchant banker shall be responsible for the Acts or omissions of its employees and agents in respect of the conduct of its business.
31. A merchant banker shall ensure that the senior management, particularly decision makers have access to all relevant information about the business on a timely basis.
32. A merchant banker shall not be a party to or instrument for—
- (a) creation of false market;
 - (b) price rigging or manipulation; or
 - (c) passing of unpublished price sensitive information in respect of securities which are listed and proposed to be listed in any stock exchange to any person or intermediary in the securities market.

Regulation 13A provides that no merchant banker other than a bank or a public financial institution who has been granted a certificate of registration shall carry on any business other than that of the securities market. However, a merchant banker who has been granted certificate of registration under these regulations may ensure market making in accordance with Chapter XA of SEBI (ICDR) Regulations, 2009.

Regulations 14 to 17 deal with maintenance of books of accounts, records, submission of half-yearly results, rectifying deficiencies pointed out in the auditors report etc.

Responsibilities of Lead Managers

Regulation 20 provides that no lead manager shall agree to manage or be associated with any issue unless his responsibilities relating to the issue mainly those of disclosures, allotment and refund are clearly defined, allocated and determined and a statement specifying such responsibilities is furnished to SEBI at least 1 month before the opening of the issue for subscription but where there are more than 1 lead merchant banker to the issue the responsibility of each such lead merchant banker shall clearly be demarcated and the statement specifying such responsibilities shall be furnished to SEBI at least 1 month before the opening of the issue for subscription.

Regulation 21 stipulates that a lead merchant banker shall not associate himself with any issue if a merchant banker not holding a certificate from SEBI is associated with the issue.

Merchant banker not to act as such for an associate

Regulation 21A provides that a merchant banker shall not lead manage any issue or be associated with any activity undertaken under any regulations made by SEBI, if he is a promoter or a director or an associate of the issuer of securities or of any person making an offer to sell or purchase securities. However, a merchant banker who is an associate of such issuer or person may be appointed, if he is involved only in the marketing of the issue or offer.

Here, a merchant banker shall be deemed to be an "associate of the issuer or person" if:

- (i) either of them controls, directly or indirectly through its subsidiary or holding company, not less than 15% of the voting rights in the other; or
- (ii) either of them, directly or indirectly, by itself or in combination with other persons, exercises control over the other; or
- (iii) there is a common director, excluding nominee director, amongst the issuer, its subsidiary or holding company and the merchant banker.

Minimum underwriting obligation

Regulation 22 lays down that in respect of every issue to be managed, the lead merchant banker holding a certificate under Category I shall accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs. 25 lakhs whichever is less but if the lead merchant banker is unable to accept the minimum underwriting obligation, that lead merchant banker shall make arrangement for having the issue underwritten to that extent by a merchant banker associated with the issue and shall keep SEBI informed of such arrangement. In case of issue made in accordance with Chapter XA of SEBI (ICDR) Regulations, 2009, the merchant banker shall itself or jointly with other merchant bankers associated with the issues, underwrite at least 15% of the issue size.

Prohibition to acquire shares

Regulations 26 and 27 deal with this matter.

Regulation 26 lays down that no merchant banker or any of its directors, partners or manager or principal officer shall either on their own account or through their associates or relatives, enter into any transaction in securities of bodies corporate on the basis of unpublished price sensitive information obtained by them during the course of any professional assignment either from the clients or otherwise.

Regulation 27 requires every merchant banker to submit to SEBI complete particulars of any transaction for acquisition of securities of any body corporate whose issue is being managed by that merchant banker, within 15 days from the date of entering into such transaction. In case of any transaction for acquisition of securities made in pursuance of underwriting or market making obligation in accordance with Chapter XA of SEBI (ICDR) Regulations, 2009, the complete particulars of the transaction shall be submitted to SEBI on quarterly basis.

Regulation 28 provides that a merchant banker is required to disclose to SEBI, as and when required, the following information, namely :—

- (i) his responsibilities with regard to the management of the issue;
- (ii) any change in the information or particulars previously furnished, which have a bearing on the certificate granted to it;
- (iii) the names of the body corporate whose issues he has managed or has been associated with;
- (iv) the particulars relating to the breach of the capital adequacy requirement;
- (v) relating to his activities as a manager, underwriter, consultant or adviser to an issue, as the case may be.

The merchant banker shall submit a half yearly report for the period ending with 31st March and 30th September of every year, in the format prescribed, within three months from the close of the period to which it corresponds.

Regulation 28A requires every merchant banker to appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications guidelines, instructions etc. issued by SEBI or Central Government and for redressal of investor grievances. Compliance officer is required to immediately and independently report to SEBI, any non-compliance observed by him and ensure that observations made or deficiencies pointed out by SEBI on/in the draft prospectus or letter of offer as the case may be, do not occur.

Procedure for inspection

Chapter IV containing Regulations 29 to 34 lays down the procedure for inspection of the merchant bankers offices and records by SEBI.

Regulation 29 empowers SEBI to appoint one or more persons as inspecting authority to undertake inspection of books of accounts, records etc. of the merchant banker, to ensure that such books and records are maintained in the prescribed manner, the provisions of SEBI Act and the rules and regulations thereunder are

complied with to investigate into complaints from investors, other merchant bankers or other persons on any matter having a bearing on the activities of the merchant banker and to investigate suo-motu in the interest of the securities business or investors interest into the working of the merchant banker.

Regulation 30 and 31 authorise SEBI to undertake such inspection with or without notice and the obligations of the merchant bankers in relation to such inspection.

Regulation 32 provides for the submission of an inspection report to SEBI by the inspecting authority on completion of inspection. Regulation 33 requires that SEBI or chairman shall after consideration of inspection or investigation report take such action as SEBI or chairman may deem fit and appropriate including action under Chapter V of the SEBI (Intermediaries) Regulations, 2008.

Regulation 34 permits SEBI to appoint a qualified auditor to investigate into the books of accounts or the affairs of the merchant banker and such auditor shall have the same powers of the inspecting authority referred to above.

Procedure for action against merchant banker in case of default

Chapter V containing Regulation 35 deals with the procedure for taking action against the merchant banker in case of default.

Regulation 35 provides that a merchant banker who contravenes any of the provisions of the Act, rules or regulations, framed thereunder shall be liable for one or more actions specified therein including the action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

2. 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.

They also render service to the existing companies in servicing the share capital contributed by the investors. The system of share transfers gives liquidity to the investment and helps the investors to easily acquire or dispose off shares in the secondary market. The share transfer agents who have the necessary expertise, trained staff, reliable infrastructure and SEBI licence render service to the corporates by undertaking and executing the transfer and transmission work relating to the company's shares and securities. Thus they have a role to play both in the primary and the secondary markets.

Though, after the introduction of the Depository system in India, very large corporates are required to switch-over to dematerialised system of share holding which does not involve issue of individual share certificates or securities to the investors, large existing companies still continue in the old system of security issue

and their transfer and transmission are being handled by the company's own securities department or in the alternative by the share transfer agents. Unless and until the old system is totally eliminated, the share transfer agents will continue to have a role to play in the Indian capital market by rendering service to the corporates in the area of public issue as well as share transfer and share transmission.

SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993

SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 were notified by SEBI on 31st May, 1993 in exercise of the powers conferred by Section 30 of SEBI Act, 1992, with the approval of Central Government.

Some of the important definitions under these Regulations are given below:

- Issue means an offer of sale or purchase of securities by any body corporate or by any other person or group of persons on its or his or their behalf to or from the public or the holders of the securities of such body corporate or person or group of persons.
- 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 i.e.:
 - (i) collecting application for investor in respect of an issue;
 - (ii) keeping a proper record of applications and monies received from investors or paid to the seller of the securities;
 - (iii) (a) assisting body corporate or person or group of persons in determining the basis of allotment of the securities in consultation with the stock exchange;
 - (b) finalising the list of person entitled to allotment of securities;
 - (c) processing and despatchment of allotment letters, refund orders or certificates and other related documents in respect of the issue;
- 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.

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.

Criteria for Registration

Regulation 6 lays down that SEBI shall take into account the following matters while considering the applications for registration. It shall assess whether the applicant:

- (a) has the necessary infrastructure like adequate office space, equipments and manpower to effectively discharge his activities;
- (b) has any past experience in the activities;
- (c) any person directly or indirectly connected with him has been granted registration by SEBI under the Act;
- (d) fulfills the capital adequacy requirement;
- (e) has been subjected to any disciplinary proceedings under the Act;
- (f) any of its director, partner or principal officer is or has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence;
- (g) is a fit and proper person.

Regulation 7 stipulates the capital adequacy requirement (networth) for category I Rs. 6,00,000 lacs and category II Rs. 3,00,000 lacs.

Regulations 8 to 10 lay down the procedure for registration, renewal of certificate, conditions of registration, period of validity of certificate and the procedure where registration is not granted. It is made clear that the applicant will be given due opportunity of being heard before rejection of his application.

Regulation 11 says that in case of refusal to grant or renew a certificate of registration, the concerned person shall cease to carry on any activity as registrar or share transfer agent.

Regulation 12 prescribes payment of fees and indicates the consequences of failure to pay fees. In the latter case SEBI may suspend the certificate with the consequence that the RTA shall cease to carry on his activity from the date of suspension of the certificate.

General Obligations and Responsibilities

Chapter III consisting of Regulations 13 to 15 lays down the general obligations and responsibilities of RTAs.

Regulation 13 lays down that the RTA holding a certificate shall at all time abide by the Code of Conduct specified below:

Code of Conduct

1. A Registrar to an Issue and share transfer agent shall maintain high standards of integrity in the conduct of its business.
2. A Registrar to an Issue and share transfer agent shall fulfil its obligations in a prompt ethical and professional manner.
3. A Registrar to an Issue and share transfer agent shall at all times exercise due diligence, ensure proper care and exercise independent professional judgement.

4. A Registrar to an Issue and share transfer agent shall exercise adequate care, caution and due diligence before dematerialisation of securities by confirming and verifying that the securities to be dematerialised have been granted listing permission by the stock exchange/s.
5. A Registrar to an Issue and share transfer agent shall always endeavour to ensure that—
 - (a) inquiries from investors are adequately dealt with;
 - (b) grievances of investors are redressed without any delay;
 - (c) transfer of securities held in physical form and confirmation of dematerialisation/rematerialisation requests and distribution of corporate benefits and allotment of securities is done within the time specified under any law.
6. A Registrar to an Issue and share transfer agent shall make reasonable efforts to avoid misrepresentation and ensure that the information provided to the investors is not misleading.
7. A Registrar to an Issue and share transfer agent shall not reject the dematerialisation/rematerialisation requests on flimsy grounds. Such request could be rejected only on valid and proper grounds and supported by relevant documents.
8. A Registrar to an Issue and share transfer agent shall avoid conflict of interest and make adequate disclosure of its interest.
9. A Registrar to an Issue and share transfer agent shall put in place a mechanism to resolve any conflict of interest situation that may arise in the conduct of its business or where any conflict of interest arises, shall take reasonable steps to resolve the same in an equitable manner.
10. A Registrar to an Issue and share transfer agent shall make appropriate disclosure to the client of its possible source or potential areas of conflict of duties and interest which would impair its ability to render fair, objective and unbiased services.
11. A Registrar to an Issue and share transfer agent shall not indulge in any unfair competition, which is likely to harm the interests of other Registrar to the Issue and share transfer agent or investors or is likely to place such other registrar in a disadvantageous position in relation to the Registrar to Issue and share transfer agent while competing for or executing any assignment.
12. A Registrar to an Issue and share transfer agent shall always endeavour to render the best possible advice to the clients having regard to their needs.
13. A Registrar to an Issue and share transfer agent shall not divulge to other clients, press or any other person any confidential information about its clients which has come to its knowledge except with the approval/authorisation of the clients or when it is required to disclose the information under any law for the time being in force.
14. A Registrar to an Issue or share transfer agent shall not discriminate amongst its clients, save and except on ethical and commercial considerations.
15. A Registrar to an Issue and share transfer agent shall ensure that any

change in registration status/any penal action taken by the Board or any material change in financials which may adversely affect the interests of clients/investors is promptly informed to the clients.

16. A Registrar to an Issue and share transfer agent shall maintain the required level of knowledge and competency and abide by the provisions of the Act, rules, regulations, circulars and directions issued by the Board. The Registrar to an Issue and share transfer agent shall also comply with the award of the Ombudsman passed under Securities and Exchange Board of India (Ombudsman) Regulations, 2003.
17. A Registrar to an Issue and share transfer agent shall co-operate with the Board as and when required.
18. A Registrar to an Issue and share transfer agent shall not neglect or fail or refuse to submit to the Board or other agencies with which he is registered, such books, documents, correspondence, and papers or any part thereof as may be demanded/requested from time to time.
19. A Registrar to an Issue and share transfer agent shall ensure that the Board is promptly informed about any action, legal proceeding, etc. initiated against it in respect of any material breach or non-compliance by it, of any law, rules, regulations, directions of the Board or of any other regulatory body.
20. A Registrar to an Issue and share transfer agent shall take adequate and necessary steps to ensure that continuity in data and record keeping is maintained and that the data or records are not lost or destroyed. Further, it shall ensure that for electronic records and data, up-to-date back up is always available with it.
21. A Registrar to an Issue and share transfer agent shall endeavour to resolve all the complaints against it or in respect of the activities carried out by it as quickly as possible.
22. (a) A Registrar to an Issue and share transfer agent or any of its employees shall not render, directly or indirectly any investment advice about any security in the publicly accessible media, whether real-time or non-real-time, unless a disclosure of its long or short position in the said security has been made, while rendering such advice.
(b) In case an employee of a Registrar to an Issue and share transfer agent is rendering such advice, the Registrar to an issue and share transfer agent shall ensure that it also discloses its own interest, the interests of his dependent family members and that of the employer including their long or short position in the said security, while rendering such advice.
23. A Registrar to an Issue and share transfer agent shall handover all the records/data and all related documents which are in its possession in its capacity as a Registrar to an Issue and/or share transfer agent to the respective clients, within one month from the date of termination of agreement with the respective clients or within one month from the date of expiry/cancellation of certificate of registration as Registrar to an Issue and/or share transfer agent, whichever is earlier.
24. A Registrar to an Issue and share transfer agent shall not make any

exaggerated statement, whether oral or written, to the clients either about its qualifications or capability to render certain services or about its achievements in regard to services rendered to other clients.

25. A Registrar to an Issue and share transfer agent shall ensure that it has satisfactory internal control procedures in place as well as adequate financial and operational capabilities which can be reasonably expected to take care of any losses arising due to theft, fraud and other dishonest acts, professional misconduct or omissions.
26. A Registrar to an Issue and share transfer agent shall provide adequate freedom and powers to its compliance officer for the effective discharge of its duties.
27. A Registrar to an Issue and share transfer agent shall develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in carrying out its duties as a Registrar to an Issue and share transfer agent and as a part of the industry. Such a code may extend to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance of conflict of interests, disclosure of shareholdings and interests, etc.
28. A Registrar to an Issue and share transfer agent shall ensure that good corporate policies and corporate governance are in place.
29. A Registrar to an Issue and share transfer agent shall ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed (including having relevant professional training or experience).
30. A Registrar to an Issue and share transfer agent shall be responsible for the acts or omissions of its employees and agents in respect of the conduct of its business.
31. A Registrar to an Issue and share transfer agent shall not, in respect of any dealings in securities, be party to or instrumental for—
 - (a) creation of false market;
 - (b) price rigging or manipulation;
 - (c) passing of unpublished price sensitive information in respect of securities which are listed and proposed to be listed in any stock exchange to any person or intermediary.

Regulation 13A prohibits an RTA from acting as such Registrar in case he or it is an associate of the body corporate issuing the securities. For the purposes of this regulation, Registrar to an Issue or the body corporate, as the case may be, shall be deemed to be an associate of other where—

- (i) he or it controls directly or indirectly not less than 10% of the voting power of the body corporate or of Registrar to an issue, as the case may be or he or any of his relative is a director or promoter of the body corporate or of the Registrar to an issue, as the case may be. The term 'relative' shall have the same meaning as assigned to it under Section 6 of the Companies Act, 1956.

The RTA has to maintain proper books and records as prescribed in Regulation 14 and preserve the account books and other records for a minimum period of 3 years. Regulation 15A provides that every Registrar to an Issue and share transfer agent shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by SEBI or Central Government and for redressal of investor grievances. Compliance officer shall immediately and independently report to SEBI any non-compliance observed by him.

Procedure for Inspection

Chapter IV containing Regulation 16 to 21 deals with procedure for inspection by SEBI appointed inspecting authority to ensure that the books of accounts and documents are maintained as prescribed and that the provisions of SEBI Act and the rules and regulations thereunder are complied with. Investigation may be undertaken on the basis of complaints received from the investors, other registrars or any other intermediaries in respect of RTA.

Regulation 17 lays down the procedure and Regulation 18 indicates the obligations of the RTA in relation to such inspection/investigation.

Regulations 19 and 20 stipulate that the inspecting authority shall on the conclusion of his inspection submit a report to SEBI. SEBI after considering the inspection or investigation report take such action as SEBI or chairman may deem fit and appropriate including action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

Regulation 21 authorises SEBI to appoint an Auditor to investigate into the books of account or the affairs of the RTA and STA. The Auditor shall have the same powers as SEBI appointed inspecting authority.

Liability for Action in Case of Default

A registrar to an Issue who—

- (i) fails to comply with any conditions subject to which registration has been granted.
- (ii) Contravenes any of the provisions of the Act, rules or regulations.
- (iii) Contravenes the provisions of the SCRA and the rules made thereunder, provisions of the Depositories Act or rules made thereunder, the rules, regulations or bye laws of the stock exchange,

shall be dealt with in the manner provided in Chapter V of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

Operational Guidelines

On 11th October, 1994, SEBI issued Operational Guidelines and instructions to be followed by RTAs. The instructions stipulate:

1. agreement to be entered into by RTA with issuer/body corporate.
2. records to be maintained by RTA.

3. periodical reports to be furnished to SEBI.
4. mandatory obligations relating to despatch of allotment letters/certificates/refund orders/cancelled stock invest/duplicate refund orders or revalidation of refund orders.
5. Other directions such as non-acceptance of work disproportionate to its capacity redressal of complaints, proper records of mail returned and undelivered.

The draft agreement between RTA and Issuer company shall fix specific responsibility either on the company or on the RTA in relation to the following items of work. Due diligence is required to be exercised in this regard.

Pre-Issue Work

1. Finalisation of bankers to issue, list of branches, controlling and collecting branches.
2. Design of application form, bank schedule, pre-printed stationery.
3. Preparing and issuing detailed instructions on procedure to be followed by collecting and controlling branches.
4. Arranging, despatch of application schedule for listing of applications to collecting and controlling branches.
5. Placing of orders for and procuring pre-printed stationery.

Issue Work

1. Collection of daily figure from bankers to the issue.
2. Expediting despatch of applications, final certificate to the controlling branches.
3. Collection of application along with final certificate and schedule pages from controlling branches of bankers to the issue.
4. Informing Stock Exchange/SEBI and providing necessary certificates to Lead Manager on closure of issue.
5. Preparing 'Obligation of Underwriters statement' in the event of under subscription and seeking extension from stock exchange for processing.
6. Scrutiny of application received from bankers to issue.
7. Numbering of application and banks schedule and batching them for control purposes.
8. Transcribing information from documents to magnetic media for computer processing.
9. Reconciliation of number of applications, securities applied and money received with final certificate received from bank.
10. Identify and reject applications having technical faults.
11. Prepare statement for deciding basis of allotment by the company in consultation with the Stock Exchange.

12. Finalising basis of allotment after approval of the stock exchange.
13. Seeking extension of time from SEBI.
14. Allotment of shares on the formula derived by stock exchange (In the case of allotment of employee it shall be ensured that only full time employee actually on rolls are given the allotment on the basis of list of employees furnished under the signature of MD/Company Secretary).
15. Obtaining certificate from auditors that the allotment has been made as per the basis of allotment.
16. Preparation of reverse list, list of allottees and non-allottees as per the basis of allotment approved by stock exchange.
17. Preparation of allotment register cum return statement register of members, index register.
18. Preparation of list of brokers to whom brokerage is to be paid.
19. Printing covering letters for despatching share certificates, for refunding application money/stock invest, printing of allotment letter cum refund order.
20. Printing postal journal for despatching share certificate or allotment letters and refund orders by registered post.
21. Printing, distribution schedule for submission to stock exchange.
22. Preparing share certificate on the computer.
23. Preparing register of member and specimen signature cards.
24. Arranging share certificate in batches for signing by authorised signatories.
25. Trimming share certificate and affixing common seal of the company.
26. Attaching share certificate to covering letter.
27. Mailing of documents by registered post.
28. Binding of application forms, application schedule and computer outputs.
29. Payment of consolidated stamp duty on allotment letters/share or debenture certificates or procuring and affixing stamp of appropriate value.
30. Issuing call notices for allotment money to allottees.
31. Issue of duplicate refund order.
32. Revalidation of refund orders.
33. Segregation of stock invest from application and safe custody thereof.
34. Preparation of separate schedule/list for stock invest applications.
35. Filing of right hand portion of stock invest in respect of allottees.
36. Lodging stock invest with computerised stock invest statement to collecting banks.
37. Cancellation of stock invest in case of non-allottees.
38. Printing of covering letters and despatching of cancelled stock invest to non-allottees.
39. Particular attention should be paid to Redressal of Investor Grievances promptly and furnishing prescribed reports in time to SEBI.

3. 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.

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. Provisions related to underwriting have been discussed in the chapter Public Issue of Shares.

The lead managers are required to satisfy themselves about the network of the underwriters and their outstanding commitments and disclose the same to SEBI. In this connection each underwriter should furnish an undertaking to the lead manager about their network and outstanding commitments. Both the lead managers and the directors are required to give a statement in the prospectus that in their opinion the underwriters have the necessary resources to discharge their liabilities, if any, in full. Penal action will be taken against underwriters for not taking up the assured amount of security in case of development and to debar them from the underwriting public issues in future. Special responsibilities are placed on the merchant bankers in this regard.

Underwriters represent one of the key elements among the capital market intermediaries. They facilitate raising of capital by assuring to take up the unsubscribed portion upto a specified limit.

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. They came into force from 8th October, 1993.

Chapter I contains preliminary matters including definitions.

Some of the important definitions are given below:

- *'Issue'* means an offer of sale of securities by any body corporate or by any other person or group of persons on its or his or their behalf, as the case may be, to the public or the holders of the securities of such body corporate or person or group of persons.
- *'Underwriting'* means an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them.
- *'Underwriter'* means a person who engages in the business of underwriting of an issue of securities of a body corporate.

Chapter II deals with the procedure for registration of underwriters and it contains Regulations 3 to 12.

Regulation 3 lays down that the applicant seeking the certificate shall apply to SEBI in form A. Regulation 4 and 5 requires the applicant to furnish further information and clarification to SEBI regarding matters relevant to underwriting. If the Board on receipt of further information is of the opinion that the information so furnished is not sufficient to decide on the application and seeking further information through correspondence may delay the matter, it may require the applicant or its principal officer to appear before SEBI in order to give an opportunity to the applicant to give further clarifications on the application.

Regulation 5 provides that an application not complete in all respects and not conforming to instructions specified in the form would be rejected. The applicant would be given an opportunity to remove within one month, the objections as may be indicated by SEBI. SEBI may however extend the time by another one month in order to enable the applicant to comply with the requirements of SEBI.

Regulation 6 prescribes the following conditions for consideration of the application:

1. the applicant shall have necessary infrastructure like adequate office space, equipments and manpower and past experience in underwriting, employing at least two persons with such experience. No person directly or indirectly connected with the applicant should have been granted registration by SEBI.
SEBI shall take into account whether a previous application for a certificate of any person directly or indirectly connected with the applicant has been rejected by SEBI or any disciplinary action has been taken against such person under the Act or any rules/regulations.
2. the applicant should be a fit and proper person, fulfilling the capital adequacy requirements and no director, partner or principal officer should have been at any time convicted for an offence involving moral turpitude or found guilty of any economic offence.

Regulation 7 prescribes for the following capital adequacy requirement:

1. The networth should not be less than Rs. 20 lakhs.
2. The stock broker-underwriter should have capital adequacy as prescribed by the stock exchange.
3. The merchant banker-underwriter shall fulfill capital adequacy as laid down in Merchant Banker's Regulations.

Regulations 8 and 9, 9A, 9B deal with procedure for registration and renewal of certificate, conditions of registration, period of validity of certificate.

Regulations 10 and 11 deal with the procedure where registration is not granted and the effect of refusal to grant or renew the certificate. Regulation 12 prescribes fees payable and consequences of failure to pay fees.

Obligations and Responsibilities of Underwriters

Chapter III consisting of Regulation 13 to 18 deals with these matters. Every underwriter shall abide by the code of conduct at all times.

Regulations 14 and 15 contain provisions regarding the matters on which every underwriter shall enter into an agreement with the body corporate and his general responsibilities.

The contents of the agreement shall include the period of agreement, the amount of underwriting obligations, the period by which the underwriter should subscribe, the amount of commission/brokerage payable, and other details for fulfilling the underwriting obligations. The general responsibilities of the underwriter are as follows:

1. The underwriter shall not derive any direct or indirect benefit from underwriting the issue other than the commission or brokerage payable under an agreement for underwriting.
2. The total underwriting obligations under all the agreements shall not exceed 20 times the networth.
3. Every underwriter, in the event of being called upon to subscribe for securities of a body corporate pursuant to an agreement shall subscribe to such securities within 45 days of the receipt of such intimation from such body corporate.

Regulation 16 to 18 relate to maintenance of proper accounts, books and records and their preservation for 5 years and SEBI's power call for and obtain information from the underwriter.

Appointment of Compliance Officer

Regulation 17A requires every underwriter to appoint a compliance officer responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by SEBI or the Central Government and for redressal of investors' grievances. The compliance officer is required to report to SEBI immediately and independently any non-compliance observed by him.

Inspection and Disciplinary Proceedings

Chapter IV containing Regulations 19 to 24 makes provisions on this subject. 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. SEBI is also empowered to investigate into complaints from investors, other underwriters etc. as well as under their own power to investigate *suo motu* in the interest of securities business and the investors.

Regulations 20 and 21 lay down the procedure for inspection and obligations of underwriter during such inspections.

Regulations 22 relate to submission of inspection report to SEBI.

Regulation 23 provides that SEBI Board or chairman after the consideration of inspection or investigation report may take action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

Regulation 24 authorizes SEBI to appoint a qualified auditor to investigate into the affairs and the accounts of the underwriter with the same powers as applicable in the case of SEBI appointed inspector.

Procedure for Action in case of default

Chapter V containing Regulation 25 to 32 lays down the procedure for action in case of default. An underwriter or a stock broker or a merchant banker entitled to carry on business of underwriting who fails to comply with any conditions subject to which certificate has been granted and who contravenes any of the provisions of the Act, rules or regulations, shall be dealt with in the manner provided under Chapter V of SEBI (Intermediaries) Regulations, 2008.

4. BANKERS TO AN ISSUE

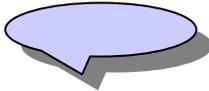
The Banks render crucial service in mobilisation of capital for companies. While one or more banks may function as Bankers to the Issue as well as collection banks, others may do the limited work of collecting the applications for securities along with the remittance in their numerous branches in different centres. The banks are expected to furnish prompt information and records to the company and to the lead manager for monitoring and progressing the issue work. For this purpose, the company has to enter into an agreement with different banks specifying the conditions, terms and remuneration for services to be rendered by each such bank.

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.

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.

Chapter II containing Regulations 3 to 11 deals with registration of Bankers to an Issue with SEBI.

Regulations 3 to 5 prescribe that the application by a scheduled bank for grant of certificate as a banker to an issue should be made to SEBI in Form A conforming to the instructions therein failing which, it shall be rejected after giving due opportunity to remove such defects within specified time. SEBI may call for and obtain further information or clarification from the applicant.

Consideration of Application

Regulation 6 prescribes the matters that are considered by SEBI in relation to the

application:

- (a) the applicant has the necessary infrastructure, communication and data processing facilities and manpower to effectively discharge his activities;
- (b) the applicant or any of its directors is not involved in any litigation connected with the securities market and which has an adverse bearing on the business of the applicant or has not been convicted of any economic offence;
- (c) the applicant is a scheduled bank and a fit and a proper person;
- (d) the applicant is a fit and proper person;
- (e) grant of certificate to the applicant is in the interest of investors.

Procedure for Registration

Regulations 7, 8, 8A and 8B deal with the procedure for registration and renewal of the certificate, conditions of registration and period of validity of certificate. Regulation 9 relates to the procedure where the registration is not granted, leading to the rejection of the application after giving an opportunity to the applicant to be heard. The applicant has right to appeal for reconsideration and SEBI shall reconsider the application and communicate its decision to the applicant in writing.

Regulation 10 lays down that the applicant whose application is refused by SEBI shall cease to carry on any activity as a banker to an issue from the date on which he receives the communication of refusal.

Regulation 11 imposes the duty on the applicant to pay the fees as prescribed. Non-payment of fees may result in suspension of the registration and the applicant shall cease to carry on the activity as a banker to the issue during the period of suspension.

General Obligations and Responsibilities

Regulation 12 requires every banker to an issue to maintain the following records:

- (a) the number of applications received, the names of the investors, the dates on which the applications were received and the amounts so received from the investors;
- (b) the time within which the applications received from the investors were forwarded to the body corporate or registrar to an issue as the case may be;
- (c) the dates and amount of the refund monies paid to the investors;
- (d) dates, names and amount of dividend/interest warrant paid to the investors.

The Banker to an issue shall intimate SEBI about the place where these documents are kept and shall preserve them for a minimum period of 3 years.

Regulation 13 requires the banker to inform SEBI as to the number of issues for which he was engaged as banker and certain other additional information regarding the monies received, the refunds made and the dividend/interest warrant paid.

Regulation 14 requires the banker to enter into an agreement with the body

corporate for whom he is the banker to an issue with regard to the following matters:

- (a) the number of centres at which the application and the application monies of an issue of a body corporate will be collected from the investors;
- (b) the time within which the statements regarding the applications and the application monies received from the investors investing in an issue of a body corporate will be forwarded to the registrar to an issue of the body corporate, as the case may be;
- (c) the daily statement will be sent by the designated controlling branch of the bankers to the issue to the registrar to an issue indicating the number of body corporate and the amount of application money received.

Regulation 15 requires the banker to inform SEBI about disciplinary action taken, if any by the RBI against him in relation to issue payment work. If as a result of such action the banker is prohibited from carrying on the activities, the certificate shall be deemed to have been cancelled or suspended as the case may be.

Code of Conduct

Regulation 16 prescribes that every banker to an issue shall abide by the Code of Conduct as specified in Schedule III of the Regulations.

Compliance Officer

Regulation 16A provides that every banker to an issue is required to appoint a compliance officer responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by SEBI or Central Government. He shall also be entrusted with the responsibility of redressal of investors' grievances. He is required to immediately and independently report to SEBI regarding any non-compliance observed by him.

Procedure for Inspection

Chapter IV containing Regulation 17 to 22 deals with inspection of Banker to an Issue.

Regulation 17 and 18 authorise SEBI to request RBI to undertake inspection of the books of accounts, records and documents of the banker, to ensure their proper maintenance, and compliance with SEBI Act, Rules and Regulations, to investigate into the complaints received from investors, body corporates or any other person in relation to the work of the banker as a banker to an issue and to investigate into any other matter referred by SEBI.

Regulation 19 lays down that RBI shall on receipt of the request from SEBI take appropriate steps to undertake inspection of Bankers to an Issue for such purposes as may be required by SEBI.

Regulation 20 requires that the banker shall offer all assistance and cooperation to RBIs inspecting officers to facilitate the inspection.

Regulation 21 stipulates that the RBI shall furnish to SEBI, copy of the inspection report along with copies of other relevant documents in support of the observations made by the inspecting authority.

Action on Inspection or Investigation Report

SEBI Board or the Chairman after consideration of inspection or investigation report may take such action as the Board or SEBI may deem fit and appropriate including action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

Procedure for Action in Case of Default

Regulation 23 provides that banker to an Issue who contravenes any of the provisions of the Act, rules or regulations framed thereunder, shall be dealt with in the manner provided under Chapter V of the SEBI (Intermediaries) Regulations, 2008.

5. 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.

Some of the important definitions are given below:

- *'Debenture'* means a debenture as defined in Section 2(12) of Companies Act, 1956.
- *'Debenture Trustee'* means a trustee of a trust deed for securing any issue of debentures of a body corporate.
- *'Trust Deed'* means a deed executed by the body corporate in favour of the trustee named therein for the benefit of the debenture holders.
- *'Associate'* in relation to a debenture trustee, or body corporate shall include a person—
 - (i) who directly or indirectly, by himself, or in combination with relatives, exercises control over the debenture trustee or the body corporate, as the case may be,
 - (ii) in respect of whom the debenture trustee or the body corporate, as the case may be, directly or indirectly, by itself or in combination with other persons, exercises control, or
 - (iii) whose director, is also a director, of the debenture-trustee or the body corporate as the case may be.

- 'Control' has the same meaning as defined under Regulation 2(c) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.
- *Principal officer*, as defined in Regulation 2(f) means,
 - (i) a secretary, manager or director of the body corporate; or
 - (ii) any person connected with the management or administration of the body corporate upon whom the Board has served notice of its intention of treating him as the principal officer thereof.

Chapter II consisting Regulations 3 to 12 deals with the procedure for registration of debenture trustees.

Regulation 3 stipulates that the application shall be made in Form A. An application for registration made shall be accompanied by a non-refundable application fee as prescribed in Regulation 4 authorises SEBI to call for and obtain further information from the applicant before granting the registration. The applicant or its principal officer may, if so required, appear before SEBI for personal representation. Regulation 5 stipulates that an application which is incomplete and does not conform to instructions shall be rejected after giving an opportunity to the applicant to remove such objections within time specified.

Regulation 6 lays down that SEBI shall take into account the following matters in considering the application, namely that the applicant:

- (1) has the necessary infrastructure like adequate office space, equipments, and manpower to effectively discharge his activities;
- (2) has any past experience as a debenture trustee or has in his employment minimum two persons who had the experience in matters which are relevant to a debenture trustee; or
- (3) any person, directly or indirectly connected with the applicant has not been granted registration by SEBI under the Act;
- (4) has in his employment at least one person who possesses the professional qualification in law from an institution recognised by the Government; or
- (5) any of its director or principal officer is or has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence and is a fit and proper person;
- (6) is a fit and proper person;
- (7) fulfills the capital adequacy requirements specified in Regulation 7A of SEBI Regulations.

Regulation 7 lays down that to be a debenture trustee the applicant shall be a scheduled bank carrying on commercial activity, a public financial institution, an insurance company or a body corporate.

Regulation 7A of the Regulations provide that the capital adequacy requirement of debenture trustee shall not be less than the networth of Rs. One crore.

Regulations 8 and 9, 9A, 9B deal with the procedure for registration and the

renewal thereof, conditions of registration, time period for disposal of application and period of validity of certificate.

Regulation 10 lays down that if an applicant does not fulfill the requirements of Regulation 6 above, it may be rejected after giving reasonable opportunity to the applicant for being heard. The rejection shall be conveyed in writing by SEBI and the applicant may again apply for reconsideration of SEBI. After due reconsideration SEBI shall communicate its bindings in writing to the applicant.

Regulations 11 and 12 deal with effect of refusal to grant or renew the certificate by SEBI and non-payment of fees by the applicant. In the absence of a valid certificate the trustee shall cease to act as a debenture trustee.

Responsibilities and Obligations of Debenture Trustees

Chapter III containing Regulations 13 to 18 deals with this topic. Regulation 13 lays down that no debenture trustee who has been granted a certificate by SEBI shall act as debenture trustee unless he enters into a written agreement with the body corporate before the opening of the subscription list for issue of debentures and the agreement *inter alia* contains that debenture trustee has agreed to act as such under the trust deed for securing an issue of debentures for the body corporate and the time limit within which the security for the debentures shall be created.

Regulation 13A stipulates that no debenture trustee shall act as such for any issue of debentures in case:

- (a) it is an associate of the body corporate; or
- (b) it has lent and the loan is not yet fully repaid or is proposing to lend money to the body corporate.

However, the requirement shall not be applicable in respect of debentures issued prior to the commencement of Companies (Amendment) Act, 2000 where—(i) recovery proceedings in respect of the assets charged against security has been initiated or the body corporate has been referred to Board for Industrial and Financial Reconstruction under Sick Industrial Companies (Special Provisions) Act, 1985 prior to commencement of SEBI (Debenture Trustee) Regulations, 2003.

Regulation 14 provides that every debenture trustee shall amongst other matters accept the trust deed which contains the matters specified in Schedule IV to the Regulations.

Duties of Debenture Trustees

Regulation 15 casts the following duties on the debenture trustees:

- (1) call for periodical reports from the body corporate;
- (2) take possession of trust property in accordance with the provisions of the trust deed;
- (3) enforce security in the interest of the debenture holders;
- (4) do such acts as necessary in the event the security becomes enforceable;
- (5) carry out such acts as are necessary for the protection of the debenture

holders and to do all things necessary in order to resolve the grievances of the debenture holders;

- (6) ascertain and specify that:
 - (a) in case where the allotment letter has been issued and debenture certificate is to be issued after registration of charge, the debenture certificates have been despatched by the body corporate to the debenture holders within 30 days of the registration of the charge with ROC;
 - (b) debenture certificates have been despatched to the debenture holders in accordance with the provisions of the Companies Act;
 - (c) interest warrants for interest due on the debentures have been despatched to the debenture holders on or before the due dates;
 - (d) debentureholders have been paid the monies due to them on the date of redemption of the debentures;
- (7) ensure on a continuous basis that the property charged to the debenture is available and adequate at all time to discharge the interest and principal amounts payable in respect of the debentures and that such property is free from any other encumbrances save and except those which are specifically agreed to by the debenture trustee.
- (8) exercise due diligence to ensure compliance by the body corporate, with the provisions of the Companies Act, the listing agreement of the stock exchange or the trust deed;
- (9) to take appropriate measures for protecting the interest of the debenture holders as soon as any breach of the trust deed or law comes to his notice;
- (10) to ascertain that the debentures have been converted or redeemed in accordance with the provisions and conditions under which they are offered to the debentureholders;
- (11) inform SEBI immediately of any breach of trust deed or provision of any law;
- (12) appoint a nominee director on the Board of the body corporate in the event of:
 - (i) two consecutive defaults in payment of interest to the debentures; or
 - (ii) default in creation of security for debentures; or
 - (iii) default in redemption of debentures.
- (13) communicate to the debenture holders on half yearly basis the compliance of the terms of the issue by the body corporate, defaults, if any, in payment of interest or redemption of debentures and action taken therefor;
- (14) The debenture trustee shall—
 - (a) obtain reports from the leading bank regarding the project.
 - (b) monitor utilization of funds raised in the issue.
 - (c) obtain a certificate from the issuer's auditors.
 - (i) in respect of utilization of funds during the implementation period of the project; and
 - (ii) in the case of debentures issued for financing working capital at the end of accounting year.

- (15) A debenture trustee may call or cause to be called by the body corporate a meeting of all the debenture holders on—
- (a) a requisition in writing signed by at least one-tenth of the debentureholders in value for the time being outstanding.
 - (b) the happening of any event, which constitutes a default or which in the opinion of the debenture trustees affects the interest of the debentureholders.
- (16) No debenture trustee can relinquish its assignment in respect of the debenture issue of any body corporate, unless and until another debenture trustee is appointed in its place by the body corporate.
- (17) A debenture trustee is required to maintain the network requirements on a continuous basis. He is under an obligation to inform SEBI immediately in respect of any shortfall in the network. He is also not entitled to undertake new assignments until it restores the network to the level of specified requirement within the time specified by the Board.
- (18) Debenture trustee may inspect books of accounts, records, registers of the body corporate and the trust property to the extent necessary for discharging its obligations.

Code of Conduct

Regulation 16 requires that every debenture trustee shall abide by the code of conduct as specified in Schedule III to the Regulations.

Maintenance of Records

Regulations 17 and 18 deal with maintenance of books of accounts, records and documents relating to trusteeship functions for a period of not less than five financial years preceding the current financial year. Every debenture trustee would inform SEBI about the place where the books of accounts records and documents are maintained and furnishing of various information to SEBI by the debenture trustee.

Appointment of Compliance Officer

Every debenture trustee is required to appoint a compliance officer responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by SEBI or Central Government. He is also responsible for redressal of investor grievances. Compliance officer is under an obligation to immediately and independently report to SEBI any non-compliance observed by him. He would also report any non-compliance of the requirements specified in the listing agreement with respect to debenture issues and debentureholders, by the body corporate to SEBI.

Information to the Board

Debenture trustee is required to submit the following information and documents to SEBI, as and when SEBI may require—

- (a) The number and nature of the grievances of the debentureholders received and resolved.
- (b) Copies of the trust deed.

- (c) Non-Payment or delayed payment of interest to debentureholders, if any, in respect of each issue of debentures of a body corporate.
- (d) Details of despatch and transfer of debenture certificates giving therein the dates, modes etc.
- (e) Any other particular or document which is relevant to debenture trustee.

Inspection and Disciplinary Proceedings

Chapter IV consisting of Regulation 19 to 24 deals with inspection and disciplinary proceedings.

Regulation 19 authorises SEBI to appoint one or more persons as inspecting authority to undertake the inspection of books of accounts, records and documents of the debenture trustee to ensure their proper maintenance and compliance with SEBI Act, Rules and Regulation, disposal of investors complaints promptly and to investigate *suo moto* in the interest of the securities business or investors interest into the affairs of the debenture trustee.

Regulations 20 to 22 deal with procedure for inspection, obligations of the trustee to fully assist and co-operate in the inspection, submission of report by the inspecting authority.

Action on Inspection or Investigation Report

SEBI Board or chairman, may after consideration of inspection or investigation report take such action as the Board or chairman may deem fit and appropriate including action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

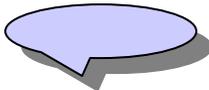
Regulation 24 permits SEBI to appoint a qualified auditor to investigate the record and affairs of the debenture trustee with the same powers given to the inspecting authority.

Procedure for action in case of default

Regulation 25 of Chapter V lays down that a debenture trustee would be dealt with in the manner provided under Chapter V of SEBI (Intermediaries) Regulations, 2008, if he fails to comply with the conditions of registration, contravenes the provisions of SEBI Act/Companies Act, Rules and Regulations.

II. SECONDARY MARKET INTERMEDIARIES

The following market intermediaries are involved in the secondary market:



- Stock brokers
- sub-brokers
- portfolio managers
- custodians
- share transfer agents

1. 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. The buyer and seller may be either a broker or a client. The transaction entered cannot be annulled except in the case of fraud, willful misrepresentation or upon prima-facie evidence of a material mistake in the transaction, in the judgement of the existing authorities. If a member of the stock exchange (broker) has orders to buy and to sell the same kind of securities, he may complete the transaction between his clients concerned.

When executing an order the stock broker may on behalf of his client buy or sell securities from his own account i.e. as principal or act as an agent. For each transaction he has to issue necessary contract note indicating whether the transaction has been entered into by him as a principal or as an agent for another. While buying or selling securities as a principal, the stock broker has to obtain the consent of his client and the prices charged should be fair and justified by the conditions of the market.

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 and Sub-Brokers) Regulations, 1992

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.

Chapter II of the Regulations containing Regulations 3 to 10 deal with registration of Stock Brokers. An application by a stock broker for grant of a certificate of registration shall be made through the Stock exchange or stock exchanges, as the case may be, of which he is admitted as a member. The stock exchange shall forward the application form to SEBI as early as possible but not later than 30 days from the date of its receipt. SEBI may require the applicant to furnish such further information or clarifications regarding the dealings in securities and related matters to consider the application for granting a certificate of registration. The applicant or its principal officer shall, if so required, appear before SEBI for personal representation.

SEBI shall take into account the following aspects before granting a certificate:

- (a) whether the applicant is eligible to be admitted as a member of a stock exchange;
- (b) whether he has the necessary infrastructure like adequate office space, equipment and manpower to effectively discharge his activities;
- (c) whether he has any past experience in the business of buying, selling or dealing in securities;
- (d) whether he was subjected to disciplinary proceedings under the rules, regulations and bye-laws of a stock exchange with respect to his business as

a stock broker involving either himself or any of his partners, directors or employees; and

(e) whether he is a fit and proper person.

SEBI, on being satisfied that the stock broker is eligible, shall grant a certificate of registration to him and send an intimation to that affect to the stock exchange or stock exchanges as the case may be. However, subject to the conditions as stipulated by SEBI for registration, a stock broker holding a certificate of registration with respect to membership of a recognised stock exchange having nationwide trading terminals shall be eligible for trading on SME platform established by such stock exchange without obtaining a separate certificate of registration for trading on the SME platform. Regulation 6A lays down the conditions of registration. The stock broker holding a certificate shall at all times abide by the Code of Conduct as specified in Schedule II of the Regulations.

Rejection of application of Brokers

Where an application for grant of a certificate does not fulfil the requirements, as prescribed in the Regulations, SEBI may reject the application after giving a reasonable opportunity of being heard. The refusal to grant the registration certificate shall be communicated by SEBI within 30 days of such refusal to the concerned stock exchange and to the applicant stating therein the grounds on which the application has been rejected. An applicant may, being aggrieved by the decision of SEBI, may apply within a period of 30 days from the date of receipt of such intimation, to SEBI for reconsideration of its decision. SEBI shall reconsider an application made and communicate its decision as soon as possible in writing to the applicant and to the concerned stock exchange. The stock broker whose application for grant of a certificate has been refused by SEBI shall not, on and from the date of the receipt of SEBI's communication, buy, sell or deal in securities as a stock broker.

Every applicant eligible for grant of a certificate of registration shall pay such fees and in such manner as specified in Schedule III to the regulations. However SEBI may on sufficient cause being shown, permit the stock broker to pay such fees at any time before the expiry of 6 months from the date on which such fees become due. Where a stock broker fails to pay the fees as provided, SEBI may suspend the registration certificate, where upon the stock broker shall cease to buy, sell or deal in securities as a stock broker.

Registration of sub-brokers

Chapter III of the Regulations containing Regulations 11 to 16 deal with registration of sub-brokers. A sub-broker cannot act such unless he holds a certificate granted by SEBI. Where a sub-broker merely charges his affiliation from one stock broker to another stock broker being a member of the same stock exchange. There is no requirement of obtaining fresh certificate. Again there is no need of obtaining fresh certificate where a registered stock broker is affiliated to stock broker who is eligible to trade on SME platform.

Regulation 11A lays down that an application by a sub-broker for the grant of certificate shall be made in Form-B. Such application from the sub-broker applicant shall be accompanied by a recommendation letter in Form-C from a stock broker of a recognised stock exchange with whom the former is to be affiliated along with two references including one from his banker. The application form shall be submitted to

the stock exchange of which the stock broker with whom he is to be affiliated is a member.

The stock exchange on receipt of an application shall verify the information contained therein and shall also certify that the applicant is eligible for registration as per criteria specified below:

- (1) In the case of an individual:
 - (a) the applicant is not less than 21 years of age;
 - (b) the applicant has not been convicted of any offence involving fraud or dishonesty;
 - (c) the applicant has at least passed 12th standard equivalent examination from an Institution recognised by the Government. However, SEBI may relax this criterion on merits having regard to the applicant's experience;
 - (d) the applicant is a fit and proper person.
- (2) In the case of partnership firm or a body corporate, the partners or directors as the case may be shall comply with the requirements stated above. It is also to be assessed whether the applicant has necessary infrastructure like adequate office space, equipment and manpower to effectively discharge his activities. The applicant should be person recognised by the stock exchange as a sub-broker affiliated to a member broker of the stock exchange. The stock exchange shall forward the application form of such applicants, alongwith recommendation letter issued by the stock broker with whom he affiliated alongwith a recognition letter issued by the stock exchange to SEBI within 30 days from the date of its receipt.

SEBI on being satisfied that the sub-broker is eligible, shall grant a certificate in Form-E to the sub-broker and send an intimation to that affect to the stock exchange or exchanges as the case may be. SEBI may grant a certificate of registration to the applicant subject to the terms and conditions as laid down by SEBI in Regulation 12A.

Regulation 12A lays down the conditions of registration. Any registration granted by SEBI shall be subject to the following conditions: —

- (a) he shall abide by the rules, regulations and bye-laws of the stock exchange which are applicable to him;
- (b) where the sub-broker proposes to change his status or constitution, he shall obtain prior approval of SEBI for continuing to act as such after the change;
- (c) he shall pay fees charged by SEBI;
- (d) he shall take adequate steps for redressal of grievances, of the investors within one month of the date of receipt of the complaint and keep SEBI informed about the number, nature and other particulars of the complaints received from such investors; and
- (e) he is authorized in writing by a stock-broker being a member of a stock exchange for affiliating himself in buying, selling or dealing in securities.

Where an application for grant of a certificate does not fulfil the requirements mentioned in Regulation 11A, SEBI may reject the application after giving a

reasonable opportunity of being heard. The refusal to grant the certificate shall be communicated by SEBI within 30 days of such refusal to the concerned stock exchange and to the applicant in writing stating therein the grounds on which the application has been rejected. An applicant being aggrieved by the decision of SEBI may, within a period of 30 days from the date of receipt of such intimation apply to SEBI for reconsideration of the decision.

SEBI shall reconsider an application made and communicate its decision to the applicant in writing and to the concerned stock exchange as soon as possible.

A person whose application for grant of a certificate has been refused by SEBI shall, on and from the date of communication of refusal cease to carry on any activity as a sub-broker. The sub-broker has the following general obligations:

- (a) pay the fees as per Schedule III;
- (b) abide by the Code of Conduct specified in Schedule II;
- (c) enter into an agreement with the stock broker for specifying the scope of his authority and responsibilities;
- (d) comply with the rules, regulations and bye laws of the stock exchange;
- (e) not be affiliated to more than one stock broker of one stock exchange.

The sub-broker shall keep and maintain the books and documents specified in the Regulations.

No director of a stock broker can act as a sub-broker to the same stock broker.

The general obligations and responsibilities, procedure for inspection and for taking action in case of default shall be the same for both stock brokers and sub-brokers.

Registration of Trading and Clearing Members

Chapter IIIA consisting of Regulation 16A to 16I deals with registration of trading and clearing members. Regulation 16A on the procedure for application for registration requires that an application for grant of certificate of registration by a trading member of a derivatives exchange or derivatives segment of a stock exchange shall be made in Form-AA of Schedule-I, through the concerned derivatives exchange or derivatives segment of a stock exchange of which he is a member. Similarly an application for grant of certificate of registration by a clearing member or self clearing member of the clearing corporation or clearing house of a derivatives exchange or derivatives segment of a stock exchange shall be made in Form-AA of Schedule-I, through the concerned clearing corporation or clearing house of which is he a member. However, a trading member who also seeks to act as a clearing member or self clearing member shall make separate applications for each activity. The concerned exchange shall forward the application to SEBI as early as possible but not later than 30 days from the date of its receipt.

SEBI may require the applicant or the concerned stock exchange or segment or clearing house or corporation to furnish such other information or clarification regarding the trading and settlement in derivatives and matters connected thereto, to consider the application for grant of a certificate. The applicant or its principal officer, if so required shall appear before SEBI for personal representation.

SEBI shall take into account the following aspects while considering the application, namely—

1. whether the applicant is eligible to be admitted as a trading member or a clearing member as the case may be;
2. whether the applicant has the necessary infrastructure like adequate office space, equipment and man power to effectively undertake his activities; and
3. whether he is/was subjected to disciplinary procedures under the rules, regulations and bye-laws of any stock exchange with respect to his business, involving either himself or any of his partners, directors or employees;
4. whether the applicant has any financial liability which is due and payable to the SEBI.

The applicant shall also have a net worth as may be specified from time to time and the approved user and sales personnel of the trading member shall have passed a certification programme approved by SEBI. An applicant who desires to act as a clearing member shall also have a minimum net worth of Rs. 300 lakhs and shall deposit at least a sum of Rs. 50 lakhs or higher amount with a clearing corporation or a clearing house of the derivatives exchange or derivatives segment in the form specified from time to time. An applicant who derives to act as a self clearing member, in addition shall comply with the requirement of minimum networth of Rs. 100 lakhs and shall deposit atleast a sum of Rs. 50 lacs or higher amount with the clearing corporation or clearing house of the derivatives exchange or derivatives segment in the form specified from time to time.

Net worth in this context shall mean paid up capital plus free reserves and other securities approved by SEBI from time to time (but does not include fixed assets, pledged securities, value of members card, non allowable securities which are unlisted, bad deliveries, doubtful dates and advances of more than three months and debt/advances given to the associate persons of the members), pre-paid expenses, losses, intangible assets and 30% value of marketable securities.

Registration Procedure for Trading and Clearing Member

On being satisfied that the applicant is eligible, SEBI shall grant a certificate in Form-DA of Schedule-I to the applicant and send an intimation to that effect to the derivative segment of the stock exchange or derivatives exchange or clearing corporation or clearing house as the case may be. Where an application does not fulfil the requirements, SEBI may reject the application after giving a reasonable opportunity to the applicant of being heard. The refusal to grant such certificate shall be communicated by SEBI within 30 days of such refusal to the concerned segment of stock exchange or clearing corporation or clearing house and to the applicant stating therein the grounds on which the application has been rejected. If aggrieved by the decision of SEBI as referred to above, the applicant may apply within a period of 30 days from the date of receipt of such information to SEBI for reconsideration of its decision. SEBI shall reconsider the application and communicate its decision as soon as possible in writing to the applicant and to the concerned segment of stock exchange or clearing house or corporation.

If certificate of registration is refused to an applicant he shall not from the date of

receipt of SEBI's letter of rejection deal in or settle the derivatives contracts as a member of the derivatives exchange as a member of derivatives exchange, segment, clearing corporation or clearing house. Every applicant eligible for grant of certificate as a trading or clearing member or self clearing member, shall pay such fee as may be specified. If the fee is not paid, SEBI may suspend or cancel the registration after giving an opportunity of being heard where upon the trading or clearing member shall cease to deal in and settle the derivatives contract.

REGISTRATION OF TRADING AND CLEARING MEMBERS OF CURRENCY DERIVATIVES SEGMENT

Chapter IIIB containing Regulation 16J to 16R deals with registration of trading and clearing member of currency derivative segment. Regulation 16J provide that the application for grant of certificate of registration by a trading member of currency derivatives segment of a stock exchange shall be made in Form AB of Schedule I, through the concerned currency derivatives segment of a stock exchange of which he is a member. An application for grant of certificate of registration by a clearing member of the clearing corporation or clearing house of currency derivatives segment of a stock exchange, shall be made in Form AB of Schedule I, through the concerned clearing corporation or clearing house of which he is a member: However, a trading member who also seeks to act as a clearing member shall make separate applications for each activity in Form AB of Schedule I. The currency derivatives segment or clearing house or corporation, as the case may be, shall forward the application to the Board as early as possible but not later than thirty days from the date of its receipt.

SEBI may require the applicant or the concerned stock exchange or segment or clearing house or corporation to furnish such other information or clarifications, regarding the trading and settlement in currency derivatives and matters connected thereto, to consider the application for grant of a certificate. The applicant or its principal officer shall, if so required, appear before SEBI for personal representation.

SEBI shall take into account for considering the grant of a certificate all matters relating to dealing and settlement in currency derivatives and in particular the following, namely—

- (a) Whether the applicant is eligible to be admitted as a trading member or a clearing member
- (b) Whether the applicant has the necessary infrastructure like adequate office place, equipment and man-power to effectively undertake his activities;
- (c) Whether he is subjected to disciplinary proceedings under the rules, regulations and bye-laws of any stock exchange with respect to his business involving either himself or any of his partners, directors or employees;
- (d) Whether the applicant has any financial liability which is due and payable to the Board under these regulations.

An applicant shall also have a net worth of Rs. 1 Crore and shall ensure that its approved user and sales personnel have passed a certification programme approved by SEBI. An applicant who desires to act as a clearing member, shall have a minimum net worth of Rs. 10 crore and shall deposit at least a sum of Rs. 50 lacs or

higher amount with the clearing corporation or clearing house of the currency derivatives segment in the form specified from time to time.

Registration Procedure

On being satisfied that the applicant is eligible, SEBI shall grant a certificate in Form DB of Schedule I, to the applicant and send an intimation to that effect to the currency derivatives segment of the stock exchange or clearing corporation or clearing house, as the case may be. Where an application for the grant of a certificate does not fulfill the requirements SEBI may reject the application of the applicant after giving a reasonable opportunity of being heard. The refusal to grant the certificate of registration shall be communicated by SEBI within 30 days of such refusal to the currency derivatives segment of the stock exchange, or clearing house or corporation and to the applicant stating therein the grounds on which the application has been rejected. An applicant may, if aggrieved by the decision of SEBI as referred to above, the applicant may apply within a period of thirty days from the date of receipt of such information to SEBI for reconsideration of its decision. SEBI shall reconsider an application made and communicate its decision as soon as possible in writing to the applicant and to the currency derivatives segment of the stock exchange or clearing house or corporation.

An applicant, whose application for the grant of a certificate of registration has been refused by SEBI shall not on and from the date of receipt of the communication deal in or settle the currency derivatives contracts as a member of the currency derivatives segment of the stock exchange or clearing corporation or clearing house.

Code of Conduct

The code of conduct specified for the stock broker as stipulated in Schedule-II shall be applicable *mutatis mutandis* to the trading member, clearing member and self-clearing member and such members shall at all times abide by the same. The trading member shall obtain details of the prospective clients in "know your client" format as specified by SEBI before executing an order on behalf of such client. The trading member shall mandatorily furnish "risk disclosure document" disclosing the risk inherent in trading in derivatives to the prospective clients in the form specified. The trading or clearing member shall deposit a margin money or any other deposit and shall maintain position or exposure limit as specified by SEBI or the concerned exchange or segment or clearing corporation or clearing house from time to time.

General Obligations and Responsibilities

Regulation 17 and 18 deal with the general obligations and responsibilities of stock brokers. It lays down that every stock broker shall keep and maintain books of accounts, records and documents namely – Register of Transactions (Sauda book); clients ledger; general ledger; journals; cash book; bank pass book; documents register including particulars of securities received and delivered in physical form and the statement of account and other records relating to receipt and delivery of securities provided by the depository participants in respect of dematerialised securities, members contract books showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other members; counterfoils or duplicates of

contract notes issued to clients; written consents of clients in respect of contracts entered into as principals; margin deposit book; registers of accounts of sub-brokers; an agreement with sub-broker specifying scope of authority, and responsibilities of the stock brokers as well as sub-brokers and an agreement with the sub-broker and with the client of sub-broker to establish privity of contract between the stock broker and the client of the sub-broker.

Every stock broker shall intimate to SEBI the place where the books of accounts, records and documents are maintained. He shall, after the close of each accounting period, furnish to SEBI if so required, as soon as possible but not later than 6 months from the close of the said period, a copy of the audited balance sheet and profit and loss account for the said accounting period.

If this is not possible, the stock broker shall keep SEBI informed of the same together with the reasons for the delay and the period of time by which such documents would be furnished to SEBI. Every stock broker shall preserve the books of accounts and other records for a minimum period of 5 years.

Stock broker shall not deal with any person as sub-broker unless such person has been granted certificate of registration by SEBI.

Compliance Officer

Every stock broker is required to appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by SEBI or Central Government and for redressal of investors' grievances. Compliance officer shall immediately and independently report to SEBI any non-compliance observed by him.

Procedure for Inspection of Stock Brokers' offices

Regulations 19 to 24 provides for procedure for inspection. It is provided that where it appears necessary to SEBI, it may appoint one or more persons as inspecting authority to undertake inspection of the books of accounts other records and documents of the stock brokers

- (a) to ensure that the books of account and other books are being maintained in the manner required,
- (b) that the provisions of the Act, rules and regulations as well as the provisions of the Securities Contracts (Regulation) Act, 1956 and the rules made thereunder are being complied with,
- (c) to investigate into the complaints received from investors, other stock brokers, sub-brokers or any other person on any other matter having a bearing on the activities of the stock brokers, and
- (d) to investigate suo motu in the interest of securities business or investors interest into the affairs of the stock broker.

Before undertaking inspection, SEBI shall give a reasonable notice to the stock broker. However, if SEBI is satisfied that in the interest of the investors or in public interest, no such notice should be given, it may by an order in writing, direct that the inspection be taken up without such notice to the stock broker. On being empowered

by SEBI, the inspecting authority shall undertake the inspection and the stock broker concerned shall be bound to discharge his obligations to facilitate and co-operate for the conduct of inspection by the said authority.

It shall be the duty of every director, proprietor, partner, officer and employee of the stock broker who is being inspected, to produce to the inspecting authority such books, accounts and other documents in his custody or control and furnish him with the statements and information relating to the transactions in securities market within such time as the inspecting authority may require.

The stock broker shall allow the inspecting authority to have reasonable access to the premises occupied by such stock broker or by any other person on his behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the stock broker or any other person and also provide copies of documents or other materials which in the opinion of the inspecting authority are relevant. The said authority in the course of inspection shall be entitled to examine or record statements of any member, director, partner, proprietor and employee of the stock broker. It shall be duty of every director, proprietor, partner, officer and employee of stock broker to give the said authority all assistance in connection with the inspection, which the stock broker may be reasonably expected to give.

The inspecting authority shall as soon as possible submit an inspection report to SEBI who shall after consideration of inspection or investigation report take such action as it may deem fits and appropriate including action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

SEBI is also empowered to appoint a qualified auditor to investigate into the books of accounts or the affairs of the stock broker. The auditor so appointed shall have the same powers of the inspecting authority as enumerated above and the obligations of the stock broker as detailed above shall be applicable to the investigation.

Procedure for Action in Case of Default

A stock broker or a sub-broker who contravenes any of the provisions of the Act, rules or regulations framed thereunder shall be liable for any one or more of the following actions—

- (i) Monetary penalty under Chapter VIA of the Act.
- (ii) Penalties as specified under Chapter V of SEBI (Intermediaries) Regulations, 2008 including suspension or cancellation of certificate of registration as a stock broker or a sub-broker.
- (iii) Prosecution under Section 24 of the Act.

Liability for monetary penalty

A stock broker or a sub-broker shall be liable for monetary penalty in respect of the following violations, namely—

- (i) Failure to file any return or report with SEBI.
- (ii) Failure to furnish any information, books or other documents within 15 days of issue of notice by SEBI.

- (iii) Failure to maintain books of account or record as per the Act, rules or regulations framed thereunder.
- (iv) Failure to redress the grievances of investors within 30 days of receipts of notice from SEBI.
- (v) Failure to issue contract notes in the form and manner specified by the Stock Exchange of which such broker is a member.
- (vi) Failure to deliver any security or make payment of the amount due to the investor within 48 hours of the settlement of trade unless the client has agreed in writing otherwise.
- (vii) Charging of brokerage which is in excess of brokerage specified in the regulations or the bye-laws of the stock exchange.
- (viii) Dealing in securities of a body corporate listed on any stock exchange on his own behalf or on behalf of any other person on the basis of any unpublished price sensitive information.
- (ix) Procuring or communicating any unpublished price sensitive information except as required in the ordinary course of business or under any law.
- (x) Counselling any person to deal in securities of any body corporate on the basis of unpublished price sensitive information.
- (xi) Indulging in fraudulent and unfair trade practices relating to securities.
- (xii) Execution of trade without entering into agreement with the client under the Act, rules or regulations framed thereunder or failure to maintain client registration form or commission of any irregularities in maintaining the client agreement.
- (xiii) Failure to segregate his own funds or securities from the client's funds or securities or using the securities or funds of the client for his own purpose or for purpose of any other client.
- (xiv) Acting as an unregistered sub-broker or dealing with unregistered sub-brokers.
- (xv) Failure to comply with directions issued by SEBI under the Act or the regulations framed thereunder.
- (xvi) Failure to exercise due skill, care and diligence.
- (xvii) Failure to seek prior permission of SEBI in case of any change in its status and constitution.
- (xviii) Failure to satisfy the net worth or capital adequacy norms, if any, specified by SEBI.
- (xix) Extending use of trading terminal or any unauthorized person or place.
- (xx) Violations for which no separate penalty has been provided under these regulations.

Liability for action under the Enquiry Proceeding

A stock broker or a sub-broker shall be liable for any action as specified in SEBI (Intermediaries) Regulations, 2008 including suspension or cancellation of his

certificate of registration as a stock broker or a sub-broker, as the case may be, if he—

- (i) ceases to be a member of a stock exchange; or
- (ii) has been declared defaulter by a stock exchange and not readmitted as a member within a period of six months; or
- (iii) surrender his certificate of registration to SEBI; or
- (iv) has been found to be not a fit and proper person by SEBI under these or any other regulations; or
- (v) has been declared insolvent or order for winding up has been passed in the case of a broker or sub-broker being a company registered under the Companies Act, 1956; or
- (vi) or any of the partners or any whole-time director in case a broker or sub-broker is a company registered under the Companies Act, 1956 has been convicted by a court of competent jurisdiction for an offence involving moral turpitude; or
- (vii) fails to pay fee as per Schedule III of these regulations; or
- (viii) fails to comply with the rules, regulations and bye-laws of the stock exchange of which he is a member; or
- (ix) fails to co-operate with the inspecting or investigating authority; or
- (x) fails to abide by any award of the Ombudsman or decision of the Board under the Securities and Exchange Board of India (Ombudsman) Regulations, 2003; or
- (xi) fails to pay the penalty imposed by the Adjudicating Officer; or
- (xii) indulges in market manipulation of securities or index; or
- (xiii) indulges in insider trading in violation of SEBI (Prohibition of Insider Trading) Regulations, 1992; or
- (xiv) violates SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003; or
- (xv) commits violation of any of the provisions for which monetary penalty or other penalties could be imposed; or
- (xvi) fails to comply with the circulars issued by SEBI; or
- (xvii) commits violations specified in Regulation 26 which in the opinion of SEBI are of a grievous nature.

Liability for prosecution

A stock broker or a sub-broker shall be liable for prosecution under Section 24 of the Act for any of the following violations, namely—

- (i) Dealing in securities without obtaining certificate of registration from the Board as a stock broker or a sub-broker.
- (ii) Dealing in securities or providing trading floor or assisting in trading outside the recognized stock exchange in violation of provisions of the Securities

Contract (Regulation) Act, 1956 or rules made or notifications issued thereunder.

- (iii) Market manipulation of securities or index.
- (iv) Indulging in insider trading in violation of SEBI (Prohibition of Insider Trading) Regulations, 1992.
- (v) Violating SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003.
- (vi) Failure without reasonable cause—
 - (a) to produce to the investigating authority or any person authorized by him in this behalf, any books, registers, records or other documents which are in his custody or power; or
 - (b) to appear before the investigating authority personally or to answer any question which is put to him by the investigating authority; or
 - (c) to sign the notes of any examination taken down by the investigating authority.
- (vii) Failure to pay penalty imposed by the adjudicating officer or failure to comply with any of his directions or orders.

A case study on fraudulent dealings

Bishwanath Murlidhar Jhunjunwala v. SEBI

SEBI noticed a spurt in the volume in the trading of the scrip of Snowcem India Ltd. (SIL), both at NSE and BSE. Though the scrip was not very liquid, it was observed that during June 1999 to August 1999, price of the scrip ranged between Rs.55 to Rs.127. The Appellant, a stock broker of BSE himself was found to have registered himself as a client with a broker of NSE and placed orders in large quantities in the scrip of SIL to the tune of 2,87,400 shares which amounted to 5.59 per cent of the total volume traded at NSE between June 1999 and August 1999. Orders placed by the Appellant were matched with those orders placed by Kosha Investment Ltd. (KIL). Further, the Appellant had not traded in his own account at BSE. The conduct of the Appellant was in violation of Regulation 4 (a), (b) and (d) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 in view of which he was prohibited from accessing capital market for a period of 2 years. Upholding the impugned order in its totality, the Hon'ble SAT noted that, it is a fact that the persons who operate in the market are required to maintain high standards of integrity, promptitude and fairness in the conduct of business dealings.

SUBMISSION OF ANNUAL RETURNS

As part of the continued compliance, National Stock Exchange of India requires its Members to submit Annual Returns i.e. details in respect of shareholding, directors, etc. in the prescribed format to the Exchange. Members having financial year ending other than March 31, are required to submit the said documents within a period of 6 months from the end of their respective financial year. Accordingly, such members are required to inform the Exchange about the financial year followed by

them on or before October 31 every year. In case any member has changed its financial year from the one followed earlier, it shall convey such details to the Exchange on or before October 31. Trading Members are required to file the prescribed information/documents in electronic form over and above the submission in hard form.

Bombay Stock Exchange of India also requires its all active members including Representative members of Cash segment, Limited Trading members & Trading and/or Clearing members of the Derivatives segment of the Bombay Stock Exchange to submit Networth Certificate to the Exchange.

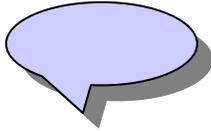
Certification by Practising Company Secretary

1. Internal Audit for Stock Brokers/Trading Members/ Clearing Members

SEBI has authorized the Practising Company Secretary to carry out complete internal audit of stock brokers/trading members/clearing members on a half yearly basis. The circular states that stock brokers/trading members/clearing members shall carry out complete internal audit on a half yearly basis by chartered accountants, company secretaries or cost and management accountants who are in practice and who do not have any conflict of interest. The scope of such audit covers, inter alia, the existence, scope and efficiency of the internal control system, compliance with the provisions of the SEBI Act, 1992, Securities Contracts (Regulation) Act 1956, SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992, circulars issued by SEBI, agreements, KYC requirements, Bye Laws of the Exchanges, data security and insurance in respect of the operations of stock brokers/clearing members. The objective of internal audit is—

- (i) to ensure that the books of account, records (including telephone records and electronic records) and documents are being maintained in the manner required under SEBI Act, 1992, SCR Act, 1956 and SEBI (Stock brokers and Sub-brokers) Regulations, 1992.
- (ii) to ascertain as to whether adequate internal control systems, procedures and safeguards have been established and are being followed by the intermediary to fulfill its obligations within the scope of the audit.
- (iii) to ascertain as to whether any circumstances exist which would render the intermediary unfit or ineligible
- (iv) to ascertain whether the provisions of the securities laws and the directions or circulars issued thereunder are being complied with
- (v) to ascertain whether the provision of stock exchange bye-laws, notices, circulars, instructions or orders issued by stock exchanges are being complied with
- (vi) to inquire into the complaints received from investors, clients, other market participants or any other person on any matter having a bearing on the activities of the stock broker.

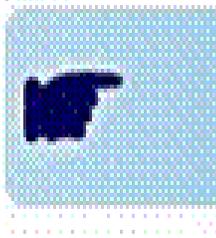
1. NSE vide its Circular No.541, Ref. NSE/MEM/7835 dated September 06, 2006 and Circular NSE/MEM/8004 dated October 12,2006 authorized Practising Company Secretary to issue the following certifications regarding Compliances by Trading Members at par with Chartered Accountants.



1. Details of directors/proprietor in prescribed format
2. Details of shareholding pattern/sharing pattern of corporates in prescribed format
3. Details of shareholding pattern/sharing pattern of firms in prescribed format
4. Details of Dominant group of corporates in prescribed format
5. Details of Dominant group of firms in prescribed format
6. Undertaking from Relative of Persons constituting Dominant Promoter Group in prescribed format
7. Undertaking from Corporates supporting Dominant Promoter Group in prescribed format

BSE vide its Notice no. 20061031-21 dated October 31, 2006 authorized Practising Company Secretary to issue Network Certificate at par with Chartered Accountants. Accordingly, the Practising Company Secretaries are authorized to issue the Network Certificate to be submitted by all active members including Representative members of Cash segment, Limited Trading members & Trading and/or Clearing members of the Derivatives segment of the Bombay Stock Exchange.

2. 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 and shall be accompanied by a non-refundable application fee, as specified in Clause (1) of Schedule II, to be paid in the manner specified in Part B thereof. Incomplete applications shall be rejected after the applicant is given an opportunity to remove within the time specified such objections on the application as may be indicated by SEBI. Before disposing the application, SEBI may require the applicant to furnish further information or clarification and the applicant or its principal officer who is mainly responsible for the activities as a portfolio manager, shall appear before SEBI to make a personal representation, if required.

Norms for registration as Portfolio Managers

The requirements to be satisfied by the applicant for getting the certificate of registration as mentioned in Regulation 6 are as follows:

- (a) the applicant is a body corporate;
- (b) the applicant has the necessary infrastructure like adequate office space, equipments and the manpower to effectively discharge the activities of a portfolio manager;
- (c) the principal officer of the applicant has the professional qualifications in finance, law, accountancy or business management from an institution recognised by the Government or a foreign university or an experience of at least 10 years in related activities in the securities market including in a portfolio manager, stock broker or as a fund manager;
- (d) the applicant has in its employment minimum of two persons who, between them, have at least five years experience as portfolio manager or stock broker or investment manager or in the areas related to fund management;
- (e) any previous application for grant of certificate made by any person directly or indirectly connected with the applicant has been rejected by SEBI;
- (f) any disciplinary action has been taken by the Board against a person directly or indirectly connected with the applicant under the Act or the Rules or the Regulations made thereunder.

The expression 'person directly or indirectly connected' means any person being an associate, subsidiary, inter-connected company or a company under the same management within the meaning of Section 370(1B) of the Companies Act, 1956 or in the same group;

- (g) the applicant fulfils the capital adequacy requirements;
- (h) the applicant, its director, principal officer or the employee as specified in Clause (d) is involved in any litigation connected with the securities market which has an adverse bearing on the business of the applicant;

- (i) the applicant, its director, principal officer or the employee as specified in Clause (d) has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence;
- (j) the applicant is a fit and proper person;
- (k) grant of certificate to the applicant is in the interests of investors.

Capital adequacy requirement

Portfolio manager must have capital adequacy requirement of not less than networth of two crore rupees. However the portfolio manager shall fulfill capital adequacy requirement under these regulations, separately and independently of capital adequacy requirements if any for each activity undertaken by it under the relevant regulations. Networth for the purpose means the aggregate value of paid-up equity capital plus free reserves (excluding reserves created out of revaluation) reduced by the aggregate value of accumulated losses and deferred expenditure not written off, including miscellaneous expenses not written off.

SEBI on being satisfied that the applicant fulfils the requirement specified above shall send an intimation to the applicant. On payment of the requisite fees by the applicant in accordance with Clause 1A of Schedule II of the Regulations, he will be granted a certificate of Registration in Form-B.

Renewal of Certificate

A portfolio manager may make an application for renewal of his registration at least three months before the expiry of the validity of his certificate.

SEBI, in addition to the information furnished in form A along with fees specified in Clause 1 of Schedule II has prescribed for certain additional information to be submitted by the applicant while seeking registration/ renewal as portfolio managers. The applicant has been required to furnish the additional detailed information in the following areas:

1. Memorandum and Articles of Association of the applicant
2. Details of Directors & shareholding pattern
3. Details of Promoters & shareholding pattern
4. Details of applicant registered with SEBI as any other intermediary
5. Details of the Principal Officer
6. Details of Key personnel
7. Details of infrastructure facilities
8. Details of the proposed Schemes
9. Details of facility for safe custody
10. Details of facility for equity research
11. Financial Accounts of the applicant
12. Report from principal bankers
13. List of brokers

14. Details regarding applicant registered with RBI (if any)
15. Details of associated registered intermediaries
16. Declaration by at least two directors
17. Declaration for fit and proper person
18. Director's Declaration under regulation 6.

The applicant has been advised to note that furnishing of incomplete information would delay the processing of the application. The applicant has also been advised to keep the Board informed of all the consequent changes in the information provided to the board.

Conditions of registration

Any registration granted or any renewal granted under these regulation shall be subject to the following conditions, namely:

- (a) where the portfolio manager proposes to change its status or constitution, it shall obtain prior approval of the Board for continuing to act as such after the change;
- (b) it shall pay the fees for registration or renewal, as the case may be, in the manner provided in these regulations;
- (c) it shall take adequate steps for redressal of grievances of the investors within one month of the date of the receipt of the complaint and keep the Board informed about the number, nature and other particulars of the complaints received;
- (d) it shall maintain capital adequacy requirements specified in these regulation at all times during the period of the certificate or renewal thereof;
- (e) it shall abide by the regulations made under the Act in respect of the activities carried on by it as portfolio manager.

Period of validity of certificate

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.

Procedure where registration is not granted

Where the applicant does not satisfy the requirement of registration, SEBI may reject the application after giving an opportunity of being heard. The refusal shall be communicated by SEBI within 30 days of such refusal indicating the grounds for rejection. An applicant if aggrieved by SEBI's rejection may apply within a period of 30 days from the date of receipt of rejection letter to SEBI for reconsideration. SEBI shall reconsider the matter and communicate its final decision as soon as possible in writing to the applicant. The applicant shall cease to carry on activity as portfolio manager on receipt of rejection of his application. If the portfolio manager fails to pay the fees as provided in Schedule II, SEBI may suspend the certificate and during the period of suspension the portfolio manager shall not carry on activity as such portfolio manager.

Code of Conduct

Regulation 13 lays down that every portfolio manager shall abide by the code of conduct as specified in Schedule III to the Regulations which is as follows:

1. A portfolio manager shall, in the conduct of his business, observe high standards of integrity and fairness in all his dealings with his clients and other portfolio managers.
2. The money received by a portfolio manager from a client for an investment purpose should be deployed by the portfolio manager as soon as possible for that purpose and money due and payable to a client should be paid forthwith.
3. A portfolio manager shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgement. The portfolio manager shall either avoid any conflict of interest in his investment or disinvestment decision, or where any conflict of interest arises, ensure fair treatment to all his customers. He shall disclose to the clients, possible sources of conflict of duties and interests, while providing unbiased services. A portfolio manager shall not place his interest above those of his clients.
4. A portfolio manager shall not make any statement or become privy to any act, practice or unfair competition, which is likely to be harmful to the interests of other portfolio managers or is likely to place such other portfolio managers in a disadvantageous position in relation to the portfolio manager himself, while competing for or executing any assignment.
5. A portfolio manager shall not make any exaggerated statement, whether oral or written, to the client either about the qualification or the capability to render certain services or his achievements in regard to services rendered to other clients.
6. At the time of entering into a contract, the portfolio manager shall obtain in writing from the client, his interest in various corporate bodies which enables him to obtain unpublished price-sensitive information of the body corporate.
7. A portfolio manager shall not disclose to any clients or press any confidential information about his client, which has come to his knowledge.
8. The portfolio manager shall where necessary and in the interest of the client take adequate steps for registration of the transfer of the clients' securities and for claiming and receiving dividends, interest payments and other rights accruing to the client. He shall also take necessary action for conversion of securities and subscription/renunciation of/or rights in accordance with the clients' instruction.
9. A portfolio manager shall endeavour to—
 - (a) ensure that the investors are provided with true and adequate information without making any misguiding or exaggerated claims and are made aware of attendant risks before any investment decision is taken by them;

- (b) render the best possible advice to the client having regard to the client's needs and the environment, and his own professional skills;
 - (c) ensure that all professional dealings are effected in a prompt, efficient and cost effective manner.
10. (1) A portfolio manager shall not be a party to—
- (a) creation of false market in securities;
 - (b) price rigging or manipulation of securities;
 - (c) passing of price sensitive information to brokers, members of the stock exchanges and any other intermediaries in the capital market or take any other action which is prejudicial to the interest of the investors.
- (2) No portfolio manager or any of its directors, partners or manager shall either on their respective accounts or through their associates or family members and relatives enter into any transaction in securities of companies on the basis of unpublished price sensitive information obtained by them during the course of any professional assignment.
11. (a) A portfolio manager or any of his employees shall not render, directly or indirectly any investment advice about any security in the publicly accessible media, whether real-time or non-real-time, unless a disclosure of his long or short position in the said security has been made, while rendering such advice.
- (b) In case an employee of the portfolio manager is rendering such advice, he shall also disclose the interest of his dependent family members and the employer including their long or short position in the said security, while rendering such advice.
12. (a) The portfolio manager shall abide by the Act, and the Rules, Regulations made thereunder and the Guidelines/Schemes issued by the Board.
- (b) The portfolio manager shall comply with the model code of conduct specified in SEBI (Prohibition of Insider Trading) Regulations, 1992.
- (c) The portfolio manager shall not use his status as any other registered intermediary to unduly influence the investment decision of the clients while rendering portfolio management services.

Contract with clients and disclosures

The portfolio manager, before taking up an assignment of management of funds or portfolio of securities on behalf of a client, enter into an agreement in writing with such client clearly defining the *inter se* relationship and setting out their mutual rights, liabilities and obligations relating to the management of funds or portfolio of securities containing the details as specified in Schedule IV to the Regulations:

The agreement between the portfolio manager and the client shall, *inter alia*, contain:

- (i) the investment objectives and the services to be provided;

- (ii) areas of investment and restrictions, if any, imposed by the client with regard to the investment in a particular company or industry;
- (iii) type of instruments and proportion of exposure;
- (iv) tenure of portfolio investments;
- (v) terms for early withdrawal of funds or securities by the clients;
- (vi) attendant risks involved in the management of the portfolio;
- (vii) period of the contract and provision of early termination, if any;
- (viii) amount to be invested subject to the restrictions provided under these regulations;
- (ix) procedure of settling client's account including form of repayment on maturity or early termination of contract;
- (x) fees payable to the portfolio manager;
- (xi) the quantum and manner of fees payable by the client for each activity for which service is rendered by the portfolio manager directly or indirectly (where such service is outsourced);
- (xii) custody of securities;
- (xiii) in case of a discretionary portfolio manager a condition that the liability of a client shall not exceed his investment with the portfolio manager;
- (xiv) the terms of accounts and audit and furnishing of the reports to the clients as per the provisions of these regulations; and
- (xv) other terms of portfolio investment subject to these regulations.

The portfolio manager shall provide to the client, the Disclosure Document as specified in Schedule V, along with a certificate in Form C as specified in Schedule I, at least two days prior to entering into an agreement with the client as referred to in Sub-regulation (1).

The Disclosure Document, shall *inter alia* contain the following—

- (i) the quantum and manner of payment of fees payable by the client for each activity for which service is rendered by the portfolio manager directly or indirectly (where such service is outsourced);
- (ii) portfolio risks;
- (iii) complete disclosures in respect of transactions with related parties as per the accounting standards specified by the Institute of Chartered Accountants of India in this regard;
- (iv) the performance of the portfolio manager:
Provided that the performance of a discretionary portfolio manager shall be calculated using weighted average method taking each individual category of investments for the immediately preceding three years and in such cases performance indicators shall also be disclosed;
- (v) the audited financial statements of the portfolio manager for the immediately preceding three years.

The contents of the Disclosure Document would be certified by an independent chartered accountant.

The portfolio manager is required to file with SEBI, a copy of the Disclosure Document before it is circulated or issued to any person and every six months thereafter or whenever any material change is effected therein whichever is earlier, along with the certificate in Form C as specified in Schedule I. The portfolio manager shall ensure that the disclosure document is given to clients along with the account opening form atleast 2 days in advance of signing of the agreement.

The portfolio manager shall charge an agreed fee from the clients for rendering portfolio management services without guaranteeing or assuring, either directly or indirectly, any return and the fee so charged may be a fixed fee or a return based fee or a combination of both.

The portfolio manager may, subject to the disclosure in terms of the Disclosure Document and specific permission from the client, charge such fees from the client for each activity for which service is rendered by the portfolio manager directly or indirectly (where such service is outsourced).

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 non discretionary 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 lacs rupees. The portfolio manager shall act in a fiduciary capacity with regard to the clients 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 clients funds or securities. The portfolio manager shall not accept from the client, funds or securities worth less than five lacs rupees. The portfolio manager shall keep the funds of all clients in a separate account to be maintained by it in a Scheduled Commercial Bank. He shall ensure proper and timely handling of complaints from his clients and take appropriate action promptly.

Investment of Clients Money

The money or securities accepted by the portfolio manager shall not be invested or managed by the portfolio manager except in terms of the agreement between the portfolio manager and the client. Any renewal of portfolio fund on maturity of the initial period shall be deemed as a fresh placement. The funds or securities can be withdrawn or taken back by the client before the maturity of the contract under the following circumstances, namely—

- (a) voluntary or compulsory termination of portfolio management services by the portfolio manager or the client.
- (b) suspension or cancellation of the certificate of registration of the portfolio manager by the Board.
- (c) bankruptcy or liquidation of the portfolio manager.

The portfolio manager shall invest funds of his clients in money market instruments or derivatives or as specified in the contract:

However, leveraging of portfolio shall not be permitted in respect of investment in derivatives. Further the portfolio manager shall not deploy the clients' funds in bill discounting, badla financing or for the purpose of lending or placement with corporate or non-corporate bodies. "Money market instruments" includes commercial paper, trade bill, treasury bills, certificate of deposit and usance bills.

The portfolio manager shall not while dealing with clients' funds indulge in speculative transactions that is, he shall not enter into any transaction for purchase or sale of any security which is periodically or ultimately settled otherwise than by actual delivery or transfer of security except the transactions in derivatives.

The portfolio manager shall, ordinarily purchase or sell securities separately for each client. However, in the event of aggregation of purchases or sales for economy of scale, inter se allocation shall be done on a pro rata basis and at weighted average price of the day's transactions. The portfolio manager shall not keep any open position in respect of allocation of sales or purchases effected in a day.

Any transaction of purchase or sale including that between the portfolio manager's own accounts and client's accounts or between two clients' accounts shall be at the prevailing market price.

The portfolio manager shall segregate each clients' funds and portfolio of securities and keep them separately from his own funds and securities and be responsible for safekeeping of clients' funds and securities.

The portfolio manager shall not hold the listed securities, belonging to the portfolio account, in its own name on behalf of its clients either by virtue of contract with clients or otherwise. The portfolio managers, may, subject to authorization by the client in writing, participate in securities lending.

Foreign institutional investors and sub accounts registered with SEBI may avail of the services of a portfolio manager.

Every portfolio manager shall appoint a custodian in respect of securities managed or administered by it. However, this regulation shall not apply to a portfolio Manager who has total assets under management of value less than five hundred crore rupees; or who performs purely advisory functions.

Accounting by Portfolio Managers

Regulations 17 to 20 deal with books of accounts, records, accounts and audit.

Regulation 17 lays down that every portfolio manager shall keep and maintain the following books of accounts, records and documents, namely - a) a copy each of balance sheet, profit and loss account and the auditor's account in respect of each accounting period b) a statement of financial position and c) records in support of every investment transaction or recommendation which will indicate the data, facts and opinions leading to that investment decision. Every portfolio manager shall intimate to SEBI where the books of accounts, records or documents are maintained. Every portfolio manager shall after the end of each accounting period furnish to SEBI

copies of the balance sheet, profit and loss account and such other documents as are required by the regulations. Regulation 18 provides that portfolio manager shall furnish to SEBI half-yearly unaudited financial results when required by SEBI with a view to assist in monitoring the capital adequacy of the portfolio manager.

The portfolio manager shall preserve the books of account and other records and documents mentioned in any of the regulations mentioned under this chapter for a minimum period of five years.

Regulation 20 lays down that the portfolio manager shall maintain separate client-wise accounts. The funds received from the clients, investments or disinvestments and all the credits to the account of the client like interest, dividend, bonus or any other beneficial interest received on the investment and debits for expenses if any shall be properly accounted for and details thereof shall be reflected correctly in the clients accounts. The tax deducted at source as required under the Income Tax Act, 1961 shall be recorded in the portfolio account. The books of account will be audited by a qualified auditor to ensure that portfolio manager has followed proper accounting methods and procedures and that he has performed the duties in accordance with the law. A certificate to this effect shall, if so specified be submitted to SEBI within 6 months of the close of the portfolio managers accounting period.

The portfolio accounts of the portfolio manager shall be audited annually by an independent chartered accountant and a copy of the certificate issued by the chartered accountant shall be given to the client.

The client may appoint a chartered accountant to audit the books and accounts of the portfolio manager relating to his transactions and the portfolio manager shall co-operate with such chartered accountant in course of the audit.

Reports by Portfolio Manager to the Client

Regulation 21 lays down that the portfolio manager shall furnish periodically a report to the client as agreed to in the contract but not exceeding a period of 6 months and such report shall contain the following details, namely—

- (a) the composition and the value of the portfolio, description of security, number of securities, value of each security held in a portfolio, cash balance and aggregate value of the portfolio as on the date of report.
- (b) transactions undertaken during the period of report including dates of transaction and details of purchases and sales.
- (c) beneficial interest received during that period in respect of interest, dividend, bonus shares, rights shares and debentures.
- (d) expenses incurred in managing the portfolio of the client.
- (e) details of risk foreseen by the portfolio manager and the risk relating to the securities recommended by the portfolio manager for investment or disinvestment.

Regulation 21(1A) provides that the report may be made available on the website of the portfolio manager with restricted access to each client.

The portfolio manager shall also furnish to the client documents and information relating only to the management of a portfolio. On termination of the contract, the portfolio manager shall give a detailed statement of accounts to the client and settle the account with the client as agreed in the contract. The client has the right to obtain details of his portfolio from the portfolio manager.

Action on auditor's report and disclosure to SEBI

Every portfolio manager shall within two months from the date of the auditor's report take steps to rectify the deficiencies made out in such report. A portfolio manager shall disclose to SEBI as and when required the information, namely - Particulars regarding the management of a portfolio; any change in the information or particulars previously furnished; which have a bearing on the certificate granted to him; the names of the clients whose portfolio he has managed; and particulars relating to the capital adequacy requirement.

Compliance officer

Every portfolio manager is required to appoint a compliance officer responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by SEBI or the Central Government and for redressal of investors' grievances. The compliance officer should independently and immediately report to SEBI for any non-compliance observed by him.

Inspection and disciplinary proceedings

Regulations 24 to 29 contain provisions on this subject.

Regulation 24 empowers SEBI to appoint one or more persons as inspecting authority to under take the inspection of the books of accounts, records and documents of the portfolio manager to ensure that they are being maintained in the manner required, that the provisions of the Act, Rules and Regulations are being complied with. The inspecting authority shall investigate into the complaints received from the investors, other portfolio managers or any other person on any matter having a bearing on the activities of the portfolio manager and investigate suo motu in the interest of securities business or investors interest into the affairs of the portfolio manager.

SEBI shall give a reasonable notice to the portfolio manager before undertaking an inspection. However, where SEBI is satisfied that in the interest of the investors, no such notice should be given it may by an order in writing direct that the inspection of the affairs of the portfolio manager be taken up without such notice. During the course of the inspection the portfolio manager against whom an inspection is being carried out shall be bound to discharge his obligations as stated below:

Obligations of portfolio manager

It shall be the duty of every director, proprietor, partner, officer and employee of the portfolio manager who is being inspected, to produce to the inspecting authority such books of accounts and documents in his custody or control and furnish him with the statements and information relating to these activities within such time as the inspecting authority may require. The portfolio manager shall allow the inspecting authority to have reasonable access to the premises occupied by the former or by any other person on his behalf and also extend reasonable facility for examining any

books, records, documents and computer data in his possession or in the possession of any other person and also provide copies of documents or other material which in the opinion of the inspecting authority are relevant for the purposes of the inspection. In the course of inspection, the inspecting authority shall be entitled to examine or record statements of any principal officer, director, partner, proprietor and employee of the portfolio manager. It shall be the duty of each such person to give to the inspecting authority all assistance in connection with the inspection which the portfolio manager may reasonably be expected to give.

The inspecting authority shall submit an inspection report to SEBI as soon as it is possible. SEBI or chairman shall after consideration of the inspection or investigation report take such action as SEBI or its chairman may deem fit and appropriate including action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

Appointment of auditor

SEBI may appoint a qualified auditor to investigate into the books of accounts or the affairs of the portfolio manager. The auditor so appointed shall have the same powers of the inspecting authority outlined above and the obligation of the portfolio manager and his employees in connection therewith shall be applicable also to the investigation under this Regulation.

Liability for action in case of default

A portfolio manager who contravenes any of the provisions of the Act, Rules or Regulations framed there under shall be liable for one or more action specified therein including the action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

Internal Audit of Portfolio Manager

Every Portfolio manager is required to appoint a Practising Company Secretary or a Practising Chartered Accountant for conducting the internal audit. The Portfolio manager is required to report the compliance of the aforesaid requirement to SEBI while submitting the half yearly report.

The report is to be submitted twice a year, as on 31st of March and 30th of September. The report should reach SEBI within thirty days of the period to which it relates.

No precise period has been prescribed for the PCS to submit his report to the Board of the company. However, it would be advisable for the PCS to give the audit report to the Portfolio Manager sufficiently well in advance to enable the Company to report the compliance of the same to SEBI.

The scope of the internal audit would comprise the checking of compliance of SEBI (Portfolio Managers) Regulations 1993 and circulars notifications or guidelines issued by SEBI and internal procedures followed by the Portfolio Manager.

3. 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

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.

The regulations define "custody account" as an account of a client maintained by a custodian of securities in respect of securities;

Application for grant of certificate

Regulation 3(1) provides that any person proposing to carry on business as custodian of securities on or after the commencement of these regulations shall make an application to SEBI for grant of a certificate. SEBI may, however in special cases, where it is of the opinion that it is necessary to do so for reasons to be recorded in writing, may extend the period upto a maximum of six months from the date of such commencement.

Any person who fails to make an application for grant of certificate within the period or the extended period specified therein, shall cease to carry on any activity as custodian of securities and shall be subject to the directions of the Board with regard to the transfer of records, documents or securities relating to his activities as custodian of securities.

Application to conform to requirements

An application which is not complete in all respects or which does not conform to the instructions specified therein will be rejected. However before rejecting any such application, SEBI would give the applicant an opportunity to remove the objection, within such time as may be specified.

Furnishing of information

SEBI may require the applicant to furnish such further information or clarification regarding matters relevant to the activities of a custodian of securities for the purpose of consideration of the application. The applicant or his authorised representative may, if so required, appear before SEBI for personal representation, in connection with the grant of certificate.

Consideration of application for grant of certificate

SEBI, while granting the Certificate shall take into account following matters which are relevant to the activities of a custodian of securities:

- (a) the applicant fulfils the capital requirement;
- (b) the applicant has the necessary infrastructure, including adequate office space, vaults for safe custody of securities and computer systems capability, required to effectively discharge his activities as custodian of securities;
- (c) the applicant has the requisite approvals under any law for the time being in force, in connection with providing custodial services in respect of gold or gold related instruments of a mutual fund, or title deeds of real estate assets held by a real state mutual funds scheme where applicable;
- (d) the applicant has in his employment adequate and competent persons who have the experience, capacity and ability of managing the business of the custodian of securities;
- (e) the applicant has prepared a complete manual, setting out the systems and procedures to be followed by him for the effective and efficient discharge of his functions and the arms length relationships to be maintained with the other businesses, if any, of the applicant;
- (f) the applicant is a person who has been refused a certificate by SEBI or whose certificate has been cancelled by SEBI;
- (g) the applicant, his director, his principal officer or any of his employees is involved in any litigation connected with the securities market;
- (h) the applicant, his director, his principal officer or any of his employees has at any time been convicted of any offence involving moral turpitude or of any economic offence;
- (i) the applicant is a fit and proper person; and
- (j) the grant of certificate is in the interest of investors.

Also SEBI shall not consider an application unless the applicant is a body corporate.

Capital requirement

Regulation 7(1) provides for the capital adequacy requirement. It provides that the applicant must have a net worth of a minimum of rupees fifty crores. The term "net worth" means the paid up capital and the free reserves as on the date of the application. However any custodian of securities which has been approved by SEBI under the provisions of SEBI (Mutual Fund) Regulations, 1993 or SEBI (Foreign Institutional Investors) Regulations, 1995, or the Government of India Guidelines for Foreign Institutional Investors dated September 14, 1992, even if it does not have the network specified in above may continue to function as a custodian of securities and shall within a period of one year from the date of commencement of these regulations raise its network as specified.

The period specified above may be extended by SEBI upto a maximum of 5 years.

Any applicant is permitted to fulfil his capital adequacy requirements within one month of the receipt of certificate.

Procedure and grant of certificate

Regulation 8(1) of the Regulation provides that after considering the application, if SEBI is satisfied that all particulars sought have been furnished and the applicant is eligible for the grant of a certificate, it will send an intimation of the same to the applicant.

On receipt of an intimation the applicant shall pay to SEBI specified registration fee. SEBI shall thereafter grant a certificate to the applicant on receipt of the registration fee. It has been provided that SEBI may restrict the certificate of registration to providing custodial services either in respect of securities or in respect of gold or gold related instruments of a client or title deeds of real estate assets held by a real estate mutual fund scheme.

A custodial of securities holding a certificate of registration may provide custodial services in respect of gold or gold related instruments of a mutual fund and in respect of title deeds of real estate assets held by a real estate mutual fund scheme, only after taking prior approval of the SEBI.

Conditions of certificate

The certificate granted to the custodian of securities may be subject to the following conditions, namely:

- (a) it shall not commence any activities as custodian of securities unless it fulfils the capital requirement;
- (b) it shall abide by the provisions of the Act and these regulations in the discharge of its functions as custodian of securities;
- (c) it shall enter into a valid agreement with its client for the purpose of providing custodial services;
- (d) it shall pay annual fees as specified in in the manner specified;
- (e) if any information previously submitted by it to SEBI is found by it to be false or misleading in any material particular, or if there is any change in such information, it shall forthwith inform SEBI in writing; and
- (f) besides providing custodial services, it shall not carry on any activity other than activities relating to rendering of financial services.

Period of validity

Regulation 9A of the Regulations provide that every certificate granted under these regulation shall be valid for a period of three years from the date of grant.

Renewal of certificate

Regulation 9B of the Regulations provide that a custodian of securities, desirous of having its certificate renewed shall make an application to SEBI for renewal of the certificate in Form A, not less than three months before the expiry of its period of validity under Regulation 9A. The application for renewal of certificate shall be dealt

with, as far as may be, as if it were an application for the grant of a fresh certificate and shall be accompanied with the application fee as specified in Schedule II. However, no registration fee is payable by a custodian in case of a renewal of certificate.

Procedure where certificate is not granted

Regulation 10(1) of the Regulations provide that after considering an application for grant of certificate, if SEBI is satisfied that a certificate should not be granted, SEBI may reject the application after giving the applicant a reasonable opportunity of being heard.

The decision of SEBI rejecting the application shall be communicated within thirty days of such decision to the applicant in writing, stating therein the grounds on which the application has been rejected. An applicant, aggrieved by the decision of SEBI may within a period of thirty days from the date of receipt of communication apply to SEBI for re-consideration of its decision.

SEBI shall, as soon as possible, in the light of the submissions made in the application for re-consideration and after giving the applicant a reasonable opportunity of being heard, convey its decision in writing to the applicant.

Effect of refusal to grant certificate

Any custodian of securities whose application for grant of certificate has been rejected by SEBI shall, on and from the date of the receipt of the communication ceases to carry on any activity as custodian of securities and shall be subject to the directions of SEBI with regard to the transfer of records, documents or securities that may be in its custody or control relating to its activity as custodian of securities.

Code of conduct

Every custodian of securities shall abide by the Code of Conduct as specified in the Third Schedule to the Regulations.

Segregation of activities

Regulation 13 provides that where a custodian of securities is carrying on any activity besides that of acting as custodian of securities, then the activities relating to his business as custodian of securities shall be separate and segregated from all other activities and its officers and employees engaged in providing custodial services shall not be engaged in any other activity carried on by him.

Mechanism for monitoring review

Regulation 14(1) provides that every custodian of securities shall have adequate mechanisms for the purposes of reviewing, monitoring and evaluating the custodian's controls, systems, procedures and safeguards. The custodian of securities shall cause to be inspected annually the mechanism by an expert and forward the inspection report to SEBI within three months from the date of inspection.

Prohibition of assignment

No custodian of securities shall assign or delegate its functions as a custodian of securities to any other person unless such person is a custodian of securities.

However, a custodian of securities may engage the services of a person not being a custodian, for the purpose of physical safekeeping of gold belonging to its client being a mutual fund having a gold exchange traded fund scheme, subject to the following conditions:

- (a) the custodian shall remain responsible in all respects to its client for safekeeping of the gold kept with such other person, including any associated risks;
- (b) all books, documents and other records relating to the gold so kept with the other person shall be maintained in the premises of the custodian or if they are not so maintained, they shall be made available therein, if so required by SEBI;
- (c) the custodian of securities shall continue to fulfill all duties to the clients relating to the gold so kept with the other person, except for its physical safekeeping.”

Separate custody account

Every custodian of securities is required to open a separate custody account for each client, in the name of the client whose securities are in its custody and ensure that the assets of one client would not be mixed with those of another client.

Agreement with the client

Every custodian of securities is required to enter into an agreement with each client on whose behalf it is acting as custodian of securities and every such agreement shall provide for the following matters, namely:

- (a) the circumstances under which the custodian of securities will accept or release securities, assets or documents from the custody account;
- (b) the circumstances under which the custodian of securities will accept or release monies from the custody account.
- (c) the circumstances under which the custodian of securities will receive rights or entitlements on the securities of the client;
- (d) the circumstances and the manner of registration of securities in respect of each client;
- (e) details of the insurance, if any, to be provided for by the custodian of securities.

Internal Controls

Every custodian of securities is required to have adequate internal controls to prevent any manipulation of records and documents, including audits for securities and rights or entitlements arising from the securities held by it on behalf of its client. Every custodian of securities would take appropriate safekeeping measures to ensure that such securities, assets or documents are protected from theft and natural hazard.

Maintenance of records and documents

Regulation 19(1) provides that every custodian of securities is required to

maintain the following records and documents, containing details of:

- (a) securities, assets or documents received and released on behalf of each client;
- (b) monies received and released on behalf of each client;
- (c) rights or entitlements of each client arising from the securities held on behalf of the client;
- (d) registration of securities in respect of each client;
- (e) ledger for each client;
- (f) instructions received from and sent to clients; and records of all reports submitted to SEBI.

The Custodian of securities would intimate to SEBI the place where the records and documents are maintained and custodian of securities shall preserve the records and documents maintained for a minimum period of five years.

Appointment of Compliance Officer

Regulation 19A(1) provides that every custodian of securities would appoint a compliance officer responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by SEBI or the Central Government. He is under an obligation for redressal of investors' grievances.

The compliance officer is required to immediately and independently report to SEBI any non-compliance observed by him.

Information to SEBI

SEBI may, at any time, call for any information from a custodian of securities with respect to any matter relating to its activity as custodian of securities. Where any information is called for by SEBI, it shall be the duty of the custodian of securities to furnish such information, within such reasonable period as SEBI may specify.

Inspection and Audit

SEBI may appoint one or more persons as inspecting officer to undertake inspection of the books of accounts, records and documents of the custodian of securities for any of the following purposes, namely:-

- (a) to ensure that the books of account, records and documents are being maintained by the custodian of securities in the manner specified in these regulations;
- (b) to investigate into complaints received from investors, clients or any other person, on any matter having a bearing on the activities of the custodian of securities;
- (c) to ascertain whether the provisions of the Act and these regulations are being complied with by the custodian of securities; and
- (d) to investigate suo motu into the affairs of the custodian of securities, in the interest of the securities market or in the interest of investors.

Notice before inspection

SEBI, before ordering inspection shall give not less than ten days notice to the custodian of securities. Where the Board is satisfied that in the interest of the investors no such notice should be given, it may by an order in writing direct that the inspection of the affairs of the custodian of securities be taken up without such notice.

The custodian of securities against whom the inspection is being carried out is under an obligation to discharge his obligations.

Obligations of custodian

It is the duty of the custodian of securities whose affairs are being inspected, and of every director, officer and employee thereof, to produce to the inspecting officer such books, securities, accounts, records and other documents in its custody or control and furnish him with such statements and information relating to his activities of the custodian of securities, as the inspecting officer may require, within such reasonable period as the inspecting officer may specify.

The custodian of securities is required to allow the inspecting officer to have reasonable access to the premises occupied by such custodian or by any other person on his behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the custodian of securities or such other person and also provide copies of documents or other materials which, in the opinion of the inspecting officer are relevant for the purposes of the inspection.

The inspecting officer, in the course of inspection, is entitled to examine or to record the statements of any director, officer or employee of the custodian of securities. It is the duty of every director, officer or employee of the custodian of securities to give to the inspecting officer all assistance in connection with the inspection, which the inspecting officer may reasonably require.

Submission of Report to SEBI

The inspecting officer shall, as soon as possible, on completion of the inspection submit an inspection report to SEBI and that if directed by SEBI, he may submit an interim report.

SEBI or the Chairman shall after consideration of inspection or investigation report take such action as the Board or Chairman may deem fit and appropriate including action under Chapter V of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

Liability for action in case of default

A custodian of securities who contravenes any of the provisions of the Act, the rules framed there under or these regulations or fails to furnish any information relating to his activity as custodian of securities as required by SEBI or furnishes to SEBI information which is false and misleading in any material particular or does not submit periodic returns or reports as required by SEBI or does not co-operate in any enquiry or inspection conducted by SEBI or fails to update its systems and procedures as recommended by SEBI or fails to resolve the complaints of clients or

fails to give a satisfactory reply to SEBI in this behalf or is guilty of misconduct or makes a breach of the Code of Conduct specified in the Third Schedule or fails to pay annual fees, shall be dealt with in the manner provided under Chapter V of SEBI (Intermediaries) Regulations, 2008.

4. 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. An application for the grant of certificate should be made to SEBI in the prescribed form.

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. An application, which is not complete in all respects and does not conform to the instructions specified in the form or is false or misleading in any material particular, should be rejected by SEBI. However before rejecting any such application, the applicant should be given a reasonable opportunity to remove, within the time specified by SEBI, such objections as may be indicated by SEBI.

Consideration of application

While granting certificate of Registration, SEBI should take into account the following matters:

- (i) the applicant's track record, professional competence, financial soundness, experience, general reputation of fairness and integrity;

However, in case of a newly established fund, the track record of the investment manager of the fund who has promoted it may be taken into consideration. However, investment manager shall furnish the details in respect of disciplinary action, if any, taken against it.
- (ii) whether the applicant is regulated by an appropriate foreign regulatory authority;

However, university funds, endowments, foundations, charitable trusts and charitable societies may be considered for registration even though they are not regulated by a foreign regulatory authority.
- (iii) whether the applicant has been granted permission under the provisions of the Foreign Exchange Regulation by the Reserve Bank of India for making investments in India as a Foreign Institutional Investor;
- (iv) whether the applicant is—
 - (a) an institution established or incorporated outside India as Pension Fund,

Mutual Fund or Investment Trust, Insurance Company or reinsurance company;

- (aa) a international or multilateral organisation or an agency thereof or a Foreign Governmental Agency, Sovereign Wealth Fund, or a Foreign Central Bank;
- (b) an Asset Management Company, investment manager or advisor, Bank or Institutional Portfolio Manager, established or incorporated outside India and proposing to make investments in India on behalf of broad based funds and its proprietary funds, if any; or
- (c) a trustee of a trust established outside India and proposing to make investments in India on behalf of broad based funds and its proprietary funds, if any;
- (d) university fund, endowments, foundations or charitable trusts or charitable societies. However while considering the application from SEBI may take into account the following namely:
 1. whether the applicant has been in existence for a period of atleast 5 years.
 2. whether it is legally permissible for the applicant to invest in securities outside the country of its incorporation or establishment;
 3. whether the applicant has been registered with any statutory authority in the country of their incorporation or establishment;
 4. whether any legal proceeding has been initiated by any statutory authority against the applicant.
 5. whether the applicant has been serving public interest.

"Broad based fund" means a fund, established or incorporated outside India, which has at least twenty investors, with no single individual investor holding more than forty-nine per cent of the shares or units of the fund.

However if the broad based fund has institutional investor(s), it shall not be necessary for the fund to have twenty investors: However that if the broad based fund has an institutional investor who holds more than forty nine per cent of the shares or units in the fund, then the institutional investor must itself be a broad based fund.
 6. whether the grant of certificate to the applicant is in the interest of the development of the securities market.
 7. whether the applicant is a fit and proper person.

Procedure for grant of certificate

SEBI, if satisfied that the application is complete in all respects, all particulars sought have been furnished and the applicant is found to be eligible for the grant of certificate, grant a certificate subject to payment of fees with in three months from the documents furnished. However SEBI may exempt from the payment of fees, an

applicant such as the World Bank and other institutions established outside India for providing aid, and which have been granted privileges and immunities from the payment of tax and duties by the Central Government. It has been provided further that SEBI should refund the fees already collected from the institutions which are exempted from the payment of fees.

Validity of certificate

Subject to the compliance of the provisions of the Act, these regulations, the circulars issued there under and the obligation to pay fees as specified in these regulation, any registration granted by SEBI shall be permanent unless suspended or cancelled by SEBI. Foreign institutional investor or a sub-account, having a certificate specified in this regulation shall file information in the prescribed form as the case may be, at least three months prior to the expiry of period of certificate. A foreign institutional investor or a sub account may surrender the certificate of registration granted to it by SEBI. While accepting a surrender of registration, SEBI may impose such conditions upon the foreign institutional investor or the sub account as it deems fit.

Grant of certificate

The grant of certificate to the Foreign Institutional Investor may be subject to the following conditions:

- (i) he shall abide by the provisions of these regulations;
- (ii) if any information or particulars previously submitted to the Board are found to be false or misleading, in any material respect, he shall forthwith inform SEBI in writing;
- (iii) if there is any material change in the information previously furnished by him to SEBI, which has a bearing on the certificate granted by SEBI, he shall forthwith inform to SEBI;
- (iv) he shall appoint a domestic custodian and before making any investments in India, enter into an agreement with the domestic custodian providing for custodial services in respect of securities;
- (v) he shall, before making any investments in India, enter into an arrangement with a designated bank for the purpose of operating a special non-resident rupee or foreign currency account;
- (vi) before making any investments in India on behalf of a sub-account, if any, he shall obtain registration of such sub-account, under these regulations.

Procedure where certificate is not granted

SEBI may reject the application where an application for grant of a certificate does not satisfy the requirements after giving the applicant a reasonable opportunity of being heard. The decision to reject the application should be communicated by SEBI to the applicant in writing stating therein the grounds on which the application has been rejected. The applicant, who is aggrieved by the decision of SEBI may, within a period of thirty days from the date of receipt of communication apply to SEBI

for reconsideration of its decision. SEBI may, in the light of the submissions made in the application for reconsideration and after giving a reasonable opportunity of being heard, convey its decision in writing to the applicant.

Application for registration of sub-accounts

A Foreign Institutional Investor should seek from SEBI registration of each sub-account on whose behalf he proposes to make investments in India. However, before making an application for registration on behalf of a proposed sub-account being a foreign corporate, the foreign institutional investor shall verify the necessary details and documents and satisfy itself about the identity of the proposed sub-account after applying its know your client procedure. Any sub-account that has been granted approval prior to the commencement of these regulations by SEBI should be deemed to have been granted registration as a sub-account by SEBI under these regulation. An application for registration as sub-account shall be made in Form AA.

Procedure and grant of registration of sub-accounts

SEBI may take into account the following matters which are relevant to the grant of such registration to the sub-account:

- (a) the applicant falls into any of the following categories, namely:
 - (i) broad based fund or portfolio which is broad based, incorporated or established outside India; or
 - (ii) proprietary fund of a registered foreign institutional investor; or
 - (iii) foreign corporate; or
 - (iv) foreign individual; or
 - (v) university fund, endowment, foundation, charitable trust or charitable society who are eligible to be registered as a foreign institutional investor under these regulations.
- (b) the applicant is a fit and proper person;
- (c) the Foreign Institutional Investor through whom the application for registration is made to SEBI holds a certificate of registration as Foreign Institutional Investor;
- (d) the Foreign Institutional Investor through whom an application for registration of sub-account is made, is authorised to invest on behalf of the sub-account;
- (e) the applicant and the foreign institutional investor through whom the application for registration is made, have submitted joint undertakings as required by Form AA of First Schedule of the Regulations;
- (f) the sub-account has paid registration fees as specified.

SEBI on receipt of the undertakings and the registration fees as may grant registration to the sub-account. A sub-account granted registration in accordance with the regulation should be deemed to be registered as a Foreign Institutional Investor

with SEBI for the limited purpose of availing of the benefits available to FIIs under Section 115AD of Income Tax Act, 1961.

Responsibility of FIIs

A foreign institutional investor shall be responsible and liable for all acts of commission and omission of all its sub-accounts and other deeds and things done by such sub-accounts in their capacity as sub-accounts under these regulations. However, it shall not be deemed to detract from any responsibility or liability of the sub-account under these regulations or under any other law for the time being in force. It shall have effect irrespective of whether the foreign institutional investor exercises discretion in respect of funds of the sub account or not.

Investment Conditions and Restrictions

Regulation 14 provides that a Foreign Institutional Investor can not make any investments in securities in India without complying with the provisions. 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.

Where a foreign institutional investor or sub-account holds equity shares in a company whose shares are not listed on any recognised stock exchange, and continues to hold such shares after initial public offering and listing thereof, such shares shall be subject to lock-in for the same period, if any, as is applicable to shares held by a foreign direct investor placed in similar position, under the policy of the Central Government relating to foreign direct investment for the time being in force. However, it shall not be deemed to prejudice the applicability of any other law, regulation or guideline.

Sub-regulation (2) of Regulation 15 the total investments in equity and equity related instruments (including fully convertible debentures, convertible portion of partially convertible debentures and tradable warrants) made by a Foreign Institutional Investor in India, whether on his own account or on account of his sub-accounts, should not be less than seventy per cent of the aggregate of all the investments of the Foreign Institutional Investor in India, made on his own account and on account of his sub-accounts. However it may apply to any investment of the foreign institutional investor either on its own account or on behalf of its sub-accounts in debt securities which are unlisted or listed or to be listed on any stock exchange if

the prior approval of SEBI has been obtained for such investments. Regulations further provide that SEBI may while granting approval for the investments impose conditions as are necessary with respect to the maximum amount which can be invested in debt securities by the foreign institutional investor on its own account or through its sub accounts. The conditions mentioned in sub-regulation (2) shall not apply to investments made by foreign institutional investors in security receipts issued by securitisation companies or asset reconstruction companies under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and the rules made thereunder.

Further, no FII shall invest in Security Receipts on behalf of its sub-account. A foreign corporate or individual is not be eligible to invest through the hundred percent debt route. In respect of investments in the secondary market, the Regulations provide for additional conditions also apply.

The Regulations clarify that unless otherwise approved by SEBI, securities shall be registered in the name of the Foreign Institutional Investor, provided the Foreign Institutional Investor is making investments on his own behalf; or in his name on account of his sub-account, or in the name of the sub-account, in case he is investing on behalf of the sub-account. However the names of the sub-accounts on whose behalf the Foreign Institutional Investor is investing are required to be disclosed to the Board by the Foreign Institutional Investor.

The purchase of equity shares of each company by a Foreign Institutional Investor investing on his own account should not exceed ten percent of the total issued capital of that company. In respect of a Foreign Institutional Investor investing in equity shares of a company on behalf of his sub-accounts, the investment on behalf of each such sub-account shall not exceed ten percent of the total issued capital of that company. However in case of foreign corporates or individuals, each of such sub-account shall not invest more than 5% of the total issued capital of the company in which such investment is made. The investment by the Foreign Institutional Investor is also subject to Government of India Guidelines. A Foreign Institutional Investor or sub-account may lend securities through an approved intermediary in accordance with stock lending scheme of the Board. The regulations provide that for the purpose of this regulation, the words security receipt, asset reconstruction, securitisation company and reconstruction company shall have the meanings respectively assigned to them under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

Conditions for issuance of offshore derivative instruments

A foreign institutional investor can not issue, or otherwise deal in offshore derivative instruments, directly or indirectly, unless the following conditions are satisfied:

- (a) such offshore derivative instruments are issued only to persons who are regulated by an appropriate foreign regulatory authority;
- (b) such offshore derivative instruments are issued after compliance with know your client' norms.

A foreign institutional investor shall ensure that no further issue or transfer is made of any offshore derivative instruments issued by or on behalf of it to any person other than a person regulated by an appropriate foreign regulatory authority. A sub-account can not, directly or indirectly, issue offshore derivative instruments:

Offshore derivative instrument means any instrument, by whatever name called, which is issued overseas by a foreign institutional investor against securities held by it that are listed or proposed to be listed on any recognised stock exchange.

–Person regulated by an appropriate foreign regulatory authority” means and includes the following, namely:

- (i) any person that is regulated/supervised and licensed/registered by a foreign central bank;
- (ii) any person that is registered and regulated by a securities or futures regulator in any foreign country or state;
- (iii) any broad based fund or portfolio incorporated or established outside India or proprietary fund of a registered foreign institutional investor or university fund, endowment, foundation, charitable trust or charitable society whose investments are managed by a person covered above.

General Obligations and Responsibilities

A Foreign Institutional Investor or a global custodian acting on behalf of the Foreign Institutional Investor, should enter into an agreement with a domestic custodian to act as custodian of securities for the Foreign Institutional Investor. The Foreign Institutional Investor should ensure that the domestic custodian takes steps for:

- (a) monitoring of investments of the Foreign Institutional Investor in India;
- (b) reporting to SEBI on a daily basis the transactions entered into by the Foreign Institutional Investor;
- (c) preservation for five years of records relating to his activities as a Foreign Institutional Investor; and
- (d) furnishing such information to SEBI as may be called for by SEBI with regard to the activities of the Foreign Institutional Investor and as may be relevant for the purpose of this regulation.

A Foreign Institutional Investor may appoint more than one domestic custodian with prior approval of SEBI, but only one custodian may be appointed for a single sub-account of a Foreign Institutional Investor. A Foreign Institutional Investor should appoint a branch of a bank approved by the Reserve Bank of India for opening of foreign currency denominated accounts and special non-resident rupee accounts. A Foreign Institutional Investor or any of his employees should not render directly or indirectly any investment advice about any security in the publicly accessible media, whether real-time or non real-time, unless a disclosure of his interest including long or short position in the said security has been made, while rendering such advice. In case, an employee of the Foreign Institutional Investor is rendering such advice, he should also disclose the interest of his dependent family members and the employer including their long or short position in the said security, while rendering such advice.

Maintenance of proper books of accounts, records, etc.

Every Foreign Institutional Investor should keep or maintain the following books of accounts, records and documents:

- (a) true and fair accounts relating to remittance of initial corpus for buying, selling and realising capital gains of investment made from the corpus;
- (b) accounts of remittances to India for investments in India and realising capital gains on investments made from such remittances;
- (c) bank statement of accounts;
- (d) contract notes relating to purchase and sale of securities; and
- (e) communication from and to the domestic custodian regarding investments in securities.

The Foreign Institutional Investor should intimate to SEBI in writing the place where such books, records and documents will be kept or maintained. Every Foreign Institutional Investor should preserve the books of accounts, records and documents as specified for a minimum period of five years.

Appointment of Compliance Officer

Every Foreign Institutional Investor should appoint a compliance officer who is responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by SEBI or the Central Government. The compliance officer should immediately and independently report to SEBI any non-compliance observed by him.

Information to SEBI

Every Foreign Institutional Investor as and when required by SEBI or the Reserve Bank of India, would submit any information, record or documents in relation to his activities.

Foreign Institutional Investors are required to fully disclose information concerning the terms of and parties to off-shore derivative instruments such as Participatory Notes, Equity Linked Notes or any other such instruments, by whatever names they are called, entered into by it or its sub-accounts or affiliates relating to any securities listed or proposed to be listed in any stock exchange in India, as and when and in such form as SEBI may require.

Procedure for action in case of default

A Foreign Institutional Investor who contravenes any of the provisions of the Act, rules or regulations framed thereunder shall be liable for one or more actions specified therein including the action under Chapter V of the SEBI (Intermediaries) Regulations, 2008

Code of Conduct

A Foreign Institutional Investor and its key personnel should observe high

standards of integrity, fairness and professionalism in all dealings in the Indian securities market with intermediaries, regulatory and other government authorities. A Foreign Institutional Investor is required at all times to render high standards of service, exercise due diligence and independent professional judgement. A Foreign Institutional Investor should ensure and maintain confidentiality in respect of trades done on its own behalf and/or on behalf of its sub-accounts/clients. A Foreign Institutional Investor is required to ensure clear segregation of its own money/securities and sub-accounts' money/securities and arms length relationship between its business of fund management/ investment and its other business. A Foreign Institutional Investor has to maintain an appropriate level of knowledge and competency and abide by the provisions of the Act, regulations made there under and the circulars and guidelines, which may be applicable and relevant to the activities carried on by it. Every Foreign Institutional Investor has to comply with award of the Ombudsman and decision of the Board under SEBI (Ombudsman) Regulations. A Foreign Institutional Investor should not make any untrue statement or suppress any material fact in any documents, reports or information furnished to the Board. A Foreign Institutional Investor is required to ensure good corporate policies and corporate governance. A Foreign Institutional Investor should ensure that it does not engage in fraudulent and manipulative transactions in the securities listed in any stock exchange in India. A Foreign Institutional Investor should not, either through its/his own account or through any associate or family members, relatives or friends indulge in any insider trading. A Foreign Institutional Investor shall not be a party to or instrumental for creation of false market in securities listed or proposed to be listed in any stock exchange in India, price rigging or manipulation of prices of securities listed or proposed to be listed in any stock exchange in India and for passing of price sensitive information to any person or intermediary in the securities market.

III. SEBI (SELF REGULATORY ORGANISATIONS) REGULATIONS, 2004

The Securities and Exchange Board of India (Self Regulatory Organizations) Regulations, 2004 came into effect on 19th February, 2004. According to Regulation 2(1)(k) "Self Regulatory Organization" means an organization of intermediaries which is representing a particular segment of the securities market and which is duly recognised by SEBI under these regulations, but excludes a stock exchange.

- "*Agent*" means any person who is associated with securities market and who conducts the business of distribution of securities products [Regulation 2(1)(c)]
- "*Certificate*" means a certificate of recognition granted to a Self Regulatory Organization by SEBI under sub-regulation (1) of regulation 5 and includes a certificate renewed under regulation 9. [Regulation 2(1)(d)]
- "*Company*" means a company which has been granted license under section 25 of the Companies Act, 1956. [Regulation 2(1)(e)]
- "*Economic offence*" means an offence to which the Economic Offences (Inapplicability of Limitation) Act, 1974, is applicable for the time being and includes an offence under the Securities and Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956 and Depositories Act, 1996. [Regulation 2(1)(f)]

- *"Governing norms"* mean the governing norms of a Self Regulatory Organization made in accordance with sub-regulation (1) of regulation 15. [Regulation 2(1)(g)]
- *"Intermediary"* means any person who is registered with the Board under section 12 of the Act. [Regulation 2(1)(h)]
- *"Member"* means an intermediary who has been admitted as a member of a Self Regulatory Organization and includes an agent who has been so admitted. [Regulation 2(1)(i)]
- *"Office bearer"* in relation to a Self Regulatory Organization means its Chairman, Managing Director, any whole time director or Chief Executive Officer, by whatever name called, and includes any person named as such by the Self Regulatory Organization in its application for grant or renewal of recognition made under these regulations. [Regulation 2(1)(j)]

Recognition of Self Regulatory Organization

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.

Every application made by such company must contain such particulars as may be specified and is to be accompanied by a copy of the governing norms of Self Regulatory Organization and also a copy of the memorandum and articles of association relating in general to the constitution of the Self Regulatory Organization and in particular, to –

- (a) Board of Directors of Self Regulatory Organization, its constitution and powers of management and the manner in which its business would be transacted;
- (b) the powers and duties of the office bearers of Self Regulatory Organization;
- (c) the admission into the Self Regulatory Organization of members, agents, their qualifications for membership, and the exclusion, suspension, expulsion and readmission of members therefrom or there into;

The application is to be signed on behalf of the applicant under authority of its Board of Directors by its Chairman, Managing Director, Chief Executive Officer or whole time director. The application is to be made in Form A of the first schedule and is to be accompanied by a non-refundable application fee, as specified in Part A of the second schedule, to be paid in the manner specified in Part B thereof.

Eligibility criteria

Regulation 4 provides the following criteria to be fulfilled by an association seeking registration under these regulations:-

- (a) the applicant should have been granted license under section 25 of Companies Act, 1956;
- (b) the memorandum of association, should specify admission of members and

discharging the functions of Self Regulatory Organization as one of its main objects;

- (c) the applicant should have a minimum networth of one crore rupees;
- (d) the applicant is to have adequate infrastructure, to enable it to discharge its functions as a Self Regulatory Organization in accordance with the provisions of the Act and these regulations;
- (e) the directors have the professional competence, financial soundness and general reputation of fairness and integrity to the satisfaction of the Board;
- (f) neither the applicant, nor any director of the applicant is involved in any legal proceeding connected with the securities market, which may have an adverse impact on the interests of the investors;
- (g) neither the applicant, nor any director has at any time in the past been convicted of any offence involving moral turpitude or any economic offence;
- (h) the applicant has, in its employment, persons having adequate professional and other relevant experience to the satisfaction of the Board;
- (i) the applicant, in all other respects, is a fit and proper person for the grant of a certificate;
- (j) grant of certificate to the applicant is in the interest of investors and the securities market.

Grant of recognition as a Self Regulatory Organization

If SEBI is satisfied, after making such inquiry as may be necessary in this behalf and after obtaining such further information, if any, as it may require,—

- (a) that the articles and governing norms of the applicant applying for recognition are in conformity with such conditions as may be specified by SEBI;
- (b) that the applicant is willing to comply with any other conditions which the Board may impose for the purpose of carrying out the objects of these Regulations; and,
- (c) that it would be in the interest of the trade and also in the public interest to grant recognition to the applicant as a Self Regulatory Organization;

SEBI may grant certificate of recognition to the applicant as a Self Regulatory Organization in Form B1 of the First Schedule subject to such terms and conditions as it may deem fit and appropriate.

Regulation 5(2) empowers the Board to specify any conditions for the grant of recognition to the applicant as a Self Regulatory Organization. Such conditions may relate to—

- (i) the qualification for membership of the Self Regulatory Organization;
- (ii) the representation of the Board in the Board of Directors of the Self Regulatory Organization by such number of directors not exceeding four as the Board may nominate in this behalf; and
- (iii) the maintenance of accounts of members and their audit by chartered accountants whenever such audit is required by the Board.

The Self Regulatory Organization cannot amend its articles without the prior written approval of the Board.

Application to conform to the requirements

Regulation 6 provides that any application for a certificate, which is not complete in all respects or does not conform to the requirements of these regulations and particularly regulations 3, 4 and 5 or instructions specified in Form A shall be rejected by the Board. However, before rejecting any such application, the Board shall give an opportunity to the applicant to remove such objections as may be indicated by the Board, within 30 days of the date of receipt of relevant communication, from the Board. On sufficient cause being shown, the Board may extend the time for removal of objections by such further time, not exceeding 30 days as it may consider fit, to enable the applicant to remove such objections.

Furnishing of information, clarification and personal representation

SEBI may under Regulation 7 require the applicant to furnish such further information or clarification as it may consider necessary for the purpose of processing of the application. It may also require the applicant to appear before it through an authorized representative for personal representation in connection with the grant of a certificate of recognition.

Conditions of certificate and validity period

As provided under Regulation 8 the certificate granted under regulation 5 is valid for a period of five years, and subject to the following conditions, namely: -

- (a) the applicant shall comply with the provisions of the Act, applicable regulations and guidelines, directions or circulars issued by the Board from time to time;
- (b) any information or particulars furnished to the Board by the applicant shall not be false or misleading in any material respect;
- (c) where any material information or particulars furnished to the Board by the applicant, in or in connection with the application for recognition, has undergone change subsequent to its furnishing, the applicant shall forthwith inform the fact to the Board in writing.

Renewal of certificate

Regulation 9 provides that an application for renewal of Certificate of Recognition shall make an application to SEBI in Form A of the First Schedule. Such application shall be made not less than three months before expiry of the period of validity of the certificate. The application shall be accompanied by a renewal fee as specified in the second schedule and, as far as may be, shall be dealt with in the same manner as if it were an application for the grant of a fresh certificate under regulation 3.

SEBI, if satisfied may renew the certificate in Form B2 of the First Schedule subject to such terms and conditions as it may deem fit and appropriate.

Procedure where certificate is not granted

Regulation 10 provides that if, after considering an application SEBI is of the opinion that a certificate should not be granted or renewed, it may, after giving the

applicant a reasonable opportunity of being heard, reject the application within a period of thirty days of receipt of such application complete in all respects or within thirty days of receipt of further information or clarification sought. The fact of the rejection of the application shall be communicated to the applicant forthwith stating the grounds for such rejection.

Effect of refusal to grant certificate

Regulation 11 provides that an applicant whose application for the grant of a certificate has been rejected shall not undertake any activity as Self Regulatory Organization. Similarly, a Self Regulatory Organization whose application for the renewal of certificate has been rejected by SEBI shall on and from the date of the receipt of the communication of rejection from SEBI cease to carry on any activity as Self Regulatory Organization.

If SEBI is satisfied that it is in the interests of investors to do so, it may permit Self Regulatory Organization to complete the functions or obligations already initiated or undertaken by it during the pendency of the application or during the period of validity of the certificate. In order to protect the interests of investors, SEBI may issue directions with regard to the transfer of records, documents or reports relating to the functions of the Self Regulatory Organization, whose application for the grant or renewal of a certificate has been rejected. Further, SEBI may, appoint any person to take charge of the records, documents or reports relating to the organization and also determine the terms and conditions of such appointment.

Composition of Board of Directors

Regulation 12 of Chapter III of the Regulations provides that the Articles of Association of a Self Regulatory Organization shall provide for the following: -

- (a) There shall be a Board of Directors of the Self Regulatory Organization and majority of directors shall be independent directors.
- (b) The independent directors shall not be required to hold any qualification shares.
- (c) The Board of Directors shall consist of nine directors out of which five directors shall be nominated by the Board and the remaining four shall be elected by the members of the Self Regulatory Organization.
- (d) The General Superintendence, direction and management of the affairs of the Self Regulatory Organization shall vest in its Board of Directors, which may exercise all powers and do all acts and things which may be exercised or done by the Self Regulatory Organization.
- (e) There shall be a Chairman, who shall be an independent professional, appointed by Board of Directors, with the prior approval of the Board.
- (f) The Chairman shall be responsible for day-to-day administration of Self Regulatory Organization and implementing the decisions of Board of Directors.
- (g) The Board of Directors may establish committees including disciplinary committee, screening committee, arbitration committee or remuneration committee in order to carry out the purposes of these regulations. It has been

provided that the committees constituted under this regulation may consist wholly of other persons or partly of directors and partly of other persons. The majority of members of each such committee shall be independent.

- (h) The office bearers of Board of Directors shall relinquish their office, when the Board passes an order under clause (c) of sub-section (4) of section 11 of the Act.
- (i) The Board of Directors of the Self Regulatory Organization shall be reconstituted as and when required by the Board.

Membership of Self Regulatory Organization

As per Regulation 13 any application for registration or renewal of registration as an intermediary with the Board under the respective regulations applicable to such intermediaries, shall in case of any applicant who is a member of a Self Regulatory Organization or who ought to be a member of a Self Regulatory Organization, be made only through the Self Regulatory Organization of which he is a member, in the specified manner. The application is to be forwarded by the Self Regulatory Organization to the Board along with its recommendation for grant or refusal of certificate of registration not later than 30 days from the date of its receipt. The Self Regulatory Organization is also required to give the reasons for its recommendation either for granting certificate of recognition or for refusal of certificate of registration by the Board.

Functions and Obligations of Self Regulatory Organization

As per Regulation 14, a Self Regulatory Organization shall always abide by the directions of the Board. It shall be responsible for investor protection and education of investors or its members and shall ensure observance of Securities Laws by its members. It is required to specify standard of conduct for its members and also shall be responsible for the implementation of the same by its members. The SRO is required to conduct inspection and audit of its members, on regular basis, through independent auditors. The Annual Report of the SRO is to be submitted to SEBI. The SRO shall treat all its members and the applications for membership in a fair and transparent manner. The SRO may collect admission and membership fees from its members for carrying out the purposes of these regulations. SEBI is to be promptly informed of violations of the provisions of the Act, the rules, the regulations, the directions, the circulars or the guidelines by any of its members. The SRO is required to conduct screening and certification tests for its members, agents and such other persons as it may determine. The SRO is to conduct training programmes for its members or agents and also conduct awareness programmes for securities market investors. The SRO is required to make endeavors for introduction of best business practices amongst its members. It must act in utmost good faith and must avoid conflict of interest in the conduct of its functions. The SRO must comply with the norms of corporate governance as applicable to listed companies. It may discharge such other functions and obligations as may be specified by SEBI, from time to time.

Governing norms of Self Regulatory Organization

Regulation 15 provides that a Self Regulatory Organization may, subject to the previous approval of SEBI, make governing norms and articles consistent with the provisions of the Act and these regulations. In particular, and without prejudice to the

generality of the foregoing power, the governing norms or articles may provide for:

- (i) eligibility criteria for admission and removal of members from Self Regulatory Organization;
- (ii) manner and the periodicity of furnishing information to the Board and to its members;
- (iii) arbitration mechanism for resolving disputes between members and / or between members and their constituents;
- (iv) procedure for proceeding against the member committing breach of the governing norms or articles including provisions for suspension or expulsion of members from the Self Regulatory Organization;
- (v) internal control standards including procedure for inspection, auditing, reviewing, monitoring and surveillance of its members by Self Regulatory Organization;
- (vi) code of conduct specifying standards for its members in the conduct of business;
- (vii) procedure for conduct of election of the office bearers and members of the committees;
- (viii) obligation of members to supply such information or explanation and to produce such documents relating to the business as Board of Directors may require;
- (ix) manner of disciplinary action against its members by Self Regulatory Organization;
- (x) contents and format of the annual report;
- (xi) procedure for conduct of the meetings, quorum etc. of Board of Directors;
- (xii) manner of maintaining accounts or records of the Self Regulatory Organization; and,
- (xiii) reporting requirements to SEBI on monthly basis about various aspects of its functioning including policy initiatives, progress in certification, number of members admitted and disciplinary action taken against members, if any.

The governing norms or articles must provide that the contravention of any of the governing norms shall render the member of Self Regulatory Organization concerned liable to one or more of the following punishments, namely:-

- (i) forfeiture of shares;
- (ii) expulsion from membership;
- (iii) suspension from membership for a specified period;
- (iv) any other penalty of a like nature not involving the payment of money.

If SEBI considers it expedient so to do, it may, by order in writing, direct a Self Regulatory Organization to make any governing norms or to amend or revoke any of them within such period as it may specify in this behalf. If a Self Regulatory Organization fails or neglects to comply with such order within the specified period,

SEBI can make, amend or revoke the governing norms either in the form specified in the order or with such modifications as it may think fit.

SEBI's right to inspect

Regulation 16 of Chapter IV provides that where it appears to SEBI so to do, it may appoint one or more persons as inspecting authority to undertake inspection of the books of accounts, other records and documents of the Self Regulatory Organization for any of the following purposes:

- (a) to ensure that the provisions of the Act, the regulations, the directions and the circulars issued by SEBI are being complied with;
- (b) to inquire into the complaints received from members, investors, or any other person on any matter having a bearing on the activities of the Self Regulatory Organization; or,
- (c) to inquire *suo motu*, in the interest of securities business or investors' interest, into the affairs of the Self Regulatory Organization.

Procedure for inspection

Regulation 17 provides that before undertaking any inspection under regulation 16, SEBI shall give a reasonable notice to the Self Regulatory Organization for that purpose. Where SEBI is satisfied that in the interest of the investors or in public interest, no such notice should be given, it may by an order in writing, direct that the inspection of the affairs of the Self Regulatory Organization be taken up without such notice. The inspecting authority shall undertake the inspection and the Self Regulatory Organization against whom an inspection is being carried out and shall be bound to discharge its obligations as provided under these regulations.

Obligations of Self Regulatory Organization on inspection by SEBI

As provided under Regulation 18, it shall be the duty of the Chairman, every Director, officer and employee of the Self Regulatory Organization, who is being inspected to produce to the inspecting authority or to any person authorized by him, such books, accounts and other documents in their custody or control and furnish to the Board the statements and information relating to the activities of Self Regulatory Organization in securities market within such time as the Board may require. The SRO shall allow the inspecting authority or any person authorized by him to have reasonable access to the premises occupied by the SRO or by any other person on its behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the SRO or any other person and also provide copies of documents or other materials which, in the opinion of the inspecting authority are relevant.

The inspecting authority in the course of inspection shall be entitled to examine or record statements of the Chairman, Director, any member and employee of the Self Regulatory Organization. It is the duty of the Chairman, every Director, officer and employee of the SRO to give to the inspecting authority all assistance in connection with the inspection, which the SRO may reasonably be expected to give.

Submission of report to SEBI

Regulation 19 provides that the inspecting authority shall, as soon as possible, submit an inspection report to SEBI.

Appointment of auditor

Under Regulation 20 SEBI can appoint a qualified auditor to inspect the books of account or the affairs of the Self Regulatory Organization. The auditor so appointed shall have the same powers of the inspecting authority and the obligations of Self Regulatory Organization shall be applicable to an inspection under this regulation. SEBI is entitled to recover the expenses of such audit or inspection as may be incurred by it, including fees paid to the auditors, from the concerned Self Regulatory Organization.

Periodical returns or direct inquiries

Regulation 21 provides that every Self Regulatory Organization is required to furnish to SEBI such periodical returns relating to its affairs as may be specified. The SRO and every member thereof shall maintain and preserve for such periods such books of account and other documents as the Board after consultation with Board of Directors of SRO concerned, may specify in the interests of the trade or in the public interest and such books of account and other documents shall be subject to inspection at all reasonable times by SEBI. If SEBI is satisfied that it is in the interests of the trade or in the public interest so to do, it may, by order, in writing,—

- (a) call upon Board of Directors of a Self Regulatory Organization or any member thereof to furnish in writing such information or explanation relating to the affairs of the Self Regulatory Organization or of the member in relation to the Self Regulatory Organization as SEBI may require; or
- (b) appoint one or more persons to make an inquiry in the prescribed manner in relation to the affairs of a Self Regulatory Organization or the affairs of any members of the Self Regulatory Organization in relation to the Self Regulatory Organization and submit a report of the result of such inquiry to SEBI within such time as may be specified in the order or, in the case of inquiry in relation to the affairs of any of the members of a Self Regulatory Organization direct Board of Directors to make the inquiry and submit its report to SEBI.

Where an inquiry in relation to the affairs of a Self Regulatory Organization or the affairs of any of its members in relation to the SRO has been undertaken the Chairman, every director, manager, secretary, or other officer, every member of the Self Regulatory Organization (if the member of the Self Regulatory Organization is a firm, every partner, manager, secretary or other officer of the firm) and, every other person or body of persons who has had dealings in the course of business with any of the members or officers of the SRO whether directly or indirectly; shall be bound to produce before the authority making the inquiry all such books of account, and other documents in his custody or power relating to or having a bearing on the subject matter of such inquiry and also furnish to the authority such statement or information as he may require within such time as may be specified by him.

Obligation of Board of Directors to take disciplinary action against a member if so directed by SEBI

Regulation 22 of Chapter V provides that after receiving the report of an enquiry made under regulation 21, SEBI may take such action as it deems proper and, in particular, may direct Board of Directors of the Self Regulatory Organization to take such disciplinary action against the delinquent member, including expulsion, suspension or any other penalty of a like nature not involving the levy of monetary penalty, as may be specified by it and thereupon, notwithstanding anything to the contrary contained in the articles or governing norms of the Self Regulatory Organization concerned, the Board of Directors of the Self Regulatory Organization shall give effect to the directions of SEBI and shall not in any manner commute, revoke or modify the action taken in pursuance of such directions, without the prior written approval of SEBI.

SEBI may either on its own motion or on representation of the member concerned, modify or withdraw any of its directions issued under sub-regulation (1), if it is satisfied that there are sufficient grounds for doing so.

Withdrawal of recognition

Regulation 23 provides that if SEBI is of the opinion that the recognition granted to a Self Regulatory Organization under the provisions of these Regulations should, in the interest of the trade or in the public interest, be withdrawn, it may serve a written notice in Form "C" on Board of Directors of the Self Regulatory Organization calling upon it to show cause as to why the recognition should not be withdrawn for the reasons stated in the notice. Where such notice is issued, SEBI may, after giving an opportunity to Board of Directors of the Self Regulatory Organization to be heard in the matter, withdraw, by passing an order, the recognition granted to the Self Regulatory Organization and thereupon the provisions of regulation 11 would apply as if the application of the Self Regulatory Organization for renewal of recognition has been rejected.

SEBI shall promptly communicate such order to the concerned Self Regulatory Organization. On receipt of the order, the Self Regulatory Organization shall cease to carry on any activity as a Self Regulatory Organization and shall comply with such directions as may be issued by SEBI.

Action in case of violation

It has been provided under Regulation 24 that if any Self Regulatory Organization, any office bearer or member thereof violates any provisions of the Act or these regulations, it may be liable for –

- (a) action under Chapter VIA of the Act;
- (b) action under subsection (3) of section 12 of the Act;
- (c) action under subsection (4) of section 11 and section 11B of the Act;
- (d) action under section 24 of the Act;
- (e) such other action permissible under the Act which may be deemed appropriate in the facts and circumstances of the case.

IV. 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. Necessary Notifications / Rules under the said Act have been published in the Gazette of India on 1st July 2005 by the Department of Revenue, Ministry of Finance, Government of India. SEBI has laid down obligations of securities market intermediaries under PMLA, 2002 and rules framed thereunder.

As per the provisions of the Act, every banking company, financial institution (which includes chit fund company, a co-operative bank, a housing finance institution and a non-banking financial company) and intermediary (which includes a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and any other intermediary associated with securities market and registered under section 12 of the Securities and Exchange Board of India Act, 1992) 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 10 lakhs 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.

It may, however, be clarified that for the purpose of suspicious transactions, reporting apart from transactions integrally connected, transactions remotely connected or related should also be considered.

SEBI has laid down the minimum requirements / disclosures to be made in respect of clients. The intermediaries are required to specify additional disclosures to be made by clients to address concerns of Money Laundering and suspicious transactions undertaken by clients, according to their requirements.

All intermediaries are advised to ensure that a proper policy framework as per the Guidelines on anti-money laundering measures is put into place within one month from the date of the circular. The intermediaries are also required to designate an officer as Principal Officer who would be responsible for ensuring compliance of the provisions of the PMLA. .

Obligations of Intermediaries under Prevention of Money Laundering Act, 2002

Section 12 of the Prevention of Money Laundering Act, 2002 lays down following obligations on an intermediary:

Every banking company, financial institution and intermediary shall—

- (A) maintain a record of all transactions, the nature and value of which may be prescribed, whether such transactions comprise of a single transaction or a

series of transactions integrally connected to each other, and where such series of transactions take place within a month;

- (B) furnish information of transactions referred to in clause (a) to the Director within such time as may be prescribed;
- (C) verify and maintain the records of the identity of all its clients, in such a manner as may be prescribed.

Provided that where the principal officer of an Intermediary or financial institution or intermediary, as the case may be has reason to believe that a single transaction or series of transactions integrally connected to each other have been valued below the prescribed limit so as to defeat the provisions of this section, such officer shall furnish information in respect of such transactions to the Director within the prescribed time.

The records shall be maintained for a period of ten years from the date of cessation of the transactions between the clients of the banking company or financial institution or intermediary, as the case may be.

Cash Transaction Report

The Prevention of Money Laundering Act, 2002 and the Rules thereunder require every intermediary to furnish details of the following cash transactions:

- (A) All cash transactions of the value of more than rupees ten lakhs or its equivalent in foreign currency.
- (B) All series of cash transactions integrally connected to each other which have been valued below rupees ten lakhs or its equivalent in foreign currency where such series of transactions have taken place within a month.

Cash Transaction Reports can be filed either in manual or electronic format. However, a reporting agency must submit all reports to FIU-IND in electronic format if it has the technical capability to do so. The required technical capability is defined as follows:

- (i) A personal computer with 32 MB memory RAM, 800 x 600 VGA video display, Windows® 98/Me/NT/2000/XP; and
- (ii) An Internet connection.

It must be noted that every intermediary has to ensure reporting by all its branches/franchisees either in manual or electronic format. Thus, an Intermediary has to adopt only one format for all its branches/franchisees.

Suspicious Transaction Report



The Prevention of Money Laundering Act, 2002 and the Rules notified thereunder require every intermediary to furnish details of suspicious transactions whether or not made in cash. Suspicious transaction means a transaction whether or not made in cash which, to a person acting in good faith –

- (a) gives rise to a reasonable ground of suspicion that it may involve the proceeds of crime; or

- (b) appears to be made in circumstances of unusual or unjustified complexity; or
- (c) appears to have no economic rationale or bonafide purpose.

Broad categories of reason for suspicion and examples of suspicious transactions for an intermediary are indicated as under:

Identity of Client

- False identification documents
- Identification documents which could not be verified within reasonable time
- Non-face to face client
- Doubt over the real beneficiary of the account
- Accounts opened with names very close to other established business entities

Suspicious Background

- Suspicious background or links with known criminals

Multiple Accounts

- Large number of accounts having a common account holder, introducer or authorized signatory with no rationale
- Unexplained transfers between multiple accounts with no rationale

Activity in Accounts

- Unusual activity compared to past transactions
- Use of different accounts by client alternatively
- Sudden activity in dormant accounts
- Activity inconsistent with what would be expected from declared business
- Account used for circular trading

Nature of Transactions

- Unusual or unjustified complexity
- No economic rationale or bonafide purpose
- Source of funds are doubtful
- Appears to be case of insider trading
- Investment proceeds transferred to a third party
- Transactions reflect likely market manipulations
- Suspicious off market transactions

Value of Transactions

- Value just under the reporting threshold amount in an apparent attempt to avoid reporting
- Large sums being transferred from overseas for making payments

- Inconsistent with the clients apparent financial standing
- Inconsistency in the payment pattern by client
- Block deal which is not at market price or prices appear to be artificially inflated/deflated

Suspicious Transaction Reports can be filed either in manual or electronic format. However, a reporting agency must submit all reports to FIU-IND in electronic format if it has the technical capability to do so. The required technical capability is defined as follows:

- (iii) A personal computer with 32 MB memory RAM, 800 x 600 VGA video display, Windows® 98/Me/NT/2000; and
- (iv) An Internet connection.

SEBI vide its Circular No. ISD/CIR/RR/AML/1/06 dated January 18, 2006 requires every intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992) to maintain a record of all the transactions; the nature and value of which has been prescribed in the Rules notified under the Prevention of Money Laundering Act. 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. 10 lakhs 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.

Further, all intermediaries are advised to ensure that a proper policy framework as per the Guidelines on anti-money laundering measures is put into place within one month from the date of the circular. The intermediaries are also advised to designate an officer as 'Principal Officer' who would be responsible for ensuring compliance of the provisions of the PMLA. Names, designation and addresses (including e-mail addresses) of 'Principal Officer' shall also be intimated to the Office of the Director-FIU, 6th Floor, Hotel Samrat, Chanakypuri, New Delhi-110021, India on an immediate basis.

Each registered intermediary should adopt written procedures to implement the anti money laundering provisions as envisaged under the Anti Money Laundering Act, 2002. Such procedures should include *inter alia*, the following three specific parameters which are related to the overall 'Client Due Diligence Process':

- (a) Policy for acceptance of clients
- (b) Procedure for identifying the clients
- (c) Transaction monitoring and reporting especially Suspicious Transactions Reporting (STR)

Client identification procedure

The 'Know your Client' (KYC) policy should clearly spell out the client identification procedure to be carried out at different stages i.e. while establishing the

intermediary – client relationship, while carrying out transactions for the client or when the intermediary has doubts regarding the veracity or the adequacy of previously obtained client identification data. SEBI has prescribed the minimum requirements relating to KYC for certain class of the registered intermediaries from time to time. Taking into account the basic principles enshrined in the KYC norms which have already been prescribed or which may be prescribed by SEBI from time to time, all registered intermediaries should frame their own internal guidelines based on their experience in dealing with their clients and legal requirements as per the established practices. Further, the intermediary should also maintain continuous familiarity and follow-up where it notices inconsistencies in the information provided. The underlying principle should be to follow the principles enshrined in the PML Act, 2002 as well as the SEBI Act, 1992 so that the intermediary is aware of the clients on whose behalf it is dealing.

Information to be maintained

Intermediaries are required to maintain and preserve the following information in respect of transactions mentioned above.

- (i) the nature of the transactions;
- (ii) the amount of the transaction and the currency in which it was denominated;
- (iii) the date on which the transaction was conducted; and
- (iv) the parties to the transaction.

Maintenance and Preservation of records

Intermediaries are required to take appropriate steps to evolve an internal mechanism for proper maintenance and preservation of such records and information in a manner that allows easy and quick retrieval of data as and when requested by the competent authorities. Further, the records have to be maintained and preserved for a period of ten years from the date of cessation of the transactions between the client and intermediary.

Intermediaries are required to formulate and implement the client identification program containing the requirements as laid down in Rule 9 and such other additional requirements that it considers appropriate. The records of the identity of clients have to be maintained and preserved for a period of ten years from the date of cessation of the transactions between the client and intermediary.

Reporting to Financial Intelligence Unit-India

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) at the following address:

Director, FIU-IND,
Financial Intelligence Unit-India,
6th Floor, Hotel Samrat,
Chanakyapuri,
New Delhi-110021.
Website: <http://fiuindia.gov.in>

The Intermediaries are required to adhere to the following:

- (a) The cash transaction report (CTR) (wherever applicable) for each month should be submitted to FIU-IND by 15th of the succeeding month.
- (b) The Suspicious Transaction Report (STR) should be submitted within 7 days of arriving at a conclusion that any transaction, whether cash or non-cash, or a series of transactions integrally connected are of suspicious nature. The Principal Officer should record his reasons for treating any transaction or a series of transactions as suspicious. It should be ensured that there is no undue delay in arriving at such a conclusion.
- (c) The Principal Officer is responsible for timely submission of CTR and STR to FIU-IND;
- (d) Utmost confidentiality is to be maintained in filing of CTR and STR to FIU-IND. The reports may be transmitted by speed/registered post/fax at the notified address.

The Trading Member should not put any restrictions on operations in the accounts where an STR has been made. Further, it should be ensured that there is no tipping off to the client at any level.

It is clarified that the registered intermediaries, irrespective of the amount of transaction and/or the threshold limit envisaged for predicate offences specified in Part B of Schedule of PMLA, 2002, should file STR if they have reasonable grounds to believe that the transactions involve proceeds of crime.

V. SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008

SEBI in exercise of the powers conferred by section 30 of the Securities and Exchange Board of India Act, 1992 issued the SEBI (Intermediaries) Regulations, 2008.

REGISTRATION OF INTERMEDIARIES

Application for grant of certificate.

(1) Regulation 3 provides that an application for grant of a certificate to act as an intermediary, shall be made to the SEBI in Form A of Schedule I with such additional information as required and the application fee, as specified.

However, the applicant seeking registration to act as a stock broker or sub-broker or a trading member or a clearing member or a depository participant shall make the application along with such additional information through the stock exchange or through the clearing corporation of which the applicant is a member or trading member or through the depository in which the applicant proposes to act as a participant, as the case may be.

(2) The stock exchange, the clearing corporation, the depository or the specified self regulatory organization, as the case may be, shall examine the eligibility of the applicant in terms of these regulations, relevant regulations and the rules, regulations or bye-laws of the concerned stock exchange, clearing corporation, depository or the self regulatory organization and forward the application with the application fees to

SEBI along with its recommendation as early as possible but not later than thirty days of receipt of the complete application with the specified application fees.

(3) An intermediary, who was granted a certificate under the relevant regulations prior to the commencement of these regulations in relation to such intermediary, may continue to act as such, subject to the following –

- (a) where the certificate was granted for a specified period, an application for grant of certificate under sub-regulation (1) shall be made by the intermediary at least three months prior to the expiry of such period or three months prior to expiry of two years from the commencement of these regulations in relation to such intermediary, whichever is earlier and if the intermediary fails to do so, it shall cease to act as an intermediary on and from the expiry of the aforementioned period;
- (b) where a certificate has been granted to an intermediary on a permanent basis, the certificate may continue to be valid under these regulations subject to the condition that the intermediary shall, within two years of commencement of these regulations in relation to such intermediary, furnish the information in Form A to SEBI and upload the information in Part I thereof on the website specified by SEBI:

However, the time may be extended by SEBI up to a period of six months on sufficient reasons being shown by the intermediary.

(5) An intermediary who has complied with the provisions of these regulations shall be deemed to have been granted certificate under these regulations, subject to the payment of fees specified under the relevant regulations.

(6) An applicant or an intermediary as the case may be may carry on the activities of one or more intermediaries only if it obtains a separate certificate to carry on each such activity.

Disclosure of information

Regulation 4 stipulates that the information contained in Part I of Form A shall be disclosed to the public by uploading such information on the website as specified by SEBI.

However, the other relevant information furnished by the intermediary in Part II of Form A which relates to commercial confidence and private information of the intermediary, may be treated as confidential by SEBI.

Any material change in the information furnished or uploaded under these regulations shall be updated by the intermediary promptly but not later than fifteen days of the occurrence of such change.

Furnishing of information and clarification

Regulation 5 lays down that the Board may require the applicant to furnish further information or clarifications, regarding matters relevant to the activity of such an intermediary and the applicant shall furnish such information and clarification to the satisfaction of SEBI, within the time specified.

Verification of information

Regulation 6 deals with the verification part. While considering the application, SEBI may, if it so desires, verify the information by physical verification of documents, office space, and inspect the availability of office space, infrastructure, and technological support which the applicant is required to have. For the purpose under sub-regulation (1), SEBI may appoint any person including an auditor.

Consideration of application

As per regulation 7 while considering an applicant, SEBI shall take into account all matters which it deems relevant to the activities in the securities market, including but not limited to the following—

- (a) whether the applicant or any of its associates have in the past been refused certificate by SEBI and if so, the ground for such refusal;
- (b) whether the applicant, its directors or partners, or trustees, as the case may be or its principal officer is involved in any pending litigation connected with the securities market which has an adverse bearing on the business of the applicant or on development or functioning of the securities markets;
- (c) whether the applicant satisfies the eligibility criteria and other requirements;
- (d) whether the grant of a certificate to the applicant is in the interest of the investors and the development of the securities market.

Any application for grant of certificate:

- (a) which is not complete in all respects and does not conform to the requirements in Form A and the requirements specified in the relevant regulation;
- (b) which does not contain such additional information as required;
- (c) which is incorrect, false or misleading in nature;
- (d) where the applicant is not in compliance with the eligibility requirements;
- (e) where the applicant is not a 'fit and proper person' as stated in Schedule II;
- (f) where the principal officer does not have the requisite qualification or experience as required under the relevant regulations;

shall be rejected by SEBI for reasons to be recorded by SEBI in writing. Before rejecting an application, the applicant shall be given an opportunity in writing to make good the deficiencies within the time specified by SEBI, for the purpose. Where an application is rejected for the reason that it contains false or misleading information, no such opportunity may be given and the applicant shall not make any application for grant of certificate under these regulations or any other regulations for a period of one year from the date of such rejection.

Procedure for grant of certificate

Regulation 8 stipulates that SEBI on being satisfied that the applicant is eligible, shall grant a certificate in the form specified in the relevant regulations and send an intimation to the applicant in this regard:

Provided that where a pending proceeding before SEBI or any court or tribunal

may result in the suspension or cancellation of the certificate, SEBI may give a conditional registration.

When an intermediary, who has been granted a certificate and who has filed Form A under these regulations, wishes to commence a new activity which requires a separate certificate under the relevant regulations, it shall, while seeking such certificate, not be required to file Form A, and shall furnish to SEBI only such additional information as is required under the relevant regulations.

Conditions of certificate

Regulation 9 provides that any certificate granted by SEBI to an intermediary shall be subject to the following conditions, namely:—

- (a) where the intermediary proposes to change its status or constitution, it shall obtain prior approval of SEBI for continuing to act as an intermediary after such change in status or constitution. A request in this regard shall be disposed off by SEBI within a period of sixty days from the date of receipt of such request and where the decision of SEBI has not been communicated to the intermediary within the said period of sixty days, the prior approval shall be deemed to have been granted and it shall contain the information in Form A;
- (b) it shall pay the applicable fees in accordance with the relevant regulations;
- (c) it shall abide by the provisions of the securities laws and the directions, guidelines and circulars as may be issued thereunder;
- (d) it shall continuously comply with the requirements of disclosure norms;
- (e) it shall meet the eligibility criteria and other requirements specified.

However, SEBI may impose other conditions as it may deem fit.

Effect of refusal to grant certificate or expiry of certificate

Regulation 10 provides that where an intermediary has failed to make an application or where an existing intermediary has been refused grant of certificate under these regulations, the intermediary shall:

- (a) forthwith cease to act as such intermediary;
- (b) transfer its activities to another intermediary which has been granted a certificate for carrying on such activity and allow its clients or investors to withdraw or transfer their securities or funds held in its custody without any additional cost to such client or investor;
- (c) make provisions as regards liability incurred or assumed by the intermediary;
- (d) take such other action, within the time period and in the manner, as may be required.

While refusing grant of certificate under these regulations to an intermediary, SEBI may impose such conditions upon the intermediary as it deems fit for protection of investors or clients of the intermediary or the securities market and such conditions shall be complied with.

Period of validity of certificate

The certificate granted to an intermediary shall be permanent unless surrendered by the intermediary or suspended or cancelled in accordance with these regulations.

General obligations

Regulation 12 lays down the general obligation of the intermediary. An intermediary shall provide SEBI with a certificate of its compliance officer on the 1st April of each year certifying; the compliance by the intermediary on a continuous basis under these regulations and the relevant regulations; disclosures made in Form A true and complete. Each intermediary shall prominently display a photocopy of the certificate at all its offices including branch offices and also the name and contact details of the compliance officer to whom complaint may be made in the event of any investor grievance.

Redressal of investor grievances

Regulation 13 provides that the intermediary shall make endeavours to redress investor grievances promptly but not later than forty-five days of receipt thereof and when called upon by SEBI to do so it shall redress the grievances of investors within the time specified by SEBI.

The intermediary shall at the end of each quarter of a Financial Year ending on 31st March upload information about the number of investor grievances received, redressed and those remaining unresolved beyond three months of the receipt thereof by the intermediary on the website specified by SEBI.

Appointment of compliance officer

Regulation 14 of these regulations provides that an intermediary shall appoint a compliance officer for monitoring the compliance by it of the requirements where applicable. The intermediary may not appoint compliance officer if it is not carrying on the activity of the intermediary.

The compliance officer shall report to the intermediary or its board of directors, in writing, of any material non-compliance by the intermediary.

Investment advice

Regulation 15 provides that an intermediary, its directors, officers, employees or key management personnel shall not render, directly or indirectly, any investment advice about any security in the publicly accessible media, whether real-time or non-real-time, unless a disclosure of its interest, direct or indirect, including its long or short position in the said security has been made, while rendering such advice and also discloses the interest of his dependent family members and that of the employer including employer's long or short position in the said security.

An intermediary shall not make a recommendation to any client or investor who may be expected to rely thereon to acquire, dispose of or retain any securities unless he has reasonable grounds to believe that the recommendation is suitable.

Code of conduct

Regulation 16 stipulates the code of conduct. An intermediary and its directors,

officers, employees and key management personnel shall continuously abide by the code of conduct specified in Schedule III.

Inspection of books, accounts and records

The intermediary shall maintain such books, accounts and records as specified in the relevant regulations. Regulation 17 provides that without prejudice to the provisions of section 11 and section 11C of the Act, SEBI may appoint one or more persons as inspecting authority to undertake the inspection of the books, accounts, records including telephone records and electronic records and documents of an intermediary for any purpose.

The purposes may include:

- (a) to ensure that the books of account, records including telephone records and electronic records and documents are being maintained in the manner required under the relevant regulations;
- (b) to ascertain whether adequate internal control systems, procedures and safeguards have been established and are being followed by the intermediary to fulfill its obligations under the relevant regulations;
- (c) to ascertain whether any circumstances exist which would render the intermediary unfit or ineligible;
- (d) to ascertain whether the provisions of the securities laws and the directions or circulars issued thereunder are being complied with;
- (e) to inquire into the complaints received from investors, clients, other market participants or any other person on any matter having a bearing on the activities of the intermediary;
- (f) to inquire *suo motu* into such matters as may be deemed fit in the interest of investors or the securities market.

Notice before inspection

Regulation 18 stipulates that before undertaking an inspection, the inspecting authority shall give a notice to the concerned intermediary. If the inspecting authority is satisfied that in the interest of the investors no such notice should be given, it may, for reasons to be recorded in writing, dispense with such notice.

Obligations of Intermediary on inspection

Regulation 19 provides that—

- (1) It shall be the duty of every director, proprietor, partner, trustee, officer, employee and any agent of an intermediary which is being inspected, to produce to the inspecting authority such books, accounts, records including telephone records and electronic records and documents in his custody or control and furnish to the inspecting authority with such statements and information relating to its activities within such time as the inspecting authority may require.
- (2) The intermediary shall allow the inspecting authority to have reasonable access to the premises occupied by such intermediary or by any other person on its behalf and also extend reasonable facility for examining such documents.

- (3) The inspecting authority shall, in the course of inspection, be entitled to examine or record statements of any principal officer, director, trustee, partner, proprietor or employee of such intermediary.
- (4) It shall be the duty of every director, proprietor, trustee, partner, officer and employee of such intermediary to give to the inspecting authority all assistance which the inspecting authority may reasonably require in connection with the inspection.

Appointment of auditor or valuer

Regulation 20 provides that SEBI may appoint a qualified auditor to inspect the books of account or the affairs of an intermediary. The auditor so appointed shall have the same powers of the inspecting authority.

Submission of report to SEBI

As per regulation 21 the inspecting authority shall submit an inspection report including interim reports to SEBI. On submission of the inspection report, SEBI may take such action thereon as it may deem fit and appropriate.

Cancellation or suspension of registration and other actions

Regulation 23 provides that where any person who has been granted a certificate of registration under the Act or regulations made thereunder –

- (a) fails to comply with any conditions subject to which a certificate of registration has been granted to him;
- (b) contravenes any of the provisions of the securities laws or directions, instructions or circulars issued thereunder.

SEBI may, without prejudice to any action under the securities laws or directions, instructions or circulars issued thereunder, by order take such action in the manner provided under these regulations.

Appointment of designated authority

Regulation 24 provides that where it appears to the designated member, that any person who has been granted certificate of registration under the Act, regulations made thereunder has committed any default of the nature specified in regulation 23, he may appoint an officer not below the rank of a Division Chief, as a designated authority.

However, the designated member may, at his discretion, appoint a bench of three officers, each of whom shall not be below the rank of a Division Chief and such bench shall be presided by the senior most amongst them and all the decisions or recommendations of such bench shall be by way of majority.

No officer who has conducted investigation or inspection in respect of the alleged violation shall be appointed as a designated authority.

Issuance of notice

As per regulation 25 the designated authority shall, if it finds reasonable grounds

to do so, issue a notice to the concerned person requiring him to show cause as to why the certificate of registration granted to it, should not be suspended or cancelled or why any other action provided herein should not be taken.

Every notice shall specify the contravention alleged to have been committed by the noticee copies of documents containing the findings arrived at in an investigation or inspection, if any, carried out.

The noticee shall be called upon to submit within a period to be specified in the notice, not exceeding twenty-one days from the date of service thereof, a written representation along with documentary evidence, if any, in support of the representation to the designated authority.

Reply by the noticee

Regulation 26 provides that the noticee shall submit to the designated authority its written representation within the period specified in the notice along with documentary evidence, if any, in support thereof. The designated authority may extend the time specified in the notice for sufficient grounds shown by the noticee and after recording reasons in writing.

Ex-parte proceedings

The noticee does not reply to the show cause notice, the designated authority may proceed with the matter ex-parte recording the reasons for doing so and make recommendation as the case may be on the basis of material facts available before it.

Action in case of default

Regulation 27 provides for the following in case of default—

- (i) suspension of certificate of registration for a specified period;
- (ii) cancellation of certificate of registration;
- (iii) prohibiting the noticee to take up any new assignment or contract or launch a new scheme for the period specified in the order;
- (iv) debarring a principal officer of the noticee from being employed or associated with any registered intermediary or other registered person for the period specified in the order;
- (v) debarring a branch or an office of the noticee from carrying out activities for the specified period;
- (vi) warning the noticee.

Procedure for action on receipt of the recommendation

Regulation 28 provides that on receipt of the report recommending the measures from the designated authority, the designated member shall consider the same and issue a show cause notice to the noticee enclosing a copy of the report submitted by the designated authority calling upon the noticee to submit its written representation as to why the action, including passing of appropriate direction, as the designated member considers appropriate, should not be taken.

The noticee may, within twenty one days of receipt of the notice send a reply to the designated member who may pass appropriate order after considering the reply,

if any received from the noticee and providing the person with an opportunity of being heard, as expeditiously as possible and endeavour shall be made to pass the order within one hundred and twenty days from the date of receipt of reply of the notice or hearing.

Intimation of the order

As per Regulation 29 and 30 deals with the order pass by the designated member. The designated member may pass a common order in respect of a number of notices where the subject matter in question is substantially the same or similar in nature. Every report made by a designated authority and every order passed by the designated member under this Chapter shall be dated and signed and sent to the noticee and also uploaded on the website of SEBI. If the noticee is a member of a stock exchange, clearing corporation, a depository or a self-regulatory organization, a copy of the order shall also be sent to the concerned stock exchange, clearing corporation, depository or self regulatory organization.

Surrender of any certificate of registration

Regulation 31 provides that any person, who has been granted a certificate of registration under the Act or the regulations made thereunder, desirous of giving up its activity and surrender the certificate, may make a request for such surrender to SEBI and while disposing such request, SEBI shall not be bound by the procedure specified in the foregoing provisions of this Chapter.

- (a) the arrangements made by the person for maintenance and preservation of records and other documents required to be maintained under the relevant regulations;
- (b) redressal of investor grievances;
- (c) transfer of records, funds or securities of its clients;
- (d) the arrangements made by it for ensuring continuity of service to the clients;
- (e) defaults or pending action, if any.

While accepting surrender, SEBI may impose such conditions as it deems fit.

Effect of debarment, suspension, cancellation or surrender

Regulation 32 provides that on and from the date of debarment or suspension of the certificate, the concerned person shall—

- (a) not undertake any new assignment or contract or launch any new scheme and during the period of such debarment or suspension;
- (b) allow its clients or investors to withdraw or transfer their securities or funds without any additional cost to such client or investor;
- (c) make provisions as regards liability incurred or assumed by it;
- (d) take such other action including the action relating to any records or documents and securities or money of the investors.

On and from the date of surrender or cancellation of the certificate, the concerned person shall—

- (a) return the certificate of registration so cancelled to SEBI and shall not

represent itself to be a holder of certificate for carrying out the activity for which such certificate had been granted;

- (b) cease to carry on any activity in respect of which the certificate had been granted;
- (c) transfer its activities to another person holding a valid certificate of registration to carry on such activity and allow its clients or investors to withdraw or transfer their securities or funds held in its custody or to withdraw any assignment given to it, without any additional cost to such client or investor;
- (d) make provisions as regards liability incurred or assumed by it;
- (e) take such other action including the action relating to any records or documents and securities or money of the investors.

Appeal to Securities Appellate Tribunal

Regulation 33 provides that the person aggrieved by an order under these regulations may prefer an appeal to the Securities Appellate Tribunal against such order in accordance with the provisions of section 15T of the Act and Rules prescribed in this regards.

Directions

As per regulation 35, SEBI can issue, necessary direction including but not limited to any or all of the following—

- (a) directing the intermediary or other persons associated with securities market to refund any money or securities collected from the investors under any scheme or otherwise, with or without interest;
- (b) directing the intermediary or other persons associated with securities market not to access the capital market or not to deal in securities for a particular period or not to associate with any intermediary or with any capital market related activity;
- (c) directing the recognised stock exchange concerned not to permit trading in the securities or units issued by a mutual fund or collective investment scheme;
- (d) directing the recognised stock exchange concerned to suspend trading in the securities or units issued by a mutual fund or collective investment scheme;
- (e) any other direction which SEBI may deem fit and proper.

Before issuing any directions SEBI shall give a reasonable opportunity of being heard to the persons concerned. Further that if the circumstances warrant any interim direction is required to be passed immediately, SEBI shall give a reasonable opportunity of hearing to the persons concerned after passing the direction, without any undue delay.

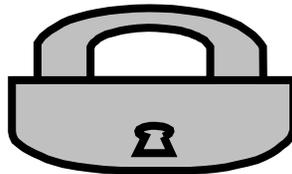
LESSON ROUND UP



- Capital market intermediaries are a vital link between the regulators, issuers and investor.
- The market intermediaries are involved in the primary market include Merchant Bankers/Lead Managers, Registrars and Transfer Agents, Underwriters, Bankers to issue, Debenture Trustees.
- 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 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.
- Underwriter means a person who engages in the business of underwriting of an issue of securities of a body corporate.
- 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 Trustee means a trustee of a trust deed for securing any issue of debentures of a body corporate.
- Stock brokers, sub-brokers, portfolio managers, custodians, share transfer agents constitute the important intermediaries in the Secondary market.
- 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.
- 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 a person.

- Every Portfolio manager is required to appoint a Practising Company Secretary or a Practising Chartered Accountant for conducting the internal audit.
- Custodian of securities means any person who carries on or proposes to carry on the business of providing custodial services.
- Foreign Institutional Investor means an institution established or incorporated outside India which proposes to make investment in India in securities.
- A listed company is required to appoint a compliance officer to directly liaise with SEBI in regard to implementation/ compliance of the various laws, rules and regulations and directives and for settlement of investors complaints. The name of the compliance officer should be intimated to SEBI and also mentioned in the offer document relating to the capital issue with details, telephone number, fax number and address of the said compliance officer.
- All intermediaries are required to appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications guidelines, instructions etc. issued by SEBI or Central Government and for redressal of investor grievances. Compliance officer is required to immediately and independently report to SEBI, any non-compliance observed by him .

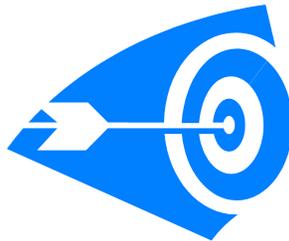
SELF TEST QUESTIONS



(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. 'Capital market' intermediaries is a vital link between SEBI and Investors. Comment.
2. Discuss the regulatory framework governing primary market intermediaries.
3. Explain general obligations and responsibilities of Merchant banker and due diligence certificate issued by the merchant banker.
4. Discuss the role and obligations of Portfolio Manager.
5. Discuss the pre-issue and post-issue work relating to public issue.
6. Explain the inspection and disciplinary proceedings which may be initiated by SEBI against underwriters.
7. Dwell upon the duties, obligations and responsibilities of Debenture Trustees under SEBI (Debenture Trustees) Regulations, 1993.
8. What are the actions which can be initiated against SEBI registered intermediaries?
9. Briefly discuss the procedure for holding enquiry by Enquiry Officer under SEBI (Intermediaries) Regulations, 2008.

STUDY VII
STOCK EXCHANGES



LEARNING OBJECTIVES

The study will enable the students to understand

- Provisions of Securities Contract (Regulation) Act, 1956
- Securities Contract (Regulation) Rules, 1957
- Listing of Securities and provisions of Listing Agreement
- Corporate Governance through Listing Agreement
- Demutualisation of Stock Exchange
- Securities Contracts (Regulation) Manner of Increasing and Maintaining Public Shareholding in Recognised Stock Exchange Regulations, 2006

INTRODUCTION

Stock exchanges constitute the primary institution of the secondary market.

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. The stock exchanges are virtually the nerve centre of the capital market and reflect the health of the country's economy as a whole.

I. SECURITIES CONTRACTS (REGULATION) ACT, 1956

The Securities Contracts (Regulation) Act, 1956 was enacted by Parliament to prevent undesirable transactions in securities by regulating the business of dealing therein, and by providing for certain other matters connected therewith. The Act extends to the whole of India and came into force on 28th February, 1957. The 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.

If the Central Government is satisfied that in the interest of trade and commerce or the economic development of the country, it is necessary or expedient so to do, it may, by notification in the Official Gazette, specify any class of contracts as contracts to which this Act or any provision contained therein shall not apply, and also the conditions, limitations or restrictions, if any, subject to which it shall not so apply.

Section 2 of this Act contains definitions of various terms used in the Act. Some of the important definitions are given below:

Securities include—

- (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or body corporate.
- (ii) derivative.
- (iii) units or any other instrument issued by any collective investment scheme to the Investors in such schemes.
- (iv) security receipt as defined in clause (zg) of Section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
- (v) units or any other such instrument issued to the investors under any mutual fund scheme.
- (vi) any certificate or instrument (by whatever name called) issued to an investor by any issuer being a special purpose distinct entity which possess any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be.
- (vii) government securities.
- (viii) such other instruments as may be declared by the Central Government to be securities and,
- (ix) rights or interests in securities.

Contract means a contract for or relating to the purchase or sale of securities.

Spot delivery contract means a contract which provides for—

- (a) actual delivery of securities and the payment of a price therefore either on the

same day as the date of the contract or on the next day, the actual period taken for the dispatch of the securities or the remittance of money therefore through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality;

- (b) transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository.

Stock Exchange means—

- (a) any body of individuals, whether incorporated or not, constituted before corporatisation and demutualisation under Sections 4A and 4B, or
- (b) a body corporate incorporated under the Companies Act, 1956 whether under a scheme of corporatisation or otherwise, for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

Recognised Stock Exchange means a stock exchange which is for the time being recognised by the Central Government. No person shall, except with the permission of the Central Government, organise or assist in organising or be a member of any stock exchange (other than a recognised stock exchange) for the purpose of assisting in, entering into or performing any contracts in securities.

Member means a member of a recognised stock exchange.

Government security means a security created and issued whether before or after the commencement of this Act, by the Central Government or a State Government for the purpose of raising a public loan and having one of the forms specified in Section 2(2) of the Public Debt Act, 1944.

A derivative includes—

- (a) a security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security and;
- (b) a contract which derives its value from the prices or index of prices of underlying securities.

Section 2A provides that words and expressions used in this Act but not defined in this Act shall have the same meanings and definitions as found in the Companies Act, 1956, SEBI Act, 1992 and the Depositories Act, 1996.

Recognised Stock Exchanges

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

Every application shall contain such particulars as may be prescribed, and shall be accompanied by a copy of the bye-laws of the stock exchange for the regulation and control of contracts and also a copy of the rules relating in general to the constitution of the stock exchange and in particular to—

- (a) the governing body of such stock exchange, its constitution and powers of management and the manner in which its business is to be transacted;

- (b) the powers and duties of the office bearers of the stock exchange;
- (c) the admission into the stock exchange of various classes of members, the qualifications, for membership, and the exclusion, suspension, expulsion and re-admission of members therefrom or there into;
- (d) the procedure for the registration of partnerships as members of the stock exchange in cases where the rules provide for such membership; and the nomination and appointment of authorised representatives and clerks.

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 in this behalf and after obtaining such further information, if any, as it may require;

- (a) that the rules and bye-laws of a stock exchange applying for registration are in conformity with such conditions as may be prescribed with a view to ensure fair dealing and to protect investors;
- (b) that the stock exchange is willing to comply with any other conditions (including conditions as to the number of members) which the Central Government, after consultation with the governing body of the stock exchange and having regard to the area served by the stock exchange and its standing and the nature of the securities dealt with by it, may impose for the purpose of carrying out the objects of this Act; and
- (c) that it would be in the interest of the trade and also in the public interest to grant recognition to the stock exchange;

it may grant recognition to the stock exchange subject to the conditions imposed upon it as aforesaid and in such form as may be prescribed.

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.

Every grant of recognition to a stock exchange under this section shall be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the stock exchange is situated, and such recognition shall have effect as from the date of its publication in the Gazette of India.

No application for the grant of recognition shall be refused except after giving an opportunity to the stock exchange concerned to be heard in the matter; and the reasons for such refusal shall be communicated to the stock exchange in writing.

Corporatisation and demutualisation of stock exchanges

Section 4A of the Act provides that on and from the appointed date, all recognised stock exchanges (if not corporatised and demutualised before the appointed date) shall be corporatised and demutualised in accordance with the provisions contained in Section 4B:

Further SEBI may, if it is satisfied that any recognised stock exchange was prevented by sufficient cause from being corporatised and demutualised on or after the appointed date, specify another appointed date in respect of that recognised stock exchange and such recognised stock exchange may continue as such before such appointed date.

–Appointed date” for the purpose means the date which SEBI may, by notification in the Official Gazette, appoint and different appointed dates may be appointed for different recognised stock exchanges:

Section 4B provides for procedure for corporatisation and demutualisation. All recognized stock exchanges referred to in Section 4A shall, within such time as may be specified by SEBI submit a scheme for corporatisation and demutualisation for its approval.

SEBI may, by notification in the Official Gazette, specify name of the recognised stock exchange, which had already been corporatised and demutualised, and such stock exchange shall not be required to submit the scheme under this Section.

On receipt of the scheme SEBI may, after making such enquiry as may be necessary in this behalf and obtaining such further information, if any, as it may require and if it is satisfied that it would be in the interest of the trade and also in the public interest, approve the scheme with or without modification.

No scheme shall be approved by SEBI if the issue of shares for a lawful consideration or provision of trading rights in lieu of membership card of the members of a recognised stock exchange or payment of dividends to members have been proposed out of any reserves or assets of that stock exchange.

Where the scheme is approved the scheme so it shall be published immediately by SEBI in the Official Gazette; and by the recognised stock exchange in such two daily newspapers circulating in India, as may be specified by SEBI.

Upon such publication, the scheme shall have effect and be binding on all persons and authorities including all members, creditors, depositors and employees of the recognised stock exchange and on all persons having any contract, right, power, obligation or liability with, against, over, to, or in connection with, the recognised stock exchange or its members.

However, where the SEBI is satisfied that it would not be in the interest of the trade and also in the public interest to approve the scheme, it may, by an order, reject the scheme and such order of rejection shall be published by it in the Official Gazette.

SEBI shall give a reasonable opportunity of being heard to all the persons concerned and the recognized stock exchange concerned before passing an order rejecting the scheme.

SEBI may, while approving the scheme by an order in writing, restrict—

- (a) the voting rights of the shareholders who are also stock brokers of the recognised stock exchange;
- (b) the right of shareholders or a stock broker of the recognised stock exchange to appoint the representatives on the governing board of the stock exchange;
- (c) the maximum number of representatives of the stock brokers of the recognised stock exchange to be appointed on the governing board of the recognised stock exchange, which shall not exceed one-fourth of the total strength of the governing board.

The order shall be published in the Official Gazette.

Every recognised stock exchange, in respect of which the scheme for corporatisation or demutualisation has been approved, shall, either by fresh issue of equity shares to the public or in any other manner as may be specified by the regulations made by the SEBI, ensure that at least fifty-one per cent. of its equity share capital is held, within twelve months from the date of publication of the order by the public other than shareholders having trading rights:

SEBI on sufficient cause being shown to it and in the public interest, may extend the said period by another twelve months.

Section 5 deals with withdrawal of recognition. The section 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.

Where the recognised stock exchange has not been corporatised or demutualised or it fails to submit the scheme within the specified time therefor or the scheme has been rejected by the SEBI, the recognition granted to such stock exchange, shall, notwithstanding anything to the contrary contained in this Act, stand withdrawn and the Central Government shall publish, by notification in the Official Gazette, such withdrawal of recognition:

However, such withdrawal shall not affect the validity of any contract entered into or made before the date of the notification, and SEBI may, after consultation with the stock exchange, make such provisions as it deems fit in the order rejecting the scheme published in the Official Gazette under sub-Section (5) of Section 4B.

It is to be noted that the powers under Section 4 (3), 4(5) and Section 5 have

been delegated concurrently to SEBI also. Hence, SEBI may exercise these powers.

Power of Central Government to Call for Periodical Returns and make Direct Enquiries

Section 6 enjoins that every recognised stock exchange shall furnish to SEBI, such periodical returns relating to its affairs as may be prescribed. Every such exchange and every member thereof shall maintain and preserve for such periods not exceeding five years such books of accounts, and other documents as the Central Government, after consultation with the stock exchange concerned, may prescribe in the interest of the trade or in the public interest, and such books of account, and other documents shall be subject to inspection to all reasonable times by SEBI.

If SEBI is satisfied that it is in the interest of the trade or in public interest so to do, may by order in writing—

- (a) call upon a recognised stock exchange or any member thereof to furnish in writing such information or explanation relating to the affairs of the stock exchange or of the member in relation to the stock exchange as SEBI may require; or
- (b) appoint one or more persons to make an inquiry in the prescribed manner in relation to the affairs of the governing body of a stock exchange or the affairs of any of the members of the stock exchange in relation to the stock exchange and submit a report of the result of such inquiry to the Securities and Exchange Board of India within such time as may be specified in the order or, in the case of an inquiry in relation to the affairs of any of the members of a stock exchange, direct the governing body to make the inquiry and submit its report to SEBI.

Where an inquiry in relation to the affairs of a recognised stock exchange or the affairs of any of its members in relation to the stock exchange has been undertaken—

- (a) every director, manager, secretary or other officer of such stock exchange;
- (b) every member of such stock exchange;
- (c) if the member of the stock exchange is a firm, every partner, manager, secretary or other officer of the firm; and
- (d) every other person or body of persons who has had dealings in the course of business with any of the persons mentioned in clauses (a), (b) and (c) whether directly or indirectly; shall be bound to produce before the authority making the inquiry all such books of account, and other documents in his custody or power relating to or having a bearing on the subject-matter of such inquiry and also to furnish the authorities within such time as may be specified with any such statement or information relating thereto as may be required of him.

Every stock exchange shall furnish to the Central Government and to SEBI a copy of its annual report which shall contain such particulars as may be prescribed by Central Government/SEBI.

Power to make Rules Restricting Voting Rights etc.

A recognised stock exchange may make rules or amend any rules made by it to provide for all or any of the following matters, namely—

- (a) the restriction of voting rights to members only in respect of any matter placed before the stock exchange at any meeting;
- (b) the regulation of voting rights in respect of any matter placed before the stock exchange at any meeting so that each member may be entitled to have one vote only, irrespective of his share of the paid-up equity capital of the stock exchange;
- (c) the restriction on the right of a member to appoint another person as his proxy to attend and vote at a meeting of the stock exchange; and
- (d) such incidental, consequential and supplementary matters as may be necessary to give effect to any of the matters specified in clauses (a) (b) and (c).

No rules of a recognised stock exchange made or amended in relation to any matter referred to in clause (a) to (d) of sub-section (1) shall have effect until they have been approved by the Central Government and published by that Government in the Official Gazette and, in approving the rules so made or amended, the Central Government may make such modifications therein as it thinks fit, and on such publication, the rules as approved by the Central Government shall be deemed to have been validly made, notwithstanding anything to the contrary contained in the Companies Act, 1956. The powers have been delegated concurrently to SEBI also in this regard.

Power to Central Government to make Rules or Direct Rules to be made in Respect of Recognised Stock Exchange

Where, after consultation with the governing bodies of stock exchanges generally or with the governing body of any stock exchange in particular, the Central Government is of opinion that it is necessary or expedient so to do, it may, by order in writing together with a statement of the reasons therefor, direct the recognised stock exchanges generally or any recognised stock exchange in particular, as the case may be, to make any rules or to amend any rules already made in respect of all or any of the matters or to amend any rules already made in respect of all or any of the matters as specified, within a period of two months from the date of the order.

If any recognised stock exchange fails or neglects to comply with any order, within the period specified therein, the Central Government may make the rules for, or amend the rules made by, the recognised stock exchange, either in the form proposed in the order or with such modifications thereof as may be agreed to between the stock exchange and the Central Government.

Where in pursuance of this section any rules have been made or amended, the rules so made or amended shall be published in the Gazette of India and also in the Official Gazette or Gazettes of the State or States in which the principal office or offices of the recognised stock exchange or exchanges is or are situate, and, on the publication thereof in the Gazette of India, the rules so made or amended shall, notwithstanding anything to the contrary contained in the Companies Act, 1956 or in

any other law for the time being in force, have effect as if they had been made or amended by the recognised stock exchange or stock exchanges, as the case may be.

Powers have been delegated concurrently to SEBI also.

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.

Sub-section (2) provides that every clearing corporation shall, for the purpose of transfer of the duties and functions of a clearing house to a clearing corporation referred to in sub-Section (1), make bye-laws and submit the same to the SEBI for its approval.

Sub-section (3) provides that SEBI may, on being satisfied that it is in the interest of the trade and also in the public interest to transfer the duties and functions of a clearing house to a clearing corporation, grant approval to the bye-laws submitted to it and approve transfer of the duties and functions of a clearing house to a clearing corporation.

Power of Recognised Stock Exchanges

Any recognised stock exchange may, subject to the previous approval of SEBI, make bye-laws for the regulation and control of contracts. In particular, and without prejudice to the generality of the foregoing power, such bye-laws may provide for:

- (a) the opening and closing of markets and the regulation of the hours of trade;
- (b) a clearing house for the periodical settlement of contracts and differences thereunder, the delivery of and payment for securities, the passing on of delivery orders and the regulation and maintenance of such clearing house;
- (c) submission to SEBI by the clearing house as soon as may be after each periodical settlement of all or any of the following particulars as SEBI may, from time to time, require, namely:
 - (i) the total number of each category of security carried over from one settlement period to another;
 - (ii) the total number of each category of security, contracts which have been squared up during the course of each settlement period;
 - (iii) the total number of each category of security actually delivered at each clearing;
- (d) the publication by the clearing house of all or any of the particulars submitted to SEBI subject to the directions, if any, issued by SEBI in this behalf;

- (e) the regulation or prohibition of blank transfers;
- (f) the number and classes of contracts in respect of which settlements shall be made or differences paid through the clearing house;
- (g) the regulation, or prohibition to badlas or carry-over facilities;
- (h) the fixing, altering or postponing of days for settlements;
- (i) the determination and declaration of market rates, including the opening, closing, highest and lowest rates for securities;
- (j) the terms, conditions and incidents of contracts, including the prescription of margin requirements, if any, and conditions relating thereto, and the forms of contracts in writing;
- (k) the regulation of the entering into making, performance, rescission and termination, of contracts, including contracts between members or between a member and his constituent or between a member and a person who is not a member, and the consequences of default or insolvency on the part of a seller or buyer or intermediary, the consequences of a breach or omission by a seller or buyer, and the responsibility of members who are not parties to such contracts;
- (l) the regulation of taravani business including the placing of limitations thereon;
- (m) the listing of securities on the stock exchange, the inclusion of any security for the purpose of dealings and the suspension or withdrawal of any such securities, and the suspension or prohibition of trading in any specified securities;
- (n) the method and procedure for the settlement of claims or disputes, including settlement by arbitration;
- (o) the levy and recovery of fees, fines and penalties;
- (p) the regulation of the course of business between parties to contracts in any capacity;
- (q) the fixing of a scale of brokerage and other charges;
- (r) the making, comparing, settling and closing of bargains;
- (s) the emergencies in trade which may arise, whether as a result of pool or syndicated operations or concerning or otherwise, and the exercise of powers in such emergencies including the power to fix maximum and minimum prices for securities;
- (t) the regulation of dealings by members for their own account;
- (u) the separation of the functions of jobbers and brokers;
- (v) the limitations on the volume of trade done by any individual member in exceptional circumstances;
- (w) the obligation of members to supply such information or explanation and to produce such documents relating to the business as the governing body may require.

Punishments for contraventions

The bye-laws made under Section 9(3) may;

- (a) specify the bye-laws, the contravention of which shall make a contract entered into otherwise than in accordance with the bye-laws void under sub-section (1) of section 14;
- (b) provide that the contravention of any of the bye-laws shall render the member concerned liable to one or more of the following punishments, namely;
 - (i) fine,
 - (ii) expulsion from membership,
 - (iii) suspension from membership for a specified period,
 - (iv) any other penalty of a like nature not involving the payment of money.

Any bye-laws made under this section shall be subject to such conditions in regard to previous publication as may be prescribed, and, when approved by SEBI, shall be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the recognised stock exchange is situated, and shall have effect as from the date of its publication in the Gazette of India:

However, if SEBI is satisfied in any case that in the interest of the trade or in the public interest any bye-laws should be made immediately, it may, by order in writing specify the reasons therefor, dispense with the condition of previous publication.

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.

Where in pursuance of this section any bye-laws have been made or amended, the bye-laws so made or amended shall be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the recognised stock exchange is situated, and on the publication thereof in the Gazette of India, the bye-laws so made or amended shall have effect as if they had been made or amended by the recognised stock exchange concerned.

Where the governing body of a recognised stock exchange objects to any bye-laws made or amended by SEBI on its own motion, it may, within two months of the publication thereof in the Gazette of India apply to SEBI for revision thereof and SEBI may, after giving an opportunity to the governing body of the stock exchange to be heard in the matter, revise the bye-laws so made or amended, and where any bye-laws so made or amended are revised as a result of any action taken under this sub-section, the bye-laws so revised shall be published and shall become effective as provided in sub-section (2) of Section 10.

The making or the amendment or revision of any bye-laws shall in all cases be subject to the condition of previous publication.

However, if SEBI is satisfied in any case that in the interest of the trade or in the public interest any bye-laws should be made, amended or revised immediately, it may, by order in writing specifying the reasons therefor, dispense with the condition of previous publication.

Power of Central Government to Supersede Companies of Stock Exchanges or Suspend Business Thereof

Without prejudice to any other powers vested in the Central Government under this Act, where the Central Government is of opinion that the governing body of any recognised stock exchange should be superseded, then notwithstanding anything contained in any other law for the time being in force, the Central Government may serve on the governing body a written notice that the Central Government is considering the super session of the governing body for the reasons specified in the notice and after giving an opportunity to the governing body to be heard in the matter, it may, by notification in the Official Gazette declare the governing body of such stock exchange to be superseded, and may appoint any person or persons to exercise and perform all the powers and duties of the governing body, and, where more persons than one are appointed, may appoint one of such persons to be the chairman and another to be the vice-chairman thereof.

On the publication of a notification in the Official Gazette, the following consequences shall ensure, namely—

- (a) the members of the governing body which has been superseded shall, as from the date of the notification of super session, cease to hold office as such members;
- (b) the person or persons appointed may exercise and perform all the powers and duties of the governing body which has been superseded;
- (c) all such property of the recognised stock exchange as the person or persons appointed may, by order in writing, specify in this behalf as being necessary for the purpose of enabling him or them to carry on the business of the stock exchange, shall vest in such person or persons.

Notwithstanding anything to the contrary contained in any law or the rules or bye-laws of the recognised stock exchange the governing body of which is superseded, the person or persons appointed under that sub-section shall hold office for such period as may be specified in the notification published under that sub-section and, the Central Government may from time to time, by notification, vary such period.

The Central Government, may at any time before the determination of the period of office of any person or persons appointed under this section call upon the recognised stock exchange to reconstitute the governing body in accordance with its rules and on such re-constitution all the property of the recognised stock exchange which has been vested in, or was in the possession of, the person or persons appointed, shall re-vest or vest, as the case may be, in the governing body so re-constituted;

Provided that until a governing body is so re-constituted, the person or persons appointed, shall continue to exercise and perform their powers and duties. If in the opinion of the Central Government an emergency, has arisen and for the purpose of meeting the emergency, the Central Government considers it expedient so to do, it may, by notification in the Official Gazette, for reasons to be set out therein, direct a recognised stock exchange to suspend such of its business for such period not exceeding seven days and subject to such conditions as may be specified in the notification, and if, in the opinion of the Central Government, the interest of the trade or the public interest requires that the period should be extended, may, by like notification extend the said period from time to time;

Provided that where the period of suspension is to be extended beyond the first period, no notification extending the period of suspension shall be issued unless the governing body of the recognised stock exchange has been given an opportunity of being heard in the matter.

Section 12A provides that if, after making or causing to be made an inquiry, SEBI is satisfied that it is necessary—

- (a) in the interest of investors, or orderly development of securities market; or
- (b) to prevent the affairs of any recognised stock exchange, or, clearing corporation, or such other agency or person, providing trading or clearing or settlement facility in respect of securities, being conducted in a manner detrimental to the interests of investors or securities market; or
- (c) to secure the proper management of any such stock exchange or clearing corporation or agency or person, referred to in clause (b), it may issue such directions—
 - (i) to any stock exchange or clearing corporation or agency or person referred to in clause (b) or any person or class of persons associated with the securities market; or
 - (ii) to any company whose securities are listed or proposed to be listed in a recognised stock exchange,

as may be appropriate in the interests of investors in securities and the securities market.

Contracts in Securities

If the Central Government is satisfied, having regard to the nature or the volume of transactions in securities in any State or States or area, that it is necessary so to do, it may, by notification in the Official Gazette, declare that section to apply to such State or States or area, and thereupon every contract in such State or States or area which is entered into after date of the notification otherwise than between members of a recognised stock exchange or recognized stock exchanges in such State or States or area or through or with such member shall be illegal.

It has been provided that any contract entered into between members of two or more recognised stock exchanges in such State or States or area, shall—

- (i) be subject to such terms and conditions as may be stipulated by the respective stock exchanges with prior approval of SEBI;

- (ii) require prior permission from the respective stock exchanges if so stipulated by the stock exchanges with prior approval of SEBI.

A stock exchange may establish additional trading floor with the prior approval of SEBI in accordance with the terms and conditions stipulated by SEBI.

Explanation—For the purposes of this section, ‘Additional Trading Floor (ATF)’ means a trading ring or trading facility offered by a recognised stock exchange outside its area of operation to enable the investors to buy and sell securities through such trading floor under the regulatory framework of that stock exchange.

Any contract entered into in any State or area specified in the notification under section 13 which is in contravention of any of the bye-laws specified in that behalf under clause(a) of sub-section (3) of section 9 shall be void:

- (i) as respects the rights of any member of the recognised stock exchange who has entered into such contract in contravention of any such bye-laws, and also
- (ii) as respects the rights of any other person who has knowingly participated in the transaction entailing such contravention.

Nothing in sub-section (1) shall be construed to affect the right of any person other than a member of the recognised stock exchange to enforce any such contract or to recover any sum under or in respect of such contract if such person had no knowledge that the transaction was in contravention of any of the bye-laws specified in clause (a) of sub-section (3) of section 9.

No member of a recognised stock exchange shall in respect of any securities enter into any contract as a principal with any person other than a member of a recognised stock exchange, unless he has secured the consent or authority of such person and discloses in the note, memorandum or agreement of sale or purchase that he is acting as a principal.

Provided that where the member has secured the consent or authority of such person otherwise than in writing he shall secure written confirmation by such person or such consent or authority within 3 days from the date of contract.

Provided further that no such written consent or authority of such person shall be necessary for closing out any outstanding contract entered into by such person in accordance with the bye-laws, if the member discloses in the note, memorandum or agreement of sale or purchase in respect of such closing out that he is acting as a principal.

If the Central Government is of opinion that it is necessary to prevent undesirable speculation in specified securities in any State or area, it may, by notification in the Official Gazette, declare that no person in the State or area specified in the notification shall, save with the permission of the Central Government, enter into any contract for the sale or purchase of any security specified in the notification except to the extent and in the manner, if any, specified therein.

All contracts in contravention of the provisions of sub-section (1) entered into after the date of the notification issued thereunder shall be illegal.

Licensing of Dealers in certain areas

Subject to the provision of sub-section (3) and to the other provisions contained in this Act, no person shall carry on or purport to carry on, whether on his own behalf or on behalf of any other person, the business of dealing in securities in any State or area to which section 13 has not been declared to apply and to which the Central Government may, by notification in the Official Gazette, declare this section to apply, except under the authority of a license granted by SEBI in this behalf.

No notification under sub-section (1) shall be issued with respect to any State or area unless the Central Government is satisfied, having regard to the manner in which securities are being dealt with in such State or area, that it is desirable or expedient in the interest of the trade or in the public interest that such dealings should be regulated by a system of licensing.

The restrictions imposed by sub-section (1) in relation to dealings in securities shall not apply to the doing of anything by or on behalf of a member of any recognised stock exchange.

Public Issue and Listing of Securities

Section 17A provides for public issue and listing of securities.

Without prejudice to the provisions contained in this Act or any other law for the time being in force, no securities of the nature referred to in sub-clause (ie) of clause (h) of section 2 shall be offered to the public or listed on any recognized stock exchange unless the issuer fulfils such eligibility criteria and complies with such other requirements as may be specified by regulations made by SEBI.

Every issuer intending to offer the certificates or instruments referred therein to the public shall make an application, before issuing the offer document to the public, to one or more recognized stock exchanges for permission for such certificates or instruments to be listed on the stock exchange or each such stock exchange.

Where the permission applied for listing has not been granted or refused by the recognized stock exchanges or any of them, the issuer shall forthwith repay all moneys, if any, received from applicants in pursuance of the offer document, and if any such money is not repaid within eight days after the issuer becomes liable to repay it, the issuer and every director or trustee thereof, as the case may be, who is in default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at the rate of fifteen per cent per annum.

In reckoning the eighth day after another day, any intervening day which is a public holiday under the Negotiable Instruments Act, 1881, shall be disregarded, and if the eighth day (as so reckoned) is itself such a public holiday, there shall for the said purposes be substituted the first day thereafter which is not a holiday.

All the provisions of this Act relating to listing of securities of a public company on a recognized stock exchange shall, *mutates mutandis*, apply to the listing of the securities of the nature referred to in sub-clause (ie) of clause (h) of section 2 by the issuer, being a special purpose distinct entity.

Exclusion of Spot Delivery Contracts

If the Central Government is of opinion that in the interest of the trade or in the public interest, it is expedient to regulate and control the business of dealing in spot delivery contracts also in any State or area (whether section 13 has been declared to apply to that State or area or not), it may, by notification in the Official Gazette, declare that the provisions of section 17 shall also apply to such State or area in respect of spot delivery contracts generally or in respect of spot delivery contract for the sale or purchase of such securities as may be specified in the notification, and may also specify the manner in which, and the extent to which, the provisions of that section shall so apply.

Contracts in Derivatives

Notwithstanding anything contained in any other law for the time being in force, contracts in derivative shall be legal and valid if such contracts are—

- (a) traded on a recognised stock exchange;
- (b) settled on the clearing house of the recognised stock exchange, in accordance with the rules and bye-laws of such stock exchange.

Section 21 of the Act provides that where securities are listed on the application of any person in any recognised stock exchange, such person shall comply with the conditions of the listing agreement with that stock exchange.

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.

The Securities Appellate Tribunal may, if it is satisfied that the company was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding one month.

Right of Appeal against Refusal of Listing by Stock Exchanges

Where a recognised stock exchange, acting in pursuance of any power given to it by its bye-laws, refuses to list the securities of any company, the company shall be entitled to be furnished with reasons for such refusal, and may,—

- (a) within fifteen days from the date on which the reasons for such refusal are furnished to it, or
- (b) where the stock exchange has omitted or failed to dispose of, within the time specified in sub-section (1A) of section 73 of the Companies Act, 1956 (hereafter referred to as the specified time'), the application for permission

for the shares or debentures to be dealt with on the stock exchange, within fifteen days from the date of expiry of the specified time or within such further period, not exceeding one month, as the Securities Appellate Tribunal may, on sufficient cause being shown, allow appeal to the Securities Appellate Tribunal having jurisdiction in the matter against such refusal, omission or failure, as the case may be, and thereupon the Securities Appellate Tribunal may, after giving the stock exchange, an opportunity of being heard,—

- (i) vary or set aside the decision of the stock exchange; or
- (ii) where the stock exchange has omitted or failed to dispose of the application within the specified time, grant or refuse the permission and where the Securities Appellate Tribunal sets aside the decision of the recognised stock exchange or grants the permission, the stock exchange shall act in conformity with the orders of the Securities Appellate Tribunal.

Every appeal under sub-section (1) shall be in such form and be accompanied by such fee as may be prescribed. The Securities Appellate Tribunal shall send a copy of every order made by it to the Board and parties to the appeal.

The appeal filed before the Securities Appellate Tribunal under sub-section (1) 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.

Procedure and Powers of Securities Appellate Tribunal 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.

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, 1860 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.

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 and Procedures under the Securities Contracts (Regulation) Act, 1956

The Act prescribes various penalties against persons who might be found guilty of offences under the Act. These offences are listed below—

Any person who—

- (a) without reasonable excuse (the burden of proving which shall be on him) fails to comply with any requisition made under sub-section (4) of section 6; or
- (b) enters into any contract in contravention of any of the provisions contained in section 13 or section 16; or
- (c) contravenes the provisions contained in section 17 or section 19; or
- (d) enters into any contract in derivative in contravention of section 18A or the rules made under section 30; or
- (e) owns or keeps a place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act and knowingly permits such place to be used for such purposes; or
- (f) manages, controls, or assists in keeping any place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act or at which contracts are recorded or adjusted or rights or liabilities arising out of contracts are adjusted, regulated or enforced in any manner whatsoever; or
- (g) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17 willfully represents to or induces any person to believe that contracts can be entered into or performed under this Act through him; or
- (h) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17, canvasses, advertises or touts in any manner either for himself or on behalf of any other person for any

business connected with contracts in contravention of any of the provisions of this Act; or

- (i) joins, gathers or assists in gathering at any place other than the place of business specified in the bye-laws of a recognised stock exchange any person or persons for making bids or offers or for entering into or performing any contracts in contravention of any of the provisions of this Act,

shall, without prejudice to any award of penalty by the Adjudicating Officer under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees or with both.

Any person who enters into any contract in contravention of the provisions contained in section 15 or who fails to comply with the provisions of section 21 or section 21A or with the orders of or the Central Government under section 22 or with the Orders of the Securities Appellate Tribunal shall, without prejudice to any award of penalty by the Adjudicating Officer under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty five crore rupees, or with both.

Penalty for failure to furnish information, return, etc.

Any person, who is required under this Act or any rules made thereunder,—

- (a) to furnish any information, document, books, returns or report to a recognized stock exchange, fails to furnish the same within the time specified therefor in the listing agreement or conditions or bye-laws of the recognised stock exchange, shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less for each such failure;
- (b) to maintain books of account or records, as per the listing agreement or conditions, or bye-laws of a recognised stock exchange, fails to maintain the same, shall be liable to a penalty of 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

If any person, who is required under this Act or any bye-laws of a recognized stock exchange made thereunder, to enter into an agreement with his client, fails to enter into such an agreement, he shall be liable to a penalty of 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

If any stock broker or sub-broker or a company whose securities are listed or proposed to be listed in a recognised stock exchange, after having been called upon by SEBI or a recognised stock exchange in writing, to redress the grievances of the investors, fails to redress such grievances within the time stipulated by SEBI or a recognised stock exchange, he or it shall be liable to a penalty of 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

If any person, who is registered under Section 12 of SEBI Act, 1992 as a stock

broker or sub-broker, fails to segregate securities or moneys of the client or clients or uses the securities or moneys of a client or clients for self or for any other client, he shall be liable to a penalty not exceeding one crore rupees.

Penalty for failure to comply with listing conditions or delisting conditions or grounds

If a company or any person managing collective investment scheme or mutual fund, fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof, it or he shall be liable to a penalty not exceeding twenty-five crore rupees.

Penalty for excess dematerialisation or delivery of unlisted securities

If any issuer dematerialises securities more than the issued securities of a company or delivers in the stock exchanges the securities which are not listed in the recognised stock exchange or delivers securities where no trading permission has been given by the recognised stock exchange, he shall be liable to a penalty not exceeding twenty-five crore rupees.

Penalty for failure to furnish periodical returns, etc.

If a recognised stock exchange fails or neglects to furnish periodical returns to SEBI or fails or neglects to make or amend its rules or bye-laws as directed by SEBI or fails to comply with directions issued by SEBI, such recognised stock exchange shall be liable to a penalty which may extend to twenty-five crore rupees.

Penalty for contravention where no separate penalty has been provided

Whoever fails to comply with any provision of this Act, the rules or articles or bye-laws or the regulations of the recognised stock exchange or directions issued by SEBI for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.

Power to adjudicate

(1) For the purpose of adjudging SEBI shall appoint any officer not below the rank of a Division Chief of SEBI to be 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.

(2) While holding an inquiry, the adjudicating officer shall have power 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 in the opinion of the adjudicating officer, 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 this Act.

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.

Crediting sum realised by way of penalties to Consolidated Fund of India

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

Appeal to Securities Appellate Tribunal

(1) 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.

(2) 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.

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

(3) 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.

(4) The Securities Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned adjudicating officer.

(5) The appeal filed 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.

Offences

(1) Without prejudice to any award of penalty by the adjudicating officer under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations or byelaws made thereunder, for which no punishment is provided elsewhere in this Act, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both.

(2) If any person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years, or with fine, which may extend to twenty-five crore rupees, or with both.

Composition of certain offences

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.

Power to grant immunity

(1) The Central Government may, on recommendation by SEBI, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder or also from the imposition of any penalty under this Act with respect to the alleged violation.

No such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity.

Further that the recommendation of the Securities Exchange Board of India under this sub-Section are not binding upon the Central Government.

(2) An immunity granted to a person under sub-Section (1) may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

Offences by companies

(1) Where an offence has been committed by a company, every person who, at the time when the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence, and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

(2) Where an offence under this Act has been committed by a company and is proved that the offence has been committed with the consent or connivance of, or is attributable to any gross negligence on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer of the company shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation.—For the purpose of this section,—

- (a) 'company' means any body corporate and includes a firm or other association of individuals, and
- (b) "director", in relation to—
 - (i) a firm, means a partner in the firm;
 - (ii) any association of persons or a body of individuals, means any member controlling the affairs thereof.

(3) The provisions of this section shall be in addition to and not in derogation of, the provisions of section 22A.

Certain offences to be cognizable

Notwithstanding anything contained in the Code of Criminal Procedure, 1898, any offence punishable under section 23 shall be deemed to be cognizable offence within the meaning of that Code.

Cognizance of offences by courts

(1) No court shall take cognizance of any offence punishable under this Act or any rules or regulations or bye-laws made thereunder, save on a complaint made by the Central Government or State Government or SEBI or a recognised stock exchange or by any person.

(2) No court inferior to that of a Court of Session shall try any offence punishable under this Act.

Entitlement of the Investors to Dividend Declared by the Company

It shall be lawful for the holder of any security whose name appears on the books of the company issuing the said security to receive and retain any dividend declared by the company in respect thereof for any year, notwithstanding that the said security has already been transferred by him for consideration, unless the transferee who claims the dividend from the transferor has lodged the security and all other documents relating to the transfer which may be required by the company with the company for being registered in his name within fifteen days of the date on which the dividend became due.

Explanation—The period specified in this section shall be extended—

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the dividend;
- (ii) in case of loss of the transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and
- (iii) in case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

Nothing contained in sub-section (1) shall affect—

- (a) the right of a company to pay any dividend which has become due to any

person whose name is for the time being registered in the books of the company as the holder of the security in respect of which the dividend has become due; or

- (b) the right of the transferee of any security to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security in the name of the transferee.

Right of Investor to Receive Income from Collective Investment Scheme

It shall be lawful for the holder of any securities, being units or other instruments issued by collective investment scheme, whose name appears on the books of the collective investment scheme issuing the said security to receive and retain any income in respect of units or other instruments issued by the collective investment scheme declared by the collective investment scheme in respect thereof for any year, though the said security, being units or other instruments issued by collective investment scheme, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units or other instruments issued by collective investment scheme from the transfer or has lodged the security and all other documents relating to the transfer which may be required by the collective investment scheme with the collective investment scheme for being registered in his name within fifteen days of the date on which the income in respect of units or other instruments issued by the collective investments scheme became due.

Explanation—The period specified in this section shall be extended—

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the income in respect of units or other instruments issued by collective investment scheme;
- (ii) in case of loss of the transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and
- (iii) in case of delay in the lodging of any security, being units or other instruments issued by the collective investment scheme, and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay. This shall not affect—
 - (a) the right of a collective investment scheme to pay any income from units or other instruments issued by collective investment scheme which has become due to any person whose name is for the time being registered in the books of the collective investment scheme as the registered holder in the books of the collective investment scheme being units or other instruments issued by collective investment scheme in respect of which the income in respect of units or other instruments issued by collective scheme has become due; or
 - (b) the right of transferee of any security, being units or other instruments issued by collective investment scheme, to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the

security being units or other instruments issued by the collective investment scheme in the name of the transferee.

Right to receive income from mutual fund

Section 27B provides that it shall be lawful for the holder of any securities, being units or other instruments issued by any mutual fund, whose name appears on the books of the mutual fund issuing the said security to receive and retain any income in respect of units or other instruments issued by the mutual fund declared by the mutual fund in respect thereof for any year, notwithstanding that the said security, being units or other instruments issued by the mutual fund, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units or other instruments issued by the mutual fund from the transferor has lodged the security and all other documents relating to the transfer which may be required by the mutual fund with the mutual fund for being registered in his name within fifteen days of the date on which the income in respect of units or other instruments issued by the mutual fund became due.

The period specified in this Section may be extended—

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the income in respect of units or other instrument issued by the mutual fund;
- (ii) in case of loss of the transfer deed by theft or any other cause beyond the control of transferee, by the actual period taken for the replacement thereof;
- (iii) in case of delay in the lodging of any security, being units or other instruments issued by the mutual fund, and other documents relating to the transfer due to cause connected with the post, by the actual period of the delay.

Sub-section (2) provides that nothing contained in Sub-section (1) shall affect—

- (a) the right of a mutual fund to pay any income from units or other instruments issued by the mutual fund which has become due to any person whose name is for the time being registered in the books of the mutual fund as the holder of the security being units or other instruments issued by the mutual fund in respect of which the income in respect of units or other instruments issued by mutual fund has become due; or
- (b) the right of transferee of any security, being units or other instruments issued by the mutual fund, to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the mutual fund has refused to register the transfer of the security being units or other instruments issued by the mutual fund in the name of the transferee.

Power of Central Government to delegate or to make rules

Section 29A of the Securities Contracts (Regulation) Act, 1956 provides that the Central Government may, by order published in the Official Gazette, direct that the powers (except the power under section 30) exercisable by it under any provision of this Act shall, in relation to such matters and subject to such conditions, if any, as may be specified in the order, be exercisable also by SEBI or the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934.

The Central Government may, by notification in the Official Gazette, make rules for the purpose of carrying into effect the objects of this Act.

In particular, and without prejudice to the generality of the foregoing power, such rules may provide for,

- (a) the manner in which applications may be made, the particulars which they should contain and the levy of a fee in respect of such applications;
- (b) the manner in which any inquiry for the purpose of recognizing any stock exchange may be made, the conditions which may be imposed for the grant of such recognition, including conditions as to the admission of members if the stock exchange concerned is to be the only recognised stock exchange in the area; and the form in which such recognition shall be granted;
- (c) the particulars which should be contained in the periodical returns and annual reports to be furnished to the Central Government;
- (d) documents which should be maintained and preserved under section 6 and the periods for which they should be preserved;
- (e) manner in which any inquiry by the governing body of a stock exchange shall be made under section 6;
- (f) the manner in which the bye-laws to be made or amended under this Act shall before being so made or amended be published for criticism;
- (g) the manner in which applications may be made by dealers in securities for licences under section 17, the fee payable in respect thereof and the period of such licences, the conditions subject to which licences may be granted, including conditions relating to the forms which may be used in making contracts, the documents to be maintained by licensed dealers and the furnishing of periodical information to such authority as may be specified and the revocation of licences for breach of conditions;
- (h) the requirements which shall be complied with—
 - (A) by public companies for the purpose of getting their securities listed on any stock exchange;
 - (B) by collective investment scheme for the purpose of getting their units listed on any stock exchange; (ha) the form in which an appeal may be filed before the Securities Appellate Tribunal under Section 22A and the fees payable in respect of such appeal.
- (ha) the grounds on which the securities of a company may be delisted from any recognised stock exchange under sub-Section (1) of Section 21A;
- (hb) the form in which an appeal may be filed before the Securities Appellate Tribunal under sub-Section (2) of Section 21A and the fees payable in respect of such appeal;
- (hc) the form in which an appeal may be filed before the Securities Appellate Tribunal under Section 22A and the fees payable in respect of such appeal;
- (hd) the manner of inquiry under sub-Section (1) of Section 23-I;

- (he) the form in which an appeal may be filed before the Securities Appellate Tribunal under Section 23L and the fees payable in respect of such appeal
- (i) any other matter which is to be or may be prescribed.

Every rule made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

Power of Securities and Exchange Board of India to make regulations

Section 31 provides that without prejudice to the provisions contained in Section 30 of SEBI Act, 1992, SEBI may, by notification in the Official Gazette, make regulations consistent with the provisions of this Act and the rules made thereunder to carry out the purposes of this Act.

In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for the manner, in which at least fifty-one per cent. of equity share capital of a recognised stock exchange is held, within twelve months from the date of publication of the order under sub-section (7), of Section 4B by the public other than shareholders having trading rights under sub-section (8) of that section and the eligibility criteria and other requirements under Section 17A.

Every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the regulation or both Houses agree that the regulation should not be made, the regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that regulation.

II. SECURITIES CONTRACTS (REGULATION) RULES, 1957

These rules were made by the Central Government in exercise of the powers conferred by Section 30 of the Securities Contracts (Regulation) Act, 1956 and notified on 21st February, 1957.

Under rules 3, it is laid down that an application under section 3 of the SCRA for recognition of a stock exchange shall be made to SEBI in Form A. This form is to be used for seeking recognition as well as renewal of recognition of a stock exchange. The annexure to form A requires the applicant stock exchange to furnish general information about itself and also details about its membership, governing body, trading and miscellaneous matters. A fee of Rs. 500 has to be paid in respect of every application and deposited in the nearest Government Treasury or the nearest

branch of State Bank of India. However at Mumbai, Kolkata and Chennai, Kanpur the fees shall be deposited in RBI and credited to the Head XLVI-Miscellaneous-Other fees, fines and forfeitures.

The application shall be accompanied by 4 copies of the rules (including the memorandum and articles of association where the applicant stock exchange is an incorporated body) and bye-laws of the stock exchange applying for recognition and the receipt obtained for payment of fees.

Before granting recognition to a stock exchange, SEBI may make such enquiries and require such further information to be furnished as it deems necessary, in relation to the information furnished in the Annexure to the application.

Form of Recognition

The recognition granted to a stock exchange shall be in Form B and subject to the following conditions, namely—

- (a) that the recognition unless granted on a permanent basis, shall be for such period not less than one year as may be specified in the recognition;
- (b) that the stock exchange shall comply with such conditions as are or may be prescribed or imposed under the provisions of the Act and these rules from time to time. In case of a recognised stock exchange, renewal of such recognition should be sought from SEBI not later than 3 months before expiry of the period of recognition.

In case SEBI desires to withdraw recognition from a stock exchange, SEBI shall first issue a show-cause notice in Form C and obtain information. Only after considering the submissions of the stock exchange SEBI can take a decision on withdrawal of recognition.

Qualification prescribed for Membership of a recognised Stock Exchange

Rule 8 contains detailed provisions on this subject and they are as follows:

No person shall be liable to be elected as a member if—

- (a) he is less than twenty-one years of age;
- (b) he is not a citizen of India;

However the governing body may in suitable cases relax this condition with the prior approval of SEBI;
- (c) he has been adjudged bankrupt or a receiving order in bankruptcy has been made against him or he has been proved to be insolvent even though he has obtained his final discharge;
- (d) he has compounded with his creditors unless he has paid 100 paise in the rupee;
- (e) he has been convicted of an offence involving fraud or dishonesty;
- (f) he is engaged as principal or employee in any business other than that of securities or commodity derivatives except as a broker or agent not involving

any personal financial liability unless he undertakes on admission to sever his connection with such business;

However no member may conduct business in commodity derivatives, except by setting up a separate company which shall comply with the regulatory requirements, such as, networth, capital adequacy, margins and exposure norms as may be specified by the Forward Market Commission, from time to time:

Provided further that nothing herein shall be applicable to any corporations, bodies corporate, companies or institutions referred to in items (a) to (k) of the proviso to sub-rule (4).

- (g) he has been at any time expelled or declared a defaulter by any other stock exchange;
- (h) he has been previously refused admission to membership unless a period of one year has elapsed since the date of such rejection.

No person eligible for admission as a member under sub-rule (1) shall be admitted as a member unless:

- (a) he has worked for not less than two years as a partner with, or as an authorised assistant or authorised clerk or remisier or apprentice to, a member; or
- (b) he agrees to work for a minimum period of two years as a partner or representative member with another member and to enter into bargains on the floor of the stock exchange and not in his own name but in the name of such other member; or
- (c) he succeeds to the established business of a deceased or retiring member who is his father, uncle, brother or any other person who is, in the opinion of the governing body, a close relative;

However the rules of the stock exchange may authorise the governing body to waive compliance with any of the foregoing conditions if the person seeking admission is in respect of means, position, integrity, knowledge and experience of business in securities, considered by the governing body to be otherwise qualified for membership;

No person who is a member at the time of application for recognition or subsequently admitted as a member shall continue as such if—

- (a) he ceases to be a citizen of India;
However this shall not affect those who are not citizens of India but who were members at the time of such application or were admitted subsequently under the provisions of clause (b) of sub- rule (1) of this rule, subject to their complying with all other requirements of this rule;
- (b) he is adjudged bankrupt or a receiving order in bankruptcy is made against him or he is proved to be insolvent;
- (c) he is convicted of an offence involving fraud or dishonesty;
- (d) he engages either as principal or employee in any business other than that of

securities or commodity derivatives except as a broker or agent not involving any personal financial liability, provided that—

- (i) the governing body may, for reasons, to be recorded in writing, permit a member to engage himself as principal or employee in any such business, if the member in question ceases to carry on business on the stock exchange either as an individual or as a partner in a firm.
- (ii) in the case of those members who were under the rules in force at the time of such application permitted to engage in any such business and were actually so engaged on the date of such application, a period of three years from the date of the grant of recognition shall be allowed for severing their connection with any such business,
- (iii) nothing herein shall affect members of a recognised stock exchange which are corporations, bodies corporate, companies or institution referred to in item (a) to (i) of the proviso to sub-rule (4).

Corporate Membership

A company as defined in the Companies Act, 1956, shall be eligible to be elected as a member of a stock exchange if—

- (i) such company is formed in compliance with the provisions of section 322 of the said Act,
- (ii) a majority of the directors of such company are shareholders of such company and also members of that stock exchange; and
- (iii) the directors of such company, who are members of that stock exchange, have ultimate liability in such company;

However where SEBI makes a recommendation in this regard, the governing body of a stock exchange shall, in relaxation of the requirements of this clause, admit as member the following corporations, bodies corporate companies or institutions, namely—

- (a) the Industrial Finance Corporation, established under the Industrial Finance Corporation Act, 1948;
- (b) the Industrial Development Bank of India, established under the Industrial Development Bank Act, 1964;
- (c) the Life Insurance Corporation of India, established under the Life Insurance Corporation Act, 1956;
- (d) the General Insurance Corporation of India constituted under the General Insurance Corporation (Nationalisation) Act, 1972;
- (e) the Unit Trust of India, established under the Unit Trust of India Act, 1963;
- (f) the Industrial Credit and Investment Corporation of India, a company registered under the Companies Act, 1956;
- (g) the subsidiaries of any of the corporations or companies specified in (a) to (f) and any subsidiary of the State Bank of India or any nationalised bank set up for providing merchant banking services, buying and selling securities and other similar activities;

- (h) any bank included in the second schedule to RBI Act, 1934;
- (i) the Export Import Bank of India, established under the Export Import Bank of India Act, 1981;
- (j) the National Bank for Agriculture and Rural Development, established under the National Bank for Agriculture and Rural Development Act, 1981 and
- (k) the National Housing Bank, established under the National Housing Bank Act, 1987.

A company as defined in the Companies Act, 1956, shall also be eligible to be elected as a member of a Stock Exchange if—

- (i) such company is formed in compliance with the provisions of section 12 of the said Act;
- (ii) such company undertakes to comply with such financial requirements and norms as may be specified by SEBI for the registration of such company under sub-section (1) of section 12 of SEBI Act, 1992;
- (iii) the directors of the company are not disqualified for being members of a stock exchange except sub-clause (b) and sub-clause (f) thereof or clause (3) except sub-clause (a) and sub-clause (f) thereof and the Director of the company had not held the offices of the Director in any company which had been a member of the stock exchange and had been declared defaulter or expelled by the stock exchange; and
- (iv) not less than two directors of the company are persons who possess a minimum two years' experience—
 - (a) in dealing in securities; or
 - (b) as portfolio managers; or
 - (c) as investment consultants.

Where any member of a stock exchange is a firm, the provisions of sub-rules (1), (3) and (4), shall, so far as they can, apply to the admission or continuation of any partner in such firm.

Regulation of transaction in the stock exchange

All contracts between the members of a recognised stock exchange shall be confirmed in writing and shall be enforced in accordance with the rules and bye-laws of the stock exchange of which they are members. The Securities and Exchange Board of India may nominate one or more persons not exceeding three in number, as member or members of the governing body of every recognised stock exchange. Such member or members shall enjoy the same status and powers as other members of the governing body.

After receiving the report of the result of an enquiry made under clause (b) of sub-section (3) of Section 6 of the Act, SEBI may take such action as they deem proper and, in particular, may direct the governing body of the stock exchange to take such disciplinary action against the offending member, including fine, expulsion, suspension or any other penalty of a like nature not involving the payment of money, as may be specified by SEBI; notwithstanding anything to the contrary contained in

the rules or bye-laws of the stock exchange concerned, the governing body shall give effect to the directions of SEBI in this behalf and shall not in any manner commute, revoke or modify the action taken in pursuance of such directions, without the prior approval of SEBI. SEBI may however, either on its own motion or on the representation of the member concerned, modify or withdraw its direction to the governing body.

Every member shall get his accounts audited by a chartered accountant whenever such audit is required by SEBI.

Books and documents to be maintained and preserved

(A) By every recognised stock exchange

Every recognised stock exchange shall maintain and preserve the following books of account and documents for a period of five years;

- (1) Minute books of the meetings of—
 - (a) members;
 - (b) governing body;
 - (c) any standing committee or committees of the governing body or of the general body of members.

Register of members showing their full names and addresses. Where any member of the stock exchange is a firm, full names and addresses of all partners shall be shown. Register of authorised clerks. Register of remisiers of authorised assistants. Record of security deposits.

Margin deposits book.
 Ledgers.
 Journals.
 Cash Book.
 Bank pass-book.

(B) By every member of a recognised stock exchange

Every member of a recognised stock exchange shall maintain and preserve the following books of account and documents for a period of five years;

- (a) Register of transactions (Sauda book).
- (b) Clients' ledger.
- (c) General ledger.
- (d) Journals.
- (e) Cash book.
- (f) Bank pass-book.
- (g) Documents register showing full particulars of shares and securities received and delivered.

Every member of a recognised stock exchange shall maintain and preserve the following documents for a period of two years;

- (a) Members' contract books showing details of all contracts entered into by him

with other members of the same exchange or counter-foils or duplicates of memos of confirmation issued to such other members.

- (b) Counter-foils or duplicates of contract notes issued to clients.
- (c) Written consent of clients in respect of contracts entered into as principals.

Manner of Enquiry in the Affairs of Stock Exchange

Rule 16 lays down that any enquiry in relation to the affairs of the governing body of a recognised stock exchange or the affairs of any member in relation to the stock exchange can be conducted only by the person or persons appointed by SEBI under section 6(3)(b) of the Act. The person or persons so appointed are referred to as the inquiry authority.

The procedure relating to the conduct of inquiry is stated below—

- where the inquiring authority consists of two or more persons, one of them shall be appointed as the chairman or senior member thereof;
- the inquiring authority shall hand over a statement of issues to be inquired into to the governing body or the member concerned, as the case may be, who will be given a reasonable opportunity to state their or his side of the case;
- if any witness is called for examination, an opportunity shall be provided to the governing body or the member whose affairs are being inquired into, as the case may be, to cross-examine such witness;
- where the inquiring authority consists of more than one person, the views of the majority shall be deemed to represent the findings of such authority and, in the event of an equality of votes, the chairman or senior member shall have a casting vote;
- the inquiring authority shall submit its report in writing to the Securities and Exchange Board of India within the period specified in the order of appointment;
- temporary absence from any hearing or hearings of any member of the inquiring authority shall not vitiate its proceedings.

Where SEBI had directed the governing body of a stock exchange to make an inquiry SEBI, the governing body concerned shall appoint one or more members thereof to make the inquiry.

Submission of annual reports and periodical returns by stock exchanges to SEBI

These matters are regulated under rule 17 & 17A respectively.

Every recognised stock exchange shall (before the 31st day of January in each year or within such extended time as SEBI may, from time to time, allow), furnish to SEBI annually with a report about its activities during the (preceding calendar year), which shall inter alia contain detailed information about the following matters:

- (a) changes in rules and bye-laws, if any;

- (b) changes in the composition of the governing body;
- (c) any new sub-committees set up and changes in the composition of existing ones;
- (d) admissions, re-admissions, deaths or resignations of members;
- (e) disciplinary action against members;
- (f) arbitration of disputes (nature and number) between members and non-members;
- (g) defaults;
- (h) action taken to combat any emergency in trade;
- (i) securities listed and de-listed; and
- (j) securities brought on or removed from the forward list.

Every recognised stock exchange shall within one month of the date of the holding of its annual general meeting, furnish to SEBI with a copy of its audited balance sheet and profit and loss account for its preceding financial year.

Every recognised stock exchange shall furnish to SEBI periodical returns relating to—

- (i) the official rates for the securities enlisted thereon;
- (ii) the number of shares delivered through the clearing house;
- (iii) the making-up prices;
- (iv) the clearing house programmes;
- (v) the number of securities listed and de-listed during the previous three months;
- (vi) number of securities brought on or removed from the forward list during the previous three months; and
- (vii) any other matter as may be specified by the Securities and Exchange Board of India.

Requirements of listing of securities with recognised stock exchanges

This is one of the most important and lengthy provision of the Securities Contracts (Regulation) Rules, 1957. Rule 19 provides for the complete procedure in this regard.

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

- (a) Memorandum and articles of association and, in the case of a debenture issue, a copy of the trust deed.
- (b) Copies of all prospectuses or statements in lieu of prospectuses issued by the company at any time.

- (c) Copies of offers for sale and circulars or advertisements offering any securities for subscription or sale during the last five years.
- (d) Copies of balance sheets and audited accounts for the last five years, or in the case of new companies, for such shorter period for which accounts have been made up.
- (e) A statement showing—
 - (i) dividends and cash bonuses, if any, paid during the last ten years (or such shorter period as the company has been in existence, whether as a private or public company),
 - (ii) dividends or interest in arrears, if any.
- (f) Certified copies of agreements or other documents relating to arrangements with or between—
 - (i) vendors and/or promoters,
 - (ii) underwriters and sub-underwriters,
 - (iii) brokers and sub-brokers.
- (g) Certified copies of agreements with—
 - (i) managing agents and secretaries and treasurers.
 - (ii) selling agents,
 - (iii) managing directors and technical directors,
 - (iv) general manager, sales manager, managers or secretary.
- (h) Certified copy of every letter, report, balance sheet, valuation contract, court order or other document, part of which is reproduced or referred to in any prospectus, offer for sale, circular or advertisement offering securities for subscription or sale, during the last five years.
- (i) A statement containing particulars of the dates of, and parties to all material contracts, agreements (including agreements for technical advice and collaboration), concessions and similar other documents (except those entered into in the ordinary course of business carried on or intended to be carried on by the company) together with a brief description of the terms, subject-matter and general nature of the documents.
- (j) A brief history of the company since its incorporation giving details of its activities including any reorganization, reconstruction or amalgamation, changes in its capital structure (authorised, issued and subscribed) and debenture borrowings, if any.
- (k) Particulars of shares and debentures issued (i) for consideration other than cash, whether in whole or part, (ii) at a premium or discount, or (iii) in pursuance of an option.
- (l) A statement containing particulars of any commission, brokerage, discount or other special terms including an option for the issue of any kind of the securities granted to any person.

- (m) Certified copies of—
 - (i) acknowledgment card or the receipt of filing offer document with the Securities and Exchange Board of India;
 - (ii) agreements, if any, with the Industrial Finance Corporation, Industrial Credit and Investment Corporation and similar bodies.
- (n) Particulars of shares forfeited.
- (o) A list of highest ten holders of each class or kind of securities of the company as on the date of application along with particulars as to the number of shares or debentures held by and the address of each such holder.
- (p) Particulars of shares or debentures for which permission to deal is applied for;

Provided that a recognised stock exchange may either generally by its bye-laws or in any particular case call for such further particulars or documents as it deems proper.

Apart from complying with such other terms and conditions as may be laid down by a recognised stock exchange, an applicant company shall satisfy the stock exchange that;

- (a) Its articles of association provide for the following among others—
 - (i) that the company shall use a common form of transfer;
 - (ii) that the fully paid shares will be free from all lien, while in the case of partly paid shares, the company's lien, if any, will be restricted to moneys called or payable at a fixed time in respect of such shares;
 - (iii) that any amount paid-up in advance of calls on any share may carry interest but shall not entitle the holder of the share to participate in respect thereof, in a dividend subsequently declared;
 - (iv) there will be no forfeiture of unclaimed dividends before the claim becomes barred by law;
 - (v) that option or right to call of shares shall not be given to any person except with the sanction of the company in general meeting;

Provided that a recognised stock exchange may provisionally admit to dealings the securities of a company which undertakes to amend its articles of association at its next general meeting so as to fulfill the foregoing requirements and agrees to act in the meantime strictly in accordance with the provisions of this clause.

- (b) At least 10% of each class or kind of securities issued by a company was offered to the public for subscription through advertisement in newspapers for a period not less than two days and that applications received in pursuance of such offer were allotted subject to the following conditions:
 - (a) minimum 20 lakhs securities (excluding reservations, firm allotment and promoters contribution) was offered to the public;
 - (b) the size of the offer to the public i.e., the offer price multiplied by the

number of securities offered to the public was minimum Rs. 100 crores; and

- (c) the issue was made only through book building method with allocation of 60% of the issue size to the qualified institutional buyers as specified by SEBI;

Provided that if a company does not fulfil the conditions, it shall offer at least 25% of each class or kind of securities to the public for subscription through advertisement in newspapers for a period not less than two days and that applications received in pursuance of such offer were allotted;

Provided further that a recognised stock exchange may relax any of the conditions with the previous approval of SEBI, in respect of a Government Company within the meaning of section 617 of the Companies Act, 1956 and subject to such instructions as that Board may issue in this behalf from time to time.

Explanation—Where any part of the securities sought to be listed have been or are agreed to be taken up by the Central Government, a State Government, development or investment agency of a State Government. Industrial Credit and Investment Corporation of India Limited, Life Insurance Corporation of India, General Insurance Corporation of India and its subsidiaries, namely, the National Insurance Company Limited, the New India Assurance Company Limited, the Oriental Fire and General Insurance Company Limited and the United Fire and General Insurance Company Limited, or Unit Trust of India, the total subscription to the securities, whether by one or more of such bodies, shall not form part of the twenty-five per cent of the securities to be offered to the public.

Conditions precedent to submission of application for listing by stock exchange

A company applying for listing shall, as conditions precedent, undertake *inter alia*—

- (a) (i) that letters of allotment will be issued simultaneously and that, in the event of its being impossible to issue letters of regret at the same time, a notice to that effect will be inserted in the press so that it will appear on the morning after the letters of allotment have been posted.
- (ii) that letters of right will be issued simultaneously,
- (iii) that letters of allotment, acceptance or rights will be serially numbered, printed on good quality paper and, examined and signed by a responsible officer of the company and that whenever possible, they will contain the distinctive numbers of the securities to which they relate.
- (iv) that letters of allotment and renounceable letters of right will contain a proviso for splitting and that, when so required by the exchange, the form of renunciation will be printed on the back of or attached to the letters of allotment and letters of right.
- (v) that letters of allotment and letters of right will state how the next payment of interest or dividend on the securities will be calculated;

- (b) to issue, when so required, receipts for all securities deposited with it whether for registration, sub-division, exchange or for other purposes; and not to charge any fees for registration of transfers, for sub-division and consolidation of certificates and for sub-division of letters of allotment, renounceable letters of right, and split consolidation, renewal and transfer receipts into denominations of the market unit of trading;
- (bb) to issue, when so required, consolidation and renewal certificates in denominations of the market unit of trading, to split certificates, letters of allotment, letters of right, and transfer, renewal, consolidation and split receipts into smaller units, to split call notices, issue duplicates thereof and not require any discharge on call receipts and to accept the discharge of members of stock exchange on split, consolidation and renewal receipts as good and sufficient without insisting on the discharge of the registered holders;
- (c) when documents are lodged for sub-division or consolidation (or renewal) through the clearing house of the exchange;
 - (i) to accept the discharge of an official of the stock exchange clearing house on the company's split receipts and (consolidation receipts and renewal receipts) as good and sufficient discharge without insisting on the discharge of the registered holders; and
 - (ii) to verify when the company is unable to issue certificates or split receipt or (consolidation receipts or renewal receipts) immediately on lodgement whether the discharge of the registered holders, on the documents lodged for sub-division or consolidation (or renewal) and their signatures on the relative transfers are in order;
- (d) on production of the necessary documents by shareholders or by members of the exchange, to make on transfers an endorsement to the effect that the power of attorney or probate or letters of administration or death certificate or certificate of the Controller of Estate Duty or similar other document has been duly exhibited to and registered by the company;
- (e) to issue certificates in respect of shares or debentures lodged for transfer within a period of one month of the date of lodgement of transfer and to issue balance certificates within the same period where the transfer is accompanied by a larger certificate;
- (f) to advise the stock exchange of the date of the board meeting at which the declaration or recommendation of a dividend (or the issue or right or bonus share) will be considered;
- (g) to recommend or declare all dividends and/or cash bonuses at least five days before the commencement of the closure of its transfer books or the record date fixed for the purpose and so advise the stock exchange in writing of all dividends and/or cash bonuses recommended or declared immediately after a meeting of the board of the company has been held to finalise the same;
- (h) to notify the stock exchange of any material change in the general character or nature of the company's business;

- (i) to notify the stock exchange of any change—
 - (i) in the company's directorate by death, resignation, removal or otherwise,
 - (ii) of managing director, managing agent or secretaries and treasurers,
 - (iii) of auditors appointed to audit the books and accounts of the company;
- (j) to forward to the stock exchange copies of statutory and annual reports and audited accounts as soon as issued, including directors' reports;
- (k) to forward to the stock exchange as soon as they are issued, copies of all other notices and circulars sent to the shareholders including proceedings of ordinary and extraordinary general meetings of the company and to file with the stock exchange certified copies of resolutions of the company as soon as such resolutions become effective;
- (l) to notify the stock exchange prior to intimating the shareholders, of any new issue of securities whether by way of right, privilege, bonus or otherwise and the manner in which it is proposed to offer or allot the same;
- (m) to notify the stock exchange in the event of re-issue of any forfeited securities or the issue of securities held in reserve for future issue;
- (n) to notify the stock exchange of any other alteration of capital including calls;
- (o) to close the transfer books only for the purpose of declaration of dividend or issue of right or bonus shares or for such other purposes as the stock exchange may agree and to give notice to the stock exchange as many days in advance as the exchange may from time to time reasonably prescribe, stating the dates of closure of its transfer books (or, when the transfer books are not to be closed, the date fixed for taking a record of its shareholders or debenture holders) and specifying the purpose or purposes for which the transfer books are to be closed (or the record is to be taken) and in the case of a right or bonus issue to so close the transfer books or fix a record date only after the sanctions of the competent authority subject to which the issue is proposed to be made have been duly obtained, unless the exchange agrees otherwise;
- (p) to forward to the stock exchange an annual return immediately after each annual general meeting of at least ten principal holders of each class of security of the company along with particulars as to the number of shares or debentures held by, and address of, each such holder;
- (q) to grant to shareholders the right of renunciation in all cases of issue of rights, privileges and benefits and to allow them reasonable time not being less than four weeks within which to record, exercise, or renounce such rights, privileges and benefits, and to issue, where necessary, coupons or fractional certificates or provide for the payment of the equivalent of the value of the fractional right in cash unless the company in general meeting or the stock exchange agrees otherwise;
- (r) to promptly notify the stock exchange—
 - (i) of any action which will result in the redemption, cancellation or retirement in whole or in part of any securities listed on the exchange,

- (ii) of the intention to make a drawing of such securities, intimating at the same time the date of the drawing and the period of the closing of the transfer books (or the date of the striking of the balance) for the drawing;
- (iii) of the amount of securities outstanding after any drawing has been made;
- (s) to intimate the stock exchange any other information necessary to enable the shareholders to appraise the position of the company and to avoid the establishment of a false market in the shares of the company;
- (t) that in the event of the application for listing being granted, such listing shall be subject to the rules and bye-laws of the exchange in force from time to time and that the company will comply within a reasonable time, with such further listing requirements as may be promulgated by the exchange as a general condition for new listings.

Procedure for listing of new securities by listed companies

A fresh application for listing will be necessary in respect of all new issues desired to be dealt in, provided that, where such new securities are identical in all respects with those already listed, admission to dealings will be granted on the company intimating to the stock exchange particulars of such new issues.

Explanation—Shares are identical in all respects only if—

- (a) they are of the same nominal value and the same amount per share has been called up;
- (b) they are entitled to dividend at the same rate and for the same period, so that at the next ensuing distribution, the dividend payable on each share will amount to exactly the same sum, net and gross; and
- (c) they carry the same rights in all other respects.

Suspension or withdrawal of admission to dealings in securities on stock exchange

A recognised stock exchange may suspend or withdraw admission to dealings in the securities of a company or body corporate either for a breach of or non-compliance with, any of the conditions of admission to dealings or for any other reason, to be recorded in writing, which in the opinion of the stock exchange justifies such action;

Provided, however, that no such action shall be taken by a stock exchange without according to the company or body corporate concerned a reasonable opportunity by a notice in writing, stating the reasons, to show cause against the proposed action;

Provided further that where a recognised stock exchange has withdrawn admission to dealings in any security, or where suspension of admission to dealings has continued for a period exceeding three months, the company or body corporate concerned may appeal to SEBI and SEBI may, after giving the stock exchange an opportunity of being heard, vary or set aside the decision of the stock exchange and thereupon the orders of SEBI shall be carried out by the stock exchange.

A recognised stock exchange may, either at its own discretion or shall in accordance with the orders of SEBI, restore or re-admit to dealings any securities suspended or SEBI withdrawn from the list.

Procedure applicable to statutory corporations

All the requirements with respect to listing prescribed by these rules, shall, so far as they may be, also apply to a body corporate constituted by an Act of Parliament or any State legislature;

Provided that a recognised stock exchange may relax the requirement of offer to the public for subscription of at least 25% of each class or kind of securities issued in respect of a body corporate referred to in this sub-rule with the previous approval of SEBI and also subject to such instructions as SEBI may issue in this behalf from time to time.

Discretionary exemption in enforcing listing requirements

SEBI may, at its own discretion or on the recommendation of a recognised stock exchange, waive or relax the strict enforcement of any or all of the requirements with respect to listing prescribed by these rules.

III. SECURITIES CONTRACTS (REGULATION) (APPEAL TO SECURITIES APPELLATE TRIBUNAL) RULES, 2000

Under the earlier section 22A of the Securities Contracts (Regulation) Act, 1956 a company could refuse to register the transfer of any of its securities in the name of transferee on any one or more of the grounds listed thereunder. This old section has been omitted w.e.f. 20.9.95.

Under the new section 22A of the Securities Contracts (Regulation) Act, 1956 inserted by the Securities Laws (Second Amendment) at 1999, it is laid down that where a recognised stock exchange refuses to list the securities of any company, the company shall be entitled to be furnished with the reasons for such refusals and in terms of that new section appeal to the Securities Appellate Tribunal against such refusal.

The procedure for such appeal is laid down in the Securities Contracts (Regulation) (Appeal to Securities Appellate Tribunal) Rules, 2000 notified on 18th February, 2000 by the Central Government in exercise of the powers conferred by Section 30 read with Section 22A of the Securities Contracts (Regulation) Act, 1956.

Limitation for filing appeal

Where a recognised stock exchange acting in pursuance of any power given to it by its bye-laws, refuses to list the securities of any company, the company shall be entitled to be furnished with reasons for such refusal and may,—

- (a) within 15 days from the date on which the reasons for such refusal are furnished to it; or
- (b) where the stock exchange had omitted or failed to dispose of, within the time specified in sub-section (1A) of section 73 of the Companies Act, 1956, the application for permission for the shares or debentures to be dealt with on the

stock exchange, within 15 days from the date of expiry of the specified time or within such further period, not exceeding one month, as the Appellate Tribunal may, on sufficient cause being shown, allow; appeal to the Securities Appellate Tribunal having jurisdiction in the matter against such refusal, omission or failure, as the case may be.

Form and procedure of appeal

A memorandum of appeal should be presented in the Form by any aggrieved person in the registry of the Appellate Tribunal within whose jurisdiction his case falls or it must be sent by registered post addressed to the Registrar and should be deemed to have been presented in the registry on the day it was received in the registry.

Sittings of Appellate Tribunal

The Appellate Tribunal is required to hold its sitting either at a place where its office is situated or at such other place falling within its jurisdiction, as it may deem fit by the Appellate Tribunal. In the temporary absence of the Presiding officer, Government may authorise one of the two other members to preside over the sitting of the Tribunal either at a place where its office is situated or at such other place falling within its jurisdiction as it may deem fit by the Appellate Tribunal.

Language of Appellate Tribunal

The proceedings of the Appellate Tribunal should be conducted in English or Hindi. No appeal, application, representation, document or other matters contained in any language other than English or Hindi, should be accepted by Appellate Tribunal, unless the same is accompanied by a true copy of translation thereof in English or Hindi.

Appeal to be in writing

Every appeal, application, reply, representation or any document filed before the Appellate Tribunal should be typewritten, cyclostyled or printed neatly and legibly on one side of the good quality paper of foolscap size in double space and separate sheets shall be stitched together and every page is required to be consecutively numbered and to be presented in five sets in a paper book along with an empty file size envelope bearing full address of the respondent and in case the respondents are more than one, then sufficient number of extra paper books together with empty file size envelope bearing full addresses of each respondent shall be furnished by the appellant.

Presentation and scrutiny of memorandum of appeal

(1) The Registrar should endorse on every appeal the date on which it is presented or deemed to have been presented and should also sign endorsement.

(2) If, on scrutiny, the appeal is found to be in order, it should be duly registered and given a serial number.

(3) If an appeal on scrutiny is found to be defective and the defect noticed is formal in nature the Registrar may allow the appellant to rectify the same in his presence and if the said defect is not formal in nature, the Registrar may allow the appellant such time

to rectify the defect as he may deem fit. If the appeal has been sent by post and found to be defective, the Registrar may communicate the defects to the appellant and allow the appellant such time to rectify the defect as he may deem fit.

(4) If the appellant fails to rectify the defect within the time allowed in sub-rule (3), the Registrar may by order and for reasons to be recorded in writing, decline to register such memorandum of appeal and communicate the order to the appellant within seven days thereof.

(5) An appeal against the order of the Registrar is required to be made within fifteen days of receiving of such order to the Presiding Officer or in his temporary absence, to the member authorised in this behalf, whose decision thereon shall be final.

Payment of fees

Every memorandum of appeal should be accompanied with a fee as prescribed and such fee may be remitted in the form of crossed demand draft drawn on a nationalised bank in favour of 'The Registrar, Securities Appellant Tribunal' payable at the station where the registry is located.

The amount of fee payable in respect of appeal against adjudication orders made under the Act has been prescribed as given below:

<i>Amount of Penalty imposed</i>	<i>Amount of fee payable</i>
1. Less than rupees ten thousand	Rs. 500
2. Rupees ten thousand or more but less than one lakh	Rs. 1200
3. Rupees one lakh or more	Rs. 1200 plus Rs. 500 for every additional one lakh of penalty or fraction thereof subject to a maximum of Rs. 1,50,000

Contents of memorandum of appeal

Every memorandum of appeal filed, shall set forth contents under distinct heads, the grounds of such appeal without any argument or narrative, and such ground should be numbered consecutively and shall be in the manner prescribed. It should not be necessary to present separate memorandum of appeal to seek interim order or direction if in the memorandum of appeal, the same is prayed for.

Documents to accompany memorandum of appeal

Every memorandum of appeal should be in five copies and also accompany with copies of the order, at least one of which should be certified copy, against which the appeal is filed. Where a party is represented by authorised representative, a copy of the authorisation to act as the authorised representative and the written consent thereto by such authorised representative, shall be appended to the appeal.

Plural remedies

A memorandum of appeal should not seek relief or reliefs therein against more than one order unless the reliefs prayed for are consequential.

Notice of appeal to the respondent

A copy of the memorandum of appeal and paper book should be served by the Registrar on the respondent as soon as they are registered in the registry, by hand delivery, or by Registered Post or Speed Post.

Filing of reply to the appeal and other documents by the respondent

(1) The respondent may file five complete sets containing the reply to the appeal along with documents in a paper book form with the registry within one month of the service of the notice on him of the filing of the memorandum of appeal.

(2) Every reply, application or written representation filed before the Appellate Tribunal should be verified in the manner provided for, in the Form.

(3) A copy of every application, reply, document or written material filed by the respondent before the Appellate Tribunal should be forthwith served on the appellant, by the respondent. The Appellate Tribunal, may in its discretion, on application by the respondent allow the filing of reply after the expiry of the period referred to therein.

Date of hearing to be notified

The appellate Tribunal should notify the parties the date of hearing of the appeal in such manner as the Presiding Officer may by general or special order direct.

Hearing of appeal

(1) On the day fixed or on any other day to which the hearing may be adjourned, the appellant should be heard in support of the appeal. The Securities Appellate Tribunal should also, if necessary, hear the Board or its authorised representative against the appeal and in such case the appellant shall be entitled to reply. During the course of the hearing of appeal the written arguments could be supplemented by time-bound oral arguments.

In case of temporary absence of the presiding officer or of the member authorised by the Government, the presiding officer can authorise the other member present on that day to hear the Board or authorised representative against the appeal.

(2) In case the appellant does not appear in person or through an authorised representative when the appeal is called for hearing the Securities Appellate Tribunal may dispose of the appeal on merits;

However it has been provided that where an appeal has been disposed of as provided above and the appellant appears afterwards and satisfies the Securities Appellate Tribunal that there was sufficient cause for his not appearing, when the appeal was called for hearing, the Securities Appellate Tribunal should make an order setting aside the ex-parte order and restore the appeal.

Order to be signed and dated

Every order of the Appellate Tribunal should be signed and dated by the Presiding Officer and the two other members. The Presiding Officer will have powers to pass interim orders or injunctions, subject to reasons to be recorded in writing,

which it considers necessary in the interest of justice. The order should also be pronounced in the sitting of the Appellate Tribunal by the member authorised in this behalf.

Publication of orders

The orders of the Appellate Tribunal, as are deemed fit for publication in any authoritative report or the press may be released for such publication on such terms and conditions as the Presiding Officer may lay down.

Communication of orders

A certified copy of every order passed by the Appellate Tribunal should be communicated to the Board, the Adjudicating Officer and to the parties, as the case may be.

Orders and directions in certain cases

The Appellate Tribunal may make such orders or give such directions as may be necessary or expedient to give effect to its orders or to prevent abuse of its process or to secure the ends of justice.

Fee for inspection of records and obtaining copies thereof

A fee of rupees twenty, for every hour or part thereof inspection subject to a minimum of rupees one hundred should be charged for inspecting the records of a pending appeal by a party thereto. A fee of rupees five for a folio or part thereof not involving typing and a fee of rupees ten for a folio or part thereof involving typing of statement and figures shall be charged for providing copies of the records of an appeal, to a party thereto.

IV. SECURITIES CONTRACTS (REGULATION) (MANNER OF INCREASING AND MAINTAINING PUBLIC SHAREHOLDING IN RECOGNISED STOCK EXCHANGES) REGULATIONS, 2006

The Securities Contracts (Regulation) (Manner of Increasing and Maintaining Public Shareholding in Recognised Stock Exchanges) Regulations, 2006 came into force w.e.f. 13th November, 2006.

The Regulations are applicable to all recognised stock exchanges in respect of which the scheme for corporatisation or demutualisation has been approved by the SEBI under section 4B of the Securities Contracts (Regulation) Act, 1956.

As per Regulation 2(b) –“associate” in relation to a shareholder having trading rights in a recognised stock exchange means a person –

- (i) who directly or indirectly, by himself or in combination with other persons, exercises control over such shareholder or holds substantial shares entitling not less than fifteen per cent of the voting rights in such shareholder being a body corporate; or
- (ii) over whom such shareholder, directly or indirectly, by itself or in combination with other persons, exercises control; or

- (iii) whose director or partner is also a director or a partner of such shareholder, being a body corporate or a partnership firm, as the case may be; or
- (iv) who is a holding company or subsidiary company of such shareholder or a company under the same management as such shareholder; or
- (v) who is a relative of the shareholder being a natural person under Schedule IA of the Companies Act, 1956; or
- (vi) who is a sub-broker of the shareholder in that stock exchange; or
- (vii) who acts in accordance with instructions of such shareholder in the exercise of voting rights and other rights in the recognised stock exchange, directly or indirectly.

Manner of increasing the public shareholding

Regulation 4 provides that subject to the provisions of section 4B(8) of the Securities Contracts (Regulation) Act, 1956 and the scheme, the recognised stock exchange shall ensure that at least fifty-one percent of its equity share capital is held by the public, either by fresh issue of equity shares to the public through issue of prospectus or in the following manner:

- (a) offer for sale, by issue of prospectus, of shares held by shareholders having trading rights therein;
- (b) placement of shares held by shareholders having trading rights to such persons or institutions as may be shortlisted by the recognised stock exchange with the approval of the Board;
- (c) issue of equity shares on private placement basis by the recognised stock exchange to any person or group of persons not being shareholders having trading rights or their associates subject to the approval of SEBI; or
- (d) any combination of the above.

Procedure for fresh issue of equity shares or offer for sale to the public

Regulation 5 provides that any fresh issue of equity shares or offer for sale to the public through a prospectus shall be in compliance with the provisions of the Companies Act, 1956 and Guidelines or Regulations of the SEBI relating to issue of capital. Where any fresh issue of equity shares or offer for sale to the public is made an application for listing thereof shall be made to the same recognised stock exchange or any other recognised stock exchange and section 73 of the Companies Act, 1956 shall apply to such application and the provisions of SEBI (ICDR) Regulations, 2009 relating to public issue shall as far as may apply to such offer for sale. Listing of equity shares or other securities of a recognised stock exchange on the same recognised stock exchange shall be in compliance with such conditions as may be specified by SEBI.

Private placement

As per Regulation 6, where a recognised stock exchange whose shares are not listed on any recognised stock exchange makes a private placement, such private placement shall be in compliance with applicable legal provisions, including those of

the Companies Act, 1956 and the Unlisted Public Companies (Preferential Allotment) Rules, 2003. It provides that where a placement is made to fifty or more persons, it shall be in compliance with provisions of the Companies Act, 1956 and Guidelines or Regulations of the SEBI relating to public issue of capital.

Confirmation of compliance with sub-section (8) of section 4B

When SEBI is satisfied that any recognised stock exchange has complied with the provisions sub-section (8) of section 4B read with this Chapter, it shall issue a confirmation to the recognised stock exchange to that effect.

Shareholding and transferability restrictions

A person resident in India should not at anytime, directly or indirectly, either individually or together with persons acting in concert, hold more than five per cent. of the equity share capital in a recognised stock exchange. However, a stock exchange, a depository, a clearing corporation, a banking company, an insurance company and a public financial institution defined under section 4A of the Companies Act, 1956 may hold, either directly or indirectly, either individually or together with persons acting in concert, upto fifteen per cent of the paid up equity share capital of the recognised stock exchange. Further , person holding equity shares in a recognised stock exchange in excess of the limits specified in this regulation at the commencement of these regulations shall reduce his holding to ensure compliance with this regulation within the time specified in sub-section (8) of section 4B of the Act or the time extended under the proviso thereto.

The combined holding of all persons resident outside India in the equity share capital of a recognised stock exchange should not exceed, at any time, forty nine per cent of its total equity share capital, subject further to the following:-

- (a) the combined holdings of such persons acquired through the foreign direct investment route shall not exceed twenty six per cent of the total equity share capital, at any time;
- (b) the combined holdings of foreign institutional investors shall not exceed twenty three per cent of the total equity share capital, at any time;
- (c) no foreign institutional investor shall acquire shares of a recognised stock exchange otherwise than through the secondary market if such exchange is listed;
- (d) no foreign institutional investor shall have any representation in the Board of Directors of the recognised stock exchange;
- (e) no foreign investor, including persons acting in concert with him, shall hold more than five per cent of the equity share capital in a recognised stock exchange.

No shareholder having trading rights in a recognized stock exchange, shall prior to issuance of confirmation, transfer his shares in such recognized stock exchange to any person otherwise than in accordance with these regulations.

Eligibility criteria for persons acquiring or holding more than five per cent equity shares in a recognised stock exchange

Regulation 9 provides that no person shall, directly or indirectly, either individually

or together with persons acting in concert with him, acquire and/or hold more than five per cent of the paid up equity capital of a recognised stock exchange after commencement of these regulations, unless he is a fit and proper person and has taken prior approval of the Board for doing so. A person is deemed to be a fit and proper person if –

- (i) such person has a general reputation and record of fairness and integrity, including but not limited to—
 - (a) financial integrity;
 - (b) good reputation and character; and
 - (c) honesty.
- (ii) such person has not incurred any of the following disqualifications—
 - (a) the person or any of its whole time directors or managing partners has been convicted by a Court for any offence involving moral turpitude or any economic offence, or any offence against the securities laws;
 - (b) an order for winding up has been passed against the person;
 - (c) the person or any of its whole time directors or managing partners has been declared insolvent and has not been discharged;
 - (d) an order, restraining, prohibiting or debarring the person, or any of its whole time directors or managing partners from dealing in securities in the capital market or from accessing the capital market has been passed by the Board or any other regulatory authority and a period of three years from the date of the expiry of the period specified in the order has not elapsed;
 - (e) any other order against the person or any of its whole time directors or managing partners which has a bearing on the capital market, has been passed by the Board or any other regulatory authority and a period of three years from the date of the order has not elapsed;
 - (f) the person has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force; and
 - (g) the person is financially not sound.

If any question arises as to whether a person is a fit and proper person, SEBI's decision on such question shall be final.

Dematerialization

Regulation 10 provides that a recognised stock exchange which has issued equity shares or whose equity shares are offered for sale in the manner provided in these regulations shall—

- (a) enter into an agreement with the depositories for dematerialization of the equity shares proposed to be issued or proposed to be sold; and
- (b) it shall give an option to the subscribers or transferees to receive the share certificate or hold the shares in dematerialized form with a depository.

Obligations of the recognised stock exchange

Under Regulation 11, a recognised stock exchange is required to monitor and ensure that no transfer or issue of equity shares therein is made otherwise than in accordance with these regulations and that at least fifty-one per cent of its equity share capital is continuously held by the public; and that the restrictions contained in these regulations are complied with in respect of the shareholding therein.

Without prejudice to the provisions of the Act and the rules made thereunder, the recognised stock exchanges shall submit a report to SEBI disclosing the following on a quarterly basis within fifteen days from the end of each quarter:-

- (a) the names of ten largest shareholders along with the number of shares held by them and their percentage shareholding;
- (b) the names of the shareholders falling who had acquired shares in that quarter;
- (c) the shareholding pattern in the recognised stock exchange in such format as may be specified by SEBI.

The recognised stock exchange is required to submit an undertaking confirming the compliance of the provisions to SEBI on a quarterly basis within fifteen days from the end of each quarter. SEBI may from time to time call for any information from the recognised stock exchange, any shareholder having trading rights or any transferee of shares held by such shareholder, under the provisions of Securities Contracts (Regulation) Act, 1956 and SEBI Act, 1992 and the rules and regulations made thereunder. The recognised stock exchange shall maintain and preserve all the books, registers, other documents and records relating to, the issue or sale of equity shares under these regulations for a period of ten years.

POWERS OF THE BOARD**Power of Inspection**

Regulation 12 provides that SEBI may at any time undertake inspection, conduct inquiries and audit of any recognised stock exchange or any shareholder having trading rights therein or any associate of such shareholder, in accordance with the provisions of SEBI Act, 1992, and the rules made thereunder. Where an inspection of any recognised stock exchange or any shareholder having trading rights therein or any associate of such shareholder is undertaken by the Board, every manager, managing director, officer and other employee of such recognised stock exchange or shareholder or associate shall co-operate with SEBI.

Action in case of default (Regulation 13)

Without prejudice to power to impose monetary penalty, initiate prosecution or issue directions under the provisions of the Act or SEBI Act, 1992, SEBI may, issue such directions as it deems fit, including—

- (a) directing disinvestment of shares held by shareholders having trading rights in breach of sub-section (8) of section 4B of the Act, in such manner as may be specified in the direction;
- (b) directing a person holding equity shares in a recognised stock exchange in

contravention of regulations 8 or 9 to divest his holding, in such manner as may be specified in the direction;

- (c) directing transfer of any proceeds or securities to the investors protection fund of a recognised stock exchange;
- (d) debarring any recognised stock exchange, any shareholder having trading rights therein, any associate of such shareholder or any transferee of shares from such shareholder from accessing the capital market or dealing in securities for such period as may be determined by SEBI.

V. LISTING OF SECURITIES

Listing of securities with stock exchange is a matter of great importance for companies and investors, because this provides the liquidity to the securities in the market.

The prices at which the securities are traded in the stock exchange are published in the News Papers. Investors are able to know these price trends from such publications. Compared to listed securities the trading of unlisted securities is difficult. The price trends in respect of unlisted securities are seldom known to the investors and the contract between the seller and buyer takes places mostly on one to one basis.

Thus, in order to avail of the benefit of listing the company seeking such listing should be applied as per conditions of listing agreement entered into with stock exchange. It is open to companies to get their securities listed in their Regional stock exchanges and one or more of the other stock exchanges in the country under this Act. Company seeking listing with stock exchanges in other countries shall have to follow the rules and regulations of those exchanges.

Only public companies are allowed to list their securities in the stock exchange. Private Limited companies cannot get listing facility. They should first convert themselves into public limited companies and their Articles of Association should also contain prohibitions as laid down in the listing agreement and as applicable to public limited companies.

Types of Listing

Listing of securities falls under 5 groups—

- (1) *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.
- (2) *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.
- (3) *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.
- (4) *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.

- (5) *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

The following benefits are available when securities are listed by a company in the stock exchange—

- (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.

Legal provisions on listing

As per Section 73(1) of the Companies Act, 1956, (as amended by 1988 Act), every company intending to offer shares or debentures to the public for subscription by the issue of a prospectus is required to make an application to one or more recognised stock exchanges before such issue for permission for the securities intending to be so offered to be dealt with in the Stock Exchange(s).

As per Section 73(1A) of the Companies Act, 1956, prospectus should state the names of the stock exchanges where application for listing has been made and any allotment of securities made on the basis of such prospectus should be void if permission of listing is not granted by the stock exchange(s) before the expiry of 10 weeks from the closure of the issue.

As per Section 73(2), if the application for listing is not made or if permission is not granted, the company should forthwith repay without interest all money received from the applicants within 8 days. If the money is not refunded within 8 days as stated, the company and its every officer in default should, from the expiry of 8th day, be jointly and severally liable to repay that money with interest (presently @15% per annum).

As per Section 4 of the Securities Contracts (Regulation) Act, 1956, every recognised stock exchange has the powers to make bye-laws for the listing of

securities on the stock exchange, inclusion of any security for the purpose of dealings and suspension or withdrawal of securities and the prohibition of trading in any specified security, subject to SEBI approval.

Every company while submitting its application for listing with the stock exchange(s) should produce a number of documents as enclosures to satisfy the requirements of the concerned stock exchange. It should also give a number of undertakings as a condition precedent before listing as sought by the concerned stock exchange. Finally when the stock exchange(s) agree(s) to list the securities, the company shall execute a listing agreement with the stock exchange(s).

When a company signs a listing agreement with a stock exchange, it means it has entered a legally binding contract with that exchange and it has to ensure compliance of each and every term and condition in the listing agreement. For failure to ensure such compliance the stock exchange can take an action against the company after giving an opportunity of being heard.

Listing of Securities on Indian Stock Exchanges, thus, is essentially 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.

Compliances under the Listing Agreement

Major Compliances ought to be followed pursuant to the Listing Agreement are given hereunder :

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
Clause 1	Share allotment— Regret Letters— Notification in Press —	Rejection letters if any, to be posted simultaneously with allotment letters. OR Publish in English morning daily newspaper the next day to the date of despatch of letters of allotment
Clause 5A	For shares which remained unclaimed and are lying in escrow account	The issuer— (a) shall send at least three reminders at the address given in the application form and depository's database. (b) in case of no response, crediting of unclaimed shares to demat suspense account opened by issuer with the depository

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
		participants.
		(c) crediting of corporate benefits which is accruing on unclaimed shares such as bonus, split etc.
		(d) details of shareholding of individual allottee and the allottee's account shall be credited after proper verification of the identity of the allottee ,as and when the allottee approaches.
		(e) the suspense account held by the issuer shall be purely on behalf of the allottee.
		(f) the voting rights on such shares shall remain frozen till the rightful owner claims the shares.
		(g) shall disclose in its annual report the aggregate number of shareholders and the outstanding shares in the suspense account lying at the beginning of the year and at the end of year.
		Number of shareholders who approached and to whom shares were transferred from suspense account.
	For shares issued in physical form which remain unclaimed	(a) In case of no response after giving three reminders, the company shall transfer all the shares into one folio in the name of "Unclaimed Suspense Account".
		(b) The issuer shall

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
		dematerialise the shares held in the Unclaimed Suspense Account with one of the Depository Participants.
		(The issuer need to comply with these two requirements in addition to the requirements specified for shares which are in dematerialize form and unclaimed)
Clause 13	Notification of any attachment or prohibiting orders against transfer of securities.	<p>(a) Notify any attachment or prohibitory orders restraining transfer of securities</p> <p>(b) Furnish particulars of the number of securities so affected, the distinctive numbers of such securities and the names of the registered holders thereof</p>
Clause 16	Book closure/Record Date	<p>(a) Atleast once in a year the books should be closed.</p> <p>(b) Gap between two book closures and/or record dates would be atleast 7 days.</p> <p>(c) No delivery period for all types of corporate actions in case of scrips traded in compulsory dematerialized mode</p> <p>(d) Intimate atleast 7 days before corporate actions like mergers, de-mergers, splits and bonus shares in case of company whose stock derivatives are available or whose stocks form part of an Index on which derivatives are</p>

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
		available.
Clause 19	<p>Convening of a Board Meeting for Declaration/Decision regarding:</p> <p>(a) Dividend</p> <p>(b) Bonus shares if forming part of Agenda.</p> <p>(c) Issue of rights shares.</p> <p>(d) Issue of convertible debentures</p> <p>(e) Issue of debentures carrying a right to subscribe to equity shares.</p> <p>(f) Passing over of dividend</p> <p>(g) Buy-back of securities</p> <p>(h) Further public offer to be made through the fixed price route</p>	<p>(a) Intimate atleast 2 days in advance about the convening of a board meeting to decide the matters (a) to (g) alongside. No prior intimation is required about board meeting in respect of issue of bonus shares if the issue is not in the Agenda of board meeting.</p> <p>(b) Undertakes to recommend to declare all dividend and/or cash bonuses at least 5 days before the commencement of the closure of its transfer books or the record date fixed for that purpose.</p> <p>(c) Prior intimation to the exchange for shares on right basis to the existing shareholders at least two days in advance.</p> <p>(d) Intimation to the exchange at least 48 hours in advance, for determination of issue price.</p>
Clause 20 & 22	Decision regarding declaration of dividend, bonus interest payment buy-back of securities, rights, re-issue of forfeited shares, calls to be made.	Furnish information to the Stock Exchanges within 15 minutes of the closure of the Board Meeting and such intimation made shall also contain the date on which dividend shall be paid/dispatched.
Clause 20A	Uniformity in dividend declaration.	All listed company shall declare their dividend on per share basis only.
Clause 21	Payment of interest on debentures/bonds, redemption amount of redeemable shares	Intimate atleast 21 days in advance, of the date on and from which the amounts will be paid.

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
	or debentures/ bonds	
Clause 25	Granting options to purchase any shares of the company	<p>Notify all the listed Exchanges</p> <p>(a) Number of shares covered by such options, of the terms thereof and of the time within which they may be exercised.</p> <p>(b) Subsequent changes or cancellation or exercise of such options</p>
Clause 27	Any action resulting in redemption, cancellation or retirement in whole or in part of listed securities, or intention to make withdrawal of such securities	<p>Notify all the listed exchanges :</p> <p>(a) of such action, or (b) of intention to make a drawing. Simultaneously intimate the date of the withdrawal and the period of closing of transfer books (or the date of striking of the balance) for the drawing, and (c) of the amount of securities outstanding after the drawing.</p>
Clause 28	Change in the form or nature of listed securities or change in the rights/privileges thereof	<p>(a) Give 21 days prior notice to the exchange.</p> <p>(b) Apply to exchange for listing of the securities as changed, if exchange so requires.</p>
Clause 28A	In case of superior rights as to voting or dividend vis-à-vis the rights on equity shares that are listed which may confer on any person.	The company shall not issue shares in any manner.
Clause 29 & 30	<p>(a) Change in general characters or nature of company's business</p> <p>(b) Change in the companies directors</p> <p>(c) Change of Managing Director</p> <p>(d) Change of Auditors</p>	Promptly notify the exchange of these changes.

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
Clause 31	Further issue of Securities and other documents to be forwarded	To forward to the exchange six copies of the Annual Reports, notices, resolutions and circulars relating to new issue of capital, three copies of all the notices, call letters etc. including notices of meetings convened u/s 391 or section 394 read with section 391 of the Companies Act, 1956, copy of the proceedings at all Annual and Extraordinary General Meetings of the Company, three copies of all notices, circulars, etc., issued or advertised in the press either by the Company, or by any company which the Company proposes to absorb or with which the Company proposes to merge or amalgamate, or under orders of the court or any other statutory authority in connection with any merger, amalgamation, reconstruction, reduction of capital, scheme or arrangement.
Clause 32	Cash Flow Statement in the Annual Report, Consolidated Financial Statement and related party disclosures	(a) Companies to prepare Cash Flow Statement in accordance with AS-3 of ICAI and present it under the indirect method. Companies to send a statement containing the salient features of the Balance Sheet, P&L A/c and Auditors' Report to each share holder. Unabridged Annual report to be sent to member of listed exchange on his request. Company will publish Consolidated Financial Statements duly audited by the statutory auditors and file the same with Stock Exchange.

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
		(b) Company will also make related party disclosures in its Annual Reports.
Clause 35	Shareholding pattern containing details of promoters holding and non-promoters holding	<p>File with the exchange the shareholding pattern in the prescribed form</p> <p>(i) One day prior to listing of its securities on the stock exchange;</p> <p>(ii) Within 21 days from the end of the quarter on a quarterly basis;</p> <p>(iii) Within 10 days of any capital restructuring of the company resulting in a change exceeding +/- 2% of the total paid-up share capital.</p> <p>The format for reporting the shareholding pattern must include details of shares pledged by the promoters and promoters group and is required to be given for each class of security separately. The additional format should disclose the voting right pattern in the company.</p>
Clause 36	Decision regarding issue of shares, forfeiture of shares, alteration of shares, cancellation of declared dividend, merger, amalgamation, de-merger, hiving off, voluntary delisting and other material decisions.	Immediately disclose all material information simultaneously to all the Stock Exchanges, where the Securities of the company are listed.
Clause 40A	Minimum Level of Public Shareholding	<p>To comply with the requirements specified in Rule 19(2) and Rule 19A of the Securities Contracts (Regulation) Rules, 1957.</p> <p>The company shall adopt any of the following methods to raise the public shareholding to the required level:</p>

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
		<p>(a) issuance of shares to public through prospectus; or</p> <p>(b) offer for sale of shares held by promoters to public through prospectus; or</p> <p>(c) sale of shares held by promoters through the secondary market.</p> <p>However, the company is required to take prior approval of the Specified Stock Exchange (SSE) which may impose such conditions as it deems fit.</p>
Clause 40B	Conditions for continued listing and Takeover	Whenever the take-over offer is made or there is any change in the control of the management of the company, the person who secures the control of the management of the company and the company whose shares have been acquired shall comply with the relevant provisions of the SEBI (Substantial Acquisition of Shares and Take-over) Regulations, 1997.
Clause 41	Preparation and Submission of Financial Results.	<p>To submit quarterly year to date and annual financial results to the stock exchange in the manner prescribed.</p> <p>To submit audited or unaudited quarterly and year to date financial results to the stock exchange within one month of end of each quarter (other than the last quarter), subject to the following:</p> <p>(a) To submit a copy of the limited review report to the stock exchange within two months from end of the quarter, in case the company opts to submit unaudited financial results</p>

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
		<p>(b) Financial results to be accompanied by auditors report in case the company opts to submit audited financial results</p> <p>To submit unaudited financial results for the quarter within one month of end of the financial year or to submit audited financial results for the entire financial year within three months of end of the financial year, subject to the following:</p> <ul style="list-style-type: none"> — To submit audited financial results for the entire financial year, as soon as they are approved by the Board, in case the company opts to submit unaudited financial results for the last Quarter — To intimate the option to the stock exchange in writing within one month of end of the financial year, in case the company opts to submit audited financial results for the entire financial year. <p>Companies having subsidiaries may, in addition to submitting quarterly and year to date stand alone financial results to the stock exchange also submit quarterly and year to date consolidated financial results; and while submitting annual audited financial results prepared on stand-alone basis, it shall also submit annual audited consolidated financial results to the stock exchange.</p>

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
Manner of approval and authentication of the financial results		<p data-bbox="883 365 1284 520">To submit financial results to the stock exchange within fifteen minutes of conclusion of the meeting of the Board or Committee in which they were approved.</p> <p data-bbox="883 541 1284 697">The quarterly financial results submitted shall be approved by the Board of Directors of the company or by a committee thereof, other than the audit committee.</p> <p data-bbox="883 722 1284 877">Provided that when the quarterly financial results are approved by the Committee they shall be placed before the Board at its next meeting:</p> <p data-bbox="883 903 1284 1268">Provided further than while placing the financial results before the Board, the Chief Executive Officer and Chief Financial Officer of the company, by whatever name called, shall certify that the financial results do not contain any false or misleading statement or figures and do not omit any material fact which may make the statements or figures contained therein misleading.</p> <p data-bbox="883 1293 1284 1470">The Committee mentioned above shall consist of not less than one third of the directors and shall include the managing director and at least one Independent director.</p> <p data-bbox="883 1495 1284 1766">The financial results submitted to the stock exchange shall be signed by the Chairman or managing director, or a whole time director. In the absence of all of them, it shall be signed by any other director of the company who is duly authorized by the Board to sign the financial results.</p>

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
		<p>The limited review report to be placed before the Board of directors or the Committee before being submitted to the stock exchange.</p> <p>Provided that when the limited review report is placed before the Committee they shall also be placed before the Board at its next meeting.</p> <p>The annual audited financial results shall be approved by the Board of Directors of the company and shall be signed.</p>
	Intimation of Board Meeting	<p>To give prior intimation of the date and purpose of meetings of the Board or Committee in which the financial results will be considered at least seven clear calendar days prior to the meeting (excluding the date of the intimation and date of the meeting).</p> <p>To issue a public notice in at least in one English daily newspaper circulating in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the company is situated.</p>
	Other requirements as to financial results	<p>Where there is a variation between the unaudited quarterly or year to date financial results and the results amended pursuant to limited review for the same period, and –</p> <p>(i) the variation in net profit or net loss after tax is in excess of 10% or Rs.10 lakhs, whichever is higher;</p>

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
		<p>or</p> <p>(ii) the variation in exceptional or extraordinary items is in excess of 10% or Rs.10 lakhs, whichever is higher -</p> <p>the company shall submit to the stock exchange an explanation of the reasons for variations, while submitting the limited review report. The explanation of variations so submitted shall be approved by the Board of Directors:</p> <p>If the auditor has expressed any qualification or other reservation in respect of audited financial results submitted or published under this clause, the company shall disclose such qualification or other reservation and impact of the same on the profit or loss, while publishing or submitting such results.</p> <p>If the auditor has expressed any qualification or other reservation in his audit report or limited review report in respect of the financial results of any previous financial year or quarter which has an impact on the profit or loss of the reportable period, the company shall include as a note to the financial results –</p> <p>(i) how the qualification or other reservation has been resolved; or</p> <p>(ii) if it has not been resolved, the reason therefor and the steps which the company intends to take in the matter.</p>

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
		<p>If the company has changed its name suggesting any new line of business, it shall disclose the net sales or income, expenditure and net profit or loss after tax figures pertaining to the said new line of business separately in the financial results and shall continue to make such disclosures for the three years succeeding the date of change in name.</p>
		<p>If the company had not commenced commercial production or commercial operations during the reportable period, the company shall, instead of submitting financial results, disclose the details of amount raised, the portions thereof which is utilized and that remaining unutilized, the details of investment made pending utilisation, brief description of the project which is pending completion, status of the project and expected date of commencement of commercial production or commercial operations.</p>
<p>Publication of financial results in newspapers</p>		<p>The company shall, within 48 hours of conclusion of the Board or Committee meeting at which the financial results were approved, publish a copy of the financial results which were submitted to the stock exchange in at least in one English daily newspaper circulating in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the company is situated:</p>

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
		<p>Provided that where the company has opted to submit audited financial results, it shall also publish the qualifications or reservations, if any, expressed by the auditor together with the audited results.</p> <p>Where the company has submitted consolidated financial results in addition to stand-alone financial results, it shall have an option to publish either stand-alone financial results or consolidated financial results in the newspapers, subject to the following:</p> <ul style="list-style-type: none">(i) If it is desirous of publishing consolidated financial results alone, it shall exercise the option in the first quarter of the financial year and such option shall not be changed during the financial year;(ii) In case the company changes its option in any subsequent year, it shall furnish comparable figures for the previous year in accordance with the option exercised for the current year.(iii) If the company opts to publish only consolidated financial results, it shall give a reference in the newspaper publication, to the places, such as the company's website and stock exchanges' websites, where the standalone results will be available for perusal.

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
		(iv) If the company opts to publish only stand-alone financial results, it shall also publish consolidated figures for turnover, net profit after tax and earnings per share.
Clause 43A	Filing of deviations in the use of public issue proceeds	Filing of deviations in the use of public issue proceeds and to appoint monitoring agency to monitor utilisation of proceeds etc.
Clause 47	Appointment of Company Secretary as Compliance Officer	Appoint 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.
	Registration of share Transfer	<p>(i) Obtain certificate from Company Secretary in Practice, on half yearly basis, that the securities lodged for transfer have been registered and despatched within 30 days from the date of lodgment with the company within 15 days from the end of half year.</p> <p>(ii) Send a copy of the same within 24 hrs of the time of receipt to all listed exchanges.</p> <p>(iii) Intimate all the exchanges within 48 hrs from the time of receipt of information of</p>

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
Clause 49	Corporate Governance	<p>loss of certificate/closure time of Board (Committee) meeting.</p> <ul style="list-style-type: none"> (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.
Clause 50	Accounting Standards	Company should comply with all the accounting standards issued by the Institute of Chartered Accountants of India.
Clause 52	CFDS	All the listed companies are required to file information with the stock exchange only through Corporate Filing and Dissemination System (CFDS) which is put in place jointly by BSE and NSE at the www.corpfilling.co.in .

<i>Reference</i>	<i>Subject Matter</i>	<i>Requirement</i>
		The compliance officer, appointed under Clause 47(a) and the company shall be responsible for ensuring the correctness, authenticity and comprehensiveness of the information, statements and reports filed under this clause and also for ensuring that such information is in conformity with the applicable laws and listing agreement. [Clause 52(1)(b)]
Clause 53	To notify the stock exchange and disseminate through its own website information on disclosures regarding immediately upon entering into agreements with media companies and/or their associates	<p>Shareholding (if any) of media companies/associates in issuer the company.</p> <p>Details of nominee of media companies on the Board, any management control or potential conflict of interest arising out of such agreement.</p> <p>Back to back treaties/ contracts/agreements/MoUs or similar instruments entered into by the issuer company with media companies and/or their associates for the purpose of advertising, publicity, etc.</p>
Clause 54	The issuer company agrees	<p>To maintain a functional website containing basic information about the company.</p> <p>To ensure that the contents of the website are updated at any given point of time.</p>

CORPORATE GOVERNANCE THROUGH LISTING AGREEMENT

Corporate governance denotes the process, structure and relationship through which the Board of Directors oversees what the management does. It is also about being answerable to different stakeholders.

CII constituted a Committee to recommend a Code of Corporate Governance to be observed by corporates in their functioning. The Committee further recommended

a Code popularly known as “Desirable Corporate Governance Code” which defined Corporate Governance as follows:

“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.*”

The Kumar Mangalam Birla Committee Constituted by SEBI has observed that:

“Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high-quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure.”

N.R. Narayana Murthy Committee on Corporate Governance constituted by SEBI has observed that:

“Corporate Governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company.”

The Institute of Company Secretaries of India has also defined the term Corporate Governance as under:

	<p>“Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.”</p>
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Good Governance in capital market has always been high on the agenda of SEBI. Corporate Governance is looked upon as a distinctive brand and benchmark in the profile of Corporate Excellence. This is evident from the continuous updation of guidelines, rules and regulations by SEBI for ensuring transparency and accountability. In the process, SEBI had constituted a Committee on Corporate Governance under the Chairmanship of Shri Kumar Mangalam Birla. The Committee in its report observed that “the strong Corporate Governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure.”

Based on the recommendations of the Committee, the SEBI had specified principles of Corporate Governance and introduced a new clause 49 in the Listing agreement of the Stock Exchanges in the year 2000. These principles of Corporate Governance were made applicable in a phased manner and all the listed companies

with the paid up capital of Rs 3 crores and above or net worth of Rs 25 crores or more at any time in the history of the company, were covered as of March 31, 2003.

SEBI, as part of its endeavour to improve the standards of corporate governance in line with the needs of a dynamic market, constituted another Committee on Corporate Governance under the Chairmanship of Shri N. R. Narayana Murthy to review the performance of Corporate Governance and to determine the role of companies in responding to rumour and other price sensitive information circulating in the market in order to enhance the transparency and integrity of the market. The Committee in its Report observed that "the effectiveness of a system of Corporate Governance cannot be legislated by law, nor can any system of Corporate Governance be static. In a dynamic environment, system of Corporate Governance need to be continually evolved."

With a view to promote and raise the standards of Corporate Governance, SEBI on the basis of recommendations of the Committee and public comments received on the report and in exercise of powers conferred by Section 11(1) of the SEBI Act, 1992 read with section 10 of the Securities Contracts (Regulation) Act 1956, revised the existing clause 49 of the Listing agreement vide its circular SEBI/MRD/SE/31/2003/26/08 dated August 26, 2003.

SEBI vide circular number SEBI/CFD/ DIL/CG/1/2004/12/10 dated October 29, 2004 again revised the existing Clause 49 of the Listing Agreement directing all the Stock Exchanges to amend the Listing Agreement by replacing the existing Clause 49 of the Listing Agreement.

The provisions of the Clause 49 shall be implemented as per the schedule of implementation given below:

- (a) For entities seeking listing for the first time, at the time of seeking in-principle approval for such listing.
- (b) For existing listed entities which were required to comply with Clause 49 which is being revised i.e. those having a paid up share capital of Rs. 3 crores and above or net worth of Rs. 25 crores or more at any time in the history of the company, by April 1, 2005.

Companies complying with the provisions of the existing Clause 49 at present (issued vide circulars dated 21st February, 2000, 9th March 2000, 12th September 2000, 22nd January, 2001, 16th March 2001 and 31st December 2001) shall continue to do so till the revised Clause 49 of the Listing Agreement is complied with or till March 31, 2005, whichever is earlier.

However noticing that large number of companies are still not in the state of preparedness to be fully compliant with the requirements of revised Clause 49 of the listing agreement, SEBI allowed more time to corporates to conform to Clause 49 of the listing agreement and extended the date for ensuring compliance with the Clause 49 of the listing agreement to December 31, 2005. Now as on date, Clause 49 is applicable.

HIGHLIGHTS OF CLAUSE 49

Composition of Board of Directors

As per the Listing Agreement, the Board of Directors of the company shall have

an optimum combination of executive and non executive directors. Further—

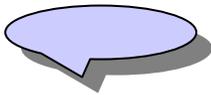
- not less than 50 per cent of the board of directors shall comprise of non-executive directors;
- the number of independent directors would depend on whether the chairman is executive or non-executive;
- if the Board has a Non-Executive Chairman, at least one third of the Board should comprise of independent directors;
- if the Board has an Executive Chairman, at least half of the Board should comprise of independent directors.

If the non-executive Chairman is a promoter or is related to promoters or persons occupying management positions at the board level or at one level below the board, at least one-half of the board of the company should consist of independent directors. The expression “related to any promoter” means:

- (a) If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;
- (b) If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.

Definition of Independent Director

‘Independent director’ shall mean non-executive director of the company who –



- (a) apart from receiving director’s remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect the independence of the director;
- (b) is not related to promoters or persons occupying management positions at the board level or at one level below the board;
- (c) has not been an executive of the company in the immediately preceding three financial years;
- (d) is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:
 - (i) the statutory audit firm or the internal audit firm that is associated with the company;
 - (ii) the legal firm(s) and consulting firm(s) that have a material association with the company.
- (e) is not a material supplier, service provider or customer or a lessor or lessee of the company which may effect the independence of the director;
- (f) is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares; and
- (g) is not less than 21 year age.

An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director within a period of not more than 180 days from the day of such resignation or removal, as the case may be. However, if the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director within the period of 180 days would not apply.

Nominee Directors to be treated as Independent Director

The clause provides that Nominee directors appointed by an institution which has invested in or lent to the company shall be deemed to be independent directors.

Non executive directors' compensation and disclosures

The clause provides that all fees/compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and require previous approval of shareholders in general meeting. The requirement of obtaining prior approval of shareholder in general meeting is not applicable to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 1956 for payment of sitting fees, without approval of the Central Government.

Disclosures on Remuneration of Directors

The specific disclosures on the remuneration of directors regarding all elements of remuneration package of individual directors summarized under major groups such as salary, benefits, bonuses, pensions, stock options etc., details of fixed component and performance linked incentives, along with performance criteria, service contracts, notice period, severance fees, stock option details, if any, and whether issued at a discount as well as the period over which accrued and over which exercisable, should be made in the section on Corporate Governance of the Annual Report.

Limits on Membership of Committees

A director shall not be a member in more than 10 committees or act as chairman of more than five committee across all companies in which he is a director.

For the purpose of considering the limit of the committees on which a director can serve, Chairmanship/membership of the Audit Committee and the Share-holders' Grievance Committee alone are to be considered.

Code of Conduct

The clause states that all Board members and senior management personnel shall affirm compliance with the code of conduct laid down by the Board on an annual basis and the Annual Report of the company shall contain a declaration to this effect signed by the CEO.

Board Meetings

The Board shall meet at least four times a year with a maximum time gap of four months between any two meetings.

Audit Committee

- (i) The requirement of giving terms of reference of the Audit Committee is a must.
- (ii) There should be minimum three members as directors.
- (iii) It further provides that 2/3rd of the members of audit committee shall be independent directors.
- (iv) The clause provides that all members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
- (v) The clause provides that the term "financially literate" means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.
- (vi) It further provides that a member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities.
- (vii) Calling of executives is optional. The finance director, head of internal audit and representative of statutory auditor may be present as invitees for the meetings of the audit committee.
- (viii) The Chairman of the audit committee should be an independent director and should also be present at the Annual General Meeting to answer shareholder queries.
- (ix) The company secretary should act as the secretary to the committee.

Quorum of Audit Committee

The quorum for the Audit Committee meeting shall be either two members or one-third of the members of the Audit Committee; whichever is greater but there should be a minimum of two independent directors present.

Powers of the Audit Committee

The powers of the Audit Committee shall include the following:

- (i) To investigate any activity within its terms of reference
- (ii) To seek information from any employee
- (iii) To obtain outside legal or other professional advice
- (iv) To secure attendance of outsiders with relevant expertise, if it considers necessary.

The powers of the Audit Committee specified above are illustrative and apart from the above, the Board may delegate such other powers, as it may deem fit and proper.

Meetings and Role of Audit Committee

There is requirement of holding atleast four meetings in a year. The clause also provides that not more than four months shall elapse between the two meetings of audit committee.

The role of the audit committee include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
4. Reviewing, with the management, the annual financial statements before submission to the board for approval, with particular reference to:
 - (a) Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (2AA) of section 217 of the Companies Act, 1956
 - (b) Changes, if any, in accounting policies and practices and reasons for the same
 - (c) Major accounting entries involving estimates based on the exercise of judgment by management
 - (d) Significant adjustments made in the financial statements arising out of audit findings
 - (e) Compliance with listing and other legal requirements relating to financial statements
 - (f) Disclosure of any related party transactions
 - (g) Qualifications in the draft audit report.
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval.
- 5A. Reviewing, with the management, the statement of uses/application of fund raised through an issue (public issue, right issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilization of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take steps in this matter.
6. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.
7. Reviewing the adequacy of internal audit function, if any, including the

structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.

8. Discussion with internal auditors any significant findings and follow up there on.
9. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
10. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
11. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
12. To review the functioning of the Whistle Blower mechanism, in case the same is existing.
- 12A. Approval of appointment of CFO (i.e. the whole-time finance Director or any other person heading the finance function or discharging that function) after assessing the qualification, experience and back of mind, etc. of the candidate.
13. Carrying out any other function as is mentioned in the terms of reference of the Audit Committee

Review of Information by Audit Committee

The Audit Committee is required to mandatorily review the following information:

- (a) Management discussion and analysis of financial condition and results of operations;
- (b) Statement of significant related party transactions (as defined by the audit committee), submitted by the management;
- (c) Management letters/letters of internal control weaknesses issued by statutory auditors;
- (d) Internal audit reports relating to internal control weaknesses; and
- (e) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

Subsidiary Company

- (i) At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of material non-listed Indian subsidiary company.
- (ii) The Audit Committee of the listed holding company shall also review the

financial statements, in particular the investments made by the unlisted subsidiary company.

- (iii) The minutes of the Board meetings of the unlisted subsidiary company is required to be placed at the Board meeting of the listed holding company.
- (iv) The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.
- (v) The term ~~material~~ "material non-listed Indian subsidiary" means an unlisted subsidiary, incorporated in India, whose turnover or net worth (i.e. paid up capital and free reserves) exceeds 20% of the consolidated turnover or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.
- (vi) The term ~~significant transaction or arrangement~~ "significant transaction or arrangement" means any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the material unlisted subsidiary for the immediately preceding accounting year.
- (vii) Where a listed holding company has a listed subsidiary which is itself a holding company, the above provisions also apply to the listed subsidiary insofar as its subsidiaries are concerned.

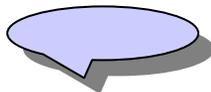
Shareholders/Investors Grievance Committee

A Board Committee under the Chairmanship of a non-executive director shall be formed to specifically look into redressal of shareholder and investors complaints like transfer of shares non-receipt of balance sheet, non-receipt of declared dividends etc. Committee shall be designated as Shareholders/Investors Grievance Committee.

The number of meetings of the Shareholders/Investors Grievance Committee should be in accordance with the exigencies of business requirements.

Disclosures

The following disclosures are required to be made under the revised clause:



- Basis of related Party Transactions
- Disclosure of Accounting Treatment
- Risk Management
- Proceeds from public issues, Rights issues, preferential issues etc.
- Remuneration of Directors
- Management
- Shareholders

CEO/CFO Certification

The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that:

- (a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :
 - (i) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
 - (ii) these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.
- (b) There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.
- (c) They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of the internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.
- (d) They have indicated to the auditors and the Audit committee —
 - (i) significant changes in internal control over financial reporting during the year;
 - (ii) significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
 - (iii) instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting.

Report on Corporate Governance

The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format prescribed in the clause. The report is required to be signed either by the Compliance Officer or the Chief Executive Officer of the company.

Compliance Certificate

The practising Company Secretaries have also been recognised to issue Certificate of Compliance of Conditions of Corporate Governance. The clause provides that the company shall obtain a certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report, which is sent

annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.

Non Mandatory Requirements

The following non-mandatory requirements have additionally been provided:

(1) The Board

A non-executive Chairman may be entitled to maintain a Chairman's office at the company's expense and also allowed reimbursement of expenses incurred in performance of his duties.

Independent Directors may have a tenure not exceeding, in the aggregate, a period of nine years, on the Board of a company. The company shall ensure that the person who is being appointed as an independent director has the requisite qualifications and experience which would be of use to the company and which in the opinion of the company would enable him to contribute effectively to the company in his capacity as an independent director.

(2) Remuneration Committee

- (i) The board may set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment.
- (ii) To avoid conflicts of interest, the remuneration committee, which would determine the remuneration packages of the executive directors may comprise of at least three directors, all of whom should be non-executive directors, the Chairman of committee being an independent director.
- (iii) All the members of the remuneration committee could be present at the meeting.
- (iv) The Chairman of the remuneration committee could be present at the Annual General Meeting, to answer the shareholder queries. However, it would be up to the Chairman to decide who should answer the queries.

(3) Shareholder Rights

A half-yearly declaration of financial performance including summary of the significant events in last six-months, may be sent to each household of shareholders.

Audit qualifications

Company may move towards a regime of unqualified financial statements.

Training of Board Members

A company may train its Board members in the business model of the company as well as the risk profile of the business parameters of the company, their responsibilities as directors, and the best ways to discharge them.

Mechanism for evaluating non-executive Board Members

The performance evaluation of non-executive directors could be done by a peer group comprising the entire Board of Directors, excluding the director being evaluated and Peer Group evaluation could be the mechanism to determine whether to extend/continue the terms of appointment of non-executive directors.

Whistle Blower Policy

The company may establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization.

VI. DEMUTUALISATION OF STOCK EXCHANGES

The process of demutualization is to convert the traditional "not for-profit" stock exchanges into a "for profit" company and this process is to transform the legal structure from a mutual form to a business corporation form. SEBI had set up a committee under the Chairmanship of Justice Kania for the same which came up with report on demutualization of Stock Exchanges through uniform scheme prescribed. Accordingly, SEBI issued scheme of demutualization to BSE and other Regional Stock Exchanges.

The important features of the demutualisation exercise are as follows:

- (1) The board of a stock exchange should consist of 75% public interest/ shareholder directors and only 25% broker directors, and
- (2) 51% shareholding of the stock exchange should be divested to public/ investors other than trading member brokers and only 49% of shareholding can remain with the trading member brokers. This will transform our broker-owned stock exchanges into professionally-run corporate stock exchanges.

The options prescribed for divestment/dilution of brokers' shareholding in a stock exchange are as follows:

- (1) Offer for sale, by issue of prospectus, of shares held by trading member brokers.
- (2) Private placement of shares (either of the shares held by the member brokers or new shares by the exchange) to any person or group of persons subject to the prior approval of SEBI and the maximum limit of 5% to any single person/group of persons.
- (3) Fresh issue of shares to the public through an IPO.

The purpose of demutualisation is as follows:

1. 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.

2. Publicly owned stock exchanges can enter into capital market for expansion of business.
3. Publicly owned stock exchange would be more professionally managed than broker owned.
4. Demutualisation enhances the flexibility of management.

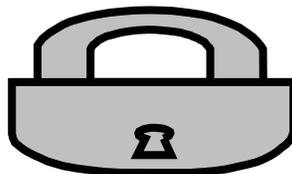
In nut shell, in a demutualised stock exchange the ownership, management and trading rights are in separate hands.

LESSON ROUND UP



- Stock exchanges constitute the primary institution of the secondary market.
- The Securities Contracts (Regulation) Act, 1956 was enacted by Parliament to prevent undesirable transactions in securities by regulating the business of dealing therein, and by providing for certain other matters connected therewith.
- Listing of securities with stock exchange is a matter of great importance for companies and investors, because this provides the liquidity to the securities in the market.
- Listing of Securities on Indian Stock Exchanges, thus, is essentially 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.

SELF TEST QUESTIONS



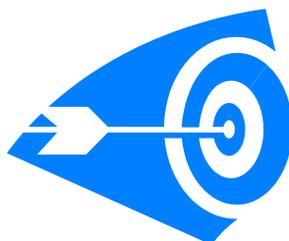
(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

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

Discuss in this light the functioning of the stock exchanges.

2. Discuss the powers of Central Government, SEBI and stock exchanges in regulation of stock exchanges.
 3. Listing of securities with stock exchange is a matter of great importance for companies and investors. Discuss.
 4. Enumerate the various requirements of listing of securities with recognised stock exchanges.
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STUDY VIII
STOCK EXCHANGE – TRADING MECHANISM



LEARNING OBJECTIVES

The study will enable the students to understand

- Operation of stock exchanges
- Stock Exchange Trading Mechanism
- Short Selling and Securities Lending and Borrowing
- BSE Online Trading System (BOLT)
- National Exchange for Automated Trading (NEAT)
- Straight Through Processing
- Direct Market Access
- Index, Futures, Options and Derivatives.

INTRODUCTION

There are 21 stock exchanges at present in India including Over The Counter Exchange of India (OTCEI), National Stock Exchange (NSE) and Inter-Connected Stock Exchange (ICSE). All of them are regulated in terms of Securities Contract (Regulation) Act, 1956 and SEBI Act, 1992 and the rules and regulations made thereunder. Some of the exchanges started of as voluntary non-profit associations such as Bombay Stock Exchange (BSE) and Indore Stock Exchange. The Stock Exchanges at Chennai, Jaipur, Hyderabad and Pune were incorporated as companies limited by guarantee. The other stock exchanges are companies limited by shares and incorporated under the Companies Act, 1956 or earlier acts.

The stock exchanges are managed by Board of Directors or Council of Management consisting of elected brokers and representatives of Government and Public appointed by SEBI. The Boards of stock exchanges are empowered to make and enforce rules, bye-laws and regulations with jurisdiction over all its members.

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 member can act as a Badla Financier, Commission Broker, Dealer in Odd lots, Government Securities, Jobber, Market Maker or Under writer. He can also take the assistance of sub-broker whom he can appoint under the procedure of registration.

I. 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. The stock exchanges are virtually the nerve centre of the capital market and reflect the health of the country's economy as a whole.

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

Shares of companies which are not in the spot list are known as 'cash' shares or 'B' Category shares. They are traded on cash basis or delivery basis and cannot be traded on settlement basis. The actual delivery of securities and payment has to be made on or before the settlement date fixed in the case of cash basis trading.

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.

All securities whether the specified list or cash list can be traded on spot basis or cash basis.

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.

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

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.

When the balance deposit in the client’s margin account falls below the required maintenance margin, the broker shall promptly make margin calls. However, no further exposure can be granted to the client on the basis of any increase in the market value of the securities.

The broker may liquidate the securities if the client fails to meet the margin calls made by the broker or fails to deposit the cheques on the day following the day on which the margin call has been made or the cheque has been dishonoured.

The broker may also liquidate the securities in case the client’s deposit in the margin account (after adjustment for mark to market losses) falls to 30% or less of the latest market value of the securities, in the interregnum between making of the margin call and receipt of payment from the client.

The broker must disclose to the stock exchange details on gross exposure including the name of the client, unique identification number, name of the scrip and if the broker has borrowed funds for the purpose of providing margin trading facilities, name of the lender and amount borrowed, on or before 12 Noon on the following day.

Stock exchanges disclose scripwise gross outstanding in margin accounts with all brokers to the market. Such disclosures regarding margin trading done on any day shall be made available after the trading hours on the following day through the website.

Thus, margin trading acts as a check on the tendency of clients to manipulate markets by placing orders on brokers without having adequate money or securities to backup the transaction.

Margin trading will also acts as a curb on short selling and short buying.

The reduction in above tendencies on the part of clients reduces volatility of prices on the stock exchange and provides stability to the common investors.

Margin trading mechanism also ensures transparency in dealings in securities and public exposure of the information regarding the backing behind all major securities transactions.

In the Indian capital markets particularly excessive short selling and market positioning have been rampant. Margin trading has acted as a stabilising force.

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 any other 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.

In accordance with Section 154 of the Companies Act, 1956 a company may close the register of members for a maximum of 45 days in a year and for not more than 30 days at any one time. Book closure become necessary for the purpose of paying dividend, making rights issue or bonus issue. The listed company is required to give notice of book closure in a news paper at least 7 days before the commencement of the book closure. The members whose names appear in the register of members on the last date of book closure are entitled to receive the benefits of dividend, right shares or bonus shares as the case may be.

Trading of Partly Paid Shares and Debentures

Companies fix the last date for payment of allotment or call money in case of partly paid shares or debentures and intimate this to all the stock exchanges wherein such shares or debentures are listed. Based on the date fixed by the company, the stock exchanges determine the settlement date upto which transactions in the scrip will be deemed to be good for delivery. After the said date, transactions in the securities take place only if they are paid up to the extent money has been called up.

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.

The high trading volume is built on rising prices, similarly the high trading volume is also linked with fall in prices. They respectively reflect a BULLISH trend and a BEARISH trend.

Turnover and Outstanding Position

The net turnover and outstanding positions in various scrips show the extent of BULLISH interest in them and are used along with trading volume to judge the intensity of the phase whether BULLISH or BEARISH. In a BULL phase there will be a sharp rise in the daily turnover of key scrips and in a BEAR phase the reverse will be the case.

Market Making

Though there are 8,500 companies listed on the stock exchanges in India only a few of them are being actively traded in the market. Thus the market sentiment was not representative of a wide range of industries or companies, because mostly concentrated on a few scrips. This leads one to conclude that mere listing of securities does not provide liquidity to scrips. A process known as market making was clearly needed to build up liquidity. The market maker by offering a two way quote not only increases the supply of scrips but also triggers of a demand in the scrips. SEBI has taken the view that market making will go a long way in reducing the bane of concentration and thus eliminating the influence of the unbalanced Sensitive Index.

In the case of OTCEI every company seeking listing should appoint two market makers. The sponsor has to be compulsorily a market maker for 3 years and arranged for atleast one more market maker for one year. Market makers are Merchant Bankers willing to make a secondary market in securities through selection and specialisation. They act as dealer cum stockist and display bid and offer price without charging any commission or brokerage.

Their profit margin is spread between bid and offer prices. A voluntary market maker can be appointed for a period of 6 months. The minimum market depth for market makers is 3 market lots of 100 shares each. After the initial period the job of market making can be assigned to another member or dealer. In April 1993, SEBI issued guidelines for market making to be introduced in the 4 Metropolitan Exchanges of Mumbai, Kolkata, Chennai and Delhi.

Securities Lending

This method is regulated by SEBI which introduced guidelines in 1997 for this purpose. Under the scheme, a person with idle shares can lend them to another who does not have the shares to fulfill his obligation under a trade finalised by him. There will be no direct contacts between the borrower and lender of securities. An intermediary who can guarantee the scheme and make good the loss in the borrower who fails to honour his obligations can alone provide substance to the scheme. The borrower has to put up collateral for his borrowings and pay cash margin levied on the securities by the authorities. Income from securities lending is exempt from Capital Gains Tax.

Short selling and securities lending and borrowing

SEBI vide Circular no MRD/DoP/SE/Dep/Cir- 14 /2007 dated December 20, 2007

permitted all classes of investors to short sell subject to the broad framework specified there in which are enumerated as follows.

Broad framework for 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.
- Naked short selling shall not be permitted in the Indian securities market and accordingly, all investors would be required to mandatorily honour their obligation of delivering the securities at the time of settlement.
- No institutional investor shall be allowed to do day trading i.e., square-of their transactions intra-day. In other words, all transactions would be grossed for institutional investors at the custodians’ level and the institutions would be required to fulfill their obligations on a gross basis.
- The custodians, however, would continue to settle their deliveries on a net basis with the stock exchanges.
- The stock exchanges shall frame necessary uniform deterrent provisions and take appropriate action against the brokers for failure to deliver securities at the time of settlement which shall act as a sufficient deterrent against failure to deliver.
- A scheme for Securities Lending and Borrowing (SLB) shall be put in place to provide the necessary impetus to short sell. The introduction of fullfledged securities lending and borrowing scheme shall be simultaneous with the introduction of short selling by institutional investors.
- The securities traded in F&O segment shall be eligible for short selling.
- SEBI may review the list of stocks that are eligible for short selling transactions from time to time.
- The institutional investors shall disclose upfront at the time of placement of order whether the transaction is a short sale. However, retail investors would be permitted to make a similar disclosure by the end of the trading hours on the transaction day.
- The brokers shall be mandated to collect the details on scrip-wise short sell positions, collate the data and upload it to the stock exchanges before the commencement of trading on the following trading day. The stock exchanges shall then consolidate such information and disseminate the same on their websites for the information of the public on a weekly basis.
- The frequency of such disclosure may be reviewed from time to time with the approval of SEBI.

Broad framework for securities lending and borrowing

- In order to provide a mechanism for borrowing of securities to enable settlement of securities sold short, the stock exchanges shall put in place, a

full fledged securities lending and borrowing (SLB) scheme, within the overall framework of "Securities Lending Scheme, 1997" (the scheme), that is open for all market participants in the Indian securities market.

- To begin with, the SLB shall be operated through Clearing Corporation/ Clearing House of stock exchanges having nation-wide terminals who will be registered as Approved Intermediaries (AIs) under the SLS, 1997.
- The SLB shall take place on an automated, screen based, order-matching platform which will be provided by the AIs. This platform shall be independent of the other trading platforms.
- To begin with, the securities traded in F&O segment shall be eligible for lending & borrowing under the scheme.
- All categories of investors including retail, institutional etc. will be permitted to borrow and lend securities. The borrowers and lenders shall access the platform for lending/borrowing set up by the AIs through the clearing members (CMs) (including banks and custodians) who are authorized by the AIs in this regard.
- The AIs, CMs and the clients shall enter into an agreement (which may have one or more parts) specifying the rights, responsibilities and obligations of the parties to the agreement. The agreement shall include the basic conditions for lending and borrowing of securities as prescribed under the scheme. In addition to that, AIs may also include suitable conditions in the agreement to have proper execution, risk management and settlement of lending and borrowing transactions with clearing member and client. Given the nature of the client base, while the major responsibility of ensuring compliance with "Know Your Client" (KYC) norms in respect of the clients rests with CMs, the exact role of AIs/CMs vis-à-vis the clients in this regard needs to be elaborated in the aforesaid agreement between the AI/CMs/clients. In this regard, there would be one master agreement with two individual parts to the same. The first part of the agreement would be between the AIs and the CMs and the second part of the agreement would be between the CMs and the clients. There would be adequate cross referencing between the two parts of the agreement so that all the concerned parties, viz., the AIs/CMs and the clients agree completely and are aware of all the provisions governing the SLB transactions between them. However, there shall be no direct agreement between the lender and the borrower. The CM will attach a certified copy of the first part of the agreement signed with the AI in the second part of the agreement signed with each client. The model agreements in this regard would be devised by the stock exchanges.
- The AIs shall allot a unique ID to each client which shall be mapped to the Permanent Account Number (PAN) of the respective clients. The AIs shall put in place appropriate systemic safeguards to ensure that a client is not able to obtain multiple client IDs.
- The tenure of lending/borrowing shall be fixed as standardised contracts. To start with, contracts with tenure of 30 trading days may be introduced.
- The settlement cycle for SLB transactions shall be on T+1 basis.

- The settlement of lending and borrowing transactions shall be independent of normal market settlement.
- The settlement of the lending and borrowing transactions shall be done on a gross basis at the level of the clients i.e. no netting of transactions at any level will be permitted.
- Als would frame suitable risk management systems to guarantee delivery of securities to borrower and return of securities to the lender. In the case of lender failing to deliver securities to the AI or borrower failing to return securities to the AI, the AI shall conduct an auction for obtaining securities. In the event of exceptional circumstances resulting in non-availability of securities in auction, such transactions would be financially closed-out at appropriate rates, which may be more than the rates applicable for the normal close-out of transactions, so as to act as a sufficient deterrent against failure to deliver securities.
- Position limits at the level of market, CM and client shall be decided from time to time by Als in consultation with SEBI. To begin with (a) the market-wide position limits for SLB transactions shall be 10% of the free-float capital of the company in terms of number of shares (b) No clearing member shall have open position of more than 10% of the market-wide position limits or Rs. 50 crore (base value), whichever is lower (c) For a FII/MF, the position limits shall be the same as of a clearing member (d) The client level position limits shall be not more than 1% of the market-wide position limits.
- There shall be no lending/borrowing activity during the periods of corporate action in the security and shall be disclosed by AI to the market.
- Any borrowing/lending and return of securities would not amount to purchase/disposal/transfer of the same for the purpose of compliance with the extant FDI/FII limits and the norms regarding acquisition of shares/disclosure requirements specified under the various Regulations of SEBI.
- Adequate systems shall be put in place by the stock exchanges/Depositories to distinguish the SLB transactions from the normal market transactions in the demat system.
- Als shall provide suitable arbitration mechanism for settling the disputes arising out of the SLB transactions executed on the platform provided by them.
- Als shall disseminate in public domain, the details of SLB transactions executed on the platform provided by them and the outstanding positions on a weekly basis. The frequency of such disclosure may be reviewed from time to time with the approval of SEBI.

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.

Settlement risk or principal risk is the risk that the seller of a security or funds delivers its obligation but does not receive payment or that the buyer of a security or funds makes payment but does not receive delivery. In this event, the full principal value of the securities or funds transferred is at risk.

Having discussed few stock exchange terminologies, below we are discussing the evolution, development and trading and settlement systems of the Bombay Stock Exchange Ltd., National Stock Exchange of India Limited.

II. 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, even older than the Tokyo Stock Exchange, which was established in 1878. It is a voluntary non-profit making Association of Persons (AOP) and is currently engaged in the process of converting itself into demutualised and corporate entity. It has evolved over the years into its present status as the premier Stock Exchange in the country. It is the first Stock Exchange in the Country to have obtained permanent recognition in 1956 from the Govt. of India under the Securities Contracts (Regulation) Act, 1956.

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

* Information compiled from www.bseindia.com and various publications of the Stock Exchange, Mumbai.

Depositories, viz., Central Depository Services (I) Ltd. (CDSL) and National Securities Depository Ltd. (NSDL) for dematerialization of their securities.

BSE also provides a facility to the market participants for on-line trading of odd-lot securities in physical form in 'A', 'B', 'T', and 'Z' groups and in rights renunciations in all groups of scrips in the Equity Segment.

With effect from December 31, 2001, trading in all securities listed in equity in the Equity segment takes place in one market segment, viz., Compulsory Rolling Settlement Segment (CRS).

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.

This facility of selling physical shares in compulsory demat scrips is called as Exit Route Scheme. This facility can also be used by small investors for selling up to 500 shares in physical form in respect of scrips of companies where trades are required to be compulsorily settled by all investors in demat mode.

Computation of closing price of scrips in the Cash Segment

The closing price of scrips is computed by the Exchange on the basis of weighted average price of all trades executed during the last 30 minutes of the continuous trading session. However, if there is no trade recorded during the last 30 minutes, then the last traded price of a scrip in the continuous trading session is taken as the official closing price.

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.

Under rolling settlements, the trades done on a particular day are settled after a given number of business days. A T+2 settlement cycle means that the final settlement of transactions done on T, i.e., trade day by exchange of monies and securities between the buyers and sellers respectively takes place on second business day (excluding Saturdays, Sundays, bank and Exchange trading holidays) after the trade day.

The transactions in securities of companies which have made arrangements for dematerialization of their securities are settled only in demat mode on T+2 on net basis, i.e., buy and sell positions of a member-broker in the same scrip are netted and the net quantity and value is required to be settled. However, transactions in securities of companies, which are in "Z" group or have been placed under "trade-to-

trade” by BSE as a surveillance measure (“T”), are settled only on a gross basis and the facility of netting of buy and sell transactions in such scrips is not available.

The transaction in “F” group securities representing “Fixed Income Securities” and “G” group representing Government Securities for retail investors are also settled at BSE on T+2 basis.

Thus, the pay-in and pay-out of funds and securities takes places on the second business day (i.e., excluding Saturday, Sundays and bank & Exchange trading holidays) of the day of the execution of the trade.

The Information Systems Department of the Exchange generates, inter-alia, the following statements, which can be downloaded by the member-brokers in their back offices on a daily basis.

- (a) Statements giving details of the daily transactions entered into by the member-brokers.
- (b) Statements giving details of margins payable by the member-brokers in respect of the trades executed by them.
- (c) Statements of securities and fund obligation.
- (d) Delivery/Receive orders for delivery/receipt of securities.

The settlement of the trades (money and securities) done by a member-broker on his own account or on behalf of his individual, corporate or institutional clients may be either through the member-broker himself or through a SEBI registered custodian appointed by him/client. In case the delivery/payment in respect of a transaction executed by a member-broker is to be given or taken by a registered custodian, then the latter has to confirm the trade done by a member-broker on the BOLT System through 6A-7A entry. For this purpose, the custodians have been given connectivity to BOLT System and have also been admitted as clearing member of the Clearing House. In case a transaction done by a member-broker is not confirmed by a registered custodian within the time permitted, the liability for pay-in of funds or securities in respect of the same devolves on the concerned member-broker.

6A/7A: A mechanism whereby the obligation of settling the transactions done by a member-broker on behalf of a client is passed on to a custodian based on confirmation of latter. The custodian can confirm the trades done by the member-brokers on-line and upto 11 a.m. on the next trading day. The late confirmation of transactions by the custodian after 11:00 a.m. upto 12:15 p.m., on the next trading day is, however, permitted subject to payment of charges for late confirmation @ 0.01% of the value of trades confirmed or Rs. 10,000/-, whichever is less.

The introduction of settlement on T+2 basis, as discussed above, has considerably reduced the settlement risk, ensured early receipt of securities and monies by the buyers and sellers respectively and has brought the Indian capital market on par with the internationally accepted standard of settlements.

SETTLEMENT AT BSE

Pay-in and Pay-out for 'A', 'B', 'T', 'C', 'F', 'G' & 'Z' group of securities

The trades done on BOLT by the Members in all securities in CRS are now

settled on BSE by payment of monies and delivery of securities on T+2 basis. All deliveries of securities are required to be routed through the Clearing House.

The Pay-in/Pay-out of funds based on the money statement and that of securities based on Delivery Order/Receiver Order issued by BSE are settled on T+2 day.

Demat pay-in

The member-brokers can effect pay-in of demat securities to the Clearing House either through the National Securities Depository Ltd. (NSDL) or Central Depository Services (I) Ltd. (CDSL). In case of NSDL, the member-brokers are required to give instructions to their respective Depository Participants (DPs) specifying settlement no., settlement type, effective pay-in date, quantity, etc.

As regards CDSL, the member-brokers give pay-in instructions to their respective DPs. The securities are transferred by the DPs to the Clearing Member (CM) Principal Account. The member-brokers are required to give confirmation to their DPs, so that securities are processed towards pay-in obligations. Alternatively, the member-brokers may also effect pay-in from the clients' beneficiary accounts. For this, the clients are required to mention the settlement details and clearing member-broker ID of the member-broker through whom they have sold the securities. Thus, in such cases the Clearing Members are not required to give any delivery instructions from their accounts.

Auto delivery facility

Instead of issuing Delivery instructions for their securities delivery obligations in demat mode in various scrips in a settlement /auction, a facility has been made available to the member-brokers of automatically generating Delivery instructions on their behalf from their CM Pool accounts maintained with NSDL and CM Principal Accounts maintained with CDSL. This auto delivery facility is available for CRS (Normal & Auction) and for trade to trade settlements. This facility is, however, not available for delivery of non-pari passu shares and shares having multiple ISINs. The member-brokers wishing to avail of this facility have to submit an authority letter to the Clearing House. This auto delivery facility is currently available for Clearing Member (CM) Pool accounts and Principal accounts maintained by the member-brokers with National Securities Depository Ltd. (NSDL) and Central Depositories Services (I) Ltd. (CDSL) respectively.

Pay-in of securities in physical form

In case of delivery of securities in physical form, the member-brokers have to deliver the securities to the Clearing House in special closed pouches along with the relevant details like distinctive numbers, scrip code, quantity, etc., on a floppy. The data submitted by the member-brokers on floppies is matched against the master file data on the Clearing House computer systems. If there is no discrepancy, then a scroll number is generated by the Clearing House and the securities are accepted.

Funds Pay-in

Once the reconciliation of securities is completed by the Clearing House, the

bank accounts of member-brokers maintained with the ten clearing banks, are directly debited through computerized posting for their funds settlement obligations. Once the pay-in of securities and funds is complete, the Clearing House arranges for the pay-out of securities and funds.

In case of those members, whose funds pay-in obligations are returned by their clearing banks on account of insufficient funds in their bank accounts at the time of pay-in, their BOLT TWSs are now immediately de-activated during the trading hours itself, on receipt of such intimation from the clearing banks as against the earlier practice of de-activating their BOLT TWSs at the end of trading on that day. BOLT TWSs of such members remain de-activated till the pay-in obligations are cleared by them.

Securities Pay-out

In case of demat securities, the same are credited by the Clearing House in the Pool/Principal Accounts of the member-brokers. The Exchange has also provided a facility to the member-brokers for transfer of pay-out securities directly to the clients' beneficiary owner accounts without routing the same through their Pool/Principal accounts in NSDL/CDSL. For this, the concerned member-brokers are required to give a client wise break up file which is uploaded by the member-brokers from their offices to the Clearing House. Based on the break up given by the member-brokers, the Clearing House instructs depositories, viz., CDSL & NSDL to credit the securities to the Beneficiary Owners (BO) Accounts of the clients. In case delivery of securities received from one depository is to be credited to an account in the other depository, the Clearing House does an inter depository transfer to give effect to such transfers.

In case of physical securities, the Receiving Members are required to collect the same from the Clearing House on the pay-out day.

This process of passing on delivery of securities purchased by the member-brokers to them by the Clearing House is called pay-out of securities.

Funds Payout

The bank accounts of the member-brokers having pay-out of funds are credited by the Clearing House with the Clearing Banks on the same day. This process is referred to as Pay-out of Funds.

In case, if a member-broker fails to deliver the securities, then the value of shares delivered short is recovered from him at the standard/closing rate of the scrips on the trading day.

In case of Rolling Settlements, pay-in and pay-out of both funds and securities, as stated earlier, is completed on the same day.

The member-brokers are required to make payment for securities sold and/ or deliver securities purchased to their clients within one working day (excluding Saturday, Sunday, bank & Exchange trading holidays) after the pay-out of the funds

and securities for the concerned settlement is completed by the Exchange. This is the timeframe permitted to the member-brokers of the Exchange to settle their funds/securities obligations with their clients as per the Byelaws of the Exchange.

The settlement calendar, which indicates the dates of the various settlement related activities, is drawn by the Exchange in advance on a quarterly basis and is circulated among the market participants. The settlement calendars so drawn have been strictly adhered to by the Exchange and there has been generally no case of clubbing of settlements or postponement of pay-in and/ or pay-out during the last over seven years.

The Exchange maintains database of fake/forged, stolen, lost and duplicate securities in physical form with the Clearing House so that distinctive numbers submitted by member-brokers in case of physical securities on delivery may be matched against the database to weed out bad paper from circulation at the time of introduction of such securities in the market. This database has also been made available to the member-brokers so that both delivering and receiving member-brokers can check the entry of fake, forged and stolen shares in the market.

Basket Trading System

The Exchange commenced trading in the Derivatives Segment with effect from June 9, 2000 to enable the investors to, inter-alia, hedge their risks. Initially, the facility of trading in the Derivatives Segment was confined to Index Futures. Subsequently, the Exchange introduced the Index Options and Options & Futures in select individual stocks. The investors in cash market had felt a need to limit their risk exposure in the market to movement in Sensex.

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. Further, the investors can alter the weights of securities in such profiled baskets and enter their own weights. The investors can also select less than 100% weightage to reduce the value of the basket as per their own requirements.

To participate in this system, the member-brokers need to indicate number of Sensex basket(s) to be bought or sold, where the value of one Sensex basket is arrived at by the system by multiplying Rs.50 to prevailing Sensex. For e.g., if the Sensex is 4000, then value of one basket of Sensex would be $4000 \times 50 =$ i.e., Rs.2,00,000/-. The investors can also place orders by entering value of Sensex portfolio to be bought or sold with a minimum value of Rs. 50,000/- for each order.

The Basket Trading System provides the arbitrageurs an opportunity to take advantage of price differences in the underlying Sensex and Futures on the Sensex

by simultaneous buying and selling of baskets comprising the Sensex scrips in the Cash Segment and Sensex Futures. This is expected to provide balancing impact on the prices in both cash and futures markets.

The Basket Trading System, thus, meets the need of investors and also improves the depth in cash and futures markets.

Surveillance at BSE

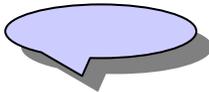
The main objective of the Surveillance function of the Exchange is to promote market integrity in two ways, first, by monitoring price and volume movements (volatility) as well as by detecting potential market abuses at a nascent stage, with a view to minimizing the ability of the market participants, both in Cash and Derivative market, to influence the price of the scrip/series in the absence of any meaningful information, and second, by managing default risk by taking necessary actions timely. All the instruments traded in the equity segment of Cash and Derivative market come under the Surveillance umbrella of BSE. Surveillance activities at the Exchange are divided broadly into two major segments, namely, price monitoring and position monitoring. Price monitoring is mainly related to the price movement/abnormal fluctuation in prices or volumes etc. whereas the position monitoring relates mainly to abnormal positions of members, etc. in order to manage default risk.

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. The department carries out investigation, if necessary, based on the preliminary examination/analysis and suitable actions are taken against members involved based on the investigation. The detailed explanation of the various Surveillance activities are as follows:

(a) Price Monitoring

The functioning of the Price Monitoring is broadly divided into following activities:



- (i) On-Line Surveillance
- (ii) Off-Line Surveillance
- (iii) Derivative Market Surveillance
- (iv) Investigations
- (v) Surveillance Actions
- (vi) Rumour Verification
- (vii) Pro-active Measures

(i) On line Surveillance

One of the most important tools of the Surveillance is the On-line Real Time Surveillance system which was commissioned in 1999 with main objectives of detecting potential market abuses at a nascent stage to reduce the ability of the market participants to unduly influence the price and volumes of the scrips traded at the Exchange, improve the risk management system and strengthen the self regulatory mechanism at the Exchange.

The system has a facility to generate the alerts on-line, in real time, based on certain preset parameters like price and volume variations in scrips, members taking unduly large positions not commensurate with their financial position or having large concentrated position(s) in one or few scrips, etc. An alert is a measure of abnormal behaviour. An Alert occurs in the Surveillance system when a metric behaves significantly differently from its benchmark. The alerts generated by the system are analyzed and corrective action based on preliminary investigations is taken in such cases. The system also provides facility to access trades and orders of members.

(ii) Off-Line Surveillance

The Off-Line Surveillance system comprises of the various reports based on different parameters and scrutiny thereof.

- High/Low Difference in prices
- % change in prices over a week/fortnight/month
- Top N scrips by Turnover
- Trading in infrequently traded scrips
- Scrips hitting New High/Low

The Surveillance actions or investigations are initiated in the scrips identified from the above-stated reports.

(iii) Derivative Market Surveillance***Areas of Focus***

- Abnormal fluctuation in the prices of a Series
- Market Movement (Cash vis-à-vis Derivative)
- Member Concentration (Cash vis-à-vis Derivative)
- Closing Price Manipulation (Cash & Derivative)

(iv) Investigations

The Exchange conducts in-depth investigations based on preliminary enquiries/analysis made into trading of the scrip as also at the instance of SEBI. In case irregularities observed, necessary actions are initiated and/or investigation case forwarded to SEBI, if necessary.

(v) Surveillance Actions***Special Margins***

Special margins are imposed on scrips which have witnessed abnormal price/

volume movements. Special margin is imposed @ 25 % or 50 % or 75 % as the case may be, on the client wise net outstanding purchase or sale position (or on both side) by the department.

Reduction of Circuit Filters

The circuit filters are reduced in case of illiquid scrips or as a price containment measure in low volume scrips. The circuit filters are reduced to 10 % or 5 % or 2 % as the case may be, based on the criteria decided by the Exchange.

Circuit Breakers

In addition to the price bands on individual scrips, SEBI decided to implement index based market wide circuit breakers system, w.e.f., July 02, 2001. The circuit breakers are applicable at three stages of the index movement either way at 10 %, 15 % and 20 %. These circuit breakers will bring about a coordinated trading halt in both Equity and Derivative market.

The market wide circuit breakers can be triggered by movement of either BSE SENSEX or the NSE NIFTY, whichever is breached earlier. The percentage movement are calculated on the closing index value of the quarter. These percentages are translated into absolute points of index variation (rounded off to the nearest 25 points in case of SENSEX). At the end of each quarter, these absolute points of index variations are revised and made applicable for the next quarter. The absolute points of SENSEX variation triggering market wide circuit breaker for a specified time period for any day of the quarter is informed by the Exchange through Press Release from time to time.

Trade to Trade

If a scrip is shifted on a Trade-to trade settlement basis, selling/ buying of shares in that scrip would result into giving/ taking delivery of shares at the gross level and no intra day/ settlement netting off/ square off facility would be permitted. The scrips which form part of 'Z group' are compulsorily settled on a trade to trade settlement basis. In addition to that Surveillance department transfers various scrips from time to time on a trade to trade settlement basis to contain the excessive volatility and/or abnormal volumes in the scrip.

Suspension of a scrip

The scrips are suspended by the Surveillance department in exceptional cases pending investigation or if the same scrip is suspended by any other Stock Exchange as a Surveillance action.

Warning to Members

The department may issue verbal/ written warning to member/s when market manipulation in the scrip is suspected.

Imposition of penalty/suspension/de-activation of terminals

The department imposes penalty or deactivate BOLT terminals or suspend the member/s who are involved in market manipulation, based on the input/ evidence available from investigation report or as and when directed by SEBI.

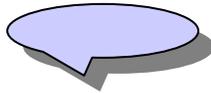
(vi) Rumour Verification

The following steps are involved in Rumour verification process:

- Surveillance Department liaises with Compliance Officers of companies to obtain comments of the company on various price sensitive corporate news items appearing in the selected New Papers.
- Comments received from the companies are disseminated to the Market by way of BOLT Ticker and/ or Notices in the Bulletin.
- Show cause notices are issued to companies which do not reply promptly to the Exchange.
- Investigations based on rumour verifications are carried out, if required, to detect cases of suspected insider trading

(vii) Pro-active Measures

- The Department compiled and disseminated a list of companies who have changed their names to suggest that their business interest is in the software Industry.
- List of NBFC's, whose application for registration rejected by RBI, was compiled and disseminated by the department.

(b) Position Monitoring are

- (i) Statement of Top 100 Purchasers/Sellers
- (ii) Concentrated Purchases/Sales
- (iii) Purchases/Sales of Scrips having Thin Trading
- (iv) Trading in B1, B2 and Z group Scrips
- (v) Pay-in liabilities above a Threshold Limit
- (vi) Verification of Institutional Trades
- (vii) Snap Investigation
- (viii) Market Intelligence

The Surveillance Department closely monitors outstanding exposure of members on a daily basis. For this purpose, it has developed various off-line and on-line market monitoring reports. The reports are scrutinised to ascertain whether there is excessive purchase or sale position build up compared to the normal business of the member, whether there are concentrated purchases or sales, whether the purchases have been made by inactive or financially weak members and even the quality of scrips is considered to assess the quality of exposure. Based on analysis of the above factors and the margins already paid and the capital deposited by the member, ad-hoc margins/early pay-in calls are made, if required. Some members are even advised to reduce their outstanding exposure in the market. Trading restrictions are placed on their business as and when deemed fit.

The department thus executes the Risk Management functions to avert possible payment default of members by taking timely corrective measures.

The following key areas are examined to assess the market risk involved.

(i) Statement of Top 100 Purchasers/Sellers

Statements of top 100 net purchasers and top 100 net sellers in case of A, B1, B2 and Z group of scrips are scrutinized, on a daily basis. This enables the Department to keep a watch on the exposure of the members, ascertain the quality of exposures, measure the risk vis-a-vis cover available by way of margins, capital etc. and initiate action such as imposition of ad-hoc margins, trading restriction etc. on the members.

A detailed report on the net outstanding positions of top purchasers and top sellers with exposures in individual scrips above certain limit, margin cover available etc., is prepared on a daily basis.

(ii) Concentrated Purchases/Sales

The concentration in purchases/sales of a member in a few scrips could be considered risky. In case, such a situation is noticed, fundamentals of the scrips, their daily turnover, their nature of transactions is ascertained. Thereafter, based on the market risk perception appropriate surveillance actions are taken.

(iii) Purchases/Sales of Scrips having Thin Trading

Purchases/sales by members in scrips having thin trading is closely scrutinised as comparatively high market risk is involved in trading in such scrips. Details of trades in such scrips are called from the members to assess the market risk involved and decide on the appropriate surveillance action.

(iv) Trading in B1, B2 and Z Group Scrips

The Exchange has classified the scrips listed on the Exchange into 'A', 'B1', 'B2' and 'Z' groups. In view of the price manipulation witnessed in a few B1, B2 and Z group scrips and also as a risk management measure, the Exchange has prescribed Exposure limits in B1, B2 and Z group scrips in a single Rolling Settlement.

(v) Pay-in liabilities of members above a threshold limit

The pay-in liability of members above a certain threshold limit is monitored with respect to the pay-in amount of the members, the members capital, the margin cover available to the Exchange against the members pay-in liability, etc. In case of inadequate margin cover, the reasons of the pay-in are ascertained. If warranted, advance pay-in is called to ensure that pay-in is completed smoothly.

(vi) Verification of Institutional Trade

The institutional trades executed by the member-brokers are verified to ascertain the genuineness of trades.

(vii) Snap Investigation

The Department also carries out, wherever considered necessary, preliminary investigation of certain dealings to verify irregularities. Further actions, viz., referring the case for detailed investigations, referring the cases to the Disciplinary Action Committee (DAC) of the Exchange for taking disciplinary action against members, referring cases to the Scrutiny Committee of the Exchange to re-assess the financial soundness of the members etc., are taken depending on the findings of preliminary investigation.

(viii) Market Intelligence

The rumours floating in the market are verified with the data available with the Exchange. Newspapers, Television news channels are referred to ascertain the national and global factors affecting the market sentiments. This enables the Exchange to avert market problems before it causes a serious damage.

On assessment of the market risk, decisions to call ad-hoc margins/early pay-in, advising the member to limit his business, summoning him for explanation, placing trading restriction, deactivation of BOLT TWS, etc. are taken.

III. NATIONAL STOCK EXCHANGE OF INDIA LTD. (NSEIL)*

Based on Pherwani Committees report submitted in June, 1991, 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 as a tax-paying company unlike other stock exchanges in the country. On its recognition as a stock exchange under the Securities Contracts (Regulation) Act, 1956 in April 1993, NSEIL commenced operations in the Wholesale Debt Market (WDM) segment in June 1994, operations in the Capital Market (CM) segment in November 1994, and operations in derivatives segment in June 2000.

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. It provides tremendous flexibility to the users in terms of kinds of orders that can be placed on the system. Several time-related (Good-till-Cancelled, Good-till-Day, Immediate-or-Cancel), price-related (buy/sell limit and stop-loss orders) or volume related (All-or-None, Minimum

* Information compiled from www.nseindia.com and various publications of the National Stock Exchange of India Ltd.

Fill, etc.) conditions can be easily built into an order. Orders are sorted and matched automatically by the computer keeping the system transparent, objective and fair. The trading system also provides complete market information on-line, which is updated on real time basis.

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.

The WDM trading system, known as NEAT (National Exchange for Automated Trading), is a fully automated screen based trading system that enables members across the country to trade simultaneously with enormous ease and efficiency. The trading system is an order driven system, which matches best buy and sell orders on a price/time priority.

Trading system provides two market sub-types: continuous market and negotiated market. In continuous market, the buyer and seller do not know each other and they put their best buy/sell orders, which are stored in order book with price/time priority. If orders match, it results into a trade. The trades in WDM segment are settled directly between the participants, who take an exposure to the settlement risk attached to any unknown counterparty. In the NEAT-WDM system, all participants can set up their counter-party exposure limits against all probable counterparties. This enables the trading member/participant to reduce/minimise the counterparty risk associated with the counterparty to trade. A trade does not take place if both the buy/sell participants do not invoke the counter-party exposure limit in the trading system.

In the negotiated market, the trades are normally decided by the seller and the buyer, and reported to the Exchange through the broker. Thus deals negotiated or structured outside the exchange are disclosed to the market through NEAT-WDM system. In negotiated market, as buyers and sellers know each other and have agreed to trade, no counter-party exposure limit needs to be invoked.

The trades on the WDM segment could be either outright trades or repo transactions with flexibility for varying days of settlement (T+0 to T+5) and repo periods (3 to 14 days). For every trade, it is necessary to specify the number of settlement days and the trade type (repo or non-repo) and in the event of a repo trade, the repo term.

The Futures and Option trading system, called NEAT-F&O trading system, provides a fully automated screen-based trading for S&P CNX Nifty futures on a nationwide basis and an online monitoring and surveillance mechanism. It supports an order driven market and provides complete transparency of trading operations. It is similar to that of trading of equities in the CM segment.

The NEAT-F&O trading system is accessed by two types of users. The Trading Member (TM) has access to functions such as, order entry, order matching, order

and trade management. The Clearing Member (CM) uses the trader workstation for the purpose of monitoring the trading member(s) for whom he clears the trades. Additionally, he can enter and set limits to position, which a trading member can take.

Contracts

Futures contract on the NSEIL is based on S&P CNX Nifty 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. A new contract is introduced on the next trading day following the expiry of the near month contract. Various conditions like, Good-till-Day, Good-till-Cancelled, Good-till- Date, Immediate or Cancel, Stop loss, etc. can be built into an order.

Clearing and Settlement

NSCCL undertakes clearing and settlement of all deals executed on the NSEIL's Derivatives segment. It acts as legal counterparty to all deals on the Derivatives segment and guarantees settlement.

Derivatives Segment

In the Derivatives segment, NSCCL has admitted Clearing Members (CMs) distinct from Trading Members (TMs) in line with the 2-tier membership structure stipulated by SEBI to enable wider participation in the Derivatives segment. All trades on the Derivatives segment are cleared through a CM of NSCCL.

Nifty index futures contracts are cash settled, i.e. through exchange of cash differences in value. Settlement is done on a daily basis by marking to market all open positions on the basis of the daily settlement price. The contracts are finally settled on expiry of the Nifty index futures contract when NSCCL marks the open positions of a CM to the closing price of the underlying index and resulting profit/loss is settled in cash.

National Securities Clearing Corporation Limited

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 Stock Exchange. This company completes the settlement promptly without delay or deferment. It operates on behalf of the clearing members from and to regional clearing centres and central clearing centres at Mumbai. It was the first organisation to start pre-delivery verification to detect bad papers in the form of fake or forged certificates or lost and stolen share certificates through the automated mechanism of the clearing corporation. A facility is provided to lend/borrow securities as well as funds at market determined rates and enables timely delivery of securities with efficiency. This corporation is connected to National Securities Depository Limited (NSDL) and Central Depositories Services (India) Limited (CDSL) and carries out clearing and settlement services for other exchanges as well as for Index Futures.

Trading and Settlement at NSE

NSE introduced for the first time in India, fully automated screen based trading. It uses a modern, fully computerised trading system designed to offer investors across

the length and breadth of the country a safe and easy way to invest. The NSE trading system called 'National Exchange for Automated Trading' (NEAT) is a fully automated screen based trading system, which adopts the principle of an order driven market.

Clearing & Settlement (Equities)

NSCCL carries out clearing and settlement functions as per the settlement cycles of different sub-segments in the Equities segment.

The clearing function of the clearing corporation is designed to work out a) what counter parties owe and b) what counter parties are due to receive on the settlement date. Settlement is a two way process which involves legal transfer of title to funds and securities or other assets on the settlement date.

NSCCL has also devised mechanism to handle various exceptional situations like security shortages, bad delivery, company objections, auction settlement etc.

NSCCL has empanelled 8 clearing banks to provide banking services to trading members and has established connectivity with both the depositories for electronic settlement of securities.

Clearing

Clearing is the process of determination of obligations, after which the obligations are discharged by settlement.

NSCCL has two categories of clearing members: trading members and custodians. The trading members can pass on its obligation to the custodians if the custodian confirms the same to NSCCL. All the trades whose obligation the trading member proposes to pass on to the custodian are forwarded to the custodian by NSCCL for their confirmation. The custodian is required to confirm these trade on T + 1 days basis.

Once, the above activities are completed, NSCCL starts its function of Clearing. It uses the concept of multi-lateral netting for determining the obligations of counter parties. Accordingly, a clearing member would have either pay-in or pay-out obligations for funds and securities separately. Thus, members pay-in and pay-out obligations for funds and securities are determined latest by T + 1 day and are forwarded to them so that they can settle their obligations on the settlement day (T+2).

Cleared and non-cleared deals

NSCCL carries out the clearing and settlement of trades executed in the following sub-segments of the Equities segment:

1. All trades executed in the Book entry/Rolling segment.
2. All trades executed in the Limited Physical Market segment.

NSCCL does not undertake clearing and settlement of deals executed in the Trade for Trade sub-segment of the Equities (Capital Market) segment of the Exchange. Primary responsibility of settling these deals rests directly with the

members and the Exchange only monitors the settlement. The parties are required to report settlement of these deals to the Exchange.

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.

Trade-for-trade deals and Limited Physical Market deals are settled on a trade for trade basis and settlement obligations arise out of every deal.

Trading in Retail Debt Segment

Trading in the Retail Debt Market takes place in the same manner in which the trading takes place in the equities (Capital Market) segment. The RETDEBT Market facility on the NEAT system of Capital Market Segment is used for entering transactions in RDM session.

Members eligible for trading in RDM segment

Trading Members who are registered members of NSE in the Capital Market segment and Wholesale Debt Market segment are allowed to trade in Retail Debt Market (RDM) subject to fulfilling the capital adequacy norms.

Trading Members with membership in Wholesale Debt Market segment only, can participate in RDM on submission of a letter in the prescribed format

Trading System

Trading in RDM also take place on the 'National Exchange for Automated Trading' (NEAT) system, a fully automated screen based trading system, which adopts the principle of an order driven market. The RETDEBT Market facility on the NEAT system of Capital Market Segment is used for entering transactions in RDM session.

The securities available in this segment will not available in F & O and inquiry terminal.

Trading Cycle

Trading in Retail Debt Market is permitted under Rolling Settlement, where in each trading day is considered as a trading period and trades executed during the day are settled based on the net obligations for the day.

Settlement is on a T+2 basis i.e. on the 2nd working day. For arriving at the settlement day all intervening holidays, which include bank holidays, NSE holidays, Saturdays and Sundays are excluded. Typically trades taking place on Monday are settled on Wednesday, Tuesday's trades settled on Thursday and so on.

Settlement

Primary responsibility of settling trades concluded in the WDM segment rests directly with the participants and the Exchange monitors the settlement. Mostly these trades are settled in Mumbai. Trades are settled gross, i.e. on trade for trade basis directly between the constituents/participants to the trade and not through any Clearing House mechanism. Thus, each transaction is settled individually and netting of transactions is not allowed.

Settlement is on a rolling basis, i.e. there is no account period settlement. Each order has a unique settlement date specified upfront at the time of order entry and used as a matching parameter. It is mandatory for trades to be settled on the predefined settlement date. The Exchange currently allows settlement periods ranging from same day (T+0) settlement to a maximum of (T+2).

On the scheduled settlement date, the Exchange provides data/information to the respective member/participant regarding trades to be settled on that day with details like security, counter party and consideration.

The participants through their Subsidiary General Ledger (SGL) account (a book entry settlement system) settle government securities including treasury bills with RBI or through exchange of physical certificates. Other instruments are settled through delivery of physical securities.

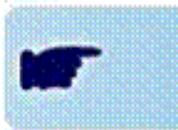
Where trade is settled through the SGL account, exchange of securities and funds is done on DVP basis. Where trade is settled through delivery of certificates, the consideration is paid through cheque, payorder, Banker's cheque or RBI cheque.

The required settlement details, i.e. certificate no., SGL form no., Cheque no., constituent etc. are reported by the member/participant to the Exchange. In case of Repo trades the settlement details of the forward leg is also reported.

The Exchange closely monitors the settlement of transactions through the reporting of settlement details by members and participants. In case of deferment of settlement or cancellation of trade, participants are required to seek prior approval from the Exchange. For any dispute arising in respect of the trades or settlement, the exchange has established arbitration mechanism for resolving the same.

IV. STRAIGHT THROUGH PROCESSING

The global securities market is passing through an interesting phase. Driven by globalization of the securities market, technology innovations and increasing trade volumes, the financial industry is moving towards Straight Through Processing.

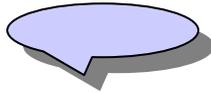


Straight Through Processing (STP) is generally understood to be a mechanism that automates the end to end processing of transactions of financial instruments. It involves use of a system to process or control all elements of the work flow of a financial transaction, what are commonly known as the Front, Middle, Back office and General Ledger. In other words, STP allows electronic capturing and processing of transactions in one pass from the point of order origination to final settlement.

STP thus streamlines the process of trade execution and settlement and avoids manual entry and re-entry of the details of the same trade by different market intermediaries and participants. Usage of STP enables orders to be processed, confirmed, settled in a shorter time period and in a more cost effective manner with fewer errors. Apart from compressing the clearing and settlement time, STP also provides a flexible, cost effective infrastructure, which enables e-business expansion through online processing and access to enterprise data.

Advantages of Straight Through Processing

Advantages of Straight through Processing as under:



- Reduced risk
- Automation of manual process minimizing errors
- Improved operational efficiency in handling larger volumes
- Facilitates movement towards shorter settlement cycles (T+1)
- Lower cost per trade
- Timely settlement of trades and instructions
- Eliminates paper work and minimizes manual intervention
- Enables increased cross border trading (FII trades)
- Greater transparency with clear audit trail
- Increases competitive advantage of our markets
- Messaging standards as per ISO 15022 standards

Straight Through Processing (STP) thus aims to bring in non-duplication of work, efficiency and automation of the manual procedures right from trade initiation to settlement processes.

SEBI had mandated the use of Straight Through Processing (STP) system for all institutional trades w.e.f. July, 2004. In order to regulate the STP service it had also issued SEBI (STP Centralised Hub and STP Service Providers) Guidelines, 2004 (STP Guidelines) which also prescribes the model agreement between the STP centralised hub and the STP service providers.

STP guidelines prescribes the eligibility criteria and conditions of approval for the STP centralised hub and the STP service providers, obligations and responsibilities of the STP centralised hub and the STP service providers and code of conduct for the STP service providers. The STP centralised hub and the STP service providers are required to abide by these Guidelines. To prescribe contractual obligations between the STP centralised hub and the STP service providers and to facilitate standardisation of service, a model agreement between the STP centralised hub and the STP service providers has also been prescribed by SEBI as Schedule II to the Guidelines. The agreement between the STP centralised hub and the STP service provider includes the provisions included in the model agreement.

SEBI (STP Centralised Hub And STP Service Providers) Guidelines, 2004

The Guidelines define "STP centralised hub" to mean an infrastructure set-up by a person or entity for the purpose of rendering STP service by providing a platform for communication between different STP service providers.

The term "STP message" under SEBI regulations Includes all the messages for electronic trade processing with a common messaging standard as may be defined by SEBI from time to time. "STP service" means the setting up and maintaining of infrastructure to create an electronic communication network to facilitate information exchange with respect to securities market transactions between various market participants from the stage of trade initiation to final settlement through a STP system flow as may be determined by SEBI from time to time.

The expression "STP service provider" in the guidelines mean a person or entity providing STP service to STP users to the extent of conveying messages between a STP user and the STP centralised hub and/or between two STP users.

"STP user" means all the users of the STP service and includes such users as are stipulated by SEBI.

Eligibility Criteria for STP Centralised Hub and STP Service Providers

SEBI Regulation provides that no person can act as an STP centralised hub or a STP Service provider unless it obtains approval from SEBI to provide such service. It has been provided that SEBI while granting a certificate of approval shall take into account the following factors:

- (i) whether the applicant is a person or entity with a minimum networth as may be prescribed from time to time,
- (ii) whether the applicant has adequate infrastructure facilities setup in India like office space, equipment and manpower with adequate experience in dealing in securities market and adequate expertise in providing necessary services and software solutions.

Obligations and Responsibilities of STP Centralised Hub

The STP centralised hub is required to comply the requirement of eligibility criteria as specified by SEBI and abide by all the provisions of the Act. Rules, Regulations, Guidelines, Resolutions, Notifications, Directions, Circular, etc. as may be issued by the Government of India/TRAI/Department of Telecommunications and SEBI from time to time.

The centralised hub should obtain such approval/s from such authorities as may be necessary to function as a centralised hub. It should also obtain a digital signature certificate from a Certifying Authority and ensure that such digital signature certificate is valid and in force at all times. A copy of the certificate is required to be submitted to all the recognized STP service providers.

The STP centralised hub is under an obligation to deliver a consistent and secure communication platform and should establish continuous connectivity with all the recognized STP service providers to the best of its ability. It should also verify the

digital signature certificate furnished by the STP Service Provider before connecting it to the STP centralized hub. It is going to confirm authenticity, integrity and non-reputability of all messages submitted by the STP Service Provider and also ensures that the message received from the STP service provider is in the specified messaging standard. It helps in the prompt delivering of the messages to the recipient STP service provider and also ensures that only the intended STP Service Provider receives the message.

The STP centralised hub is required to digitally sign all messages sent to the STP service provider, maintain a directory of all STP service providers and STP users and maintain a complete record of the flow of messages processed. The records of the STP centralised hub shall be open for inspection by SEBI or any other person duly authorised by SEBI for this purpose. It cannot modify/amend the communication protocol without consulting all the approved STP service providers and ensures that the message is not misused or tampered with while in its possession.

Thus STP centralised hub maintains confidentiality, of information about its users and shall not divulge the same to other clients, the press or any other person except in accordance with law or as per the directions of any court of law or of SEBI.

Obligations and Responsibilities of STP Service Provider

The STP service provider has to establish connectivity with the STP centralised hub before providing STP service to its users. He has to provide the necessary details of the STP users connected with it and all its details to the STP centralised hub for the purpose of creating and maintaining a directory of STP service providers and STP users. The STP service provider is required to comply with the minimum specifications specified by the STP centralised hub and should abide by the service standards as specified by SEBI and/or the STP centralised hub in consultation with the STP service providers. The STP Service Provider is required to obtain a digital signature certificate from a Certifying Authority and submit a copy of the Certificate to the STP centralised hub and also ensures that the digital signature certificate is valid and in force. The STP service providers have to deliver a consistent and secure communication platform and establish continuous connectivity with the STP centralised hub to the best of its ability. They also have to ensure that the message sent to the STP centralised hub is in the prescribed messaging standard. The STP service provider shall verify-the digital signature certificate furnished by the STP centralised hub before connecting itself to the STP centralised hub and should confirm the authenticity, integrity and nonrepudiability of all messages submitted to the STP centralised hub. The service provider has to keep complete track of the flow of messages for record and audit and may charge reasonable fees from the STP users. He can exchange messages between other STP service providers only through the STP centralised hub. It has also been provided that in force majeure measures or any other circumstances due to which the connectivity of the STP centralised hub is not available, the STP service provider after mutual discussion may exchange messages directly among themselves for such period. The service providers is required to digitally sign all messages sent from it to the STP centralised hub and enter into an agreement with all its STP users specifying the fees payable by the STP user for the services. They have to maintain a directory of the STP users connected to it and also a complete record of the flow of messages handled. The records of the STP service

provider should be open for inspection by SEBI or any other person duly authorised by SEBI for this purpose and should verify the digital signature on the message of the STP user connected to the STP Service Provider and also required to ensure that the message from the STP user is in the specified messaging format. They should promptly deliver messages to and from the STP user whereas in respect of inter STP service provider messages, the STP service provider shall perform all actions to the best of its ability in the same manner, diligence, speed and with all checks and balances as if the message is to be delivered/received by the same service provider. Nothing in these guidelines shall exempt the STP service provider from discharging any obligations placed on it by any law, regulations and guidelines.

Conditions of Approval

The approval by SEBI should be for an initial period of five years for STP centralised hub and for a period of three years for STP service providers and must be renewed periodically. The STP centralised hub and STP service provider must ensure continuous validity of approval by SEBI in order to function as a STP service provider. SEBI has the right to suspend/cancel the approval of the STP centralised hub and/or STP service provider in case of violation of the terms of the guidelines.

Code of Conduct

Every STP service provider is required to abide by the following Code of Conduct as prescribed—

- (a) The STP service provider should render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment.
- (b) The STP service provider should disclose to the clients its possible sources or potential areas of conflict of duties and interest and provide unbiased services.
- (c) The STP service provider herein agrees and undertakes to perform its duties as a STP service provider with the highest standards of integrity and fairness in all its dealings.
- (d) The STP service provider should abide by the obligation as specified under these Guidelines and the terms of the agreement entered into by the STP service provider with the STP users/STP centralised hub.
- (e) The STP service provider is required to maintain true and correct record of the messages processed by it under the scheme and in particular the records in respect of:
 - (i) the STP users
 - (ii) the messages exchanged within the same STP service provider.
 - (iii) the messages exchanged with other STP service provider through the STP centralised hub
- (f) The STP service provider should ensure that the message is not misused or tampered with while in its possession.
- (g) The STP service provider should maintain confidentiality information about its

users and shall not divulge the same to other clients, the press or any other interested party except in accordance with law or as per the directions of any court of law.

- (h) The STP service provider should also abide by all the provision of the Act, Rules, Regulations, Guidelines, Resolutions) Notifications, Directions, Circular, etc. as may be issued by the Government of India/Telecom Regulatory Authority of India/Department of Telecommunications and Securities and Exchange Board of India from time to time as may be, applicable to the STP service provider.

Service Changes and Discontinuation

STP centralised hub, if directed by regulatory authorities, suspend the STP Service Provider's access to the STP Centralized Hub at any time without notice. The STP Service Provider agrees that STP centralised hub will not be liable to any third party for any modification or discontinuance of the STP Centralized Hub. If STP centralised hub receives prior notice of such direction it shall be communicated to the service provider immediately.

In order to maintain the security and integrity of the service STP centralised hub may also suspend the STP Service Provider's access to the STP Centralized Hub. The STP Service Provider agrees that STP centralised hub will not be liable to or any third party for any modification or discontinuance of the STP Centralized Hub. The Parties shall make every effort to resolve amicably by direct informal negotiation any disagreement or dispute arising between them under or in connection with the arrangement. In the case of any issues arising out of the security and integrity of the messages being exchanged through the hub, the same shall be resolved by mutual discussion. In the event the parties are not able to settle the same within the time frame agreed between the parties either party may, by written notice of 30 days sent to the other party, temporarily suspend the arrangements, in whole or in part, till the parties find a technical solution to the security and technical issues. The notice of termination shall specify the termination is at whose instance, the extent to which performance of the agreement is suspended, and the date upon which such suspension becomes effective.

Force Majeure

If the performance of any obligations by any party as specified in this agreement is prevented, restricted, delayed or interfered by reason of force majeure then notwithstanding anything hereinbefore contained, the party affected shall be excused from its performance to the extent such performance relates to such prevention, restriction, delay or interference and provided the party so affected uses its best efforts to remove such cause of non-performance and when removed the party shall continue performance with utmost urgency. For the purpose of this clause "Force Majeure" means & includes fire, explosion, cyclone, floods, war, revolution, blockage or embargo, any law, order, demands or requirements of any Government or statutory authority, strikes, which are not instigated for the purpose of avoiding obligations herein or any other circumstances beyond the control of the party affected.

Waiver of Rights

No forbearance, delay or indulgence by any party in enforcing any of the

provisions of this agreement shall prejudice or restrict the rights of that party nor shall any waiver of its rights operate as a waiver of any subsequent breach and no rights, powers, remedies herein conferred upon or reserved for the parties is exclusive of any other right, power or remedy available to that party and each right, power or remedy shall be cumulative.

Arbitration and Jurisdiction

In the case of any dispute or any difference between the parties arising out of or in relation to this agreement including dispute or difference as to the validity of this agreement or interpretation of any of the provisions of this agreement or losses or damages arising under clause C-8 and the relevant clause under STP Centralizedized hub of this agreement, the same shall be resolved by mutual discussion. If the parties fail to settle the dispute or difference mutually, then the same shall be resolved in accordance with and subject to the provisions of the Arbitration and Conciliation Act, 1996 or any modifications or amendments thereto, or any enactment for the time being in force subject to the stipulation that only courts at Mumbai shall have exclusive jurisdiction in all such matters. The provisions of this clause shall survive the termination of this agreement.

Confidentiality

The Parties hereto shall at all times maintain and Keep secret and confidential any knowhow, Information and data which It has or may acquire from time to time relating to the business, activities or operations of the other Party and shall not disclose or divulge the same or any part thereof to any third party. The terms of this clause shall survive termination of the Agreement. The obligations shall not apply with respect to Information which:

- Is or becomes publicly available other than through a breach of this Agreement or is unlawfully appropriated;
- Is already in the possession of the other party without any breach of this Agreement;
- Is obtained by the other party from a third party without any breach of this Agreement.
- Is required to be produced before a judicial authority and only where the other party is compelled to do so by such an authority, provided that the said authority (or Individual representing such authority) has the authority, under the laws in force, to compel such disclosure.

Notwithstanding the foregoing, before making any use or disclosure on any of the foregoing exceptions, the Party disclosing such Information shall intimate the Other Party as soon as practicable the applicable exceptions (s) and circumstances giving rise thereto.

V. DIRECT MARKET ACCESS (DMA)

Direct Market Access (DMA) is a facility which allows brokers to offer clients direct access to the exchange trading system through the broker's infrastructure without

manual intervention by the broker. Some of the advantages offered by DMA are direct control of clients over orders, faster execution of client orders, reduced risk of errors associated with manual order entry, greater transparency, increased liquidity, lower impact costs for large orders, better audit trails and better use of hedging and arbitrage opportunities through the use of decision support tools / algorithms for trading.

While ensuring conformity with the provisions of the Securities Contract (Regulations) Act, 1956, Stock Exchanges may facilitate Direct Market Access for investors subject to the following conditions:

1. Application for Direct Market Access (DMA) facility

Brokers interested to offer DMA facility shall apply to the respective stock exchanges giving details of the software and systems proposed to be used, which shall be duly certified by a Security Auditor as reliable.

The stock exchange should grant approval or reject the application as the case may be, and communicate its decision to the member within 30 calendar days of the date of completed application submitted to the exchange.

The stock exchange, before giving permission to brokers to offer DMA facility shall ensure the fulfillment of the conditions specified in this circular.

2. Operational specifications

All DMA orders shall be routed to the exchange trading system through the broker's trading system. The broker's server routing DMA orders to the exchange trading system shall be located in India. The broker should ensure sound audit trail for all DMA orders and trades, and be able to provide identification of actual user-id for all such orders and trades. The audit trail data should be available for at least 5 years. Exchanges should be able to identify and distinguish DMA orders and trades from other orders and trades. Exchanges shall maintain statistical data on DMA trades and provide information on the same to SEBI on a need basis. The DMA system shall have sufficient security features including password protection for the user ID, automatic expiry of passwords at the end of a reasonable duration, and reinitialisation of access on entering fresh passwords. Brokers should follow the similar logic/priorities used by the Exchange to treat DMA client orders. Brokers should maintain all activities/ alerts log with audit trail facility. The DMA Server should have internally generated unique numbering for all such client order/trades. A systems audit of the DMA systems and software shall be periodically carried out by the broker as may be specified by the exchange and certificate in this regard shall be submitted to the exchange. The exchanges and brokers should provide for adequate systems and procedures to handle the DMA trades.

3. Client Authorization and Broker – Client agreement

Exchanges shall specify from time to time the categories of investors to whom the DMA facility can be extended. Initially, the permission is restricted to institutional clients. Brokers shall specifically authorize clients for providing DMA facility after fulfilling Know Your Client requirements and carrying out due diligence regarding clients' credit worthiness, risk taking ability, track record of compliance and financial soundness. Brokers shall ensure that only those clients who are deemed fit and

proper for this facility are allowed access to the DMA facility. Brokers shall maintain proper records of such due diligence. Individual users at the client end shall also be authorized by the broker based on minimum criteria. The records of user details, user-id and such authorization shall be maintained by the broker. Details of all user-ids activated for DMA shall be provided by the broker to the exchange.

The broker shall enter into a specific agreement with the clients for whom they permit DMA facility. This agreement will include the following safeguards:

- (a) The client shall use the DMA facility only to execute his own trades and shall not use it for transactions on behalf of any other person / entity.
- (b) Electronic/Automated Risk management at the broker's level before release of order to the Exchange system. The client shall agree to be bound by the various limits that the broker shall impose for usage of the DMA facility.
- (c) Right to withdraw DMA facility if the limits set up are breached or for any other such concerns
- (d) Withdrawal of DMA facility on account of any misuse or on instructions from SEBI/Exchange.

Exchanges shall prepare a model agreement for this purpose. The broker's agreement with clients should not have any clause that is less stringent/contrary to the conditions stipulated in the model agreement

4. Risk Management

The broker shall ensure that trading limits/ exposure limits/ position limits are set for all DMA clients based on risk assessment, credit quality and available margins of the client. The broker system shall have appropriate authority levels to ensure that the limits can be set up only by persons authorized by the risk / compliance manager. The broker shall ensure that all DMA orders are routed through electronic/automated risk management systems of the broker to carry out appropriate validations of all risk parameters including Quantity Limits, Price Range Checks, Order Value, and Credit Checks before the orders are released to the Exchange.

All DMA orders shall be subjected to the following limits:

- (a) Order quantity / order value limit in terms of price and quantity specified for the client.
- (b) All the position limits which are specified in the derivatives segment as applicable.
- (c) Net position that can be outstanding so as to fully cover the risk emanating from the trades with the available margins of the specific client.
- (d) Appropriate limits for securities which are subject to FII limits as specified by RBI.

The broker may provide for additional risk management parameters as they may consider appropriate.

5. Broker to be liable for DMA trades

The broker shall be fully responsible and liable for all orders emanating through

their DMA systems. It shall be the responsibility of the broker to ensure that only clients who fulfill the eligibility criteria are permitted to use the DMA facility

6. Cross Trades

Brokers using DMA facility for routing client orders shall not be allowed to cross trades of their clients with each other. All orders must be offered to the market for matching.

7. Other legal provisions

In addition to the requirements mentioned above, all existing obligations of the broker as per current regulations and circulars will continue without change. Exchanges may also like to specify additional safeguards / conditions as they may deem fit for allowing DMA facilities to their brokers.

VI. INDEX, FUTURES, OPTIONS AND DERIVATIVES

Derivatives are contracts which derive values from the value of one or more of other assets, called underlying assets. Some of the most commonly traded derivatives are futures, forward, options and swaps. Derivatives trading in Chicago Board Options Exchange has been adopted for the institutional framework. This is also referred as option trading.

Futures

This is a contract to buy or sell an underlying financial instrument at a specified future date at an agreed price (strike price) quoted when the contract is entered. The strike price or premium is influenced by the level of interest rate, market liquidity, dividend and expected variance in the price in future and time period of option. The terms of the contract allow the holder and not the maker of the option to cancel the option. The idea behind the futures trading is to transfer future changes in security prices from one person in the contract to the other. It offers the means to manage the risk in participating financial market. Futures do not create values, they only transfer values. It is a means for reducing risk or assuming risk with a view to profit.

Every futures contract has two sides—

- (a) A willing buyer
- (b) A willing seller

If one side of contract makes a profit and the other side will make a loss. The futures market is thus a zero sum game, since all futures market participants taken together can neither lose nor gain. A margin has to be deposited at the clearing house for futures. The size of the market is large and the investing public impersonal due to the presence of a central depository.

The right to buy is referred to as a call option whereas the right to sell is known as a put option. Options are generally described by the nature of underlying commodities. An option on common stock is said to be stock option; an option on bond is called a bond option; an option on foreign currency is referred as a currency option; an option on future contract is known as a future option and so on. The specified price at which

the underlying commodity may be bought (in the case of a call) or sold (in the case of put) is called exercise price or the striking price of the option.

In simple terms, futures markets are those where hedgers and speculators come together to discover the future prices of a security, to protect against price risk and to provide a pool of risk capital. These markets offer a large measure of flexibility in managing financial risk. Hedgers and speculators are given room to manoeuvre to offset buying options in one contract with selling options in another. Swap means exchange. If a trader has entered into a contract for purchasing from another trader, he may try to set it off or swap it for another contract which he may enter into for selling to that trader.

Functioning of Option Trading

It is relevant to know that Chicago Board Options Exchange (CBOE) introduced an institutional framework for optional trading.

Essentially the Option Trading system works like this—there is 'striking price' which represents the price the holder of the buy option must pay to the seller in order to claim the shares. The option has to be exercised before the expiration of the specified period. For instance, an IBM July call would allow an investor to buy 100 shares of the company at US\$60 per share any time before the expiration of the period of 90 days. If IBM rises at US\$70 within the period, the option's intrinsic value will be US\$1000 (market price-strike price). Conversely, if the IBM share fell below US\$60, the investor could opt out of the deal on paying the option charges.

Important terminology

- *Call option*: Right to buy at fixed price.
- *Put option*: Right to sell at fixed price.
- *Striking or exercise price*: Fixed price at which the option may be exercised and the underlying asset bought or sold.
- *Premium*: Price or cost of option.
- *Maturity*: Day on which option is exercised.
- *Exercise*: To put into effect, the right to buy or sell.
- *Write*: To sell an option.
- *Out of the money*: Option exercised price is above (in case of call) or below (in case of put) prevailing price of underlying asset.
- *American style*: Exercisable any time before maturity.
- *European style*: Exercisable on maturity.

Investment Strategies

Straddle: Combination of put and identical call. Holder pays premium equal to premium on put and call. He is insured against any movement on either side and has opportunity to gain from upmove and downmove. To break even, stock must move either way by at least the amount of premium paid for straddle.

Strip: Buyer of strip is confident that scrip price will change. He also feels it is more likely to go down, and enters into two puts and one call. Here, the premium is equal to the sum of the premia on the two puts and one call. The chances of loss increase. But, so also possibilities of favourable outcomes. As buyer enters into two puts, a smaller downside in prices is able to recover premium and chances of larger profit rise.

Strap: The strap buyer feels the market may go either way, but is more likely to go up. He, therefore, enters into two calls and a put. Here again, the premium paid is the sum of the premia paid on the two calls and one put. The buyer recovers cost if there is a slight upswing in the market and chances of profit rise.

Practical Aspects

Futures trading

A future contract is an arrangement by which a buyer/seller agrees to take/give delivery of the securities on a specified future date at a fixed price and make payment on the delivery date. Such contracts are zero-sum games where the gain equals loss. The clearing house is the counterparty in such contracts. A buyer is called the 'long' and the seller 'short'.

A margin has to be deposited at the clearing house for futures. The size of the market is large and investing public impersonal due to presence of a central depository.

Future markets provide precise price information and make it possible to transfer risk from those who wanted to shed it (hedgers) to those who are willing to accept it (speculators). These important benefits are:

- price discovery and risk transfer
- extend to every sector in which time and place considerations create economic risk.

Simply stated, future markets are those where hedgers and speculators come together to discover the future price of a security, to protect against price risk and to provide a large pool of risk capital. Future markets also afford a large measure of flexibility in managing financial risk. Hedgers and speculators are given room to manoeuvre, to offset buying options in one contract with selling options in another.

Options Trading

An option is a contract between two parties in which the maker of the option (option writer) agrees to buy or sell a specified number of shares at later date for an agreed price (strike price) to the holder of the option (option buyer) on a due date (answer date) and time, when and if the later so desires, in consideration of a sum of money (premium). The strike price or premium is the price which is required to be paid for purchase of right to buy or sell. The premium is influenced by level of interest rate, market liquidity, dividend and expected variance in price in future and time period of option. The terms of the contract allow the holder, not the maker, to cancel the option.

The option buyer is required to notify the option maker on the 'answer day' if he intends to exercise his rights, and in case the former does not do so, the option contract lapses. The premium (option price) is determined on the basis of market volatility, interest rates, the spot price, the duration of the option, the agreed price and investors' sentiment.

Types of Option

Options are of two types. In call option, an investor has a right to buy. An investor takes a call option if he expects that the market price will be higher than the strike price to earn the difference as his profit. In put option, an investor has a right to sell. An investor takes a put option if he expects that the market price will be lower than the strike price. The lower the market price than the strike price, the higher will be the profit for investor.

An investor can simultaneously buy call as well as put option if he is uncertain about the market conditions.

Exercising Options

There are two ways of exercising options—(i) On the expiry date (European options system) and (ii) anytime before the expiry of specified time (American option system). The rate of premium is higher in case of American option system as it covers risk all the times during the option period.

Option can be allowed either on the basis of the price of shares or indices of shares. In case of option on the price of shares, the delivery has to be made on the specified date and the difference in share price is paid to the investor. But, in case of share indices, the difference between the share index at the time of taking the option and the date of exercising the option is settled without delivery of shares.

The main purpose of an option market is to manage risk and not to create it. The risks are apparent in every trade and it is nothing more than common prudence to guard against risks. Put and call options redistribute the risks inherent in investment. An investor can use options in high or low risk ways but options themselves are not inherently risks.

Although options do not increase or decrease the total level of risk in the market, both parties to a particular option transaction can reduce their portfolio risk simultaneously through a combination of stock option and short-term debt position. The net effect of option transactions is a re- allocation of risk and reward between buyer and seller.

To understand options trading in proper perspective, the following terminology needs brief explanation:

A standard option contract allows the buyer to buy fixed number of shares at a specific price during a specific period of time, regardless of the market price of that stock.

The expiration date is the date on which the option contract expires; i.e., the date on which an option can be exercised by the buyer.

The 'striking' price is the price at which the buyer of a call can purchase the stock during the period of option, and the price at which the buyer of a put can sell the stock during the life of the option. The terms 'buyer' and 'holder' are synonymous with expression 'seller' and 'writer'. In the latter case, however, a seller of an existing option is not necessarily the writer. He might have purchased the option from a writer.

The premium is the price the buyer pays to the writer for an option contract at the time of buying the option. The term 'premium' is often synonymous with the word 'price'.

How the system works?

Futures and options allow investors to buy and sell forward or at a future date. However, in doing so, they have to pay upfront to the option writer. It is the premium, which is a factor of the interest rate, depending on the volatility of a particular scrip. An investor may not be willing to buy immediately in the uncertain market conditions, but can buy an option to pick up the shares at a future date. As for every buyer of shares, there is a corresponding seller, it ensures that there is always a fairly good amount of floating stock in the market.

For example, a person who has 1000 shares of a company currently priced at Rs. 90 in the market has to liquidate his holdings after two years, when he requires money to finance child's education. In two years, the price of the shares slumps to Rs. 60 and the investor stands to lose Rs. 30,000 on his holding which he can ill-afford. He can avoid the risk of loss, by buying a put Option (right without obligation to sell) to sell 100 shares at Rs. 90 two years later. For this, he will have to pay a premium of Rs. 2000. Suppose, after two years the market price of share is about Rs. 100. In this case, the holder need not exercise the option of selling his 1000 shares at Rs. 90 each because he is able to sell the shares at Rs. 100 each.

Advantages of options

The main advantages of options are as follows—

Options are openly traded and ensure transparency in transactions.

Options limit risk exposure for the stipulated time and enable investors to manage their risk under volatile conditions. There is no default because clearing house is counter-party to all transactions and guarantor for payment and deliveries. There is opportunity to maintain position without margin calls.

There is realistic forecast of prices for securities by studying the published prices of future contract.

There will be tendency to estimate in advance total risk in future transactions.

There will be integration of the Indian capital market with the developed capital markets.

An option market is less vulnerable to the manipulations of operators. At both the highest and lowest prices, there are both buyers and sellers to keep the speculation under control. Secondly, if a particular industry is going through a rough weather, an investor can always hedge by buying a put options or selling the shares without

worrying about payment of backwardation charge (Undha badla). Thirdly, an investor can get an idea of the future price trend in a right/bonus scrip. Fourthly, even during speculations, it is possible to manage the risk within limits. Finally, the system will be more transparent as all option trades will be reported and the information disseminated to investors.

Pre-requisites for Option Trading

The most important pre-requisite of starting option trading is proper infrastructure and writers of options. Institutional infrastructure has to be developed. This will require writers of options, who are speculators willing to take risk for high rewards. They generally have sufficiently large resource base and are able to meet commitments in case the buyer of the option exercises his right. The successful functioning of option trading will require:

1. Standardisation of the terms of contract. This will decrease cost of transactions and facilitate development of the secondary market in options.
2. Careful selection of underlying securities. The securities selected must be registered and listed on major stock exchanges and widely held.
3. Appointment of market-makers. A number of market-makers, with sound financial base, are required to provide trading in options on a regular basis.
4. Setting up of options clearing house. It will require an efficient clearing house to collect fees from every buyer and create a guarantee fund for insuring future performance of the contract. In case any party to a future contracts commits default, the clearing house will have to pay cost to carry out the contract from the fund.
5. Creation of a central market. The creation of a central market will require regulation, surveillance and price dissemination.

Position in Advanced Countries

Futures and options are traded in the US, UK, France, Germany and other European countries since 18th Century. With a constructive regulatory environment and close scrutiny of derivatives market, the law makers in the advanced countries have been able to prevent the speculative abuse of the future and option trading without destroying the utility of the instruments.

In USA and UK, the stock exchanges have extended the concept of future and option dealing by introducing, in addition to the traditional stock market, a market in 'traded option'. The London market in traded option was opened in 1978 by 18 British companies.

Vital Issues

How the derivatives will check risk? The derivatives are used as tools of investment risk management. The futures and options trading will not only provide a way to hedge against the market risk of a large stock portfolio, but it will also enable investors to hedge their position in the market.

How to ensure performance of contract? One of the salient features of option is

that losses to the buyer are limited to the amount paid for purchase of option, but there is scope of earning unlimited profits. The amount of premium is relatively small and possibility of making profit is higher. It is the buyer who has the option and flexibility to take the risk to the extent he likes and pass on the rest to the option writer. It is the option writer who is fully exposed to the risk of price fluctuations and has to exercise due care and diligence. As such, the system can fail like option trading if adequate precaution is not taken in advance to ensure the risk of the option writer. The stock exchange authorities have to ensure the performance of the contract in the event of the failure of the option writer. In USA, stock exchanges provide the guarantee for performance of the contract in case the option writer fails to meet his liability.

As such, stock exchange authorities have to obtain insurance policy to ward off the risk of failure by option writers. The premium amount can be collected by levying fees on the turnover of option transactions. The stock exchange members should be advised to work within their limits and in case of frequent default, the membership of the broker can be cancelled.

Is the futures and the options trading flawless ? In fact, the degree of speculation can be much higher in futures and options market because players know that their losses can be quantified and limited to the amount of premium paid.

There are legislative measures in the USA and European countries to check abuses of option trading without undermining its usefulness. In India, it is quite possible that like in the present system, the sentiment can sway the market and the volumes could go up to unsustainable levels. As such, checks and balances have to be provided to bring the market back to normal.

Care will have to be taken to ensure that under the option trading system, transaction would be dealt at the fixed price for specific delivery and no carry forward charges would be fixed. Consequently, the buyers or sellers would only get the price difference as against the present system of price-differential and plus/ minus carry forward charges as fixed by the market at turn of settlement.

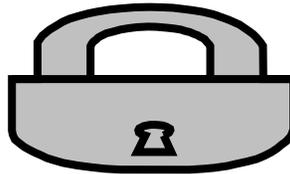
LESSON ROUND UP



- Securities traded in the stock exchanges can be classified as Listed cleared Securities and Permitted Securities.
- Listing of securities falls under 5 groups viz. Initial Listing; Listing for Public Issue; Listing for Rights Issue; Listing of Bonus Shares; Listing for merger or amalgamation:

- Settlement is the process of netting of transactions and actual delivery/receipt of securities and transfer deeds against receipts/payment of agreed amount.
- National Securities Clearing Corporation Limited 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 Stock Exchange.
- The member-brokers at BSE &NSE now enter orders for purchase or sell of securities from Trader Work Stations (TWSs) through BOLT and NEAT system.
- Securities lending is a scheme under which a person with idle shares can lend them to another who does not have the shares to fulfill his obligation under a trade finalized by him.
- Straight Through Processing (STP) is a mechanism that automates the end to end processing of transactions of financial instruments.
- Direct Market Access (DMA) is a facility which allow brokers to offer clients direct access to the exchange trading system through the broker's infrastructure without manual intervention by the broker.
- The process of demutualisation is to convert the traditional 'not for profit' stock exchanges into a "for profit" company and this process is to transform the legal structure from a mutual form to a business corporation form.

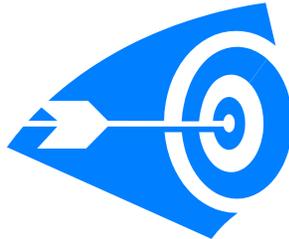
SELF TEST QUESTIONS



(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Write short notes on
 - (a) BOLT
 - (b) NEAT
 2. Discuss the procedure for settlement of securities under rolling settlement.
 3. Discuss the framework for securities lending and borrowing.
 4. What is straight through processing? What are its advantages?
 5. What are the prerequisites for trading in Option?
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STUDY IX
MUTUAL FUNDS



LEARNING OBJECTIVES

The study will enable the students to understand

- Trend of mutual funds in India over a period of time, mobilization of resources by Mutual Funds.
- Various schemes of mutual funds
- Risks involved in mutual funds
- Offer document of Mutual Fund Scheme
- Payment through ASBA
- Net Asset Value of Mutual funds
- Overviews of SEBI (Mutual Fund) Regulations, 1996
- Code of conduct for Mutual funds
- Restriction on investment by mutual funds
- Gold Exchange Traded Fund Scheme/Capital protection oriented scheme
- Real Estate Mutual Funds

INTRODUCTION

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. Investments in securities are spread across a wide cross-section of industries and sectors and thus the risk is reduced. Diversification reduces the risk because all stocks may not move in the same direction in the same proportion at the same time. Mutual fund issues units to the investors in accordance with quantum of money invested by them. Investors of mutual funds are known as unitholders. 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.

The small investors who generally lack expertise to invest on their own in the securities market have reinforced the saying "Put not your trust in money, put your money in trust". They prefer some kind of collective investment vehicle like, MFs,

which pool their marginal resources, invest in securities and distribute the returns therefrom among them on cooperative principles. The investors benefit in terms of reduced risk and higher returns arising from professional expertise of fund managers employed by the MFs. This approach was conceived in the USA in the 1930s. In developed financial markets, MFs have almost overtaken bank deposits and total assets of insurance funds.

Experiment with MFs in India began in 1964 with the establishment of Unit Trust of India (UTI), which continues to be market leader even today with a corpus of investible funds of about Rs. 76,547 crore at the end of March 2000, accounting for 68% of total market. UTI lost its monopoly status in 1987 with the entry of other public sector MFs promoted by public sector banks and insurance companies. The industry was opened to private sector, including foreign institutions, in 1993 giving Indian investors a broader choice and increasing competition to public sector funds.

I. An Overview of Trends in Mutual Funds

As in mature markets, mutual funds in emerging markets have been among the fastest growing institutional investors. Indeed, mutual funds assets under management in emerging markets grew by 96 per cent between the end of 1997 and June 2003 and as a result, it rose from 8 per cent of GDP to 15 per cent. One key difference between mutual funds of mature and emerging markets has been the relative importance of bond and equity funds are often much larger than those of bond funds (particularly in Japan, the United Kingdom, the United States). In contrast, emerging market bond funds in a number of countries have larger assets under management than do equity funds particularly in Brazil, Mexico, Korea and Taiwan. In part, this reflects the difference in the relative development of the local markets in mature and emerging markets. This difference reflects a search for higher yield on the part of retail investors. As the nominal interest rates have declined in many emerging countries since the late 1990s, retail investors have seen an extended decline in the interest rate of traditional savings instruments. To obtain higher yields, retail investors subscribe to bond funds with investment in longer term government and corporate bonds.

Household savings play an important role in domestic capital formation. Only a small part of the household savings in India is channelised to the capital market. Attracting more households to the capital market requires efficient intermediation. The mutual funds have emerged as one of the important class of financial intermediaries which cater to the needs of retail investors. As a traditional investment vehicle, the mutual funds pool resources from the households and allocate them to various investment opportunities.

Advantages of Mutual Funds

The advantages of investing in a mutual fund are:

1. *Professional Management:* Investors avail the services of experienced and skilled professionals who are backed by a dedicated investment research team which analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme.
2. *Diversification:* Mutual funds invest in a number of companies across a broad cross-section of industries and sectors. This diversification reduces the risk

because seldom do all stocks decline at the same time and in the same proportion. Investors achieve this diversification through a Mutual Fund with far less money than one can do on his own.

3. *Convenient Administration:* Investing in a mutual fund reduces paper work and helps investors to avoid many problems such as bad deliveries, delayed payments and unnecessary follow up with brokers and companies. Mutual funds save investors time and make investing easy and convenient.
4. *Return Potential:* Over a medium to long term, Mutual funds have the potential to provide a higher return as they invest in a diversified basket of selected securities.
5. *Low Costs:* Mutual funds are a relatively less expensive way to invest compared to directly investing in the capital markets because the benefits of scale in brokerage, custodial and other fees translate into lower costs for investors.
6. *Liquidity:* In open ended schemes, investors can get their money back promptly at net asset value related prices from the mutual fund itself. With close ended schemes, investors can sell their units on a stock exchange at the prevailing market price or avail of the facility of direct repurchase at net asset value (NAV) related prices which some close ended and interval schemes offer periodically or offer it for redemption to the fund on the date of maturity.
7. *Transparency:* Investors get regular information on the value of their investment in addition to disclosure on the specific investments made by scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

Schemes according to Maturity Period

The MFs in India offer a wide array of schemes that cater to different needs suitable to any age, financial position, risk tolerance and return expectations. These include: open-ended schemes, which provide easy liquidity; close-ended schemes with a stipulated maturity period; growth schemes, which provide capital appreciation over medium to long term; income schemes, which provide regular and steady income to investors; balanced schemes, which provide both growth and income by periodically distributing a part of income and capital gains they earn; money market schemes; which provide easy liquidity, preservation of capital and moderate income; and tax saving schemes, which offer tax rebates to investors under tax laws as prescribed from time to time.

(i) *Open ended mutual funds:* An 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. The fund itself buys back the shares surrendered and is ready to sell new shares. Generally the transaction takes place at the net asset value which is calculated on a periodical basis. The net asset value (Net Asset Value per share value of the fund's is total net assets after liabilities divided by the total number of shares outstanding on a given day) of the mutual funds rises or falls as a result of the performance of securities in the portfolio and the stock exchanges.

(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. Primary

example of such mutual fund is UTI's Master share. The shares of such mutual funds are traded in the secondary markets. The requirement for listing is laid down to grant liquidity to the investors who have invested with the mutual fund. Therefore, close ended funds are more like equity shares. The main differences between close ended and open ended funds are:

<i>CLOSE ENDED SCHEMES</i>	<i>OPEN ENDED SCHEMES</i>
1. Fixed corpus: no new units can be offered beyond the limit	1. Variable corpus due to on going purchase and redemption
2. Listed on the stock exchange for buying and selling	2. No listing on exchange transactions done directly with the fund
3. Two values available namely NAV and the Market Trading Price	3. Only one price namely NAV
4. Mostly liquid	4. Highly Liquid

Schemes according to investment objective:

Besides these, there are other types of mutual funds also to meet the investment needs of several groups of investors. Some of them include the following:

- (a) *Income Oriented Schemes*: The fund primarily offer 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. These funds, with a view to satisfying the growth needs of investors, primarily concentrate on the low risk and high yielding spectrum of equity scrips of the corporate sector.
- (c) *Hybrid Schemes*: These funds cater to both the investment needs of the prospective investors - namely fixed income as well as growth orientation. Therefore, investment targets of these mutual funds are judicious mix of both the fixed income securities like bonds and debentures and also sound equity scrips. In fact, these funds utilise the concept of balanced investment management. These funds are, thus, also known as "balanced funds".
- (d) *High Growth Schemes*: As the nomenclature depicts, 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. Aggressive investors willing to take excessive risks are the normal target group of such funds.
- (e) *Capital Protection Oriented Scheme*: It is a scheme which protects the capital invested in the mutual fund through suitable orientation of its portfolio structure.
- (f) *Tax Saving Schemes*: These schemes offer tax rebates to the investors under tax laws as prescribed from time to time. This is made possible because the Government offers tax incentive for investment in specified avenues. For example, Equity Linked Saving Schemes (ELSS) and pensions schemes.

- (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 (which invest in specific industries) or sectoral schemes (which invest exclusively in segment such as 'A' Group or initial public offering). Index fund schemes are ideal for investors who are satisfied with a return approximately equal to that of an index. Sectoral fund schemes are ideal for investors who have already decided to invest in particular sector or segment.
- (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. They tend to indulge in speculative trading and risky investments.
- (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)* are a new variety of mutual funds that first became available in 1993. ETFs have from rapidly and now hold nearly \$80 billion in assets. ETFs are sometimes described as mere "tax efficient" than traditional equity mutual funds, since in recent years, some large ETFs have made smaller distribution of realized and taxable capital gains than most mutual funds.
- (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. Money market mutual funds used to be regulated by the Reserve Bank of India on the basis of specified guidelines to be laid down by the Reserve Bank of India. However, money market schemes of other mutual funds were regulated by the Securities and Exchange Board of India. But consequent upon withdrawal of guidelines by Reserve Bank of India on Money Market Mutual Funds w.e.f. March 7, 2000, the schemes of such funds, like other mutual fund schemes would exclusively be governed by SEBI (Mutual Funds) Regulations, 1996.

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. Such funds invest both in bonds and blue chip shares. While bonds give stable interest income, the share dividends will be fluctuated though in the long run, they may give larger benefits. The exact balance between the two asset classes namely - shares and bonds depends on the fund managers ability to take risk and his priority for return. The normal ratio between stocks and bonds is 55:45 but if the fund manager is aggressive he could choose a larger equity component.

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.

Offer Document of Mutual Fund Scheme

The Offer Document shall have two parts i.e. Scheme Information Document (SID) and Statement of Additional Information (SAI). SID shall incorporate all information pertaining to a particular scheme. SAI shall incorporate all statutory information on Mutual Fund. The Mutual Funds shall prepare SID and SAI in the prescribed formats. Contents of SID and SAI shall follow the same sequence as prescribed in the format. The Board of the AMC and the Trustee(s) shall exercise necessary due diligence, ensuring that the SID/SAI and the fees paid are in conformity with the Mutual Funds Regulations. All offer documents (ODs) of Mutual Fund schemes shall be filed with SEBI in terms of the Regulations. For the schemes launched in the first half of a financial year, the SID shall be updated within 3 months from the end of the financial year. However, for the schemes launched in the second half of a financial year, SID shall be updated within 3 months of the end of the subsequent financial year.

For example, for a scheme launched in May, 2008 the SID shall be updated by June 30, 2009 and for a scheme launched in December 2008, the SID shall be updated by June 30, 2010. Thereafter, the SID shall be updated once every year.

Additional mode of payment through Applications Supported by Blocked Amount (hereinafter referred to as "ASBA") in Mutual Funds

ASBA facility which investors have been enjoying for subscription to public issue

of equity capital of companies has been extended to the investors subscribing to New Fund Offers (NFOs) of mutual fund schemes. It shall co-exist with the current process, wherein cheques/ demand drafts are used as a mode of payment. The banks which are in SEBI's list shall extend the same facility in case of NFOs of mutual fund schemes to all eligible investors in Mutual Fund units. Mutual Funds shall ensure that adequate arrangements are made by Registrar and Transfer Agents for the implementation of ASBA. Mutual Funds/AMCs shall make all relevant disclosures in this regard in the SAI. The Mutual Funds/AMCs have to compulsorily provide ASBA facility to the investors for all NFOs launched on or after October 1, 2010.

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.

Calculation of 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. Thus if the NAV is the more than the face value of Rs. 10/-, there is an appreciation for the investment. If the NAV is less than the face value, it indicates depreciation of the investment. NAV also includes dividends, interest accruals and reduction of liabilities and expenses apart from market value of investments. 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.

Mutual Fund Costs

There are two broad categories of mutual fund costs, namely - (a) Operating expenses (b) Sales charges. These terms are explained below:

- (a) *Operating Expenses*: Costs incurred in operating mutual funds include advisory fees paid to investment managers, custodial fees, audit fees, transfer agent fees, trustee fees, agents commission etc. The break-up of

these expenses is required to be reported in the schemes offer document. When the operating expenses are divided by the average net asset, the expense ratio is arrived at. Based on the type of the scheme and the net assets, operating expenses are determined within the limits indicated by SEBI Mutual Fund Regulations, 1996. Expenditure which is in excess over the specified limits shall be borne by the Asset Management Company, the Trustees or the Sponsors. Operating expenses are calculated on an annualised basis but are accrued on a daily basis. Therefore, an investor face expenses prorated for the time he has invested in the fund.

- (b) *Sales Charges*: These are otherwise called as sales loads and are charged directly to the investors. Mutual funds use the sales loads for payment of agents commission and expenses for distribution and marketing.

There is no entry load for all mutual fund schemes. The scheme application forms carry a suitable disclosure to the effect that the upfront commission to distributors will be paid by the investor directly to the distributor, based on his assessment of various factors including the service rendered by the distributor. Of the exit load or CDSC charged to the investor, a maximum of 1% of the redemption proceeds is required to be maintained in a separate account which can be used by the AMC to pay commissions to the distributor and to take care of other marketing and selling expenses. Any balance shall be credited to the scheme immediately. Contingent Deferred Sales charges (CDSC) is a structured back end load paid when the units are redeemed during the initial of ownership. The distributors should disclose all the commissions (in the form of trail commission or any other mode) payable to them for the different competing schemes of various mutual funds from amongst which the scheme is being recommended to the investor. AMC(s) shall not charge entry/or exit load on bonus units and units allotted on reinvestment of dividend.

Transaction costs

Some funds impose a switch over fee as a charge on transfer of investment from one scheme to another within the same mutual fund family and also to switch over from one plan to another within the same scheme. A cost conscious investor has to consider two aspects: (i) compare a funds expense ratio with that of similar funds in the industry and find out justification based on performance (ii) compare the exit load with that of similar funds, since a load will reduce the investment by the amount of load. Besides these aspects the investors should carefully consider his goals, risk tolerance and investment preferences.

Judging efficiency of mutual funds is done with reference to various factors such as -

- whether the fund is stable
- whether it is liquid (listed on exchanges)
- whether it offers increase in NAV, consistent growth in dividend and capital appreciation
- whether the investment objectives are clearly laid and implemented
- whether the issuer has a proven track record and offers assured returns or returns not less than a percentage
- whether it observes investment norms to balance risks and profits

Roll over of a scheme

A mutual fund can roll over a close ended scheme on or before the redemption of the scheme after giving an option to investors to redeem their units at NAV based price. The roll over scheme may include a fresh extension of period or continue under the same terms of the original scheme with or without modifications.

Switch over one scheme to another

A mutual fund may use its discretion to permit switching over of the investment in units from one to another of its schemes, to help the investor shift, from a high risk scheme to a low risk one or vice-versa.

Annualised Returns

Investors buy and sell mutual fund shares/units during a short period and make profits. Percentage of profits in such short periods can not be a reliable measure. The proper method is to calculate returns on an annualised basis at the compounded average rate over a year.

Asset Management Company (AMC)



Under SEBI Regulations, every mutual fund is required to have an Asset Management Company (AMC) incorporated in the Companies Act, 1956 to manage the funds of the mutual fund. The AMC should be approved by SEBI and should enter into an agreement with the trustees of the mutual fund to formulate schemes, raise money against units, invest the funds in accrued securities and after meeting the permissible costs as per norms, distribute income to the share holders of the funds.

II. SEBI (Mutual Fund) Regulations, 1996

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

Some of the important definitions in these regulations are given below:

- *Advertisement* includes every form of advertising whether in a publication by display of notices, signs, labels or by means of circulars, catalogues or other documents, by an exhibition of pictures or photographic films, by way of sound, broadcasting or television or in any other manner.
- *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.
- *Mutual Fund* means a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities including money market instruments or gold or gold related instruments.

- *Money Market Mutual Fund* means a scheme of a mutual fund set up with the objective of investing exclusively in money market instruments.
- *Money Market Instruments* includes commercial papers, commercial bills, treasury bills, Government securities having an unexpired maturity upto one year, call or notice money, certificate of deposit, and any other like instruments as specified by RBI from time to time.
- *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.
- *Close-ended scheme* means any scheme of a mutual fund in which the period of maturity of scheme is specified.
- *Open-ended scheme* means a scheme of a mutual fund which offers units for sale without specifying any duration for redemption.
- *Gold exchange traded fund* scheme means a mutual fund scheme that invests primarily in gold or gold related instruments.
- *Gold related instrument* means such instrument having gold as underlying, as may be specified by the Board from time to time.
- *Capital protection oriented scheme* means a mutual fund scheme which is designated as such and which endeavours to protect the capital invested therein through suitable orientation of its portfolio structure.

Registration of Mutual Fund

Regulation 7 lays down the following eligibility criteria to be fulfilled by an applicant to get a certificate of registration. In the opinion of SEBI the applicant should be a fit and proper person. The other criteria are:

- (a) the sponsor should have a sound track record and general reputation of fairness and integrity in all his business transactions.

The regulations provide that "Sound track record" means the sponsor -

- (i) is carrying on business in financial services for a period of not less than five years; and
- (ii) the networth is positive in all the immediately preceding five years; and
- (iii) the networth in the immediately preceding year is more than the capital contribution of the sponsor in the asset management company; and
- (iv) the sponsor has profits after providing for depreciation, interest and tax in three out of the immediately preceding five years, including the fifth year;

- (aa) the applicant is a fit and proper person;
- (b) in the case of an existing mutual fund, such fund is in the form of a trust and the trust deed has been approved by SEBI;
- (c) the sponsor has contributed or contributes at least 40% to the networth of the asset management company;

However any person who holds 40% or more of the net worth of an asset management company shall be deemed to be a sponsor and will be required to fulfil the eligibility criteria specified in these regulations;
- (d) the sponsor or any of its directors or the principal officer to be employed by the mutual fund should not have been guilty of fraud or has not been convicted of an offence involving moral turpitude or has not been found guilty of any economic offence;
- (e) appointment of trustees to act as trustees for the mutual fund in accordance with the provisions of the regulations; appointment of asset management company to manage the mutual fund and operate the scheme of such funds in accordance with the provisions of these regulations;
- (f) appointment of asset management company to manage the mutual fund and operate the scheme of such funds in accordance with the provisions of these regulations;
- (g) appointment of custodian in order to keep custody of the securities or gold and gold related instrument or other assets of the mutual fund held in terms of these regulations, and provide such other custodial services as may be authorised by the trustees.

Regulation 10 lays down that the registration granted to a mutual fund is subject to the following terms and conditions:

- (a) the trustees, the sponsor, the asset management company and the custodian comply with the provisions of these regulations;
- (b) the mutual fund to inform SEBI, if any information or particulars previously submitted to SEBI was misleading or false in any material respect;
- (c) the mutual fund to inform SEBI, of any material change in the information or particulars previously furnished, which have a bearing on the registration granted by it;
- (d) payment of the prescribed fees.
- (e) payment of annual service fee for each financial year before 15th April. SEBI may not permit a mutual fund to launch any scheme if it has not paid the service fee.

Constitution and Management of Mutual Fund and Operation of Trustees

Regulation 14 stipulates that a mutual fund shall be constituted in the form of a trust and the instrument of trust shall be in the form of a deed duly registered under Indian Registration Act, 1908 and executed by the sponsor in favour of the trustees named in the instrument.

Regulation 15 lays down that the trust deed shall not contain any clause which has the effect of limiting or extinguishing the obligations and liabilities of the trusts in relation to any mutual fund or the unit holders or indemnifying the trustees or the asset management company for loss or damage caused to the unit holders by their acts of negligence, commission or omission.

Contents of the Trust Deed

The Third Schedule prescribing the contents of the Trust Deed is reproduced below:

1. (i) A trustee in carrying out his responsibilities as a member of the Board of Trustees or of trustee company, shall maintain arms' length relationship with other companies, or institutions or financial intermediaries or any body corporate with which he may be associated.
 - (ii) No trustee shall participate in the meetings of the Board of Trustees or trustee company when any decision for investments in which he may be interested are taken.
 - (iii) All the trustees shall furnish to the board of trustees or trustee company particulars of interest which he may have in any other company, or institution or financial intermediary or any corporate by virtue of his position as director, partner or with which he may be associated in any other capacity.
2. Minimum number of trustees must be mentioned in the Trust Deed.
 3. The Trust Deed must provide that the trustees shall take into their custody, or under their control all the property of the schemes of the mutual fund and hold it in trust for the unit holders.
 4. The Trust Deed must specifically provide that unit holders would have beneficial interest in the trust property to the extent of individual holding in respective schemes only.
 5. The trust deed shall provide that it is the duty of trustees to provide or cause to provide information to unit holders and Board as may be specified by the Board.
 6. The trust deed shall provide that it would be the duty of the trustees to act in the interest of the unit holders.
 7. The trust deed shall provide that the trustees shall appoint an AMC approved by the Board, to float schemes for the mutual fund after approval by the trustees and Board, and manage the funds mobilised under various schemes, in accordance with the provisions of the trust deed and Regulations. The trustees shall enter into an Investment Management Agreement with the AMC for this purpose, and shall enclose the same with the Trust Deed.
 8. The trust deed shall provide for the duty of the trustee to take reasonable care to ensure that the funds under the schemes floated by and managed by the AMC are in accordance with the Trust Deed and Regulations.

9. The trust deed must provide for the power of the trustees to dismiss the AMC under the specific events only with the approval of Board in accordance with the Regulations.
10. The trust deed shall provide that the trustees shall appoint a custodian and shall be responsible for the supervision of its activities in relation to the mutual fund and shall enter into a Custodian Agreement with the custodian for this purpose.
11. The trust deed shall provide that the auditor for the mutual fund shall be different from the Auditor of the AMC.
12. The trust deed shall provide for the responsibility of the trustees to supervise the collection of any income due to be paid to the scheme and for claiming any repayment of tax and holding any income received in trust for the holders in accordance with the Trust Deed Regulations.
13. Board policies regarding allocation of payments to capital or income must be indicated in the Trust Deed.
14. The trust deed shall also explicitly forbid the acquisition of any asset out of the trust property which involves the assumption of any liability which is unlimited or shall not result in encumbrance of the trust property in any way.
15. The trust deed shall forbid the mutual fund to make or guarantee loans or take up any activity not in contravention of the Regulations.
16. Trusteeship fee, if any, payable to trustee shall be provided in the Trust Deed.
17. The trust deed shall provide that no amendment to the Trust Deed shall be carried out without the prior approval of the Board or unit holders.

However in case a Board of trustees is converted into a trustee company subsequently such conversion shall not require the approval of unit holders.
18. The removal of the trustee in all cases would require the prior approval of Board.
19. The trust deed shall lay down the procedure for seeking approval of the unit holders under such circumstances as are specified in the Regulations.
20. The trust deed shall state that a meeting of the trustees shall be held at least once in every two months and at least six such meetings shall be held in every year.
21. The trust deed shall specify the quorum for a meeting of the trustees.

However the quorum for a meeting of the trustees shall not be constituted unless one independent trustee or director is present at the meeting.
22. The trust deed shall state that the minimum number of trustees shall be four.

Regulation 16 lays down the attributes of a person to be appointed as trustee. These attributes are:

- (a) he should be a person of ability, integrity and standing;

- (b) he has not been found guilty of moral turpitude;
- (c) he has not convicted of any economic offence or violation of any securities law and has furnished particulars as required in the prescribed form;
- (d) an asset management company or any of its directors including independent directors, officers or employees shall not be eligible to act as a trustee;
- (e) a person already appointed as a trustee of a mutual fund can not be appointed again as a trustee of any other mutual fund;
- (f) 2/3 of the trustees shall be independent persons not associated with the sponsors in any manner;
- (g) where the companies appointed as trustee, then its directors can act as trustees of any other trust provided that the object of the trust is not in conflict with the object of the mutual fund; and
- (h) prior approval of SEBI shall be necessary for the appointment of any trustee.

Rights and Obligations of Trustees

Regulation 18 lays down the following rights and obligations for the trustees:

(1) The trustees and the AMC shall with the prior approval of SEBI enter into an investment management agreement.

(2) Such agreement shall contain all the clauses as prescribed in these Regulations or as well as other clauses necessary for the purpose of making investments; The fourth Schedule contains clauses which are to be included as contents of the investment management agreement.

(3) The trustees are entitled to obtain from the AMC all the information which the trustees consider necessary;

(4) the trustees shall ensure before the launch of any scheme that the asset management company has—

- (a) systems in place for its back office, dealing room and accounting;
- (b) appointed all key personnel including fund manager(s) for the scheme(s) and submitted their bio-data which shall contain the educational qualification, past experience in the securities market with the trustees, within 15 days of their appointment;
- (c) appointed auditors to audit its accounts;
- (d) appointed a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by the board or the Central Government and for redressal of investors grievances.
- (e) appointed registrars and laid down parameters for their supervision;
- (f) prepared a compliance manual and designed internal control mechanisms including internal audit systems;
- (g) specified norms for empanelment of brokers and marketing agents;

In addition to the aforementioned certification, the trustees are required to certify that “the trustees have ensured that the (name of the scheme/Fund) approved by them is a new product offered by (name of the MF) and is not a minor modification of the existing scheme/fund/product. This certification shall also be disclosed in the offer document along with the date of approval of the scheme by the trustees. However, the said certification is not applicable to Fixed Maturity Plans and close-end schemes but is applicable to close-end schemes with a feature of conversion into open-ended on maturity.

(5) The compliance officer appointed under clause (d) of sub-regulation (4) shall in immediately and independently report to the Board any non-compliance observed by him.

(6) The trustees shall ensure that the asset management company (AMC) has been diligent in empaneling the brokers, in monitoring the securities transactions with brokers and avoiding undue concentration of business with any broker;

(7) The trustees shall ensure the AMC has not given any undue or unfair advantage to any associate or dealt with any of the associates of the AMC in a manner detrimental to the unit holders;

(8) The trustees shall ensure that the transaction entered into by the AMC or in accordance with these regulations and the mutual fund scheme concerned;

(9) The trustees shall ensure that the AMC has been managing the mutual fund schemes independently of other activities and have taken adequate steps to see that the interest of the investors of one scheme are not being compromised with those of any other scheme or of other activities of the AMC;

(10) The trustees shall ensure that all the activities of the AMC are in accordance with the provisions of these regulations;

(11) Where the trustees have reason to believe that the conduct of business of the mutual fund is not in accordance with these regulations and the scheme, they shall forthwith take such remedial steps as are necessary, and shall immediately inform SEBI of the violation and the action taken by them;

(12) Each trustee shall file the details of his transactions of dealing in securities with a mutual fund on a quarterly basis;

(13) The trustees shall be accountable for and be the custodian of the funds and the property of the respective schemes and shall hold the same in trusts for the benefit of the unitholders in accordance with these regulations and the trust deed;

(14) The trustees shall take steps to ensure that the transactions of the mutual fund are in accordance with the provisions of the trust deed;

(15) The trustees shall be responsible for the calculation of any income to be paid to the mutual fund and also of any income received in the mutual fund for the holders of the unit of any scheme in accordance with these regulations and the trust deed;

(16) The trustees shall obtain the consent of the unit holders –

(a) whenever required to do so by SEBI in the interest of the unit holders; or

- (b) whenever required to do so on the requisition of 3/4 of the unit holders of any scheme; or
- (c) when the majority of the trustees decide to wind up or pre-maturely redeem the units;

(17) The trustees shall ensure that no change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme and affects the interest of unit holders, shall be carried out unless, -

- (i) a written communication about the proposed change is sent to each unit holder and an advertisement is given in one English daily newspaper having nationwide circulation as well as in a newspaper published in the language of the region where the Head Office of the mutual fund is situated; and
- (ii) the unit holders are given an option to exit at the prevailing Net Asset Value without any exit load;

(18) The trustees shall on a quarterly basis review all transactions carried out between the mutual funds, AMC and its associates and also the networth of the AMC. In case of any short fall the trustees shall ensure that the AMC make up for the short fall;

(19) The trustees shall periodically review all service contracts such as custody arrangements, transfer agency of the securities and satisfy itself that they are executed in the interest of the unit holders. Similarly, the trustees shall periodically review the investor complaints received and ensure redressal by AMC;

(20) The trustees shall abide by the code of conduct as specified in the Fifth Schedule, namely—

Code of Conduct for Mutual Funds

- (a) Mutual fund schemes should not be organised, operated, managed or the portfolio of securities selected, in the interest of sponsors, directors of AMCs, members of Board of trustees or directors of trustee company, associated persons in the interest of special class of unit holders rather than in the interest of all classes of unit holders of the scheme.
- (b) Trustees and AMCs must ensure the dissemination to all unit holders of adequate, accurate, explicit and timely information fairly presented in a simple language about the investment policies, investment objectives, financial position and general affairs of the scheme.
- (c) Trustees and AMCs should avoid excessive concentration of business with broking firms, affiliates and also excessive holding of units in a scheme among a few investors.
- (d) Trustees and AMCs must avoid conflicts of interest in managing the affairs of the schemes and keep the interest of all unit holders paramount in all matters.
- (e) Trustees and AMCs must ensure schemewise segregation of bank accounts and securities accounts.
- (f) Trustees and AMCs shall carry out the business and invest in accordance

with the investment objectives stated in the offer documents and take investment decision solely in the interest of unit holders.

- (g) Trustees and the AMC shall maintain high standards of integrity and fairness in all their dealings and in the conduct of their business.
 - (h) Trustees and AMC must not use any unethical means to sell; market or induce any investor to buy their schemes.
 - (i) Trustees and the AMC shall render at all times high standard of service, exercise due diligence, ensure proper care and exercise independent professional judgment.
 - (j) The AMC shall not make any exaggerated statement, whether oral or written, either about their qualifications or capability to render investment management services or their achievements.
 - (k) (a) The sponsor of the mutual fund, the trustees or the asset management company and any of their employees shall not render, directly or indirectly any investment advice about and security in the publicity accessible media, whether real time or non-real-time, unless a disclosure of his interest including long or short position in the said security has been made, while rendering such advice.
 (b) In case, an employee of the sponsor, the trustees or the asset management company is rendering such advice, he shall also disclose the interest of his dependent family members and the employer including their long or short position in the said security, while rendering such advice.
- (21) The trustees shall furnish to SEBI on a half yearly basis—
- (a) a report on the activities of the mutual fund;
 - (b) a certificate that the trustees have not found any instances of self dealing or front running by any of the trustees, directors or key personnel of the AMC and a certificate to the effect that the AMC has been managing the schemes independently of any other activities and protecting the interest of the unit holders. The independent trustees shall give their comments on the report of the AMC as regards investments by the mutual fund in the securities of group companies of the sponsor.

General Due Diligence and Specific Due Diligence by Trustees

The trustees shall exercise due diligence as under:

(A) General Due Diligence:

- (i) the trustees shall be discerning in the appointment of the directors on SEBI of the asset management company.
- (ii) trustees shall review the desirability of continuance of the asset management company if substantial irregularities are observed in any of the schemes and shall not allow the asset management company to float new schemes.
- (iii) the trustee shall ensure that the trust property is properly protected, held and administered by proper persons and by a proper number of such persons.

- (iv) the trustee shall ensure that all service providers are holding appropriate registrations from SEBI or concerned regulatory authority.
- (v) the trustees shall arrange for test checks of service contracts.
- (vi) trustees shall immediately report to SEBI of any special developments in the mutual fund.

(B) Specific Due Diligence:

The trustees shall:

- (i) obtain internal audit reports at regular intervals from independent auditors appointed by the trustees;
- (ii) obtain compliance certificate at regular intervals from the asset management company;
- (iii) hold meeting of trustee more frequently;
- (iv) consider the reports of the independent auditor and compliance reports of asset management company at the meetings of trustees for appropriate action;
- (v) maintain records of the decisions of the trustees at their meetings and of the minutes of the meetings;
- (vi) prescribe and adhere to a code of ethics by the trustees, asset management company and its personnel;
- (vii) communicate in writing to the asset management company of the deficiencies and checking on the rectification of deficiencies.

Independent Directors' Responsibilities

The independent directors of the trustees or the AMC shall pay specific attention to the following:

- (1) the investment management agreement and the compensation paid under the said agreement;
- (2) service contract with affiliates to identify payments in excess of market rates with outside contractors;
- (3) selection of AMCs independent directors;
- (4) securities transactions involving affiliates where permissible;
- (5) selecting and nominating individuals to fill vacancies of independent directors;
- (6) code of ethics to prevent fraudulent, deceptive or manipulative practices by insiders in connection with personal securities transactions;
- (7) reasonableness of fees paid to sponsors, AMCs and others for services rendered;
- (8) principal underwriting contracts and their renewals, service contracts with associates of AMC.

Advertisement Code for Mutual Funds

All advertisements shall be in accordance with the advertisement code given in the Sixth Schedule and shall be submitted to SEBI within 7 days from the date of their issue. The advertisement shall avoid misleading statements as well as incorrect or false opinions and shall disclose investment objective of each scheme.

The Advertisement code clauses are -

1. An advertisement shall be truthful, fair and clear and shall not contain a statement, promise or forecast which is untrue or misleading.
2. An advertisement shall be considered to be misleading if it contains -
 - (a) Misleading Statements: Representations made about the performance or activities of the mutual fund in the absence of necessary explanatory or qualifying statements, and which may give an exaggerated picture of the performance or activities, than what it really is.
 - (b) An inaccurate portrayal of a past performance or its portrayal in a manner which implies that past gains or income will be repeated in the future.
 - (c) Statements promising the benefits of owning units or investing in the schemes of the mutual funds without simultaneous mention of material risks associated with such investments.
3. The advertisement shall not be so designed in content and format or in print as to be likely to be misunderstood, or likely to disguise the significance of any statement. Advertisements shall not contain statements which directly or by implication or by omission may mislead the investor.
4. The sales literature may contain only information, the substance of which is included in the funds current advertisements in accordance with the Code.
5. Advertisements shall not be so framed as to exploit the lack of experience or knowledge of the investors. As the investors may not be sophisticated in legal or financial matters, care should be taken that the advertisement is set forth in a clear, concise, and understandable manner. Extensive use of technical or legal terminology or complex language and the inclusion of excessive details which may detract the investors should be avoided.
6. The advertisement shall not contain information, the accuracy of which is to any extent dependent on assumptions. Any advertisement that makes claims about the performance of the fund shall be supported by relevant figures.
7. The advertisement shall not compare one fund with another, implicitly or explicitly, unless the comparison is fair and all information relevant to the comparison is included in the advertisement.
8. The funds which advertises yield must use standardised computations such as annual dividend on face value, annual yield on the purchase price, and annual compounded rate of return.
9. Mutual funds shall indicate in all advertisements, the names of the Settlor, Trustee, Manager and/or Financial Advisor to the Fund, bringing out clearly their legal status and liability of these entities. All advertisements containing information regarding performance, advertising yield, return or any scheme

detail or inviting subscription to the scheme shall contain disclosures of all the risk factors.

10. All advertisements shall also make a clear statement to the effect that all mutual funds and securities investments are subject to market risks, and there can be no assurance that the fund's objectives will be achieved.
11. If however, in any advertisement a mutual fund guarantees or assures any minimum rate of return or yield to prospective investors, resources to back such a guarantee shall also be indicated.
12. If any existing mutual fund indicates the past performance of the fund in advertisements, the basis for computing the rates of return/yield and adjustments made, if any, must be expressly indicated with a statement that, such information is not necessarily indicative of future results and may not necessarily provide a basis for comparison with other investments. Any advertisement containing information regarding performance, NAV, yield or returns shall give such data for the past three years, wherever applicable.
13. All advertisements issued by a mutual fund or its sponsor or AMC, shall state all investments in mutual funds and securities are subject to market risks and the NAV of the schemes may go up or down depending upon the factors and forces affecting the securities market.
14. All advertisement launched in connection with the scheme should also disclose prominently the risks factors as stated in the offer document along with the following warning statements:
 - (a) is only the name of the scheme and does not in any manner indicate either the quality of the scheme, its future prospects or returns; and
 - (b) please read the offer document before investing;Any advertisement reproducing or purporting to reproduce any information contained in a offer document shall reproduce such information in full and disclose all relevant facts and not be restricted to select extracts relating to that item which could be misleading. No celebrities shall form part of the advertisement.
15. No name can be given to a scheme with a view to subtly indicate any assurance of return, except in the cases of guaranteed return scheme in accordance with regulation 38.
16. No advertisement shall be issued stating that the scheme has been subscribed or oversubscribed during the period the scheme is open for subscription.
17. If a corporate advertisement is issued by the sponsor or any of the companies in the group, or an associate company of the sponsor during the subscription period, no reference shall be made to the scheme of the mutual fund or mutual fund itself; otherwise it will be treated as an issue advertisement.
18. If a corporate advertisement of a sponsor issued prior to the launch of a scheme makes a reference to the mutual fund sponsored by it or any of its schemes launched/to be launched, it shall contain a statement to the effect

that the performance of the sponsor has no bearing on the expected performance of the mutual fund or any of its schemes.

19. Advertisement on the performance of a mutual fund or its AMC shall compare the past performances only on the basis of per unit of statistics as per these Regulations. Advertisements for NAVs must indicate the past as well as these latest NAV of a scheme. The yield calculations will be made as provided in these regulations.

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.

Regulation 33 says that Units of a close ended scheme, other than those of an equity linked savings scheme, shall not be repurchased before the end of maturity period of such scheme. It also permits conversion of close ended scheme into open ended scheme subject to specified conditions, otherwise a close ended scheme shall be fully redeemed at the end of the maturity period unless rolled over with due information to SEBI. Such roll over is permitted only where unit holders express their consent in writing therefor and the others who have not so expressed, their holdings shall be redeemed in full at NAV based price.

Regulation 34 lays down that no scheme of mutual fund other than an initial offering of equity linked savings scheme shall be open for subscription for more than 15 days.

Regulations 35 and 36 deal with allotment of units, refunds and issue of unit certificates and statement of accounts.

Regulation 37 states that a unit is freely transferable except where it is specifically restricted or prohibited under the scheme. Such transfers which conform to proper procedure shall be effected within 30 days from the date of application. A unit holder in a close ended scheme listed on a recognized stock exchange, who desires to trade in units shall hold units in dematerialized form. The asset management company shall, on production of instrument of transfer with relevant unit certificates, register the transfer and return the unit certificate to the transferee within 30 days from the date of such production.

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.

Capital protection oriented schemes

Regulation 38A of the Regulations provides that a capital protection oriented scheme may be launched, subject to the following:

- (a) the units of the scheme are rated by a registered credit rating agency from

the viewpoint of the ability of its portfolio structure to attain protection of the capital invested therein;

- (b) the scheme is close ended; and
- (c) there is compliance with such other requirements as may be specified by SEBI in this behalf.

Regulation 39 to 42 deal with winding up of a close ended scheme on the expiry of its duration, the effect of winding up, the procedure and manner thereof. It is enjoined that trustees shall forward to SEBI and to the unitholders a report on the winding up. On SEBI being satisfied about the completion of all the necessary measures, a scheme shall cease to exist. The units of a mutual fund scheme must delisted from a recognized stock exchange in accordance with the guidelines as may be specified by SEBI.

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.

Investment objectives and valuation policies

Regulation 43 lays down that the monies collected under any scheme of a mutual fund shall be invested only in securities, money market instruments; privately placed debentures; securitised debt instruments which are either asset backed or mortgage backed securities, gold or gold related instruments or real estate assets. Investment shall be made in accordance with the investment objective of the relevant mutual fund scheme. However monies collected under any money market scheme of a mutual fund shall be invested only in money market instruments. Moneys collected under any gold exchange trade fund scheme shall be invested only in gold or gold related instruments, moneys collected under a real estate scheme shall be invested in accordance with Regulation 49E.

Regulation 44 talks about investment, borrowing and connected restrictions. Any investments shall be made subject to the investment restriction specified in the Seventh Schedule to the Regulations which contains 11 clauses, as reproduced below. However, seventh schedule does not apply to a gold exchange traded fund scheme.

Restrictions on Investments by Mutual Funds

1. A mutual fund scheme shall not invest more than 15% of its NAV in debt instruments issued by a single issuer which are rated now below investment grade by a credit rating agency authorised to carry out such activity under the Act. Such investment limit may be extended to 20% of the NAV of the scheme with the prior approval of the Board of Trustees and the Board of AMC;

However such limit shall not be applicable for investments in government securities and investment within such limit can be made in mortgaged backed securitised debt which are rated not below investment grade by a credit rating agency registered with SEBI.

A mutual fund scheme shall not invest more than 10% of its NAV in unrated debt instruments issued by a single issuer and the total investment in such instruments shall not exceed 25% of the NAV of the scheme. All such investments shall be made with the prior approval of the Board of Trustees and the Board of AMC. No mutual fund scheme shall invest more than thirty per cent of its net assets in money market instrument of an issuer. However, such limit shall not be applicable for investment in government securities treasury bills and collateralized borrowing and lending obligations.

It has been clarified by SEBI that investments made in securitised debt (mortgage backed securities/asset backed securities) restrictions at the originator level would not be applicable.

2. No mutual fund under all its schemes should own more than 10% of any company's paid up capital carrying voting rights;
3. Transfers of investments from one scheme to another scheme in the same mutual fund shall be allowed only if—
 - (a) such transfers are done at the prevailing market price for quoted instruments on spot basis.
 - (b) the securities so transferred shall be in conformity with the investment objective of the scheme to which such transfer has been made.
4. A scheme may invest in another scheme under the same AMC or any other mutual fund without charging any fees, provided that aggregate investment made by all schemes under the same management or in schemes under the management of any other AMC shall not exceed 5% of the net asset value of the mutual fund. It has been provided in the regulations that this clause will not apply to any fund of fund scheme.
5. Every mutual fund shall buy and sell securities on the basis of deliveries and shall in all cases of purchases, take delivery of relative securities and in all cases of sale, deliver the securities. However a mutual fund may engage in short selling of securities in accordance with the framework relating to short selling of securities lending and borrowing specified by SEBI.

Further sale of government security already contracted for purchase shall be permitted in accordance with the guidelines issued by the Reserve Bank of India in this regard. The mutual funds may enter into derivatives transactions in a recognised stock exchange subject to such guidelines as may be specified by SEBI.

6. Every mutual fund shall, get the securities purchased or transferred in the name of the mutual fund on account of the concerned scheme, wherever investments are intended to be of long term nature.
7. Pending deployment of funds of a scheme in securities in terms of investment objectives of the scheme a mutual fund can invest the funds of the scheme in short term deposits of scheduled commercial banks.

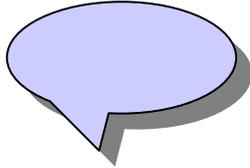
8. No mutual fund shall make any investment in
 - (a) any unlisted security of an associate or group company of the sponsor; or
 - (b) any security issued by way of private placement by an associate or group company of the sponsor; or
 - (c) the listed securities of group companies of the sponsor which is in excess of 25% of the net assets.
9. No scheme of mutual fund shall make any investments in any fund of funds scheme.
10. No mutual fund scheme shall invest more than 10% of its NAV in the equity shares or equity related instruments of any company;

However the limit of 10% shall not be applicable for investments in index fund or sector or industry specific scheme.
11. A mutual fund scheme shall not invest more than 5% of its NAV in the unlisted equity shares or equity related instruments in case of open ended scheme and 10% of its NAV in case of close ended scheme.
12. A fund of funds scheme shall be subject to the following investment restrictions:
 - (a) A fund of funds scheme shall be subject to the following investment restriction.
 - (b) A fund of funds scheme shall not invest its asset other than in schemes of mutual funds, except to the extent of funds required for meeting the liquidity requirement for the purpose of repurchase or redemptions, as disclosed in the offer documents of funds of funds scheme.

A mutual fund having an aggregate of securities which are worth Rs. 10 crore or more as on the latest balance sheet date, shall settle their transactions only through dematerialised securities, as per instructions of SEBI. The mutual funds shall not borrow except to meet temporary liquidity needs for the purpose of repurchase, redemption of units or payment of interest or dividend to the unit holders. Such borrowals should not exceed 20% of the net asset value of the scheme and the duration of the borrowing shall not exceed six months. The mutual fund shall not advance any loans for any purpose but may lend securities in accordance with the stock lending scheme of SEBI.

Overseas Investment by Mutual Funds

The aggregate ceiling for overseas investments is US \$ 7 billion and within the overall limit of US \$ 7 billion, mutual funds can make overseas investments subject to a maximum of US \$ 300 million per mutual fund. The overall ceiling for investment in overseas ETFs that invest in securities is US \$ 1 billion subject to a maximum of US \$ 50 million per mutual fund.

Mutual Funds are permitted to make investment in:

- (i) ADRs/ GDRs issued by Indian or foreign companies
- (ii) Equity of overseas companies listed on recognized stock exchanges overseas
- (iii) Initial and follow on public offerings for listing at recognized stock exchanges overseas
- (iv) Foreign debt securities in the countries with fully convertible currencies, short term as well as long term debt instruments with rating not below investment grade by accredited/registered credit rating agencies
- (v) Money market instruments rated not below investment grade
- (vi) Repos in the form of investment, where the counterparty is rated not below investment grade; repos should not however, involve any borrowing of funds by mutual funds
- (vii) Government securities where the countries are rated not below investment grade
- (viii) Derivatives traded on recognized stock exchanges overseas only for hedging and portfolio balancing with underlying as securities
- (ix) Short term deposits with banks overseas where the issuer is rated not below investment grade
- (x) Units/securities issued by overseas mutual funds or unit trusts registered with overseas regulators and investing in (a) aforesaid securities, (b) Real Estate Investment Trusts (REITs) listed in recognized stock exchanges overseas or (c) unlisted overseas securities (not exceeding 10% of their net assets).

Transaction in excess of permissible limits — A case study

SEBI v. Shriram Mutual Fund & Others - Appeal No. 9523-24 of 2003



- (a) A penalty of Rs.2 lakh was imposed by Adjudicating Officer (AO) on Shriram Mutual Fund (SMF) as it had repeatedly exceeded the permissible limits of transactions through its associate broker, in terms of Regulation 25(7) (a) of SEBI (Mutual Funds) Regulations.
- (b) On an appeal by SMF, SAT vide its final judgment and order dated August 21, 2003, set aside AO's order inter-alia on the ground that the limit was not exceeded intentionally.
- (c) SEBI filed an appeal under Section 15Z of the SEBI Act in the Hon'ble Supreme Court.
- (d) The Hon'ble Supreme Court pronounced its final judgment and order on May 23, 2006. Hon'ble Supreme Court set aside the judgment of SAT and settled the issues, as under:
- Mens rea is not an essential ingredient for contravention of the provisions of a Civil Act.
 - Penalty is attracted as soon as contravention of the statutory obligation as contemplated by the Act is established, and therefore the intention of the parties committing such violation becomes immaterial.
 - Unless the language of the statute indicated the need to establish the element of mens rea, it is generally sufficient to prove that a default in complying with the statute has occurred.
 - Once the contravention is established, the penalty has to follow and only the quantum of penalty is discretionary
 - The SAT has erroneously relied on the judgment in the case of Hindustan Steel Limited vs. State of Orissa (AIR 1970 SC 253) as the said case has no application in the present case which relates to imposition of civil liabilities under SEBI Act and Regulations; and is not a criminal / quasi-criminal proceeding.
 - Imputing mens rea into the provisions of Chapter VIA is against the plain language of the statute and frustrates entire purpose and object of introducing Chapter VIA which was to give teeth to the SEBI to secure strict compliance of the Act and the Regulations.

Prohibition on carry forward transaction, short selling

Regulation 45 prohibits option trading or short selling or carry forward transactions with funds of a mutual fund scheme.

Underwriting

Regulation 46 permits mutual funds to enter into underwriting agreement after obtaining a certificate of registration in terms of SEBI Underwriters Rules and SEBI

Underwriters Regulations. The Underwriting obligations will be deemed to be investments made in such securities. The capital adequacy norms for the purpose of underwriting shall be the net asset of the scheme. However the Underwriting obligation of a mutual fund shall not at any time exceed the total NAV of the scheme.

Investment Valuation Norms

Regulation 47 deals with the method of valuation of investments. Every mutual fund shall compute and carry out valuation of its investments in its portfolio and publish the same in accordance with the valuation norms specified in the Eighth Schedule to the Regulations namely—

Mutual fund shall value its investments according to the following valuation norms:

NAV of a scheme as determined by dividing the net assets of the scheme by the number of outstanding units on the valuation date.

1. Traded Securities:

- (i) The securities shall be valued at the last quoted closing price on the stock exchange.
- (ii) When the securities are traded on more than one recognised stock exchange, the securities shall be valued at the last quoted closing price on the stock exchange where the security is principally traded. It would be left to the AMC to select the appropriate stock exchange, but the reasons for the selection should be recorded in writing. There should however be no objection for all scrips being valued at the prices quoted on the stock exchange where a majority in value of the investments are principally traded.
- (iii) Once a stock exchange has been selected for valuation of a particular security, reasons for change of the exchange shall be recorded in writing by the AMC.
- (iv) When a security is not traded on any stock exchange on a particular valuation day, the value at which it was traded on the selected stock exchange or any other stock exchange, as the case may be, on the earliest previous day may be used provided such date is not more than thirty days prior to the valuation date.

2. Non-traded Securities:

- (i) When a security is not traded on any stock exchange for a period of thirty days prior to the valuation date, the scrip must be treated as a 'non-traded' scrip.
- (ii) Non-traded securities shall be valued 'in good faith' by the AMC on the basis of appropriate valuation methods based on the principles approved by the Board of AMC. Such decision of the Board must be documented in the Board minutes and the supporting data in respect of each security so valued must be preserved. The methods used to arrive at values 'in good faith' shall be periodically reviewed by the trustees and reported upon by the auditors as 'fair and reasonable' in their report on the annual

accounts of the fund. For the purpose of valuation of non-traded securities, the following principles should be adopted -

- (a) equity instruments shall generally be valued on the basis of capitalisation of earnings solely or in combination with the net asset value, using for the purposes of capitalisation, the price or earning ratios of comparable traded securities and with an appropriate discount for lower liquidity;
- (b) debt instruments shall generally be valued on a yield to maturity basis, the capitalisation factor being determined for comparable traded securities and with an appropriate discount for lower liquidity;
- (c) while investments in call money, bills purchased under rediscounting scheme and short term deposits with banks shall be valued at cost plus accrual; other money market instruments shall be valued at the yield at which they are currently traded. For this purpose, non traded instruments, that is, instruments not traded for a period of seven days will be valued at cost plus interest accrued till the beginning of the day plus the difference between the redemption value and the cost spread uniformly over the remaining maturity period of the instruments; government securities will be valued at yield to maturity based on the prevailing market rate;
- (d) in respect of convertible debentures and bonds, the non convertible and convertible components shall be valued separately. The non convertible component be valued on the same basis as would be applicable to a debt instrument. The convertible component should be valued on the same basis as would be applicable to an equity instrument. If after conversion the resultant equity instrument would be traded *pari-passu* with an existing instrument which is traded, the value of the latter instrument can be adopted after an appropriate discount for the non-tradability of the instrument during the period preceding the conversion. While valuing such instruments, the fact whether the conversion is optional should also be factored in;
- (e) in respect of warrants to subscribe for shares attached to instruments, the warrants can be valued at the value of the share which would be obtained on exercise of the warrant as reduced by the amount which would be payable on exercise of the warrant. A discount similar to the discount to be determined in respect of convertible debentures must be deducted to account for the period which must elapse before the warrant can be exercised.
- (f) where instruments have been bought on 'repo' basis, the instrument must be valued at the resale price after deduction of applicable interest upto date of resale. Where an instrument has been sold on a 'repo' basis, adjustment must be made for the difference between the repurchase price (after deduction of applicable interest upto date of repurchase) and the value of the instrument. If the repurchase price exceeds the value, the depreciation must be provided for and if the repurchase price is lower than the value, credit must be taken for the appreciation.

3. Until they are traded, the value of the 'rights' shares should be calculated as:

$$V_r = \frac{n}{m} \times (P_{ex} - P_{of})$$

Where

V_r = Value of rights
 n = no. of rights offered
 m = no. of original shares held
 P_{ex} = Ex-rights price
 P_{of} = Rights Offer Price

Where the rights are not treated *pari-passu* with the existing shares, suitable adjustment should be made to the value of rights. Where it is decided not to subscribe for the rights but to renounce them and renunciations are being traded, the rights can be valued at the renunciation value.

4. All expenses and incomes accrued upto the valuation date shall be considered for computation of net asset value. For this purpose, while major expenses like management fees and other periodic expenses should be accrued on a day to day basis, other minor expenses and income need not be so accrued, provided the non-accrual does not affect the NAV calculations by more than 1%.
5. Any changes in securities and in the number of units be recorded in the books not later than the first valuation date following the date of transaction. If this is not possible given the frequency of the Net Asset Value disclosure, the recording may be delayed upto a period of seven days following the date of the transaction, provided that as a result of the non-recording, the Net Asset Value calculations shall not be affected by more than 1%.
6. In case the Net Asset Value of a scheme differs by more than 1%, due to non-recording of the transactions, the investors or scheme/s as the case may be, shall be paid the difference in amount as follows:
- (i) If the investors are allotted units at a price higher than Net Asset Value or are given a price lower than Net Asset Value at the time of sale of their units, they shall be paid the difference in amount by the scheme.
 - (ii) If the investors are charged lower Net Asset Value at the time of purchase of their units or are given higher Net Asset Value at the time of sale of their units, asset management company shall pay the difference in amount to the scheme.
7. Thinly traded securities as defined in the guidelines should be valued in the manner as specified in the guidelines issued by the Board.
8. The aggregate value of illiquid securities as defined in the guidelines should not exceed 15% of the total assets of the scheme and any illiquid securities held above 15% of the total assets shall be valued in the manner as specified in the guidelines issued by Board.

Regulation 48 lays down that every mutual fund shall compute the NAV of each scheme by dividing the net assets of the scheme with a number of units of that scheme outstanding on the valuation date. It shall be calculated and published at least in two daily newspapers at intervals not exceeding one week. However the NAV of a close ended scheme other than that of a equity linked saving scheme should be calculated on daily basis and published in atleast two daily newspapers having circulation all over India.

Regulation 49 deals with pricing of units. The price at which units may be subscribed or sold and the price at which such units may at any time be purchased by the mutual fund shall be made available to the investors. In the case of open ended scheme the mutual fund shall at least once in a week publish in a daily newspaper of All India circulation, the sale and repurchase price of the units. The funds shall ensure that such repurchase price is not lower than 93%of NAV. The difference between repurchase price and sale price of the unit shall not exceed 7% calculated on the sale price.

The price of units shall be determined with reference to the last determined NAV, unless the scheme announces the NAV on a daily basis and the sale price is determined with or without a fixed premium added to the future NAV which is declared in advance.

General Obligations of the Mutual Funds

Regulation 50 lays down that every AMC for each scheme shall keep and maintain proper books of accounts, records and documents, for each scheme so as to explain its transactions and to disclose at any point of time the financial position of each scheme and in particular, give a true and fair view of the state of affairs of the fund and intimate to SEBI the place where such books of accounts, records and documents are maintained. All these documents shall be preserved by the AMC for a period of 8 years.

The AMC shall follow the accounting policies and standards as specified in these Regulations to provide appropriate details of the scheme-wise disposition of the assets of the fund at the relevant accounting date and the performance during that period together with information regarding distribution or accumulation of income accruing to the unit holder in a fair and true manner.

Regulation 51 provides that the financial year for the all the schemes shall end as on March, 31 every year.

Regulation 52 lays down that all expenses should be clearly identified and apportioned to the individual schemes. The AMC may charge the mutual fund with investment and advisory fees as provided in these Regulation and disclose it fully in the offer document.

Regulation 52A provides that a mutual fund may declare dividends in accordance with the offer document and subject to such guidelines as may be specified by SEBI.

Regulation 53 lays down that every mutual fund and AMC shall despatch to the unit-holders the dividend warrants within 30 days of the declaration of the dividend and despatch the redemption or repurchase proceeds within 10 working days from the date of such redemption or repurchase. If AMC fails in this regard, it shall be

liable to pay interest to the unit holders at such rate as may be specified by SEBI for the period of delay. Besides this, the AMC may also be liable for penalty in respect of the delay.

Regulations 54 to 57 deal with the annual report, auditors report, publication thereof and forwarding to SEBI. Every mutual fund or AMC shall prepare in respect of each financial year an annual report and an annual statement of accounts of the schemes and the fund as specified in these Regulations. Every mutual fund shall have the annual statement of accounts audited by a practising Chartered Accountant who is not in any way associated with the auditor of the AMC. The auditor shall be appointed by the trustees to whom the auditor shall forward his report. It shall be included as part of the annual report of the mutual fund.

Regulation 56 requires that the scheme-wise annual report of a mutual fund or an abridged summary thereof shall be published through an advertisement and that an abridged scheme-wise annual report shall be mailed to all unit holders within 6 months from the date closure of the relevant accounting year.

Regulation 57 requires that the mutual funds annual report shall be forwarded to SEBI within 4 months from the date of closure of each financial year.

Regulations 58 and 59 indicate the periodical and continual disclosures as well as half yearly disclosures to be made by the mutual fund, AMC and others closely connected to them.

Regulation 60 enjoins that the trustee shall be bound to make all essential disclosures to unit holders to keep them informed about any information which may have an adverse bearing on their investments.

Inspection and Audit

SEBI is empowered to appoint inspecting officer to inspect and investigate the affairs of a mutual fund, the trustees, the AMC etc. SEBI may give a notice to the fund before such inspection or may dispense with it, if it feels the need.

Regulation 63 indicates the obligations of the mutual fund, trustees or AMC when they are taken up for inspection by SEBI.

The inspecting officer shall submit his reports to SEBI and SEBI after considering the same communicate the findings of the inspecting officer to the mutual fund, trustees or AMC and give him an opportunity to be heard.

Liability for Action in Case of Default

Chapter IX containing Regulation 68 deals with the above subject. A mutual fund who contravenes any of the provisions of the Act, Rules or Regulations framed there under shall be liable for one or more action specified therein including the action under Chapter V of the SEBI (Intermediaries) Regulations, 2008.

Gold Exchange Traded Funds

Gold Exchange Traded Fund (GETF) schemes are permitted to invest primarily in

- (a) Gold.

- (b) Gold related instruments i.e. such instruments having gold as underlying, as are specified by SEBI from time to time.

A gold exchange traded fund scheme is subject to the following investment restrictions:

- (a) the initial issue expenses in respect of any such scheme should not exceed six percent of the funds raised under that scheme;
- (b) the funds of any such scheme should be invested only in gold or gold related instruments in accordance with its investment objective, except to the extent necessary to meet the liquidity requirements for honouring repurchases or redemptions, as disclosed in the offer document; and
- (c) pending deployment of funds in accordance with clause (b), the mutual fund may invest such funds in short term deposits of scheduled commercial banks.

1. Valuation

Since physical gold and other permitted instruments linked to gold are denominated in gold tonnage, it will be valued based on the market price of gold in the domestic market and will be marked to market on a daily basis. The market price of gold in the domestic market on any business day would be arrived at as under:

Domestic price of gold = (London Bullion Market Association AM fixing in US\$/ounce X conversion factor for converting ounce into kg for 0.995 fineness X rate for US\$ into INR) + custom duty for import of gold + sales tax/octroi and other levies applicable.

The Trustees reserve the right to change the source (centre) for determining the exchange rate. The AMC should record in writing the reason for change in the source for determining the exchange rate.

2. Determination of Net Asset Value

NAV of units under the Scheme would be calculated as shown below:

$$\text{NAV (Rs.)} = \frac{\text{Market or Fair Value of Scheme's investments + Current Assets} - \text{Current Liabilities and Provision}}{\text{No. of Units outstanding under Scheme on the Valuation Date}}$$

The NAV shall be calculated up to four decimals.

3. Recurring Expenses

For a GETF, the limits applicable to equity schemes as specified in SEBI Regulations shall be applicable.

4. Benchmark for GETF

As there are no indices catering to the gold sector/securities linked to Gold, currently GETF shall be benchmarked against the price of Gold.

5. Half Yearly Report by Trustees

Physical verification of gold underlying the Gold ETF Units shall be carried out by statutory auditors of mutual fund schemes and reported to trustees on half yearly basis. The confirmation on physical verification of gold shall form part of half yearly report by trustees to SEBI.

Real Estate Mutual Fund Schemes (REMFS)

“Real Estate Mutual Fund Scheme” means a mutual fund scheme that invests directly or indirectly in real estate assets or other permissible assets in accordance with SEBI (Mutual Funds) Regulations, 1996.

“real estate assets” means an identifiable immovable property-

- (i) which is located within India in such city as may be specified by the Board from time to time or in a special economic zone within the meaning of Special Economic Zones Act, 2005;
- (ii) on which construction is complete and which is usable;
- (iii) which is evidenced by valid title documents;
- (iv) which is legally transferable;
- (v) which is free from all encumbrances;
- (vi) which is not subject matter of any litigation;

but does not include-

- I. a project under construction; or
- II. vacant land; or
- III. deserted property; or
- IV. land specified for agricultural use; or
- V. a property which is reserved or attached by any Government or other authority or pursuant to orders of a court of law or the acquisition of which is otherwise prohibited under any law for the time being in force.

Some of the salient features of REMFs are as under:

1. Existing Mutual Funds are eligible to launch real estate mutual funds if they have adequate number of experienced key personnel/directors.
2. Sponsors seeking to set up new Mutual Funds, for launching only real estate mutual fund schemes, shall be carrying on business in real estate for a period not less than five years. They shall also fulfill all other eligibility criteria applicable for sponsoring a MF.
3. Every real estate mutual fund scheme shall be close-ended and its units shall be listed on a recognized stock exchange.
4. Net asset value (NAV) of the scheme shall be declared daily.
5. At least 35% of the net assets of the scheme shall be invested directly in real estate assets. Balance may be invested in mortgage backed securities, securities of companies engaged in dealing in real estate assets or in undertaking real estate development projects and other securities. Taken together, investments in real estate assets, real estate related securities

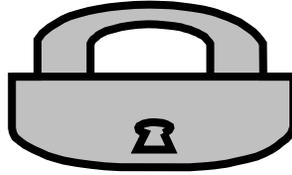
(including mortgage backed securities) shall not be less than 75% of the net assets of the scheme.

6. Each asset shall be valued by two valuers, who are accredited by a credit rating agency, every 90 days from date of purchase. Lower of the two values shall be taken for the computation of NAV.
7. Caps will be imposed on investments in a single city, single project, securities issued by sponsor/associate companies etc.
8. Unless otherwise stated, the investment restrictions specified in the Seventh Scheme shall apply.
9. No mutual fund shall transfer real estate assets amongst its schemes.
10. No mutual fund shall invest in any real estate asset which was owned by the sponsor or the asset management company or any of its associates during the period of last five years or in which the sponsor or the asset management company or any of its associates hold tenancy or lease rights.
11. A real estate mutual fund scheme shall not undertake lending or housing finance activities.
12. Accounting and valuation norms pertaining to Real Estate Mutual Fund schemes have also been specified.

LESSON ROUND UP



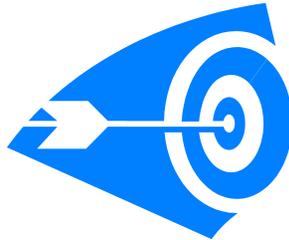
- Mutual Funds, pool their marginal resources, invest in securities and distribute the returns therefrom among them on cooperative principles.
- As in mature markets, mutual funds in emerging markets have been among the fastest growing institutional investors.
- Mutual funds are regulated by SEBI (Mutual Fund) Regulations, 1996
- An investor can subscribe to New fund offers of mutual fund schemes through Application Supported by Block Amount Facility.
- Offer document of mutual funds scheme offering new fund has two parts: Scheme Information Document (SID) and Statement of Additional Information (SAI).
- Various schemes of Mutual Funds are Open ended mutual funds; Close ended mutual funds; Capital Oriented Protection Scheme; Income Oriented Schemes; Growth Oriented Schemes; Hybrid Schemes; High Growth Schemes; Money Market Mutual Funds; Tax Saving Schemes etc.
- Various risks involved in mutual funds are Excessive diversification of portfolio; losing focus on the securities of the key segments; Too much concentration on blue-chip securities; Poor planning of investment with minimum returns; Unresearched forecast on income, profits and Government policies etc.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Discuss the various advantages, schemes and general obligations of Mutual Funds.
2. Describe various schemes of Mutual funds.
3. What are the risks involved in Mutual funds?
4. Write short notes on:
 - (a) Net Asset Value (NAV)
 - (b) Mutual Fund Cost
 - (c) Asset Management Company
 - (d) Gold Exchange Traded funds
 - (e) Capital Protection Oriented Schemes.
5. Briefly discuss the code of conduct to be followed by mutual funds.

STUDY X
VENTURE CAPITAL



LEARNING OBJECTIVES

The study will enable the students to understand

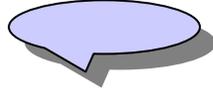
- Concept of Venture Capital
- Venture Capital-Domestic and International Scenario
- Overview of SEBI(Venture Capital Funds) Regulations, 1996
- SEBI(Foreign Venture Capital Investors) Regulations, 2000

INTRODUCTION

Venture capital is the capital that is invested in equity or debt securities (with equity conversion terms) of young unseasoned companies promoted by technocrats who attempt to break new path. It is a source of finance for new or relatively new, high risk, high profit potential products as the projects belong to untried segments or technologies. It is difficult for the promoters to obtain finance from conventional sources. The venture capitalists step-in to fill this gap. The venture capitalists are knowledgeable and sophisticated investors who come forward to face higher risks with the calculated hope of making much higher gains when the new projects succeed. They work on the theory that the greater the risk, the greater will be the profit. The success of a venture capital project depends on the care with which the projects are evaluated and selected for investment and the trust in the capabilities of the promoters in making a success of their projects. Venture capitalists take faster decisions in appraising projects and releasing funds than Banks and FIs.

A Venture Capital Fund (VCF) thus strives to provide entrepreneurs with the support they need to create up-scalable business with sustainable growth, while providing their contributors with outstanding returns on investment, for the higher risks they assume.

Venture Capital Fund generally provides following services:



- Finance new and rapidly growing companies
- Typically knowledge-based, sustainable, up scaleable companies
- Purchase equity/quasi-equity securities
- Assist in the development of new products or services
- Add value to the company through active participation
- Take higher risks with the expectation of higher rewards
- Have a long-term orientation.

Speciality about industry

Venture Capital is money provided by professionals who invest alongside management in rapidly growing companies; Venture Capital derives its value from the brand equity, professional image, constructive criticism, domain knowledge, industry contacts; they bring to table at a significantly lower management agency cost.

Venture capital financing may be interpreted as an agency relation between the VC (the principal) and the E (the agent), the latter selling to the former a stake of his starting-up enterprise. This transaction is governed by long-term contractual provisions.

Vcs typically concentrated in industries with a great deal of uncertainty, where the information gap among Es and investors is commonplace. Therefore, information asymmetries and moral hazard provoke agency costs, related to the E's opportunistic behavior. First, Es might invest in projects that have high personal returns and private benefits but low expected monetary payoffs. Similarly, they have the incentive to pursue high-variance strategies since they claim a call option on the equity capital.

Venture capitalists typically raise funds largely from investors such as financial institutions, banks, pension funds, corporations, endowments/foundations and high net-worth individuals. Pension funds contribute nearly 55% of the resources of the venture capitalists in the US but only 5% in Japan. In Europe, an estimated 24% of resources raised by venture capitalists during 2000 were from pension funds, followed by banks (22%) and, insurance companies (13%). While the US has allowed pension funds to invest in private equity since 1979, many countries (including India) prohibit pension funds from participating in the VC market. Unlike in Europe, banks in the US account for a much smaller percentage of VC financing because US banking laws impose more restrictions on banks making equity investments in companies in their loan portfolios. In India, banks have traditionally been the dominant providers of institutional financing to firms and economic entities:

1. An Indian scheduled commercial banks (SCBs) aggregate investment in shares, convertible debentures, bonds, etc. should not exceed 5% of their total outstanding advances (including Commercial Paper) as on March 31 of

the previous year. The ceiling excludes a SCBs investment in venture capital, including units of dedicated VC funds meant for Information Technology (IT), subject to the condition that the VC funds/companies are registered with the Securities and Exchange Board of India (SEBI). However, banks investments are negligible primarily because of their traditional risk-averse behavior. As compared with risky equity investments, most SCBs in India prefer the safety of Government securities.

2. Most startups incur losses in the early stages of their existence. The existing guidelines for valuation of equity shares held by SCBs specify that equity shares for which current quotations are not available or which are not quoted on the stock exchanges should be valued at break-up value (without considering revaluation reserves).

Categorization

The “venture funds” available could be from:

Incubators

An incubator is a hardcore technocrat who works with an entrepreneur to develop a business idea, and prepares a Company for subsequent rounds of growth & funding. EVentures, Infinity are examples of incubators in India.

Angel Investors

An angel is an experienced industry-bred individual with high net worth. Typically, an angel investor would invest only his chosen field of technology, take active participation in day-to-day running of the Company invest small sums in the range of USD 1-3 million not insist on detailed business plans sanction the investment in up to a month help company for “second round” of funding.

Venture Capitalists (VCs)

VCs are organizations raising funds from numerous investors and hiring experienced professional managers to deploy the same. They typically: invest at “second” stage invest over a spectrum over industry/ies have hand-holding “mentor” approach insist on detailed business plans invest into proven ideas/businesses provide “brand” value to investee invest between USD 2-5 million.

Private Equity Players

They are established investment bankers. They typically invest into proven/ established businesses. They have “financial partners” approach and invest between USD 5-100 million.

Trust or a Company

A fund established in the form of a trust or a company including a body corporate and registered under SEBI Regulations and which has a dedicated pool of capital, raised in a manner specified in the Regulations and invests in venture Capital undertaking.

II. SEBI (Venture Capital Funds) Regulations, 1996

These Regulations were notified by SEBI in exercise of the powers conferred by section 30 of SEBI Act, 1992 and took effect from 4th December, 1996.



'Venture capital fund' under the Regulations means a fund established in the form of a trust or a company including a body corporate and registered under these regulations which—

- (i) has a dedicated pool of capital,
- (ii) raised in a manner specified in the regulations, and
- (iii) invests in venture capital undertaking in accordance with the regulations.

Trust for the purpose means a trust established under the Indian Trusts Act, 1882 or under an Act of Parliament or State Legislation.

Unit means beneficial interest of the investors in the scheme or fund floated by trust or shares issued by a company including a body corporate.

Venture capital undertaking means a domestic company –

- (i) whose shares are not listed on a recognised stock exchange in India;
- (ii) which is engaged in the business for providing services, production or manufacture of article or things or does not include such activities or sectors which are specified in the negative list by SEBI with the approval of the Central Government by notification in the Official Gazette in this behalf.

Registration of Venture Capital Funds

Any company or trust or a body corporate in order to carry on any activity as a venture capital fund on or after the commencement of the regulations have to make an application to SEBI for grant of a certificate. An application for grant of certificate should be made to SEBI in the prescribed form accompanied by a non-refundable application fee as specified. Any company or a body corporate who fails to make an application for grant of a certificate within the period specified should cease to carry on any of its activity as a venture capital fund.

Eligibility Criteria

The applicant for registration as Venture Capital Fund should fulfil the following conditions:

- (1) if the application is made by a company, -
 - (a) memorandum of association has as its main objective, the carrying on of the activity of a venture capital fund;
 - (b) it is prohibited by its memorandum and articles of association from making an invitation to the public to subscribe to its securities;

- (c) its director or principal officer or employee is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant;
 - (d) its director, principal officer or employee has not at any time been convicted of any offence involving moral turpitude or any economic offence.
 - (e) it is a fit and proper person.
- (2) if the application is made by a trust, -
- (a) the instrument of trust is in the form of a deed and has been duly registered under the provisions of the Indian Registration Act, 1908 (16 of 1908);
 - (b) the main object of the trust is to carry on the activity of a venture capital fund;
 - (c) the directors of its trustee company, if any, or any trustee is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant;
 - (d) the directors of its trustee company, if any, or a trustee has not at any time, been convicted of any offence involving moral turpitude or of any economic offence;
 - (e) the applicant is a fit and proper person.
- (3) if the application is made by a body corporate
- (a) it is set up or established under the laws of the Central or State Legislature.
 - (b) the applicant is permitted to carry on the activities of a venture capital fund.
 - (c) the applicant is a fit and proper person.
 - (d) the directors or the trustees, as the case may be, of such body corporate have not been convicted of any offence involving moral turpitude or of any economic offense.
 - (e) the directors or the trustees, as the case may be, of such body corporate, if any, is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant.
- (4) the applicant has not been refused a certificate by SEBI or its certificate has not been suspended or cancelled.

SEBI may require the applicant to furnish further information, if it considers necessary.

Consideration of application

An application, which is not complete in all respects should be rejected by SEBI. However before rejecting any such application, the applicant should be given an opportunity to remove, within thirty days of the date of receipt of communication, the objections indicated by SEBI. On being satisfied that it is necessary to extend the period, SEBI can extend such period by such further time not exceeding ninety days.

Procedure for grant of certificate

SEBI after getting satisfied that the applicant is eligible for the grant of certificate should send intimation to the applicant and after the receipt of intimation, the applicant should pay the registration fee as specified. SEBI on receipt of the registration fee grants a certificate of registration. The venture capital fund should abide by the provisions of the Act. It should not carry on any other activity other than that of a venture capital fund and should forthwith inform SEBI in writing. If any information or particulars previously submitted to SEBI are found to be false or misleading in any material particular or if there is any change in the information already submitted. After considering an application, if SEBI is of the opinion that a certificate should not be granted, it can reject the application after giving the applicant a reasonable opportunity of being heard. The decision of SEBI to reject the application should be communicated to the applicant within thirty days.

Effect of refusal to grant certificate

Any applicant whose application has been rejected cannot carry on any activity as a venture capital fund. Thus any company or trust or a body corporate whose application for grant of certificate has been rejected by SEBI should on and from the date of the receipt of the communication ceases to carry on any activity as a venture capital fund. SEBI in the interest of the investors has the right to issue directions with regard to the transfer of records, documents or securities or disposal of investments relating to its activities as a venture capital fund and can also appoint any person to take charge of records, documents, securities and for this purpose also determine the terms and conditions of such an appointment.

Investment Conditions and Restrictions

A venture capital fund can raise monies from any investor whether Indian, foreign or non-resident Indians by way of issue of units. No venture capital fund set up as a company or any scheme of a venture capital fund or set up as a trust can accept any investment from any investor which is less than five lakh rupees. However nothing applies to investors who are the employees or the principal officer or directors of the venture capital fund, or directors of the trustee company or trustees where the venture capital fund has been established as a trust; or the employees of the fund manager or asset management company. Each scheme launched or fund set up by a venture capital fund should have firm commitment from the investors for contribution of an amount of at least Rupees five crores before the start of operations by the venture capital fund.

Venture capital fund is required to disclose the investment strategy at the time of application for registration and should not invest more than 25% corpus of the fund in one venture capital undertaking. Venture capital fund may invest in Securities of foreign companies subject to such conditions or guidelines that may be stipulated or issued by RBI and SEBI from time to time. It should also not invest in the associated companies. Venture capital fund shall make the investment in the venture capital undertaking as given below:

- (i) at least 66.67% of the investible funds shall be invested in unlisted equity shares or equity linked instruments of venture capital undertaking.

- (ii) not more than 33.33% of the investible funds can be invested by way of subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed; debt or debt instrument of a venture capital undertaking in which the venture capital fund has already made an investment by way of equity, preferential allotment of equity shares of a listed company subject to lock-in period of one year, equity shares or equity linked instrument of financing weak company or a sick individual company whose shares are listed and special purpose vehicles created by VCF for the purpose of facilitating or promoting investment in accordance with these regulations. Venture capital fund shall disclose the duration of life cycle of the fund.

Prohibition on listing

No venture capital fund is entitled to get its units listed on any recognised stock exchange till the expiry of three years from the date of the issuance of units by the venture capital fund.

General Obligations and Responsibilities

No venture capital fund can issue any document or advertisement inviting offers from the public for the subscription or purchase of any of its units. A venture capital fund can receive monies for investment in the venture capital fund only through private placement of its units.

Maintenance of books and records

Every venture capital fund is required to maintain for a period of eight years books of accounts, records and documents which shall give a true and fair picture of the state of affairs of the venture capital fund. Every venture capital fund should intimate SEBI, in writing, the place where the books, records and documents.

Powers of SEBI

SEBI can at any time call for any information from a venture capital fund with respect to any matter relating to its activity as a venture capital fund. Where any information is called for, it should be furnished within the time specified by SEBI. SEBI may at any time call upon the venture capital fund to file such reports as SEBI may desire with regard to the activities carried on by the venture capital fund.

Winding up

A scheme of a venture capital fund set up as a trust should be wound up if—

- (a) the period of the scheme, if any, mentioned in the placement memorandum is over;
- (b) in the opinion of the trustees or the trustee company, that the scheme should be wound up in the interests of investors in the units;
- (c) if seventy five percent of the investors in the scheme pass a resolution at a meeting of unit holders that the scheme be wound up or if SEBI so directs in the interests of investors.

A venture capital fund set up as a company should be wound up in accordance with the provisions of the Companies Act, 1956. It should be wound up in accordance with the provisions of the statute under which it is constituted. The trustees or trustee company of the venture capital fund set up as a trust or SEBI of Directors in the case of the venture capital fund is set up as a company (including body corporate) should intimate SEBI and investors of the circumstances leading to the winding up of the Fund or Scheme.

No further investments should be made on behalf of the scheme so wound up on and from the date of intimation. Within three months from the date of intimation, the assets of the scheme should be liquidated, and the proceeds accruing to investors in the scheme be distributed to them after satisfying all liabilities.

Placement Memorandum

The venture capital fund established as a trust before issuing any units file a placement memorandum with SEBI which should give details of the terms subject to which monies are proposed to be raised from investors. A venture capital fund established as a company should before making an offer inviting any subscription to its securities, file with SEBI a placement memorandum which shall give details of the terms subject to which monies are proposed to be raised from the investors.

The placement memorandum should contain the following, namely:

- (i) details of the securities that are being offered;
- (ii) details of investments that are proposed to be made;
- (iii) details of directors of the company;
- (iv) tax implications that are likely to apply to investors;
- (v) manner of subscription to the securities that are to be issued;
- (vi) manner in which the benefits accruing to investors in the securities are to be distributed; and
- (vii) details of the asset management company, if any, and of fees to be paid to such a company.

The placement memorandum is to be issued for private circulation only after the expiry of twenty-one days of its submission to SEBI. However it has been provided that if within twenty one days of submission of the placement memorandum, SEBI communicates any amendments to the placement memorandum, the venture capital fund should carry out such amendments in the placement memorandum before such memorandum is circulated to the investors.

Amendments or changes to any placement memorandum already filed with SEBI can be made only if a copy of the placement memorandum indicating the changes is filed with SEBI and secondly within twenty one days of such filing, SEBI has not communicated any objections or observations on the said amendments or changes.

Inspection and Investigation

SEBI can appoint one or more persons as inspecting or investigating officer to undertake inspection or investigation of the books of accounts, records and

documents relating to a venture capital fund for any of the following reasons:

- (a) to ensure that the books of account, records and documents are being maintained by the venture capital fund in the manner specified in these regulations;
- (b) to inspect or investigate into complaints received from investors, clients or any other person, on any matter having a bearing on the activities of the venture capital fund;
- (c) to ascertain whether the provisions of the Act and regulations are being complied with by the venture capital fund; and
- (d) to inspect or investigate suo moto into the affairs of a venture capital fund, in the interest of the securities market or in the interest of investors.

Notice before inspection or investigation

Before ordering an inspection or investigation SEBI should give notice to the venture capital fund. Where SEBI is satisfied that in the interest of the investors no such notice should be given, it can through order in writing direct that the inspection or investigation of the affairs of the venture capital fund be taken up without such notice. During the course of an inspection or investigation, the venture capital fund against whom the inspection or investigation is being carried out should be bound to discharge its obligations as provided in regulation.

Obligation of venture capital fund on inspection or investigation

It is the duty of every officer of the Venture Capital Fund in respect of whom an inspection or investigation has been ordered and any other associate person who is in possession of relevant information pertaining to conduct and affairs of such Venture Capital Fund including fund manager or asset management company, if any, to produce to the Investigating or Inspecting Officer such books, accounts and other documents in his custody or control and furnish him with such statements and information as the said Officer may require for the purposes of the investigation or inspection. Every officer of the Venture Capital Fund and any other associate person who is in possession of relevant information pertaining to conduct and affairs of the Venture Capital Fund required to give to the Inspecting or Investigating Officer all such assistance and should extend all such co-operation as required in connection with the inspection or investigations and should also furnish such information sought by the inspecting or investigating officer in connection with the inspection or investigation.

The Investigating or Inspecting Officer for the purposes of inspection or investigation, has the power to examine and record the statement of any employees, directors or person responsible for or connected with the activities of venture capital fund or any other associate person having relevant information pertaining to such Venture Capital Fund. The Inspecting or Investigating Officer should for the purposes of inspection or investigation, have power to obtain authenticated copies of documents, books, accounts of Venture Capital Fund, from any person having control or custody of such documents, books or accounts.

Submission of Report

The inspecting or investigating officer as soon as possible on completion of the inspection or investigation submits an inspection or investigation report to SEBI. However if directed by SEBI, he may submit an interim report.

Communication of findings

SEBI after consideration of the investigation or inspection report and after giving reasonable opportunity of hearing to the venture capital fund or its trustees, directors issue such direction as it deems fit in the interest of securities market or the investors including directors in the nature of:

- (a) requiring a venture capital fund not to launch new schemes or raise money from investors for a particular period;
- (b) prohibiting the person concerned from disposing of any of the properties of the fund or scheme acquired in violation of these regulations;
- (c) requiring the person connected to dispose of the assets of the fund or scheme in a manner as specified in the directions;
- (d) requiring the person concerned to refund any money or the assets to the concerned investors along with the requisite interest or otherwise, collected under the scheme;
- (e) prohibiting the person concerned from operating in the capital market or from accessing the capital market for a specified period.

Procedure for action in case of default

A venture capital fund which –

- (a) contravenes any of the provisions of the Act or these regulations;
- (b) fails to furnish an information relating to its activity as venture capital fund as required by SEBI;
- (c) furnishes to SEBI information which is false or misleading in any material particular;
- (d) does not submit periodic returns or reports as required by SEBI;
- (e) does not co-operate in any enquiry, inspection or investigation conducted by SEBI;
- (f) fails to resolve the complaints of investors or fails to give a satisfactory reply to SEBI in this behalf,

should be dealt with in the manner provided in Chapter V of SEBI (Intermediaries) Regulations, 2008.

III. 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.

Application for grant of certificate

The applicant is required to make an application along with the registration fee to SEBI for the purposes of seeking registration in the form specified.

Eligibility Criteria

SEBI assesses the application of VCF on the following criteria:

- (i) the applicants track record, professional competence, financial soundness, experience, general reputation of fairness and integrity;
- (ii) whether the applicant has been granted necessary approval by the Reserve Bank of India for making investments in India;
- (iii) whether the applicant is an investment company, investment trust, investment partnership, pension fund, mutual fund, endowment fund, university fund, charitable institution or any other entity incorporated outside India; or
- (iv) whether the applicant is an asset management company, investment manager or investment management company or any other investment vehicle incorporated outside India;
- (v) whether the applicant is authorised to invest in venture capital fund or carry on activity as a foreign venture capital investors;
- (vi) whether the applicant is regulated by an appropriate foreign regulatory authority or is an income tax payer; or submits a certificate from its banker of its or its promoter's track record where the applicant is neither a regulated entity nor an income tax payer;
- (vii) the applicant has not been refused a certificate by SEBI;
- (viii) whether the applicant is a fit and proper person.

SEBI may require the applicant to furnish further information, if it considers necessary. An application which is not complete in all respects is rejected by SEBI. However before rejecting any such application, it has been provided in the Regulations that the applicant should be given an opportunity to remove, within thirty days of the date of receipt of communication, the objections indicated by SEBI. SEBI may, on being satisfied that it is necessary to extend the period specified above may extend such period but not beyond ninety days.

Procedure for grant of certificate

If SEBI is satisfied that the applicant is eligible for the grant of certificate, it should send an intimation to the applicant and on the receipt of intimation, the applicant has to pay the registration fee specified in Part A of the second schedule in the manner specified in Part B thereof. SEBI on receipt of the registration fee grants a certificate of registration in Form B.

Procedure where certificate is not granted

However after considering an application, if SEBI is of the opinion that a certificate should not be granted, it may reject the application after giving the

applicant a reasonable opportunity of being heard. The decision of SEBI to reject the application should be communicated to the applicant. Any applicant whose application has been rejected should not carry on any activity as a Foreign Venture Capital Investor.

Conditions of certificate

The certificate to be granted to the foreign venture capital is subject to the the conditions that:

- (i) it should abide by the provisions of the Act, and these regulations;
- (ii) it should appoint a domestic custodian for purpose of custody of securities;
- (iii) it should enter into arrangement with a designated bank for the purpose of operating a special non-resident rupee or foreign currency account;
- (iv) it should forthwith inform SEBI in writing if any information or particulars previously submitted to SEBI are found to be false or misleading in any material particular or if there is any change in the information already submitted.

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.

A "financially weak company" means a company, which has at the end of the previous financial year accumulated losses, which has resulted in erosion or more than 50% but less than 100% of its net worth as at the beginning of the previous financial year.
- (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.

Maintenance of books and records

Every Foreign Venture Capital Investor is required to maintain for a period of eight years, books of accounts, records and documents which should give a true and fair picture of the state of affairs of the Foreign Venture Capital Investor. Every Foreign Venture Capital Investor should intimate to SEBI, in writing, the place where the books, records and documents are being maintained.

Power to call for information

SEBI may at any time call for any information from a Foreign Venture Capital Investor with respect to any matter relating to its activity as a Foreign Venture Capital Investor. In case any information is called for, it should be furnished within the time specified by SEBI.

General Obligations and Responsibilities

Foreign Venture Capital Investor or a global custodian acting on behalf of the foreign venture capital investor should enter into an agreement with the domestic custodian to act as a custodian of securities for Foreign Venture Capital Investor. Foreign Venture Capital Investor should ensure that domestic custodian takes steps for monitoring of investment of Foreign Venture Capital Investors in India, furnishing of periodic reports to SEBI and furnishing such information as may be called for by SEBI.

Appointment of Designated bank

Foreign Venture Capital Investor is required to appoint a branch of a bank approved by Reserve Bank of India as designated bank for opening of foreign currency denominated accounts or special non-resident rupee account.

Inspection or investigation

SEBI may, suo-moto or upon receipt of information or complaint, cause an inspection or investigation to be made in respect of conduct and affairs of any foreign venture capital investor by an Officer whom SEBI considers fit:

- (i) to ensure that the books of account, records and documents are being maintained by the foreign venture capital investor in the manner specified in these regulations and to inspect or investigate into complaints received from investors, clients or any other person, on any matter having a bearing on the activities of the foreign venture capital investor;
- (ii) to ascertain whether the provisions of the Act and these regulations are being complied with by the foreign venture capital investor and to inspect or investigate suo-moto into the affairs of a foreign venture capital investor in the interest of the securities market or in the interest of investors.

Obligations of Foreign Venture Capital Investor

It should be the duty of every Foreign Venture Capital Investor in respect of

whom an inspection or investigation has been ordered and any other person associated who is in possession of relevant information pertaining to conduct and affairs of such Foreign Venture Capital Investor including asset management company or fund manager, to produce to the Inspecting or Investigating Officer such books, accounts and other documents in his custody or control and furnish him with such statements and information as the said officer may require for the purposes of the inspection or investigation. It should be the duty of Foreign Venture Capital Investor and any other person associated who is in possession of relevant information pertaining to conduct and affairs of the Foreign Venture Capital Investor to give to the Inspecting or Investigating Officer all such assistance and shall extend all such co-operation as may be required in connection with the inspections or investigations and shall furnish such information sought by the Inspecting or Investigating Officer in connection with the inspections or investigations. The Inspecting or Investigating Officer have the power to examine on oath and record the statement of any person responsible for or connected with activities of Foreign Venture Capital Investor or any other person associated having relevant information pertaining to such Foreign Venture Capital Investor. The Inspecting or Investigating Officer has the power to get authenticated copies of documents, books, accounts of Foreign Venture Capital Investor, from any person having control or custody of such documents, books or accounts. The Inspecting or Investigating Officer submits a report to SEBI after the completion of inspection or investigations.

Powers of SEBI

SEBI after considering investigation report and giving a reasonable opportunity of hearing to the Foreign Venture Capital Investor, require the Venture Capital Fund to take such measure or issue such directions as it deems fit in the interest of capital market and investors, including directions requiring the person concerned to dispose of the securities or disinvest in a manner as may be specified in the directions; or requiring the person concerned not to further invest for a particular period; or prohibiting the person concerned from operating in the capital market in India for a specified period.

Suspension/Cancellation of certificate

SEBI after considering the investigation report, initiate action for suspension or cancellation of the registration of such Foreign Venture Capital Investor. However no such certificate of registration shall be suspended or cancelled unless the procedure specified in regulation has been complied with.

SEBI may suspend the certificate if the Foreign Venture Capital Investor contravenes any of the provisions of the Act or these regulations or fails to furnish any information relating to its activity as a Foreign Venture Capital Investor as required by SEBI or furnishes to SEBI information which is false or misleading in any material particular or does not submit periodic returns or reports as required by SEBI or does not co-operate in any enquiry or inspection conducted by SEBI.

SEBI may cancel the certificate granted to a Foreign Venture Capital Investor if the Foreign Venture Capital Investor is guilty of fraud or has been convicted of an offence involving moral turpitude. Also SEBI may cancel the certificate if the Foreign Venture Capital Investor has been guilty of repeated defaults of the nature mentioned in the regulation or Foreign Venture Capital Investor does not continue to meet the

eligibility criteria laid down in the regulations or contravenes any of the provisions of the Act or regulations.

Enquiry under the Regulations

No order of penalty or cancellation of certificate should be imposed on the Foreign Venture Capital Investor except after holding an enquiry in accordance with the procedure specified in Chapter V of the SEBI (Intermediaries) Regulations, 2008.

Appeal to Securities Appellate Tribunal

Any person aggrieved by an order of SEBI may prefer an appeal to the Securities Appellate Tribunal.

Action against intermediary

SEBI may initiate action for suspension or cancellation of registration of an intermediary holding a certificate of registration under section 12 of the Act who fails to exercise due diligence in the performance of its functions or fails to comply with its obligations under these regulations.

However, no such certificate of registration shall be suspended or cancelled unless the procedure specified in the regulations applicable to such intermediary is complied with.

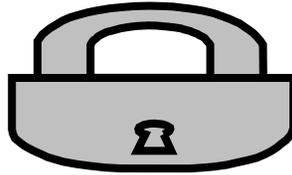
LESSON ROUND UP



- Venture capital is the capital that is invested in equity or debt securities (with equity conversion terms) of young unseasoned companies promoted by technocrats who attempt to break new path.
- In India, Venture Capital is regulated by SEBI (Venture Capital Funds) Regulations, 1996
- A Venture Capital Fund (VCF) strives to provide entrepreneurs with the support they need to create up-scalable business with sustainable growth, while providing their contributors with outstanding returns on investment, for the higher risks they assume.
- Venture capitalists typically raise funds largely from investors such as financial institutions, banks, pension funds, corporations, endowments/foundations and high net-worth individuals.
- 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 SEBI(Foreign Venture Capital Investors) Regulations, 2000
- Incubators - An incubator is a hardcore technocrat who works with an entrepreneur to develop a business idea, and prepares a Company for subsequent rounds of growth & funding.

- Angel Investors - An angel is an experienced industry-bred individual with high net worth. Typically, an angel investor would invest only his chosen field of technology, take active participation in day-to-day running of the Company, invest small sums in the range of USD 1-3 million not insist on detailed business plans sanction the investment in up to a month help company for "second round" of funding. Venture Capitalists (VCs)
- Venture Capitalists are organizations raising funds from numerous investors and hiring experienced professional managers to deploy the same.
- Private Equity Players- They are established investment bankers. They typically invest into proven/established businesses. They have "financial partners" approach.
- Trust or a Company – It is a fund established in the form of a trust or a company including a body corporate and registered under SEBI Regulations which has a dedicated pool of capital, raised in a manner specified in the Regulations and invests in venture Capital undertaking.

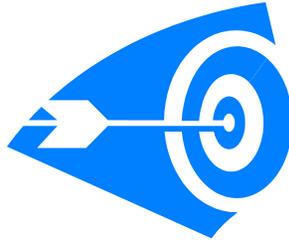
SELF TEST QUESTIONS



(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Highlight the major provisions of SEBI (Venture Capital Funds) Regulations, 1996.
 2. Write short note on:
 - (a) Off-shore venture capital funds
 - (b) Obligations of Venture Capital Fund.
 - (c) SEBI's powers of inspection and investigation of venture capital funds
 - (d) Placement Memorandum.
 3. Elaborate the domestic and International scenario of Venture Capital.
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STUDY XI
COLLECTIVE INVESTMENT SCHEMES



LEARNING OBJECTIVES

The study will enable the students to understand

- Concept of Collective Investment Scheme
- Overview of SEBI(Collective Investment Scheme)Regulations, 1999
- Restriction on business activities of Collective Investment Management Company
- Rights/Obligations of Collective Investment Management Company

INTRODUCTION

In order to strengthen the hands of SEBI to protect interests of investors in plantation companies, the Securities Laws (Amendment) Act, 1999 amended the definition of “securities” in the SCRA so as to include within its ambit the units or any other instruments issued by any CIS to the investors in such schemes. The Act also inserted a definition of the CIS in the Securities and Exchange Board of India Act, 1992. The CIS has been defined to mean any scheme or arrangement made or offered by any company under which (a) the contributions, or payments made by the investors, by whatever name called, are pooled and utilised solely for the purposes of the scheme or arrangement; (b) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable from such scheme or arrangement; (c) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors; and (d) the investors do not have day to day control over the management and operation of the scheme or arrangement.

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. The Act empowers the Central Government to make rules to provide for the requirements, which shall be complied with by CIS for the purpose of getting their units listed on any stock exchange.

I. SEBI (Collective Investment Scheme) Regulations, 1999 – An Overview



SEBI (Collective Investment Scheme) 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 organise, operate and manage a collective investment scheme.

No person other than a Collective Investment Management Company which has obtained a certificate under the regulations should carry on or sponsor or launch a collective investment scheme. Any person proposing to carry any activity as a Collective Investment Management Company on or after the commencement of the regulations should make an application to SEBI for the grant of registration in the specified form. Any person who immediately prior to the commencement of the regulations was operating a scheme, should subject to the provisions of the regulations make an application to SEBI for the grant of a certificate within a period of two months from such date.

Application fee to accompany the application

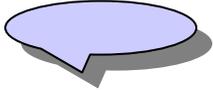
Every application for registration should be accompanied by a non-refundable application fee as specified. An application, which is not complete in all respects or does not conform to the requirements should be rejected by SEBI. However before rejecting any such application, the applicant is given an opportunity to remove within one month such objections as indicated by SEBI. The regulation further provides that SEBI can extend the time where sufficient reason being shown in order to enable the applicant to remove such objections.

Furnishing of information

SEBI can direct the applicant to furnish such further information or clarification as may be required by it, for the purpose of processing the application. SEBI, if it so desires can also ask the applicant or its authorised representative to appear before SEBI for personal representation in connection with the grant of a certificate.

Conditions for eligibility

The applicant should satisfy the following eligibility criteria:



- (a) the applicant is set up and registered as a company under the Companies Act, 1956;
- (b) the applicant has, in its Memorandum of Association specified the managing of collective investment scheme as one of its main objects;
- (c) the applicant has a net worth of not less than rupees five crores. However at the time of making the application the applicant shall have a minimum net worth of rupees three crores which has to be increased to rupees five crores within three years from the date of grant of registration;
- (d) the applicant is a fit and proper person for the grant of such certificate;
- (e) the applicant has adequate infrastructure to enable it to operate collective investment scheme in accordance with the provision of these regulations;
- (f) the directors or key personnel of the applicant should consist of persons of honesty and integrity having adequate professional experience in related field and have not been convicted for an offence involving moral turpitude or for any economic offence or for the violation of any securities laws;
- (g) at least fifty per cent of the directors of such Collective Investment Management Company shall consist of persons who are independent and are not directly or indirectly associated with the persons who have control over the Collective Investment Management Company;
- (h) no person, directly or indirectly connected with the applicant has in the past been refused registration by SEBI under the Act;
- (i) at least one of the directors on the board of the Collective Investment Management Company, who is not subject to retirement, is a representative of the trustee;
- (j) the Collective Investment Management Company is not a trustee of any collective investment scheme.
- (k) in case the applicant is an existing collective investment scheme, it complies with the regulations.

Grant of certificate

SEBI on receipt of an application and on being satisfied that the applicant complies with the requirements specified can call upon the applicant to pay registration fee as specified. SEBI grants a certificate on receipt of registration fee on such terms and conditions as are in the interest of investors and as specified.

Terms and conditions

The certificate granted should be subject to following conditions:-

- (a) any director of the Collective Investment Management Company should not be a director in any other Collective Investment Management Company unless such person is an independent director and approval of SEBI of Collective Investment Management Companies of which such person is an independent director, has been obtained;
- (b) the Collective Investment Management Company should forthwith inform SEBI of any material change in the information or particulars previously furnished, which have a bearing on the certificate granted by it;
- (c) appointment of a director of a Collective Investment Management Company should be made with the prior approval of the trustee;
- (d) the Collective Investment Management Company should comply with provisions of the Act and these regulations;
- (e) no change in the controlling interest of the Collective Investment Management Company shall be made without obtaining prior approval of SEBI, the trustee and the unit holders holding at-least one-half of the nominal value of the unit capital of the scheme.
- (f) The Collective Investment Management Company should take adequate steps to redress the grievances of the investors within one month from the date of receipt of the complaint from the aggrieved investor.

Procedure where registration is not granted

SEBI may reject the application if it does not satisfy the conditions specified in regulation. It also gives a reasonable opportunity to an applicant of being heard and inform the applicant of the same. The decision should be communicated to the applicant by SEBI within 30 days of such decision stating therein the grounds on which the application has been rejected.

Restrictions on business activities

The 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 Collective Investment Management Company 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.

Obligations of Collective Investment Management Company

Every Collective Investment Management Company should:

- (i) be responsible for managing the funds or properties of the scheme on

behalf of the unit holders and take all reasonable steps and exercise due diligence to ensure that the scheme is managed in accordance with the provisions of the regulations, offer document and the trust deed;

- (ii) exercise due diligence and care in managing assets and funds of the scheme and also responsible for the acts of commissions and omissions by its employees or the persons whose services have been availed by it;
- (iii) remain liable to the unit holders for its acts of commission or omissions, notwithstanding anything contained in any contract or agreement and be incompetent to enter into any transaction with or through its associates, or their relatives relating to the scheme. However in case the Collective Investment Management Company enters into any transactions relating to the scheme with any of its associates, a report to that effect should be immediately sent to the trustee and to SEBI;
- (iv) appoint registrar and share transfer agents and should also abide by the Code of Conduct as specified;
- (v) give receipts for all monies received by it and also give a report to SEBI every month, particularly of receipts and payments;
- (vi) hold a meeting of board of Directors to consider the affairs of scheme atleast twice in every three months and also ensures that its officers or employees do not make improper use of their position or information to gain, directly or indirectly, an advantage for themselves or for any other person or to cause detriment to the scheme;
- (vii) obtain adequate insurance against the property of the scheme and comply with such guidelines, directives, circulars and instructions as may be issued by SEBI from time to time, on the subject of collective investment schemes.

Submission of information and documents

The Collective Investment Management Company should prepare quarterly reports on its activities and the position regarding compliance with these regulations and submit the same to the trustees within one month of the expiry of each quarter. The Collective Investment Management Company should file with the trustee and SEBI particulars of all its directors alongwith their interest in other companies within fifteen days of their appointment. It should furnish a copy of the Balance Sheet, Profit and Loss Account and a copy of the summary of the yearly appraisal report to the unit holders within two months from the closure of financial year and should also furnish to SEBI and the trustee such information and documents to SEBI and the trustee as may be required by them concerning the affairs of the scheme.

Trustees and their obligations

A scheme should be constituted in the form of a trust and the instrument of trust should be in the form of a deed duly registered under the provisions of the Indian Registration Act, 1908 executed by the Collective Investment Management Company in favour of the trustees named in such an instrument. It can appoint a trustee to hold the assets of the scheme for the benefit of unit holders.

Contents of trust deed

The trust deed should contain such clauses as are specified and other clauses as are necessary for safeguarding the interests of the unit holders. No trust deed should contain a clause which has the effect of limiting or extinguishing the obligations and liabilities of the Collective Investment Management Company in relation to any scheme or the unit holders; or indemnifying the trustee or the Collective Investment Management Company for loss or damage caused to the unit holders by their acts of negligence or acts of commissions or omissions.

Eligibility for appointment as trustee

The persons registered with SEBI as Debenture Trustee under SEBI (Debenture Trustee) Regulations, 1993 are only eligible to be appointed as trustees of collective investment scheme. However no person is eligible to be appointed as trustee, if he is directly or indirectly associated with the persons who have control over the collective investment management company.

No person should be appointed as trustee of a scheme if he has been found guilty of an offence under the securities laws or SEBI or any authority to which SEBI has delegated its power has passed against such person, an order under the Act for violation of any provision of the Act or of regulations made hereunder.

The trustee and the Collective Investment Management Company should enter into an agreement for managing the scheme property. The agreement for managing the scheme property should contain clauses as specified and such other clauses as are necessary for the purpose of fulfilling the objectives of the scheme.

Rights and obligations of the trustee

The trustee have a right to obtain from the Collective Investment Management Company such information as is considered necessary by the trustee and to inspect the books of accounts and other records relating to the scheme. The trustee should ensure that the Collective Investment Management Company has;

- (i) the necessary office infrastructure;
- (ii) appointed all key personnel including managers for the schemes and submitted their bio-data which shall contain the educational qualifications and past experience in the areas relevant for fulfilling the objectives of the schemes;
- (iii) appointed auditors to audit the accounts of the scheme from the list of auditors approved by SEBI;
- (iv) appointed a compliance officer to comply with the provisions of the Act and these regulations and to redress investor grievances;
- (v) appointed registrars to an issue and share transfer agent;
- (vi) prepared a compliance manual and designed internal control mechanisms including internal audit systems;
- (vii) taken adequate insurance for the assets of the scheme;
- (viii) not given any undue or unfair advantage to any associates of the company

or dealt with any of the associates in any manner detrimental to the interest of the unit holders;

- (ix) operated the scheme in accordance with the provisions of the trust deed, these regulations and the offer document of the scheme(s);
- (x) undertaken the activity of managing schemes only;
- (xi) taken adequate steps to ensure that the interest of investors of one scheme are not compromised with the object of promoting the interest of investors of any other scheme;
- (xii) minimum networth on a continuous basis and shall inform SEBI immediately of any shortfall;
- (xiii) been diligent in empanelling the marketing agents and in monitoring their activities.

The trustee should forthwith take such remedial steps as are necessary and immediately inform SEBI of the action taken where the trustee believes that the conduct of business of the scheme is not in accordance with the regulations. The trustee should be accountable for, and be the custodian of, the funds and property of the respective schemes and should hold the same in trust for the benefit of the unit holders in accordance with these regulations and the provisions of trust deed. The trustee should be responsible for the calculation of any income due to be paid to the scheme and also for any income received in the scheme to the unit holders. The trustee is required to convene a meeting of the unit holders whenever required to do so by SEBI in the interest of the unit-holders or whenever required to do so on the requisition made by unit holders holding at least one-tenth of nominal value of the unit capital of any scheme or when any change in the fundamental attributes of any scheme which affects the interest of the unit holders is proposed to be carried out. However no such change should be carried out unless the consent of unit holders holding at least three-fourths of nominal value of the unit capital of the scheme is obtained.

The expression "fundamental attributes" means the investment objective and terms of a scheme.

The trustee should review on a quarterly basis every year all activities carried out by the Collective Investment Management Company, periodically all service contracts relating to registrars to an issue and share transfer agents and satisfy itself that such contracts are fair and reasonable in the interest of the unit holders and investor complaints received and the redressal of the same by the Collective Investment Management Company.

The trustee should ensure that net worth of Collective Investment Management Company is not deployed in a manner which is detrimental to interest of unitholders and also that the property of each scheme is clearly identifiable as scheme property and held separately from property of the Collective Investment Management Company and property of any other scheme. Clearances or no objection certificate should be obtained, in respect of transactions relating to property of the scheme from such authority as is competent to grant such clearance or no objection certificate. The trustee should abide by the Code of Conduct as specified. The

trustee is required to furnish to SEBI on a quarterly basis every year a report on the activities of the scheme and a certificate stating that the trustee has satisfied himself that affairs of the Collective Investment Management Company and of the various schemes are conducted in accordance with these regulations and investment objective of each scheme.

The trustee should cause:

- (a) the profit and loss accounts and balance sheet of the schemes to be audited at the end of each financial year by an auditor empanelled with SEBI.
- (b) each scheme to be appraised at the end of each financial year by an appraising agency.
- (c) scheme rated by a credit rating agency.

A meeting of the trustees to discuss the affairs of the scheme should be held at least twice in every three months in a financial year. The trustee should also report to SEBI any breach of these regulations and has had, or is likely to have, a materially adverse effect on the interests of unit holders as soon as they become aware of the breach. The trustee should ensure that the fees and expenses of the scheme are within the limits as specified and the accounts of the schemes are drawn up in accordance with the accounting norms as specified and should comply with accounts of the scheme and the format of the balance sheet and the profit and loss account as specified.

Termination of trusteeship

The trusteeship of a trustee should come to an end—

- (a) If the trustee ceases to be trustee under SEBI (Debentures Trustees) Regulations, 1993; or
- (b) if the trustee is in the course of being wound up; or
- (c) if unit holders holding at least three-fourths of the nominal value of the unit capital of the scheme pass a resolution for removing the trustee and SEBI approves such resolution; or
- (d) if in the interest of the unit holders, SEBI, for reasons to be recorded in writing decides to remove the trustee for any violation of the Act or these regulations committed by them. However the trustee should be afforded reasonable opportunity of hearing before action is taken under this clause;
- (e) if the trustee serves on the Collective Investment Management Company a notice of not less than three months expressing its intention not to continue as trustee.

Another trustee should be appointed by the Collective Investment Management Company on the termination of the trusteeship. The appointment of the new trustee should be completed within three months from the date the previous trusteeship came to an end. SEBI can appoint any person as a trustee if the Collective Investment Management Company fails to appoint a trustee. The trustee appointed under should stand substituted as a trustee in all the documents to which the

trustee so removed was a party. The person appointed by SEBI should apply to the Court for an order directing the Collective Investment Management Company to wind up the scheme. A trust-deed in the form as specified under these regulation shall be executed by the Collective Investment Management Company in favour of the trustees so appointed and from the date of such appointment, trustees shall be subject to all the rights and duties as specified in these regulations. The trustees so removed shall from such date be discharged from complying with the obligations under the trust deed but shall remain liable for any action taken by them before such removal.

Termination of the Agreement with the Collective Investment Management Company

The agreement entered into by the trustee with the Collective Investment Management Company may be terminated—

- (a) if the Collective Investment Management Company is in the course of being wound up as per the provisions of the Companies Act, 1956 or;
- (b) if unit holders holding at least three-fourths of the nominal value of the unit capital of the scheme pass a resolution for terminating the agreement with the Collective Investment Management Company and the prior approval of SEBI has been obtained, or
- (c) if in the interest of the unit holders SEBI or the trustee, after obtaining prior approval of SEBI, and after giving an opportunity of being heard to the Collective Investment Management Company, decide to terminate the agreement with the Collective Investment Management Company.

Another Collective Investment Management Company registered with SEBI, should be appointed upon the termination of agreement by the trustee within three months from the date of such termination. The Collective Investment Management Company so removed continues to act as such at the discretion of trustee or the trustee itself may act as Collective Investment Management Company till such time as new Collective Investment Management Company is appointed. The Collective Investment Management Company appointed should stand substituted as a party in all the documents to which the Collective Investment Management Company so removed was a party. The Collective Investment Management Company so removed should continue to be liable for all acts of omission and commissions notwithstanding such termination. If, none of the Collective Investment Management Company, registered under the regulations, consent to be appointed as Collective Investment Management Company within a further period of three months, then the trustee may wind up the scheme. An agreement for managing scheme property should be executed in favour of the new Collective Investment Management Company subject to all the rights and duties as specified in the regulations.

Procedure for launching of schemes

No scheme should be launched by the Collective Investment Management Company unless such scheme is approved by the Trustee and obtain rating from a credit rating agency and has been appraised by an appraising agency.

Disclosures in the offer document

The Collective Investment Management Company before launching any scheme file a copy of the offer document of the scheme with SEBI and pay filing fees as specified in the Second Schedule. The offer document should contain such information as specified. The offer document should also contain true and fair view of the scheme and adequate disclosures to enable the investors to make informed decision. SEBI may in the interest of investors require the Collective Investment Management Company to carry out such modifications in the offer document as it deems fit. In case no modifications are suggested by SEBI in the offer document within 21 days from the date of filing, the Collective Investment Management Company may issue the offer document to public.

Advertisement material

Advertisements in respect of every scheme is required to be in conformity with the Advertisement Code as specified and should also disclose in addition to the investment objectives, the method and periodicity of valuation of scheme property.

Misleading Statements

The offer document and advertisement materials should not be misleading or contain any statement or opinion which are incorrect or false. Where an offer document or advertisement includes any statement or opinion which are incorrect or false or misleading, every person who is a director of the Collective Investment Management Company at the time of the issue of the offer document and who has issued the offer document and shall be punishable under the Act unless he proves either that the statement or opinion was immaterial or that he had reasonable ground to believe at the time of the issue of the offer document or advertisement that the statement was true.

Allotment of Units and refunds of moneys

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 Collective Investment Management Company should refund the application money to the applicants, if the scheme fails to receive the minimum subscription amount. Any amount refundable should be refunded within a period of six weeks from the date of closure of subscription list, by Registered A.D. and by cheque or demand draft marked "A/C Payee" to the applicants. In the event of failure to refund the amounts within the period specified, the Collective Investment Management Company has to pay interest to the applicants at a rate of fifteen percent per annum on the expiry of six weeks from the date of closure of the subscription list.

Unit certificates

The Collective Investment Management Company should issue to the applicant whose application has been accepted, unit certificates as soon as possible but not later than six weeks from the date of closure of the subscription list. However if the units are issued through a depository, a receipt in lieu of unit certificate will be issued as per provisions of SEBI.

Transfer of units

A unit certificate issued under the scheme should be freely transferable. The Collective Investment Management Company on production of instrument of transfer together with relevant unit certificates, register the transfer and return the unit certificate to the transferee within thirty days from the date of such production. However if the units are held in a depository such units shall be transferable in accordance with the provisions of SEBI.

The subscription amount received should be kept in a separate bank account in the name of the scheme and utilised for—

- (1) (a) adjustment against allotment of units only after the trustee has received a statement from the registrars to the issue and share transfer agent regarding minimum subscription amount, as stated in the offer document, having been received from the public, or
- (b) for refund of money in case minimum subscription amount, as stated in the offer document, has not been received or in case of over-subscription.
- (2) The minimum subscription amount as specified in the offer document couldn't be less than the minimum amount, as specified by the appraising agency, needed for completion of the project for which the scheme is being launched.
- (3) The moneys credited to the account of the scheme should be utilised for the purposes of the scheme and as specified in the offer document.
- (4) Any unutilised amount lying in the account of the scheme should be invested in the manner as disclosed in the offer document.

Investments and segregation of funds

The Collective Investment Management Company should:

- (a) not invest the funds of the scheme for purposes other than the objective of the scheme as disclosed in the offer document.
- (b) segregate the assets of different schemes.
- (c) not invest corpus of a scheme in other schemes.
- (d) not transfer funds from one scheme to another scheme.

However it has been provided that inter scheme transfer of scheme property may be permitted at the time of termination of the scheme with prior approval of the trustee and SEBI.

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 purpose of the scheme. A scheme may also 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; 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 Collective Investment Management Company, the purpose of the scheme can not be accomplished and it obtains the approval of the trustees and also of the unit holders of the scheme holding atleast $\frac{3}{4}$ of the nominal value of the unit capital of the scheme with a resolution that the scheme be wound up and the approval of SEBI is obtained.

The trustee should dispose of the assets of the scheme concerned in the best interest of the unit holders of that scheme. The proceeds of sale realised under clause(a), should be first utilised towards the discharge of such liabilities as are due and payable under the scheme and after making appropriate provision for meeting the expenses connected with such winding up, the balance shall be paid to the unit holders in proportion to their unit holding. After the completion of the winding up, the trustee should forward to SEBI and the unit holders—

- (a) a report on the steps taken for realisation of assets of the scheme, expenses for winding up and net assets available for distribution to the unit holders and
- (b) a certificate from the auditors of the scheme to the effect that all the assets of the scheme are realised and the details of the distribution of the proceeds.

The unclaimed money if any at the time of winding up should be kept separately in a bank account by the trustee for a period of three years for the purpose of meeting investors' claims and thereafter should be transferred to investor protection fund, as may be specified by SEBI.

Effect of commencement of winding up proceedings

The trustee or the Collective Investment Management Company as the case may be, shall cease to carry on any business activities in respect of the scheme so wound up on and from the date of the publication of notice. If, after the receipt of the report SEBI is satisfied that all the measures for winding up of the scheme have been complied with, the scheme should cease to exist.

General obligations

Every Collective Investment Management Company should keep and maintain proper books of accounts, records and documents, for each scheme so as to explain its transactions and to disclose at any point of time the financial position of each scheme and in particular give a true and fair view of the state of affairs of the

scheme and intimate to SEBI and the trustees the place where such books of accounts, records and documents including computer records are maintained. Every Collective Investment Management Company should continue to maintain and preserve, for a period of five years after the close of each scheme, its books of accounts, records, computer data and documents.

Statement of Accounts and Annual Report

The Collective Investment Management Company should not exceed the ceilings on expenses or fees in respect of the scheme as specified. It should prepare the accounts of the scheme in accordance with accounting norms as specified and comply with format of balance sheet and profit and loss accounts as specified. An annual report and annual statement of accounts of each scheme should be prepared in respect of each financial year. Every Collective Investment Management Company should within two months from the date of closure of each financial year forward to SEBI a copy of the Annual Report.

Auditor's Report

Every scheme should have the annual statement of accounts audited by an auditor who is empanelled with SEBI and who is not in any way associated with the auditor of the Collective Investment Management Company. The auditor should be appointed by the trustee. The auditor should forward his report to the trustee and such report shall form part of the Annual Report of the scheme. The auditor's report should comprise the following certificate to the effect that:-

- (i) he has obtained all information and explanations which, to the best of his knowledge and belief, were necessary for the purpose of the audit;
- (ii) the balance sheet and the revenue account give a fair and true view of the scheme, state of affairs and surplus or deficit in the scheme for the accounting period to which the Balance Sheet or, as the case may be the Revenue Account relates;
- (iii) the statement of account has been prepared in accordance with accounting policies and standards as specified.
- (iv) any other matter which in the opinion of the auditor is vital and has a bearing on the schemes.

Functions of auditors of scheme

The auditor of the scheme should, as soon as possible, notify SEBI and the trustee in writing if he has reasonable grounds to suspect that a contravention of the regulations has occurred or if the schemes are not conducted on sound commercial principles. The auditor of the scheme should have a right of access at all reasonable times to the books of the scheme; and may require any employee of the Collective Investment Management Company to give the auditor information and explanations for the purposes of the audit.

Removal or Resignation of auditors

The trustee, after prior approval of the trustee and for reasons to be recorded in writing remove the auditor of the scheme for misconduct or inefficiency after giving

the auditor a reasonable opportunity of hearing. However it has been provided that another auditor for the scheme is appointed by trustee immediately from auditors empanelled with SEBI. The auditor of the scheme may resign by giving a three months written notice to the Collective Investment Management Company and to the trustee.

Publication of Annual Report

The scheme wise annual report or an abridged form thereof should be published in a national daily as soon as possible but not later than two calendar months from the date of finalisation of accounts. The annual report shall contain details as specified and such other details as are necessary for the purpose of providing a true and fair view of the operations of the collective investment scheme. The report if published in abridged form should carry a note that full annual report shall be available for inspection at the Head Office and all branch offices of the Collective Investment Management Company.

Periodic and continual disclosures

The Collective Investment Management Company and the trustee, should make such disclosures or submit such documents as they may be called upon by SEBI to make or submit. The Collective Investment Management Company on behalf of the scheme shall furnish the following periodic reports to SEBI, namely:

- (a) copies of the duly audited annual statements of accounts including the balance sheet and the profit and loss account in respect of each scheme, once a year;
- (b) a copy of quarterly unaudited accounts;
- (c) a quarterly statement of changes in net assets for each of the schemes.

Quarterly disclosures

A Collective Investment Management Company, on behalf of the scheme should before the expiry of one month from the close of each quarter that is 31st March, 30th June, 30th September and 31st December publish its unaudited financial results in one daily newspaper having nation wide circulation and in a newspaper published in the language of the region where the Head Office of the Collective Investment Management Company is situated. However it has been provided that the quarterly unaudited report should contain details as specified in the regulations and such other details as are necessary for the purpose of providing a true and fair view of the operations of the scheme.

Disclosures to the investors

The trustee should ensure that the Collective Investment Management Company should make such disclosures to the unit holders as are essential in order to keep them informed about any matter which may have an adverse bearing on their investments.

Inspection and audit

SEBI may appoint one or more persons as inspecting officer to undertake the inspection of the books of accounts, records, documents and infrastructure, systems and procedures or to investigate the affairs of the trustee and Collective

Investment Management Company for any of the following purposes:

- (a) to ensure that the books of accounts are being maintained by the Collective Investment Management Company in the manner specified in these regulations;
- (b) to ascertain whether the provisions of the Act and these regulations are being complied with by the trustee and Collective Investment Management Company;
- (c) to ascertain whether the systems, procedures and safeguards followed by the Collective Investment Management Company are adequate;
- (d) to investigate into the complaints received from the investors or any other person on any matter having a bearing on the activities of the trustee and Collective Investment Management Company;

Notice before inspection and investigation

SBI should give ten days notice before ordering an inspection to the Collective Investment Management Company or trustee as the case may be and where SEBI is satisfied that in the interest of the investors no such notice is required to be given, it may, by an order in writing direct that such inspection or investigation be taken up immediately without any notice. During the course of inspection or investigation, the trustee or Collective Investment Management Company against whom the inspection or investigation is being carried out should be bound to discharge his obligations.

Obligations during inspection and investigation

It should be the duty of the trustee or Collective Investment Management Company whose affairs are being inspected or investigated, and of every director, officer and employee thereof, to produce such books, accounts, records, and other documents in its custody or control and furnish him such statements and information relating to the activities as trustee or Collective Investment Management Company, as the inspecting officer may require, within such reasonable period as the inspecting officer may specify. It should allow the inspecting officer to have a reasonable access to the premises occupied by it or by any other person on its behalf and also provide necessary infrastructure for examining any books, records, documents, and computer data in the possession of the trustee and Collective Investment Management Company or such other person and also provide copies of documents or other materials which in the opinion of the inspecting officer are relevant for the purpose of the inspection.

Submission of report to SEBI

The inspecting officer shall, on completion of the inspection or investigation, submit a report to SEBI. However provided that if directed to do so by SEBI, he should submit interim reports. SEBI or the Chairman shall after consideration of inspection or investigation report take such action as SEBI or the chairman may deem fit and appropriate including action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

Appointment of Auditor and recovery of expenses

SEBI has the power to appoint an auditor to inspect or investigate, as the case may be, into the books of accounts or the affairs of the trustee or Collective Investment Management Company in respect of schemes. However provided that the Auditor so appointed should have the same powers of the inspecting officer as stated in regulation and the obligation of the Collective Investment Management Company or trustee and their respective employees should be applicable to the inspection under this regulation.

Payment of inspection fees to SEBI

SEBI should be entitled to recover such expenses including fees paid to the auditors as may be incurred by it for the purposes of inspecting the books of accounts, records and documents of the trustee or Collective Investment Management Company.

Liability for action in default

A collective investment management company who contravenes any of the provisions of the Act, Rules or Regulations framed thereunder shall be liable for one or more action specified therein including the action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

Directions by SEBI

SEBI may, in the interests of the securities market and the investors may initiate action including initiation of criminal prosecution gives such directions as it deems fit in order to ensure effective observance of these regulations, including directions:

- (a) requiring the person concerned not to collect any money from investors or to launch any scheme;
- (b) prohibiting the person concerned from disposing of any of the properties of the scheme acquired in violation of these regulations;
- (c) requiring the person concerned to dispose of the assets of the scheme in a manner as may be specified in the directions;
- (d) requiring the person concerned to refund any money or the assets to the concerned investors along with the requisite interest or otherwise, collected under the scheme.
- (e) prohibiting the person concerned from operating in the capital market or from accessing the capital market for a specified period.

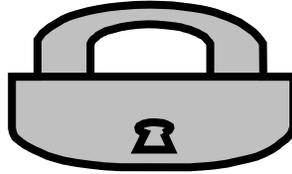
Action against intermediaries

SEBI may initiate action for suspension or cancellation of registration of an intermediary registered with SEBI who fails to exercise due diligence in the performance of its functions or fails to comply with its obligations under these regulations. However no such certificate of registration should be suspended or cancelled unless the procedure specified in the regulations applicable to such intermediary is complied with.

LESSON ROUND UP



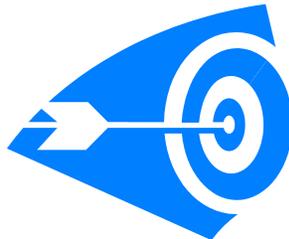
- The CIS is any scheme or arrangement made or offered by any company under which (a) the contributions, or payments made by the investors, by whatever name called, are pooled and utilised solely for the purposes of the scheme or arrangement; (b) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable from such scheme or arrangement; (c) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors; and (d) the investors do not have day to day control over the management and operation of the scheme or arrangement.
- A scheme should be constituted in the form of a trust and the instrument of trust should be in the form of a deed duly registered under the provisions of the Indian Registration Act, 1908 executed by the Collective Investment Management Company in favour of the trustees named in such an instrument.
- Collective Investment Management Company is regulated by SEBI (Collective Investment Scheme) Regulations, 1999.
- SEBI (Collective Investment Scheme) 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 organise, operate and manage a collective investment scheme.
- The 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.
- The trustee have a right to obtain from the Collective Investment Management Company such information as is considered necessary by the trustee and to inspect the books of accounts and other records relating to the scheme.
- 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.
- A scheme should be wound up on the expiry of duration specified in the scheme or on the accomplishment of the purpose of the scheme.
- SEBI may appoint one or more persons as inspecting officer to undertake the inspection of the books of accounts, records, documents and infrastructure, systems and procedures or to investigate the affairs of the trustee and Collective Investment Management Company.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What are the obligations of collective investment management company?
 2. Discuss the various restrictions on business activities of collective investment management company?
 3. Enumerate the rights and obligations of trustees of collective investment schemes?
 4. What are the provisions relating to inspection and investigation of the affairs of the trustee and collective investment management company?
 5. Discuss the circumstances under which a collective investment scheme could be wound up?
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STUDY XII
BUY BACK OF SECURITIES



LEARNING OBJECTIVES

The study will enable the students to understand

- Concept & Objectives of buy-back of securities
- Relevant Sections of the Companies Act, 1956
- Overview of SEBI(Buy-back of Securities)Regulations, 1998
- Unlisted Public Company(Buy-Back of Securities) Rules, 1999
- Procedure for buy back of securities
- Modes of Buy-back of Securities

INTRODUCTION

Till the early nineties, the Indian economy functioned in an environment regimented by control and regulations. With the reforms initiated by the Government, the economy moved from controlled to market driven. The forces of globalisation and liberalisation compelled the corporates to restructure the business by adopting the tools, viz., mergers, amalgamations and takeovers. All these activities, in turn, impacted the functioning of the capital market, more particularly the movement of share prices. As the shares of companies are held by different segments of society, viz., entrepreneurs, institutional investors and individual shareholders including small investors, it is reasonable that there should be equality of treatment and opportunities to all shareholders, transparency, proper disclosure and above all protection of interests of small and minority shareholders. In order to ensure observance of these basic principles in takeover of companies, right from 1994 Takeover Regulations were introduced and amended from time to time to meet the fast changing market realities.

Similarly buy-back of securities is a corporate financial strategy which involves capital restructuring and is prevalent globally with the underlying objectives of increasing earnings per share, averting hostile takeovers, improving returns to the stakeholders and realigning the capital structure.

In India, while buy-back of securities is not permitted as a treasury option under which the securities may be reissued later, a company can resort to buy-back to reduce the number of shares issued and return surplus cash to the shareholders.

I. Concept – Buy-Back of Securities

The concept of buy-back of securities was proposed in the Companies Bill, 1997. The Companies (Amendment) Ordinance, 1998 promulgated on 31st October 1998, contained provisions for buy-back of securities. Subsequently, the Companies (Amendment) Bill, 1998 (Bill No.174 of 1998) was introduced in the Lok Sabha on 22nd November 1998 but was not passed. Consequently, a new Ordinance, the Companies (Amendment) Ordinance, 1999 (No.1 of 1999) was promulgated on 7th January 1999. The concept of buy-back was introduced in the Companies Act, 1956 (the Act) by the Companies (Amendment) Act, 1999 by the insertion of Sections 77A, 77AA and 77B.

Consequent upon the promulgation of the Companies (Amendment) Ordinance in 1998, the SEBI issued the Securities and Exchange Board of India (Buy-Back of Securities) Regulations, 1998 which were published in the Official Gazette of India on 14th November 1998. These Regulations are applicable to the buy-back of securities of a company listed on a stock exchange. Buy-back of securities by any other company is governed by the Private Limited Company and Unlisted Public Limited Company (Buy-Back of Securities) Rules, 1999 issued by the Department of Company Affairs, Central Government, which were published in the Official Gazette of India on 6th July, 1999.

Prior to the enactment of the Companies (Amendment) Act, 1999, no company limited by shares and no company limited by guarantee and having a share capital could buy its own securities unless the consequent reduction of capital was effected and sanctioned pursuant to the provisions of Sections 100 to 104 or of Section 402 of the Act.

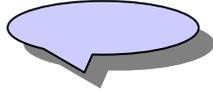
The Company Law Board*, pursuant to the provisions of Section 402 of the Act, may order a company to purchase the shares or any interest of its members in the company on an application made by members under Sections 397 or 398 of the Act to remedy oppression and mismanagement. The reduction of share capital as a consequence of such an order is not affected by nor will it be governed by the provisions of the Act relating to buy-back of securities.

The provisions of the Act relating to buy-back of securities are also not applicable to the extent of the sanction of a High Court to any scheme of compromise or arrangement pursuant to Sections 391 to 394 of the Act.

* The Companies (Second Amendment) Act, 2002 has substituted National Company Law Tribunal for CLB.

II. Objectives of buy-back

Buy-back is a process whereby a company purchases its own shares or other specified securities from the holders thereof for any of the following purposes:



- To improve earnings per share;
- To improve return on capital, return on net worth and to enhance the long-term shareholder value;
- To provide an additional exit route to shareholders when shares are under valued or are thinly traded;
- To enhance consolidation of stake in the company;
- To prevent unwelcome takeover bids;
- To return surplus cash to shareholders;
- To achieve optimum capital structure;
- To support share price during periods of sluggish market conditions;
- To service the equity more efficiently.

The decision to buy-back is also influenced by various other factors relating to the company, such as growth opportunities, capital structure, sourcing of funds, cost of capital and optimum allocation of funds generated.

III. Some important definitions

- *“Buy-back”* means the purchase of its own shares or other specified securities by a company.
- *“Control”* includes the right to appoint a majority of the Board or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or voting agreements or in any other manner.
- *“Date of acceptance of offer”* means the date of completion of verification of offers.
- *“Date of completion of buy-back”* means the date when the last of the payments is made to the securityholders.
- *“Date of offer”* means the date of signing of the letter of offer which should be the date of the Board resolution approving the letter of offer.
- *“Debt”* means secured and unsecured debt but excludes current liabilities.
- *“Escrow Account”* means an account opened by a company with a scheduled commercial bank by way of a security for discharging its

obligation and shall consist either of cash or bank guarantee in favour of a merchant banker or deposit of acceptable securities with appropriate margin with a merchant banker or any combination thereof for the purpose of buy-back of securities.

- “*Free Reserves*” means those reserves which as per the latest audited balance sheet of the company are free for distribution as dividend and shall include balance to the credit of securities premium account but shall not include share application money.
- “*Merchant Banker*” means a merchant banker registered under Section 12 of the Securities and Exchange Board of India Act, 1992.
- “*Paid-up capital*” or “*capital paid-up*” includes capital credited as paid-up.
- “*Securities*” means equity shares, preference shares and any other securities as may be notified by the Central Government from time to time.
- “*Specified Date*” means the date on which the names of the securityholders would be determined for the purpose of despatch of letter of offer to securityholders.
- “*Stock Exchange*” means the stock exchange on which the securities of a company are listed.
- “*Tender Offer*” means an offer by a company, through a letter of offer, to buy-back its securities from the holders of the securities.

Under the Section Buy-Back of Securities in this chapter, Reference herein to Sections, Regulations and Rules relate, respectively, to Sections of the Companies Act, 1956, the Regulations contained in the SEBI (Buy-Back of Securities) Regulations, 1998 and the Rules contained in the Private Limited Company and Unlisted Public Limited company (Buy-Back of Securities) Regulations, 1999, unless otherwise stated.

IV. Authority and quantum of buy-back of securities

1. Authority in the Articles

Buy-back of securities should be authorised by the Articles of Association of the company. [Section 77A(2)(a)]. In case the Articles do not contain such a provision, they should be amended appropriately authorizing the buy-back of securities. Such an amendment should be made either at a meeting preceding the meeting wherein the resolution for buy-back is to be passed or at the same meeting wherein the resolution for buy-back is to be passed but the resolution for amendment of Articles should precede the resolution for buy-back of securities.

2. Board resolution and quantum of buy-back

By passing a resolution, the Board can authorize the buy-back of securities not exceeding 10% of the total paid-up equity capital and free reserves of the company. [Proviso to Section 77A(2)]. The aforesaid limit is to be applied not to the number of securities to be bought back but to the amount required for buy-back of such securities.

The resolution authorizing buy-back should be passed at a meeting of the Board [Section 292(1)(aa)]. Such a resolution should not be passed by circulation or at a meeting of a committee of the Board. However, the methodology, mode of buy-back and other procedural requirements for buy-back may be delegated by the Board.

3. Shareholders' resolution and quantum of buy-back

By passing a special resolution, the shareholders can authorize the buy-back of securities not exceeding 25% of the total paid-up capital and free reserves of the company in that financial year. [Section 77A(2)(b) and (c)].

Paid-up capital includes both equity and preference share capital.

Whereas unlisted companies should obtain shareholders' approval by passing the special resolution only at a duly convened general meeting, listed companies should obtain such approval by postal ballot.

The notice containing the special resolution proposed to be passed should be accompanied by an explanatory statement stating:

- (a) all material facts, fully and completely disclosed;
- (b) the necessity for buy-back;
- (c) the class of security intended to be purchased under the buy-back;
- (d) the amount to be invested under buy-back; and
- (e) the time limit for completion of buy-back [Section 77A(3)].

4. Maximum quantum of buy-back

A company cannot buy-back more than 25% of its total paid-up capital and free reserves. [Section 77A(2)(c)]. The aforesaid limit is to be applied not to the number of securities to be bought back but to the amount required for buy-back of such securities.

Buy-back of equity shares in any financial year should not exceed 25% of the total paid-up equity capital of the company. [Proviso to Section 77A(2)(c)].

A company may buy-back its entire (i.e. 100%) securities other than equity shares, viz. preference shares and any other securities as may be notified by the Central Government from time to time, in a financial year, subject to the overall limit of 25% of the total paid-up capital and free reserves of the company.

5. Further offer of buy-back

Once the buy-back has been made with the authorization of the Board and not that of the shareholders, no further offer for buy-back of any securities can be made without the consent of shareholders accorded by a special resolution within 365 days reckoned from the date of the offer. [Second Proviso to Section 77A(2)].

However, the shareholders can make further offer within a period of 365 days, provided the aggregate of authorisation does not exceed the quantum specified above.

V. Available sources for buy-back of securities

A company may buy-back its securities out of :

- (i) its free reserves; or
- (ii) the securities premium account; or
- (iii) the proceeds of issue of any shares or other specified securities.

However, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. [Section 77A(1)]

1. Free reserves and securities premium account

While the surplus in the profit and loss account can be used for buy-back of securities, in case the profit and loss account shows a debit balance, such debit balance should first be deducted from free reserves.

Capital redemption reserve, revaluation reserve, investment allowance reserve, profit on re-issue of forfeited shares, profits earned prior to incorporation of the company and any other specific reserve are not available for distribution as dividend and hence do not form part of free reserves for the purpose of buy-back.

Even though Section 77A(1) provides that a company may buy-back its securities out of securities premium account, sub-section (2) of Section 78 does not mention buy-back of securities as one of the purposes for which the balance in the securities premium account may be utilised. However, by virtue of the non obstante clause in Section 77A, namely „Notwithstanding anything contained in this Act....’, Section 77A prevails over Section 78. Therefore, the securities premium account can be utilized for buy-back of securities.

2. Proceeds of issue

Buy-back may be made out of the proceeds of an issue of securities other than the same kind of securities as are proposed to be bought back.

The proceeds of an earlier issue of one kind of securities may be used for the purpose of buy-back of any other kind of securities. The proceeds of an issue of preference shares may be used to buy-back equity shares and the proceeds of an issue of equity shares may be used to buy-back preference shares.

However, the proceeds of issue of preference shares carrying differential rights as to dividend, voting etc. cannot be utilized inter se for the purpose of buy-back. For instance, the proceeds of issue of 10% preference shares cannot be utilized for buy-back of 8% preference shares, as these are of the same kind, though of different classes of shares.

There should be no direct nexus between the proceeds of an issue and buy-back of securities of a company. For instance, if equity shares had been issued by a company in 2001 and the funds raised therefrom were deposited in a bank account, buy-back of equity shares by the company in 2011 will be permissible from the funds in that account, if there is evidence to prove that, over the years, the

aforesaid bank account has functioned as common pool for deposit of all the funds raised and no direct nexus can be established between the proceeds of the issue in 2001 and the buy-back in 2011.

3. Borrowings from banks/financial institutions

Where a company has borrowed any money from banks/financial institutions for any purpose, it should not utilize such money for buy-back of securities. [Rule 8(e)]. Further, if any approval is required to be obtained from banks/financial institutions, such approval should be obtained before passing the Board resolution for buy-back of securities.

VI. Conditions to be fulfilled and obligations for buy-back of securities

1. Only fully paid-up securities qualify for buy-back. [Section 77A (2)(e)]

If some securityholders have not made the payment of calls or any sums due on the securities, it would not disentitle the company from buy-back. However, the securities on which the call money remains in arrears cannot be bought back.

Fully paid-up securities, even if quoted below par on the stock exchanges, qualify for buy-back.

If a security has been issued at a discount, the payment of the total amount due thereon should be considered as a sufficient qualification for its buy-back.

After buy-back, the company should have a debt-equity ratio not exceeding 2:1, i.e. all secured and unsecured debts of the company should not be more than twice the aggregate of its capital and free reserves. However, the Central Government has the power to prescribe a higher debt-equity ratio for a class or classes of companies. [Section 77A(2)(d)].

For the purpose of computing debt-equity ratio, „debt’ includes :

- (i) long-term loans/deposits (repayable after 12 months) including interest bearing unsecured loans from government;
- (ii) debentures including convertible debentures (except the part of debentures which are compulsorily convertible into equity), until they are converted, irrespective of the maturity period;
- (iii) deferred payments;
- (iv) redeemable preference shares due for redemption between 1 to 3 years.

„Equity’ includes :

- (i) paid-up equity share capital;
- (ii) redeemable preference shares due for redemption after 3 years;
- (iii) share premium;
- (iv) free reserves less accumulated losses, arrears of unabsorbed depreciation, all items of assets which are of intangible nature or expenditure not written off;

(v) Government subsidies.

A housing finance company should have a post buy-back debt-equity ratio not exceeding the ratio specified by the National Housing Bank in consultation with the Central Government.

Buy-back should be completed within 12 months from the date of passing of the Board resolution or the special resolution or where the resolution is passed through postal ballot, the date of the declaration of result of the postal ballot, as the case may be. [Section 77A(4)].

Where buy-back of shares is made out of free reserves, the company should transfer to the capital redemption reserve account referred to in clause (d) of the proviso to sub-section (1) of Section 80, a sum equal to the nominal value of the shares so bought back and the details of such transfer should be disclosed in the balance sheet. [Section 77AA].

The reference to „free reserves’ in Section 77AA is to the „free reserves’ under Section 77A, which in Clause (b) of its Explanation provides that free reserves include securities premium account. Therefore, when a company purchases its own shares or other specified securities out of securities premium account also, in accordance with Section 77A, a sum equal to the nominal value of the shares so bought back should be transferred to capital redemption reserve account.

In any other case, the company is not required to transfer to the capital redemption reserve account a sum equal to the nominal value of the shares so bought back.

Such transfer to capital redemption reserve account will also not be required when buy-back is of securities other than shares (the Central Government may, from time to time, notify other securities as specified securities and such notified securities may not be shares).

No further issue of the same kind of securities should be made within a period of 6 months from the date of completion of buy-back of securities. [Section 77A(8)]. The date of further issue of securities, for this purpose, means the date of the resolution passed by the Board or shareholders, as the case may be.

Hence, an issue of preference shares may be made by a company within a period of 6 months from the date of completion of buy-back of equity shares and vice versa. However, further issue of the same kind of securities is allowed by way of bonus issue or in discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares. [Section 77A(8)].

An issue of shares in pursuance of a scheme of amalgamation, being by virtue of a court order, is permissible. However, no buy-back of securities should be undertaken while a petition for amalgamation is pending.

No issue of any security including bonus shares should be made till the closure of offer of buy-back. [Regulation 19(1)(b) and Rule 8(1)(b)].

A company should not make any announcement in respect of buy-back of

securities from the date of approval by the Board of any scheme of compromise or arrangement pursuant to the provisions of the Act, upto the date of filing of the court order with the Registrar. [Regulation 19(2)].

No offer of buy-back of securities should be made if such offer would result in reducing the non-promoter holding below the limit of public shareholding specified under the SEBI (ICDR) Regulations, 2009 as applicable at the time of initial listing.

Convertible debentures can be bought back before the date of their conversion but such a purchase would amount to the company purchasing its own shares and all the provisions relating to buy-back shall become applicable.

Promoters or persons acting in concert should not deal in the securities of the company while the buy-back offer is open. [Regulation 19(1)(e)].

VII. Pricing for buy-back

The Board should either determine or recommend to the shareholders a fair price for buy-back based on all relevant parameters such as:

- (a) Earnings per share;
- (b) Prices of securities quoted on the stock exchange;
- (c) Past performance;
- (d) Book value per share;
- (e) Previous buy-back undertaken, if any;
- (f) Net worth of the company;
- (g) Post buy-back scenario;
- (h) Industry outlook.

VIII. Securities not available for buy-back

1. Securities in lock-in period

In the case of a listed company, securities issued to the promoters, to a group, or to employees, subject to lock-in period as per SEBI (ICDR) Regulations, 2009 are not available for buy-back until the lock-in period expires. [Regulation 19(5)].

2. Non-transferable securities

Securities which are under lien or are pledged or restricted by any court for transfer or which otherwise statutorily cannot be transferred are not available for buy-back until such securities again become freely transferable. [Regulation 19(5)].

3. Disputed securities kept in abeyance

Securities which are under dispute and have been kept in abeyance under Section 206A, or in respect of which transfer or transmission has not been effected, are not available for buy-back.

Before undertaking any buy-back, the company should ensure that no transfer deed is pending for registration.

IX. Modes of buy-back

Buy-back of securities may be made :

- (a) from the existing securityholders on a proportionate basis; or
- (b) from the open market; or
- (c) from odd lots, that is to say, where the lot of securities of a public company whose shares are listed on a recognized stock exchange is smaller than such marketable lot as may be specified by the stock exchange; or
- (d) by purchasing securities which had been issued to employees of the company pursuant to a scheme of stock option or sweat equity. [Section 77A(5)].

A company can implement buy-back by any of the aforesaid methods but, for a single offer of buy-back, different modes of buy-back cannot be adopted.

It is desirable that the overall amount to be deployed for buy-back of securities and the details of estimated cost involved in the process of buy-back of securities are disclosed in the letter of offer.

In terms of the Regulations, a listed company may buy-back its securities by any one of the following methods :

- (a) from existing securityholders on a proportionate basis through tender offer;
- (b) from the open market through :
 - (i) book-building process;
 - (ii) stock exchange(s);
- (c) from odd-lot holders [Regulation 4(1)].

Negotiated deals

A listed company should not buy-back its securities from any person through negotiated deals whether on or off the stock exchange or through spot transactions or through any private arrangement. [Regulation 4(2)].

The expression „negotiated deals’ refers to those deals where the shares are acquired through private and mutual negotiations. Such deals are only with a seller or group of sellers and the same offer is not available to other shareholders. As negotiated deals tend to lead to preferential treatment by the company, such deals are not permitted.

In terms of the Rules, private companies and unlisted public companies may buy-back their securities by either of the following methods:

- (a) from the existing shareholders on a proportionate basis through private offers;
- (b) by purchasing securities which had been issued to employees of the company pursuant to a scheme of stock option or sweat equity. [Rule 3].

X. Restrictions on buy-back of securities in certain circumstances

A company should not buy-back its securities if default subsists in repayment of deposits or interest payable thereon, or in redemption of debentures or preference shares or repayment of any term loan or interest payable thereon to any financial institution or bank. [Section 77B(1)(c)].

Deposits for this purpose include deposits under Section 58A read with Rule 2(b) of the Companies (Acceptance of Deposits) Rules, 1975.

Buy-back should not be made if a company has defaulted in relation to preparation and filing of its annual return. [Section 77B(2)].

However, such a company may buy-back its securities after the default has been rectified.

Buy-back should not be made in the event of any default in relation to payment of dividend to any equity or preference shareholder. [Section 77B(2)].

Where a dividend has been declared by a company but has not been paid in accordance with the provisions of the Act, the company may buy-back its securities only after payment of dividend and interest thereon as per the provisions of the Act.

Buy-back should not be made in the event of default in preparation of the annual accounts. [Section 77B(2)].

Where the report of the statutory auditors of the company contains a qualification that annual accounts are not prepared as per the accounting standards or otherwise are not in accordance with the provisions of Section 211, the company cannot proceed to buy-back its securities.

However, compounding of the aforementioned defaults or subsequent curing of the default may qualify as an enabling provision for buy-back.

Buy-back should not be made by a company :

- (i) through any subsidiary company including its own subsidiary companies;
- (ii) through any investment company or group of investment companies. [Section 77B(1)(a) and (b)].

XI. Declaration of solvency

Where the Board or the shareholders of a listed company pass a resolution to buy-back shares, the company should, before making such buy-back, file with the Registrar and SEBI a declaration of solvency in the prescribed form.

A private company and a public company whose shares are not listed on a stock exchange should file the declaration of solvency with the Registrar in the prescribed form.

The declaration of solvency should be verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company as a result of which it has formed an opinion that the company is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of

adoption of the declaration by the Board. The declaration of solvency should be signed by at least two directors of the company, one of whom shall be the managing director, if any. [Section 77A(6)].

XII. Extinguishment of security certificates

Where a company buys back its own securities it should extinguish and physically destroy the security certificates within 7 days of the date of completion of buy-back. [Section 77A(7)].

XIII. Return of buy-back

After the completion of buy back, a listed company should file with the Registrar and SEBI a return containing the prescribed particulars relating to the buy-back within 30 days of such completion. However, a private company and a public company whose shares are not listed on a stock exchange should file the return of buy-back only with the Registrar. [Section 77A(10)].

XIV. Rescinding of buy-back

The passing of the resolution by a company does not create any obligation on the company to buy-back its securities.

The Regulations provide that a company should not withdraw the offer to buy-back its securities after the draft letter of offer is filed with SEBI or a public announcement of the offer to buy-back is made. [Regulation 19(1)(d)].

The Rules provide that the company should not withdraw the offer once the draft letter of offer is filed with the Registrar [Rule 8(1)(d)].

A company cannot rescind the offer of buy-back of securities on the ground that the option of buy-back has been exercised only by a few shareholders of the company.

Where the buy-back fails on account of the minimum number of securities not being tendered, notice of such failure should be given immediately to the Stock Exchange(s) on which the securities are listed.

XV. Stamp duty on buy-back

Transfer of shares attracts stamp duty vide Schedule I, entry 62 to the Indian Stamp Act, 1899. For completion of transfer of shares, a company is required to register the shares in the name of the transferee. In the case of buy-back, the shares bought back have to be statutorily extinguished within 7 days from the last date of completion of buy-back. Hence, no registration of such shares takes place in the name of the company. The names of the members/ holders of the shares have to be struck off from the register of members if the entire holding is bought back. Therefore, buy-back cannot be construed as transfer and stamp duty would not be payable in a case where buy-back of shares takes place in physical form even if the shares are accompanied by an application form for transfer of shares in favour of the company. Further, buy-back of shares will not be construed as "release" falling under Article 55 of the Indian Stamp Act attracting stamp duty.

Shares received by the company for buy-back in electronic mode do not attract stamp duty in terms of the provisions contained in the Depositories Act, 1996.

XVI. Buy back of shares from non-resident (NR) shareholders-the foreign exchange management act, 1999 (FEMA) aspects

1. Permission to be obtained from Reserve Bank of India (RBI)

A company proposing to buy-back securities is required to obtain specific permission from RBI on a case to case basis for acquisition of securities from non-resident holders under FEMA. However, the company may seek in-principle approval from RBI.

Documents required for obtaining RBI permission

- (i) A copy of the offer document;
- (ii) Application in Form TS1 with requisite covering letter;
- (iii) Copies of offer form duly accepted by NR holder, RBI approval, letter from authorised dealer, consent letter etc.
- (iv) Copy of general permission/special permission obtained by the company while issuing shares to the NR holders;
- (v) Letter from Registrar and Share Transfer Agents to RBI with a statement containing name, address, number of shares held/accepted, RBI approval Number and Date and confirming that the said cases have the requisite permission for repatriation of sale proceeds.

2. Special terms applicable to GDR/ADR holders

GDR/ADR holders who wish to tender their shares underlying the receipts should cancel the same and withdraw the underlying equity shares. They should request the depository to instruct the Custodian to deliver the equity share certificates accompanied by an instrument executed in blank in respect of such share certificates to the registrar to the offer.

3. Documents required to be submitted by NR holders

- (i) A copy of permission received from RBI to acquire the shares that are held by them;
- (ii) A letter from authorised dealer/bank, in the case of permission with repatriation benefits, confirming that at the time of acquiring the said shares, payment was made from the appropriate account (e.g. NRE A/c) as specified by RBI in its approval.

If such a letter is not submitted, the shares would be deemed to have been acquired without repatriation benefits. In that case, the NR holder should submit a consent letter addressed to the company allowing payment on a non-repatriation basis.

- (iii) A no objection certificate or tax clearance certificate (indicating the amount of tax to be deducted by the acquirer before remitting the consideration) obtained from the Income Tax authorities.

If any of the aforesaid documents are not enclosed along with the offer form, the shares tendered are liable to be rejected. The aforesaid requirements do not apply to Foreign Institutional Investors (FIIs).

4. Conditions attached to RBI permission

RBI permission for acquisition normally contains the following conditions:

- (i) all expenses connected/incidental to sale/transfer of shares including stamp duty shall be borne by transferor/transferee as performance agreement between them or as per relevant stock exchange rules;
- (ii) the approval shall be valid for 6 months from the date of receipt and all transfer formalities should be completed before the time limit;
- (iii) the sale proceeds payable to FIIs shall be credited to their NR Special Rupee Account and shall be reported to RBI in Form LEC (FII); and
- (iv) the sale consideration shall be subject to payment of applicable taxes.

5. Formalities for remittance of money for shares acquired

The following aspects should be taken into consideration for remitting consideration to the Non-resident holders:

- (i) acquisition consideration payable;
- (ii) tax to be deducted for capital gains;
- (iii) interest for delayed payment to be paid;
- (iv) tax to be deducted on interest payable.

XVII. Maintenance of records and registers

Where a company buys back its securities, it should maintain a register containing information of the securities so bought back, the consideration paid for the securities bought back, the date of cancellation of securities, the date of extinguishing and physically destroying the securities and such other particulars as may be prescribed. [Section 77A(9)].

The company should also maintain a record of names, folio numbers, type of securities, number of securities, date of issue/transfer of securities.

Such particulars should be entered in the register of buy-back of securities within 7 days of the date of completion of buy-back of securities. Completion, in this context, refers to the date when securities are cancelled or destroyed.

The provisions of Section 163 shall not apply to this register and therefore it need not be kept at the registered office nor made available for inspection.

The particulars regarding members and the certificates cancelled or destroyed should be entered in the register of members and register of share certificates.

The company should keep all the documents relating to buy-back of securities for a minimum period of 8 years.

XVIII. Disclosure in board's report

Where a company fails to complete the buy-back of securities within 12 months from the date of passing of the resolution by the Board or the shareholders, as the case may be, authorizing the buy-back of securities, the Board's report should specify the reasons for such failure. Disclosure should also be made in the Board's report, in case buy-back has not been completed but is in process. [Section 217(2B)]. It is desirable that completion of buy-back of securities is also disclosed in the Board's report.

XIX. Shareholding or voting rights

As a consequence of buy-back of securities by a company, a person may not be aware that his shareholding or voting rights have increased. Therefore, it is desirable that immediately after completion of buy-back, a communication is sent by the company to the shareholders whose shareholding and/or voting rights have increased consequent to the change in capital structure due to buy-back of securities, to enable such shareholders to make an official communication/ announcement.

XX. Procedure for buy-back of securities by a listed company**1. Amendment of Articles of Association**

Where Articles do not contain a provision authorizing buy-back, they should be first amended.

2. Filing of Board resolution

A copy of the Board resolution authorizing buy-back should be filed by the company with SEBI and the stock exchange(s) where the shares or other specified securities of the company are listed, within 2 days of the date of passing of the resolution. [Regulation 5A(2)].

3. Approval of shareholders by postal ballot

The company should seek the approval of shareholders for buy-back only by postal ballot.

The company should file a certified true copy of the special resolution authorizing the buy-back with the Registrar, the stock exchange(s) where the shares or other specified securities of the company are listed and SEBI within 7 days of passing of such resolution. [Regulation 5(2)].

4. Explanatory statement

An explanatory statement containing full and complete disclosure of all the material facts and the disclosures prescribed in Schedule I of the Regulations should be annexed to the notice where the buy-back is pursuant to shareholders' approval.

The explanatory statement should include the following [Regulation 5(1)]:

- (i) the date of the Board meeting at which the proposal for buy-back was approved by the Board;

- (ii) the necessity for the buy-back;
- (iii) an indication that the shareholders at the general meeting may authorise the Board to adopt at the appropriate time one of the methods referred to in sub-regulation (1) of Regulation 4;
- (iv) the maximum amount required under the buy-back and the sources of funds from which the buy-back would be financed;
- (v) the basis of arriving at the buy-back price;
- (vi) the number of securities that the company proposes to buy-back;
- (vii) (a) the aggregate shareholding of the promoter and of the directors of the promoter company, where the promoter is a company, and of persons who are in control of the company as on the date of the notice convening the general meeting or the meeting of the Board;
- (b) the aggregate number of equity shares purchased or sold by persons including persons mentioned in (a) above during a period of 6 months preceding the date of the Board meeting at which the buy-back was approved till the date of notice convening the general meeting;
- (c) the maximum and minimum price at which purchases and sales referred to in (b) above were made along with the relevant dates;
- (viii) intention of the promoters and persons in control of the company to tender their specified securities for buy-back indicating the number of specified securities, details of acquisition, with dates and price;

If the promoters and persons in control of the company do not intend to tender their securities for buy-back, it is desirable that the reasons thereof are given in the explanatory statement.
- (ix) a confirmation that there are no defaults subsisting in repayment of deposits, redemption of debentures or preference shares or repayment of term loans to any financial institution or bank;
- (x) a confirmation that the Board has made a full enquiry into the affairs and prospects of the company and that it has formed the opinion :
 - (a) that immediately following the date on which the general meeting or the meeting of the Board is convened there will be no grounds on which the company could be found unable to pay its debts;
 - (b) as regards its prospects for the year immediately following that date that, having regard to the intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in the view of the Board be available to the company during that year, the company will be able to meet its liabilities as and when they fall due and will not be rendered insolvent within a period of one year from that date; and
 - (c) in forming their opinion for the above purposes, the directors have taken into account the liabilities as if the company were being wound up under the provisions of the Act (including prospective and contingent liabilities).

- (xi) a report addressed to the Board by the company's auditors stating that :
 - (i) they have inquired into the company's state of affairs;
 - (ii) the amount of the permissible capital payment for the securities in question is in their view properly determined; and
 - (iii) the Board has formed the opinion as specified in clause (x) on reasonable grounds that the company will not, having regard to its state of affairs, be rendered insolvent within a period of one year from that date.

5. Nomination of compliance officer

The company should nominate a compliance officer for ensuring compliance of the provisions of the Act, the Regulations, listing agreement and any other applicable laws relating to buy-back of securities and to redress the grievances of the investors. [Regulation 19(3)].

For this purpose, a Board resolution should be passed and Form 1AA and Form 1AB of the Companies (Central Government's) General Rules and Forms, 1956 should be filed with the Registrar by the person designated as compliance officer.

The name, telephone no., fax no. and e-mail ID of the compliance officer should be given in the public announcement and letter of offer.

6. Investor service centre

The company should have at least one investor service center. It is desirable that such centers are opened in all such cities where the securityholders holding 10% or more of voting rights reside. [Regulation 19(3)].

7. Appointment of merchant banker

The company should appoint a merchant banker registered with SEBI, for buy-back of securities through any of the modes specified. Such appointment should be made before the public announcement for buy-back of securities.

The merchant banker should ensure that the company is able to implement the offer, escrow account has been opened, firm arrangements for payment to fulfill the obligations have been made, public announcement is made in accordance with the terms of the Regulations, the contents of public announcement are true, fair and correct and the letter of offer is duly filed [Regulation 20(a) to (e)]. He should also ensure compliance of Sections 77A and 77B and any other clause or rules as may be applicable in this regard [Regulation 20(h)]. He should submit a due diligence certificate to SEBI which should accompany the draft letter of offer. [Regulation 20(f)].

The merchant banker, upon ensuring fulfillment of all obligations by the company, is required to inform the bank with whom the escrow account or special account has been opened and funds have been deposited, to release the balance amount to the company. [Regulation 20(i)].

The merchant banker should submit a final report to SEBI in the specified form within 15 days from the date of closure of the buy-back offer. [Regulation 20(j)].

SEBI may take action against the merchant banker for non-compliance of any of his obligations. [Regulation 21].

XXI. Buy-back through tender offer

A listed company may buy-back its securities from existing securityholders on a proportionate basis through the tender offer. [Regulation 6].

The tender offer should be made in accordance with the provisions of the Regulations and should be at a price fixed through the resolution of the Board or of the shareholders, as the case may be. It is desirable that pricing for buy-back is done after considering all relevant parameters, market trends, and perception of future performance and post buy-back scenario.

In the case of buy-back through tender offer, the following additional disclosures are required to be made in the explanatory statement:

- (i) the maximum price at which the buy-back of securities shall be made;
- (ii) whether the Board is being authorised at the general meeting to determine subsequently the specific price at which the buy-back may be made at the appropriate time;
- (iii) in case the promoters intend to offer their securities:
 - (a) the quantum of securities proposed to be tendered by promoters; and
 - (b) the details of their transactions and their holdings for the last 6 months prior to the passing of the special resolution for buy-back including information on number of securities acquired, the price and the date of acquisition. [Regulation 7]

Promoters are permitted to offer their securities for buy-back provided adequate disclosure is made in the offer document.

Public Notice

A company authorised to buy-back its securities by way of a Board resolution should, before making the public announcement for buy-back, give a public notice in at least one English National daily, one Hindi National daily and a regional language daily, having wide circulation at the place where the registered office of the company is situated. [Regulation 5A(1)(a)]. It is desirable that the selected newspapers also have a wide circulation within such States of India where more than 1,000 or 10% of the total members reside.

The public notice should be given within 2 days of passing of the resolution by the Board. [Regulation 5A(1)(b)]. This is required to be given since, where buy-back is with the authorization of the Board, no explanatory statement is required to be given unlike in case where the buy-back is made with the authorization of shareholders. Such public notice should contain the particulars specified in Schedule I to the Regulations [Regulation 5A(1)(c)] as given below (which are the

same as are given in the explanatory statement to the special resolution) :

- (i) the date of the Board meeting at which the proposal for buy-back was approved by the Board;
- (ii) the necessity for the buy-back;
- (iii) an indication that the shareholders at the general meeting may authorise the Board of the company to adopt one of the methods referred to in sub-regulation (1) of Regulation 4 at the appropriate time;
- (iv) the maximum amount required under the buy-back and the sources of funds from which the buy-back would be financed;
- (v) the basis of arriving at the buy-back price;
- (vi) the number of securities that the company proposes to buy-back;
- (vii) (a) the aggregate shareholding of the promoter and of the directors of the promoter company, where the promoter is a company, and of persons who are in control of the company as on the date of the notice convening the general meeting or the meeting of the Board;
- (b) aggregate number of equity shares purchased or sold by persons including persons mentioned in (a) above during a period of 6 months preceding the date of the Board meeting at which the buy-back was approved till the date of notice convening the general meeting;
- (c) the maximum and minimum price at which purchases and sales referred to in (b) above were made along with the relevant dates;
- (viii) intention of the promoters and persons in control of the company to tender specified securities for buy-back indicating the number of specified securities, details of acquisition, with dates and price;
- (ix) a confirmation that there are no defaults subsisting in repayment of deposits, redemption of debentures or preference shares or repayment of term loans to any financial institution or bank;
- (x) a confirmation that the Board has made a full enquiry into the affairs and prospects of the company and that it has formed the opinion :
 - (a) that immediately following the date on which the general meeting or the meeting of the Board is convened there will be no grounds on which the company could be found unable to pay its debts;
 - (b) as regards its prospects for the year immediately following that date that, having regard to the intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in the view of the Board be available to the company during that year, the company will be able to meet its liabilities as and when they fall due and will not be rendered insolvent within a period of one year from that date; and
 - (c) in forming their opinion for the above purposes, the directors have taken into account the liabilities as if the company were being wound up under the provisions of the Act (including prospective and contingent liabilities);

- (xi) a report addressed to the Board by the company's auditors stating that :
 - (i) they have inquired into the company's state of affairs;
 - (ii) the amount of the permissible capital payment for the securities in question is in their view properly determined; and
 - (iii) the Board has formed the opinion as specified in clause (x) on reasonable grounds and that the company will not, having regard to its state of affairs, be rendered insolvent within a period of one year from that date.

If the promoters and persons in control of the company do not intend to tender their securities for buy-back, it is desirable that the reasons thereof are given in the public notice.

Public Announcement

A listed company, after being authorised to buy-back its securities, but before buy-back, should make a public announcement in this regard at least in one English national daily, one Hindi national daily and a regional language daily, having a wide circulation at a place where the registered office of the company is situated. [Regulation 8(1)]. It is desirable that the selected newspapers also have a wide circulation within such States of India where more than 1,000 or 10% of the total members reside.

The public announcement should contain all the material information specified in Schedule II of the Regulations and should be made by the company on the authorization of its Board or shareholders, as the case may be. [Regulation 8(1)]

Though, as per the Regulations, the requirement of at least 7 days prior public announcement is applicable when buy-back is made through stock exchange or book building, it is desirable that in case of tender offer also, public announcement is made 7 days prior to commencement of buy-back of securities.

In terms of Schedule II of the Regulations, the public announcement should include the following :

1. details of the offer including the total number and percentage of the total paid-up capital and free reserves proposed to be bought back and price of offer;
2. the proposed time table from opening of the offer till the extinguishment of the certificates;
3. the specified date;
4. authority for the offer of buy-back;
5. a full and complete disclosure of all material facts including the contents of the explanatory statement annexed to the notice for the general meeting at which the special resolution approving the buy-back was passed or the contents of public notice issued after the passing of the resolution by the Board authorising the buy-back;
6. the necessity for the buy-back;

7. the process and methodology to be adopted for the buy-back;
8. the maximum amount to be invested under the buy-back;
9. the minimum and the maximum number of securities that the company proposes to buy-back, sources of funds from which the buy-back would be made and the cost of financing the buy-back;
10. brief information about the company;
11. audited financial information for the last 3 years. The lead manager shall ensure that the particulars (audited statement and un-audited statement) contained therein shall not be more than 6 months old from the date of the public announcement together with financial ratios as may be specified by SEBI;
12. details of escrow account opened and the amount deposited therein;
13. listing details and stock market data :
 - (a) high, low and average market prices of the securities of the company proposed to be bought-back, during the preceding 3 years;
 - (b) monthly high and low prices for the 6 months preceding the date of the public announcement;
 - (c) the number of securities traded on the days when the high and low prices were recorded on the relevant stock exchanges during the periods stated at (a) and (b) above;
 - (d) the stock market data referred to above shall be shown separately for periods marked by a change in capital structure, with such period commencing from the date the concerned stock exchange recognises the change in the capital structure (e.g. when the securities have become ex-rights or ex-bonus);
 - (e) the market price immediately after the date of the resolution of the Board approving the buy-back; and
 - (f) the volume of securities traded in each month during the 6 months preceding the date of the public announcement. Along with high, low and average prices of securities of the company, details relating to volume of business transacted should also be stated for the respective periods.
14. present capital structure (including the number of fully paid and partly paid securities) and shareholding pattern;
15. the capital structure including details of outstanding convertible instruments, if any, post buy-back;
16. the aggregate shareholding of the promoter group and of the directors of the promoter company, where the promoter is a company and of persons who are in control of the company;
17. the aggregate number of shares or other specified securities purchased or sold by persons mentioned in clause (16) above during a period of 12 months preceding the date of the public announcement; the maximum and

minimum price at which purchases and sales referred to above were made along with the relevant dates;

18. management discussion and analysis on the likely impact of buy-back on the company's earnings, public holdings, holdings of NRIs/FIIs etc., promoters holdings and any change in management structure;
19. the details of statutory approvals obtained;
20. collection and bidding centers;
21. name of the compliance officer and details of investor service centers;
22. such other disclosures as may be specified by SEBI from time to time by way of guidelines.

The public announcement should be dated and signed on behalf of the Board of Directors of the company by its manager or secretary, if any, and by not less than two directors of the company, one of whom shall be a managing director where there is one.

Specified Date

In case of tender offer route, the Board should determine a particular date as the specified date and mention the same in the public announcement for the purpose of despatch of letter of offer to the securityholders. [Regulation 8(2)]. Such specified date should not be later than 30 days from the date of the public announcement. [Regulation 8(3)]. For instance, if the public announcement is made on 30th September 2010, the specified date can be any date between 31st October 2010 and 11th November 2010.

The shareholders whose names appear in the Register of Members on the specified date should be given tender offer by the company. However, unregistered shareholders may be allowed to tender their shares on receipt of an application from them signed by all the shareholders, stating folio number, address, number of shares held, share certificate number, number of shares tendered for buy-back, bank account details and accompanied by original share certificates, duly executed transfer deeds and other relevant documents as may be required by the company.

Letter of Offer

A draft letter of offer, alongwith the fees prescribed in Schedule IV of the Regulations, should be filed with SEBI, within 7 working days of the public announcement, through a merchant banker not associated with the company. The date of the public announcement is to be excluded while calculating the 7 working days. The draft letter of offer should include the following particulars mentioned in Schedule III of the Regulations [Regulation 8(4) and 8(5)]:

1. disclaimer clause as may be prescribed by SEBI;
2. details of the offer including the total number of shares and percentage of the total paid-up capital and free reserves proposed to be bought back and price;
3. the proposed time table from opening of the offer till the extinguishment of the certificates.

4. the specified date;
5. authority for the offer of buy-back;
6. a full and complete disclosure of all material facts including the contents of the explanatory statement annexed to the notice for the general meeting at which the special resolution approving the buy-back was passed or the contents of the public notice issued after the passing of the resolution by the Board authorising the buy-back;
7. the necessity for the buy-back;
8. the process to be adopted for the buy-back;
9. the maximum amount to be invested under the buy-back;
10. the minimum and the maximum number of securities that the company proposes to buy-back, sources of funds from which the buy-back would be made and the cost of financing the buy-back;
11. brief information about the company;
12. audited financial information for the last 3 years. The lead manager should ensure that the particulars (audited statement and un-audited statement) contained therein shall not be more than 6 months old from the date of the offer document, together with financial ratios as may be specified by SEBI;
13. details of escrow account opened and the amount deposited therein;
14. listing details and stock market data :
 - (a) high, low and average market prices of the securities of the company proposed to be bought-back, during the preceding 3 years;
 - (b) monthly high and low prices for the 6 months preceding the date of filing the draft letter of offer with SEBI, which shall be updated till the date of the letter of offer;
 - (c) the number of securities traded on the days when the high and low prices were recorded on the relevant stock exchanges during the periods stated at (a) and (b) above;
 - (d) the stock market data referred to above shall be shown separately for periods marked by a change in capital structure, with such period commencing from the date the concerned stock exchange recognises the change in the capital structure (e.g. when the securities have become ex-rights or ex-bonus);
 - (e) the market price immediately after the date of the resolution of the Board approving the buy-back; and
 - (f) the volume of securities traded in each month during the 6 months preceding the date of the offer document. Along with high, low and average prices of securities of the company, details relating to volume of business transacted should also be stated for the respective periods;
15. present capital structure (including the number of fully paid and partly paid securities) and shareholding pattern;

16. the capital structure including details of outstanding convertible instruments, if any, post buy-back;
17. the aggregate shareholding of the promoter group and of the directors of the promoter company, where the promoter is a company and of persons who are in control of the company;
18. the aggregate number of equity shares purchased or sold by persons mentioned in clause (17) above during a period of 12 months preceding the date of the public announcement and from the date of public announcement to the date of the letter of offer; the maximum and minimum price at which purchases and sales referred to above were made along with the relevant dates;
19. management discussion and analysis on the likely impact of buy-back on the company's earnings, public holdings, holdings of NRIs/FIIs etc., promoters holdings and any change in management structure;
20. the details of statutory approvals obtained;
21. collection and bidding centers;
22. name of compliance officer and details of investor service centers;
23.
 - (i) a declaration to be signed by at least two whole-time directors or by any two directors authorized by the Board that there are no defaults subsisting in repayment of deposits, redemption of debentures or preference shares or repayment of term loans to any financial institutions or banks;
 - (ii) a declaration to be signed by at least two whole-time directors, one of whom shall be the managing director, or by any two directors authorized by the Board stating that the Board has made a full enquiry into the affairs and prospects of the company and has formed the opinion:
 - (a) as regards the company's prospects for the year immediately following the date of the letter of offer that, having regard to the intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in the view of the Board be available to the company during that year, the company will be able to meet its liabilities and will not be rendered insolvent within a period of one year from that date;
 - (b) in forming their opinion for the above purposes, the directors shall take into account the liabilities as if the company were being wound up under the provisions of the Act (including prospective and contingent liabilities);
24. the declaration must in addition have annexed to it a report addressed to the directors by the company's auditors stating that:
 - (i) they have inquired into the company's state of affairs; and
 - (ii) the amount of permissible capital payment for the securities in question is in their view properly determined; and

- (iii) they are not aware of anything to indicate that the opinion expressed by the directors in the declaration as to any of the matters mentioned in the declaration is unreasonable in all the circumstances;
25. such other disclosures as may be specified by SEBI from time to time by way of guidelines.

The offer document should be dated and signed on behalf of the Board of Directors of the company by its manager or secretary, if any, and by not less than two directors of the company, one of whom shall be a managing director where there is one.

The company cannot withdraw the offer to buy-back securities after the draft letter of offer is filed with SEBI or the public announcement of the offer is made. [Regulation 19(1)(d)].

The company should ensure that the public announcement of the offer or any other advertisement, circular, brochure, or publicity material contains true, factual and material information and that it does not contain any misleading information. Any such announcement or disclosure must state that the directors of the company accept the responsibility for the information contained in such documents. [Regulation 19(1)(a)].

It is desirable that the letter of offer is also placed on the website of the company.

Declaration of Solvency

The company should file, along with the draft letter of offer, a declaration of solvency in Form 4A of the Companies (Central Government's) General Rules and Forms, 1956 with the Registrar and SEBI, within 7 working days of public announcement, in the manner prescribed in Section 77A(6). [Regulation 8(7)].

Opening and closing of offer

A company opting for buy-back of securities through tender offer should despatch the letter of offer to the securityholders only after 21 days from submission of the draft letter of offer to SEBI and it should reach the securityholders before the offer opens. For the purpose, the company should ensure that all the letters of offer are despatched at least 48 hours before the offer opens. If the letter of offer is despatched through post, such service shall be deemed to be effected at the expiration of 48 hours after posting.

If SEBI specifies any modification in the draft letter of offer within 21 days from the date of submission, the merchant banker and the company should carry out such modification before the letter of offer is despatched to the securityholders [Regulation 8(6)]. Further, if any clarification or document related thereto has to be furnished to SEBI, the period of 21 days shall be counted from the date of such submission to SEBI.

Non-receipt of letter of offer by, or accidental omission to despatch the letter of offer to any person who is otherwise eligible to receive the offer, shall not invalidate the offer of buy-back.

The offer should remain open for a period of not less than 15 days and not more than 30 days from the date of despatch of the letter of offer to the securityholders. [Regulation 9(1)].

The date of opening of the offer should not be earlier than 7 days nor later than 30 days from the specified date [Regulation 9(2)]. Specified date shall not be later than 30 days from the date of public announcement.

Submission of tender offer

A shareholder should submit separate tender/offer forms for each of his folios or each of the depository accounts.

In case of companies submitting tender offer forms, the necessary certified corporate authorizations (i.e. Board/general meeting resolutions) should be sent alongwith the letter of offer.

In case shares are held in physical form, it is desirable that the shareholder sends an application either in the form prescribed by the company or if no such format is prescribed, on a plain paper furnishing the details of name, address, folio number, number of shares held, certificate number, number of shares tendered for buy-back and distinctive numbers thereof, bank account particulars for payment of consideration, original share certificates, etc. The application should reach the collection centers before the close of business hours on the date of closure of buy-back. In case of unregistered shareholders, the application and other documents should also be accompanied by valid share transfer form(s), original equity share certificate(s) and the original broker contract note of a registered broker of a recognised stock exchange. If shares are held by jointholders, the transfer form should be signed by all shareholders.

In case the shares are in dematerialized form, it is desirable that the shareholder sends an application in the prescribed form or if no such format is prescribed or letter of offer is not received, on a plain paper. The application should contain details of name, address, DP Name/ID, beneficiary account number, number of shares tendered for buy-back, bank account particulars for the payment of consideration and enclosing therewith a photocopy of the delivery instruction in „off-market’ mode, duly acknowledged by the Depository participant in favour of depository account. The application should reach the collection centre before the close of business hours on the date of closure of buy-back.

In case one or more of the joint holders is deceased, the form must be signed by all the surviving holder/s and submitted along with the certified or attested true copy of the death certificate/s, with necessary direction for deleting the name of the deceased shareholder(s) from the register of members. If the sole holder is deceased, the form must be signed by the legal representative/s of the deceased and submitted along with the certified or attested true copy of probate/letter of administration/succession certificate while tendering the equity shares for buy-back.

Where a joint holder is deceased, the shares tendered will be consolidated with the shares, if any, held and tendered by the surviving shareholder/s for the purpose of reckoning the aggregate number of shares to be bought back from the surviving shareholder/s.

Duly attested power of attorney should also be attached if any person other than the shareholder has signed the relevant form. In case the form is signed under power of attorney or by authorised signatory/ies on behalf of a company, the power of attorney must be registered with the company. The registration serial number of such document should be mentioned below the relevant signatures. Where the relevant document is not so registered, a copy thereof, duly certified by a notary/gazetted officer, should be enclosed with the form.

Non-resident shareholders should also enclose a copy of the permission received from RBI for acquiring the shares held by them and the no objection certificate/tax clearance certificate from the Income Tax authorities, indicating the amount of tax to be deducted by the company before remitting the consideration. In case the aforesaid no objection certificate/tax clearance certificate is not submitted, the company should arrange to deduct tax at the maximum marginal rate as may be applicable to the category of the shareholder on the entire consideration amount payable to such shareholder/s.

Verification of offers

The company should complete the verification of the offers received within 15 days of the closure of the offer.

The offer may be rejected on account of any lacunae and/or defect, incomplete information, late receipt or modifications in the letter of offer or other documents submitted.

Where no communication of rejection of offer is made by the company within 15 days of closure of the offer, the securities lodged for the purpose of buy-back shall be deemed to be accepted. [Regulation 9(5)].

Acceptance of securities on proportionate basis

Where the number of securities offered by the holders is more than the total number of securities to be bought back by the company, the acceptance should be on a proportionate basis, related to the number of shares offered per securityholder. [Regulation 9(4)].

Acceptances tendered by the securityholders should be divided by total acceptances received and multiplied by the total number of securities to be bought back i.e.

$$\begin{array}{l} \text{Proportional acceptance} \\ \text{per shareholder} \end{array} = \frac{\text{Number of shares to be bought back X}}{\text{Number of shares offered / acceptances received}}$$

Acceptance of securities in full

Where the number of securities offered is less than or equal to the total number of securities to be bought back by the company, the offer of each securityholder should be accepted in full.

Opening of Special Depository Account

For shares tendered in dematerialised mode, a "Special Depository Account"

should be opened through the Registrars to the offer. The following are the salient features of the account :

1. The account should be opened by the Registrars to the offer jointly with the company by executing the requisite agreements with a Depository Participant of NSDL/CDSL.
2. The Registrars should have powers to receive shares into the account.
3. The special depository account should be open only during the period of offer and should be kept only in "Receipt Mode", i.e. with powers only to receive shares.
4. The Registrars should verify the electronic receipt of shares into the account with the confirmation received by post in the form of offer-cum-acknowledgement form received and verify the contents as in the form and as received in the special depository account.
5. The transfer of shares from the special depository account into the company's account and/or reference-transfer of unaccepted/rejected shares to the investors should be executed jointly by the Registrars and the company upon confirmation by the managers to the offer that all formalities including remittance of consideration for the shares acquired have been completed.
6. The account should be closed upon completion of all formalities and upon transfer of all shares held in the account of the company/investors as the case may be.
7. The company should reimburse/pay all expenses related to the opening, operating and closing of the account to the Registrars.
8. The company should also pay the depository participant the applicable fee charged by the depository (on performance transaction basis) for the transfer of shares from special depository account to the company and the investors.
9. Shares tendered by Non-resident holders should be transferred into the company's account only upon receipt by the Registrars of RBI's permission for acquisition of shares. However, return of unaccepted/rejected shares should be effected immediately upon closure of the offer period/upon receipt of authorization by the company.

The Registrars to the issue should carry out the following functions in respect of shares tendered physically under the offer:

1. Upon receipt of shares tendered, they should put a stamp of "Surrendered under buy-back offer" on the certificates.
2. The Registrars may also receive all items sent to them by post upto 48 hours from the close of the offer.
3. The shares tendered should be checked with the shareholders' master data for verification of details/contents of the shares tendered and the signature of the person tendering the shares.
4. If the acceptance is only pro rata, in accordance with the permission given

by the investor in the offer-cum-acknowledgement form, the shares should be split and split certificates to the extent of shares accepted should be transferred in favour of the company and shares unaccepted/rejected (through new share certificates issued) should be returned to the investor.

Escrow Account

The company should deposit in an escrow account opened with a scheduled commercial bank on or before the opening of the offer for buy-back of securities, such sum as is specified below:

- (i) Where the (estimated) consideration payable for buy-back does not exceed Rs. 100 crores, 25% of the consideration payable;
- (ii) In case the consideration payable for buy-back exceeds Rs. 100 crores, 25% upto Rs. 100 crores and 10% of the balance. [Regulation 10(1) and (2)].

Where a company opts to deposit cash in an escrow account, it should empower the merchant banker to instruct the bank to issue a banker's cheque or demand draft for the amount lying to the credit of the escrow account in his favour. [Regulation 10(4)].

Apart from cash, the escrow account may consist of bank guarantee in favour of the merchant banker or deposit of acceptable securities with the appropriate margin, with the merchant banker. The escrow account can also be maintained as a combination of the above. [Regulation 10(3)]. The discretion in respect of 'acceptable' securities and 'appropriate' margin shall be exercised by the merchant banker.

Where the escrow account opened by the company consists of bank guarantee, it should be in favour of the merchant banker and should remain valid for 30 days after the closure of the offer. [Regulation 10(5)]. The bank guarantee should not be returned by the merchant banker till the completion of all obligations under the Regulations. [Regulation 10(7)].

At the time of opening of the account, the company should deposit with the bank, in cash, a sum of at least 1% of the total consideration payable as security for fulfillment of obligations under the Regulations. [Regulation 10(8)].

Deposit of acceptable securities

Where a company deposits the acceptable securities for the purpose of escrow account, such securities should be deposited with appropriate margin as decided by the merchant banker and should not be returned to the company till the fulfillment of all the obligations under the Regulations. [Regulation 10(7)].

The company should also empower the merchant banker to realize the value of such securities. In case of any deficit on realization of the value of the securities, the merchant banker is liable to make good the deficit. [Regulation 10 (6)].

Forfeiture

In case of non-fulfillment of obligations under the Regulations by the company,

SEBI may forfeit the amount in the escrow account either in full or part and distribute the amount pro rata amongst the securityholders who accepted the offer and utilize the balance, if any, for investors' protection. [Regulation 10(10) and 10(11)].

Opening of a special bank account for payment to securityholders

The company should open a special bank account with a Banker to the Issue registered with SEBI.

The special account should be opened immediately after the date of closure of the offer. Such amount as would together with 90% of the amount lying in escrow account make up the entire sum due and payable as consideration for buy-back of securities should be deposited in such account at the time of opening of the account. For the purpose of deposit in such account, the amount lying in the escrow account may be transferred to such special bank account. [Regulation 11(1)].

Payment towards consideration of buy-back

Payment for buy-back of securities should be made within 7 days from the date of completion of verification of offers as mentioned in the letter of offer. [Regulation 11(2)].

The requirement for the completion of verification is 15 days from the date of closure of the offer. In case the verification is completed before the time specified, the payment should be made within 7 days from the date of completion of verification.

The payment for buy-back of securities should be made to those securityholders whose offers have not been rejected in part or in full by the company, and may be made in cash or through bank draft or pay order or cheque payable, in the case of jointholders, to the first named person.

Immediately after the date of completion of verification of offers, the company should return by registered post and within 7 days, the security certificates to those securityholders whose offers have been rejected. [Regulation 11(2)]. Where the rejection is in respect of part of the shares offered, the certificates should be split and returned in respect of shares not accepted.

Extinguishment of security certificates and reduction in the number of beneficial owners

The company should extinguish and physically destroy the security certificates so bought back in the presence of the Registrars or merchant banker and statutory auditor within 15 days of the date of acceptance of the shares or other specified securities. The company shall ensure that all the securities bought back are extinguished within seven days of the last date of completion of buy-back [Regulation 12(1)]. Merely stamping "cancelled" on the certificate is not sufficient and the process of complete physical destruction should be resorted to.

The shares or other specified securities offered for buy-back, if already dematerialized, should be extinguished and destroyed in the manner specified under SEBI (Depositories and Participants) Regulations, 1996 and the bye-laws framed thereunder. [Regulation 12(2)].

Certificate of extinguishment

The company should furnish a certificate to SEBI, certifying the compliance of the Regulations relating to extinguishment of certificates on a monthly basis by the seventh day of the month succeeding the month in which the securities certificates are the extinguished and destroyed.

Such certificate should be duly verified by:

- (a) the Registrar and whenever there is no such Registrar by the merchant banker;
- (b) two directors of the company one of whom shall be managing director where there is one, and
- (c) the statutory auditor of the company [Regulation 12(3)].

The company should also furnish the particulars of the securities extinguished and destroyed to the stock exchanges where the securities of the company are listed on a monthly basis by the seventh day of the month succeeding the month in which the Securities Certificates are extinguished and destroyed, within 7 days of such extinguishment and destruction. [Regulation 12(4) and 19(4)].

Public advertisement – post buy-back

Within 2 days of completion of buy-back, the company should issue a public advertisement in a national daily. [Regulation 19(7)]. It is desirable that the advertisement is issued in at least one English national daily, one Hindi national daily and a regional language daily, all with wide circulation at the place where the registered office of the company is situated.

Such public advertisement should contain the following particulars :

- (i) number of securities bought back;
- (ii) price at which the securities were bought back;
- (iii) total amount invested in the buy-back;
- (iv) details of the securityholders from whom securities exceeding 1% of total securities were bought back; and
- (v) the consequent changes in the capital structure and the shareholding pattern after and before the buy-back.

Return of buy-back

The company should file a return containing the particulars prescribed by the Central Government relating to buy-back of securities with the Registrar and SEBI within 30 days of completion of buy-back. [Section 77A(10)].

Maintenance of records and registers

Where a company buys back its securities, it shall maintain a register of the securities so bought back, the consideration paid for the securities bought back, the date of cancellation of securities, the date of extinguishing and physically destroying securities and such other particulars as may be prescribed. [Section 77A(9) and Regulation 12(5)].

Preservation of records and registers

The company should keep all documents relating to buy-back of securities for a minimum period of 8 years.

Transfer to Investor Education and Protection Fund

The unpaid or unclaimed money lying in the special bank account need be transferred to the Investor Education and Protection Fund after 7 years.

XXII. Buy-back through Stock Exchange

A company can buy back its securities from the open market through stock exchanges. [Regulation 14(2)(a)].

In the special resolution or Board resolution passed for buy-back through stock exchange, the maximum price at which the buy-back shall be made should be specified. [Regulation 15(a)].

Buy-back should be made only through stock exchanges which have electronic trading facility. [Regulation 15(g)]. The electronic screen of such stock exchanges should show the identity of that listed company as a purchaser of securities to be bought back. The company should appoint a merchant banker and make a public announcement as provided in the case of a buy-back through tender offer [Regulation 15(c)]. The public announcement should be made at least 7 days prior to the commencement of buy-back. [Regulation 15(d)]. A copy of the public announcement should be filed with SEBI within 2 days of such announcement along with the fees as specified in Schedule IV. [Regulation 15(e)]. The public announcement should also contain disclosures regarding details of the brokers and the stock exchanges through which the buy-back of securities would be made. [Regulation 15(f)].

The buy-back shall be made only on stock exchanges having nationwide trading terminals.

The buy-back of shares or other specified securities shall be made only through the order matching mechanism except 'all or none' order matching system. [Regulation 15(h)]

The company and the merchant banker is required to submit the information regarding the shares or other specified securities bought- back to the stock exchange on a daily basis and publish the said information in a national daily on a fortnightly basis and every time when an additional five per cent of the buy back has been completed [Regulation 15(i)]. However where there is no buy back during a particular period the company and the Merchant Banker is not required to publish the details in a national daily.

Though the Regulations do not stipulate the opening date of offer, in the case of buy-back through stock exchange, the offer may be opened from the specified date.

No letter of offer is required in the case of buy-back of securities through stock exchanges.

A listed company should buy back its securities only through the order matching mechanism except „all or none’ order matching system [Regulation 15(h)].

The company should purchase all the securities offered by the holders thereof at the price stipulated by the company without attaching any condition to their offer. If the seller has attached a condition to the effect that he is prepared to sell only if all the securities offered by him are accepted, the securities should not be purchased.

Promoters or persons in control are not permitted to offer their securities when buy-back is made through stock exchanges. [Regulation 15(b)].

Beneficial owners who desire to sell their shares under the buy-back offer should do so through a broker informing him the details of shares they intend to sell when the company has placed a “Buy” order for buy-back of shares. The trade may be executed at the price at which the order matches and that price would be the price for that seller.

The execution of the order, the issuance of contract note, delivery of securities to the member and receipt of payment from the member may be carried out in accordance with the requirements of the stock exchange and SEBI.

The shares bought back by the company may not be at a uniform price. Further, the company is under no obligation to place a “Buy” order on daily basis or to place an order on both the odd lots as well as the normal trading segment of the stock exchanges, as applicable.

Shareholders whose shares are in physical form can sell their shares at the odd lot trading segment if and when the company places an order in that segment.

The company should pay the consideration to the brokers on every settlement date, as applicable to the respective stock exchanges.

The company should complete the verification of acceptances within 15 days from the date of payment. [Regulation 16(2)]. On completion of the buy-back through stock exchanges, share certificates should be extinguished within 7 days from the date of completion of buy-back.

The procedure for the extinguishment of certificates and filing of compliance certificate should be followed in the same manner as in buy-back through tender offer.

XXIII. Buy-back through book building

A listed company may buy-back its securities from the open market through book building. This is a process by which a supply of the securities proposed to be bought back by a listed company is elicited and built up and the price for buy-back of such securities is assessed for the determination of the quantum of such securities to be bought back.

In the special resolution/Board resolution passed for buy-back through book building, the maximum price at which the buy-back shall be made should be specified. [Regulation 17(1)(a)]. The explanatory statement to be attached thereto/public notice should contain disclosures as specified in Schedule I to the Regulations.

The following additional disclosures should also be made in the explanatory statement where the buy-back of securities is made through book building :

- (i) the maximum price at which the buy-back of securities shall be made;
- (ii) whether the Board is being authorised at the general meeting to determine subsequently the specific price at which the buy-back may be made at the appropriate time;
- (iii) in case the promoters intend to offer their securities, the following disclosures shall also be made in the explanatory statement:
 - (a) the quantum of securities proposed to be tendered by promoters; and
 - (b) the details of their transactions and their holdings for the last 6 months prior to the passing of the special resolution for buy-back including information of number of securities acquired, the price and the date of acquisition. [Regulation 7].

The book building process should be conducted through an electronically linked transparent facility and all bidding centers, the number of which should not be less than 30, should have at least one electronically linked computer terminal. [Regulation 17(g) and (h)].

The company should appoint a merchant banker and make a public announcement as in the case of a buy-back through tender offer. [Regulation 17(1)(b)].

The public announcement should be made at least 7 days prior to the commencement of buy-back. [Regulation 17(1)(c)]. Besides the disclosures mentioned in tender offer, the public announcement should also contain disclosures relating to the detailed methodology of the book building process, the manner of acceptance, the format of acceptance to be sent by the securityholders pursuant to the public announcement and the details of bidding centers. [Regulation 17(1)(f)]. A copy of the public announcement should be filed with SEBI within 2 days of such announcement along with the fees as specified in Schedule IV of the Regulations. [Regulation 17(1)(e)].

The company should open an escrow account as in the manner prescribed for buy-back through tender offer. However, the amount to be deposited in the escrow account should be determined with reference to the maximum price specified in the public announcement. The deposit in the escrow account should be made before the date of the public announcement. [Regulation 17(1)(d)].

Though the Regulations do not stipulate the opening date of offer, in case of buy-back through book building, the offer may be opened from the specified date.

The offer for buy-back should remain open to securityholders for not less than 15 days and not more than 30 days . [Regulation 17(1)(i)].

The price of securities to be bought back should be decided by the merchant banker and the company on the basis of quotations received from the securityholders [Regulation 17(1)(j)]. The highest accepted price should be final and it should be paid to all holders whose securities have been accepted for buy-back. [Regulation 17(1)(k)].

No letter of offer is required in the case of buy-back of securities through book building process.

In this mode of buy-back, the promoters and persons in control are permitted to offer their securities for buy-back as in the case of tender offer.

Shareholders may indicate the number of shares that they are willing to tender at specified period(s) given in the tender/offer form and the number of shares they would like to tender at the "cut-off price" which may be determined by the Board.

Shareholders should submit separate tender/offer form per folio.

In case one or more of the joint holders is/are deceased, the tender/offer form must be signed by all the surviving holder(s) and submitted alongwith the certified or attested true copy of death certificate(s). If the sole holder is deceased, the tender/offer form must be signed by the legal representative(s) of the deceased and submitted along with the certified or attested true copy of probate/letter of administration /succession certificate, while tendering the shares for buy-back.

Photocopies of approval(s) from RBI for acquiring and holding shares in the company should be submitted in case of NRIs/FIIs.

The receipt of the tender/offer form may be acknowledged by the bidding centers. Shareholders should preserve the receipt, as it may be required in case of revision of bids.

The revision of bids should be on separate revision form, which should be made available at all the bidding centers. The shareholders should enclose original acknowledgement receipt of the earlier tender/offer form alongwith the duly filled in revised bid form. In case a revised bid is submitted, the previous bid submitted would stand automatically cancelled. Revised bids should be submitted at the same bidding centre where the original bids were submitted.

In arriving at the "final buy-back price", the book position is built up from the valid bids received at the minimum of the offer price range. The "final buy-back price" should be determined by the company, in consultation with the manager to the offer, which should not be lower than the minimum of the range.

The "final buy-back price" will be the price applicable to all the shareholders whose bids have been accepted.

If the shares tendered by the shareholders at the price at which the "final buy-back price" has been arrived at exceeds the total number of shares offered to be bought back by the company, the bids should be accepted by the company in consultation with the manager to the offer keeping in view the following:

- (a) the shareholders who have quoted at "cut-off price as determined in the minimum offer price range" or have quoted the price below the "final buy-back price" should be given priority;
- (b) the remaining bids should be accepted on pro-rata basis. To facilitate small shareholders and to control odd lots, all odds lots should be accepted initially and thereafter bids should be accepted on pro rata basis in such a way that all valid bids should be accepted in multiples of particular number of shares;
- (c) the shares submitted in physical form to the extent not accepted or rejected

should be returned to the shareholders, by registered post, at the registered address of the shareholders;

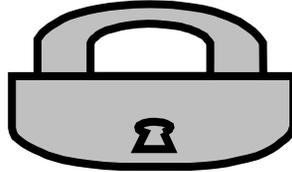
- (d) shares held in demat form to the extent not accepted for buy-back should be released to the beneficial owner's Depository Account with the respective Depository Participant as per details furnished by the beneficial owner in the tender/offer form. An intimation to that effect should be sent to the beneficial owner by ordinary post.

The procedure of verification of acceptances, opening of a special account, payment of consideration and extinguishment of security certificates should be followed in the same manner as is prescribed in the case of buy-back through tender offer. [Regulation 17(2)].

LESSON ROUND UP



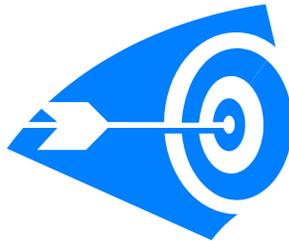
- “Buy-back” means the purchase of its own shares or other specified securities by a company.
- Buy-back of securities is a corporate financial strategy which involves capital restructuring and is prevalent globally with the underlying objectives of increasing earnings per share, averting hostile takeovers, improving returns to the stakeholders and realigning the capital structure.
- Buy-back of shares is regulated by Securities and Exchange Board of India (Buy-Back of Securities) Regulations, 1998 in case of listed companies and Unlisted Public Limited Company (Buy-Back of Securities) Rules, 1999 and the Companies Act, 1956 in case of unlisted companies.
- The main objective of buy-back may be to improve earnings per share; to improve return on capital, return on net worth and to enhance the long-term shareholder value; to provide an additional exit route to shareholders when shares are under valued or are thinly traded; to enhance consolidation of stake in the company; to prevent unwelcome takeover bids; to return surplus cash to shareholders; to achieve optimum capital structure; to support share price during periods of sluggish market conditions and to service the equity more efficiently.
- Buy-back of securities may be made :
 - (a) from the existing security holders on a proportionate basis; or
 - (b) from the open market; or
 - (c) from odd lots, that is to say, where the lot of securities of a public company whose shares are listed on a recognized stock exchange is smaller than such marketable lot as may be specified by the stock exchange; or
 - (d) by purchasing securities which had been issued to employees of the company pursuant to a scheme of stock option or sweat equity.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Briefly explain the procedure for Buy Back of Securities by a listed company.
 2. Explain the procedure for Buy Back of Securities through Book building.
 3. What are various objectives of buy-back of shares?
 4. What are the different modes of buy-back of shares?
 5. What are various restrictions on buy-back of securities?
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STUDY XIII
DEPOSITORIES



LEARNING OBJECTIVES

The study will enable the students to understand

- The Concept and Overview of Depository System
- Legal framework for depository system in India
- Provisions of Depositories Act, 1996
- Overview of SEBI(Depositories and Participants) Regulations, 1996
- Internal Audit of Depository Participants
- Audit by a Practising Company Secretary under SEBI(Depositories and Participants) Regulations, 1996

INTRODUCTION

The advent of online automated trading in India brought with it several associated benefits such as transparency in trading and equal opportunity for market players all over the country but the problems related to settlement of trades such as high instances of bad deliveries and long settlement cycles continued. As an answer to these settlement problems and in order to provide a safe and efficient system of trading and settlement, Depositories Act, 1996 was enacted. SEBI notified Regulations in order to provide the regulatory framework for the depositories. Depositories gave a new dimension and a new scope for conducting transactions in capital market-primary as well as secondary, in a more efficient and effective manner, in a paperless form on an electronic book entry basis. It provided electronic solution to the aforementioned problems of bad deliveries and long settlement cycles.

I. DEPOSITORY

A Depository is an organisation 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 utilise the services offered by a Depository, the investor has to open an account with the Depository through a Depository Participant.



According to Section 2(e) of the Depositories Act, 1996. "Depository means a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under Section 12(1A) of the Securities and Exchange Board of India Act, 1992".

As per Section 2(10) of the Companies Act, 1956, a company means a company as defined in Section 3 of the Act. According to Section 3 company means a company formed and registered under the Companies Act, 1956. A depository cannot act as a depository unless it obtains a certificate of commencement of business from SEBI.

There are two Depositories functioning in India, namely the National Securities Depository Limited (NSDL) and the Central Depository Services (India) Limited (CDS). Under the provisions of the Depositories Act, these Depositories provide various services to investors and other Participants in the capital market, such as, clearing members, stock exchanges, investment institutions, banks and issuing corporates. These include basic facilities like account opening, dematerialisation, rematerialisation, settlement of trades and advanced facilities like pledging, distribution of non-cash corporate actions, distribution of securities to allottees in case of public issues, etc.

All the securities held by a depository shall be dematerialized and shall be in a fungible form. To utilize the services offered by a depository, the investor has to open an account with the depository through a participant, similar to the opening of an account with any of the bank branches to utilize services of that bank. Registration of the depository is required under SEBI (Depositories and Participants) Regulations, 1996 and is a precondition to the functioning of the depository. Depository and depository participant both are regulated by Securities and Exchange Board of India.

Difference between depository and custodian

Both depository and custodial services are responsible for safe keeping of securities but they are different in the sense that the Depository can legally transfer beneficial ownership, which a custodian cannot. The main objective of a Depository is to minimize the paper work involved with the ownership, trading and transfer of securities.

Benefits of depository system

In the depository system, the ownership and transfer of securities takes place by means of electronic book entries. At the outset, 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". In the physical environment, buyer of shares was required to take the risk of transfer and face uncertainty of the quality of assets purchased. In a depository environment good money certainly begets good quality of assets.

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. There is no further need to send it to the company's registrar for registration. Having purchased securities in the physical environment, the investor has to send it to the company's registrar so that the change of ownership can be registered. This process usually takes around three to four months and is rarely completed within the statutory framework of two months thus exposing the investor to opportunity cost of delay in transfer and to risk of loss in transit. To overcome this, the normally accepted practice is to hold the securities in street names i.e. not to register the change of ownership. However, if the investors miss a book closure the securities are not good for delivery and the investor would also stand to lose his corporate entitlements.

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 dematerialised securities - Brokers provide this benefit to investors as dealing in dematerialised securities reduces their back office cost of handling paper and also eliminates the risk of being the introducing broker.

Reduction in handling of huge volumes of paper and periodic status reports to investors on their holdings and transactions, leading to better controls.

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.

II. DEPOSITORY SYSTEM - AN OVERVIEW

The Depository System functions very much like the banking system. A bank holds funds in accounts whereas a Depository holds securities in accounts for its clients. A Bank transfers funds between accounts whereas a Depository transfers securities between accounts. In both systems, the transfer of funds or securities happens without the actual handling of funds or securities. Both the Banks and the Depository are accountable for the safe keeping of funds and securities respectively.

In the depository system, share certificates belonging to the investors are to be dematerialised and their names are required to be entered in the records of depository as beneficial owners. Consequent to these changes, the investors' names in the companies' register are replaced by the name of depository as the registered owner of the securities. The depository, however, does not have any voting rights or other economic rights in respect of the shares as a registered owner. The beneficial

owner continues to enjoy all the rights and benefits and is subject to all the liabilities in respect of the securities held by a depository. Shares in the depository mode are fungible and cease to have distinctive numbers. The transfer of ownership changes in the depository is done automatically on the basis of delivery v. payment.

In the Depository mode, corporate actions such as IPOs, rights, conversions, bonus, mergers/amalgamations, subdivisions & consolidations are carried out without the movement of papers, saving both cost & time. Information of beneficiary owners is readily available. The issuer gets information on changes in shareholding pattern on a regular basis, which enables the issuer to efficiently monitor the changes in shareholdings.

The Depository system links the issuing corporates, Depository Participants (DPs), the Depositories and clearing corporation/ clearing house of stock exchanges. This network facilitates holding of securities in the soft form and effects transfers by means of account transfers.

Following presentation about depositories reveal all about depositories, its concepts and trading, i.e. models of depositories, Depository functions, Legal linkage, depository participant, Registrars and issuers, dematerialisation, rematerialisation, electronic credit in new issues, trading system, corporate action—

Models of Depository

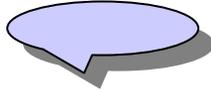
- *Immobilisation* – Where physical share certificates are kept in vaults with the depository for safe custody. All subsequent transactions in these securities take place in book entry form. The actual owner has the right to withdraw his physical securities as and when desired. The immobilization of fresh issue may be achieved by issuing a jumbo certificate representing the entire issue in the name of depository, as nominee of the beneficial owners.
- *Dematerialisation* – No Physical scrip in existence, only electronic records maintained by depository. This type of system is cost effective and simple and has been adopted in India.

Dematerialisation

Dematerialisation is a process by which the physical share certificates of an investor are taken back by the Company and an equivalent number of securities are credited his account in electronic form at the request of the investor. An investor will have to first open an account with a Depository Participant and then request for the dematerialisation of his share certificates through the Depository Participant so that the dematerialised holdings can be credited into that account. This is very similar to opening a Bank Account.

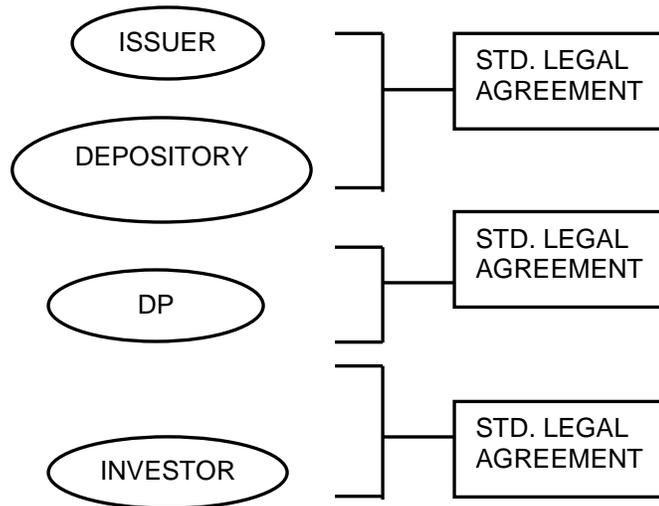
Dematerialisation of shares is optional and an investor can still hold shares in physical form. However, he/she has to demat the shares if he/she wishes to sell the same through the Stock Exchanges. Similarly, if an investor purchases shares from the Stock Exchange, he/she will get delivery of the shares in demat form. Odd lot share certificates can also be dematerialized.

Depository Functions



- Account opening
- Dematerialisation
- Rematerialisation
- Settlement
- Initial Public Offers (IPO's), corporate benefits
- Pledging

Legal linkage



Depository Participant

Just as a brokers act an agent of the investor at the Stock Exchange; a Depository Participant (DP) is the representative (agent) of the investor in the depository system providing the link between the Company and investor through the Depository. The Depository Participant maintains securities account balances and intimate the status of holding to the account holder from time to time. According to SEBI guidelines, Financial Institutions like banks, custodians, stockbrokers etc. can become participants in the depository. A DP is one with whom an investor needs to open an account to deal in shares in electronic form. While the Depository can be compared to a Bank, DP is like a branch of that bank with which an account can be opened. The main characteristics of a depository participant are as under:

- Acts as an Agent of Depository
- Customer interface of Depository

- Functions like Securities Bank
- Account opening
- Facilitates dematerialisation
- Instant transfer on pay-out
- Credits to investor in IPO, rights, bonus
- Settles trades in electronic segment

Registrar/Issuer

- Dematerialisation
- Confirmation of Beneficiary Holdings
- Corporate Actions – Rights, Bonus, etc.
- Reconciliation of Depository Holdings
- Rematerialisation

Dematerialisation

- Investor opens account with DP
- Fills Dematerialisation Request Form (DRF) for registered shares
- Investor lodges DRF and certificates with DP
- DP intimates the Depository
- Depository intimates Registrar/Issuer
- DP sends certificates and DRF to Registrar/Issuer
- Registrar/Issuer confirms demat to Depository
- Depository credits investor a/c

Rematerialisation

- Client submits Rematerialisation Request Form (RRF) to DP
- DP intimates Depository
- Depository intimates the Registrar/Issuer
- DP sends RRF to the Registrar/Issuer
- Registrar/Issuer prints certificates and sends to Investor
- Registrar/Issuer confirms remat to Depository
- Investor's account with DP debited

Electronic Credit in New Issues

- Investor opens account with DP
- Submits application with option to hold securities in depository giving DP-Id and Client-Id
- Registrar uploads list of allottees to Depository

- Depository credits allottee's account with DP
- Refunds sent by Registrar as usual

Trading System

- Separate quotes in Book Entry
- Trading Member to have Clearing Account with DP
- Settlement as per Settlement Calendar of Stock Exchange
- Trading can be introduced in any Stock exchange if settlement is guaranteed

Corporate Actions

- Dividends/cash benefits – these benefits are directly forwarded to the investors by the company or its registrar and transfer agent.
- Non-cash benefits, viz. Bonus, Rights Issue, etc. – these benefits are electronically credited to the beneficial owner's account through Depository.

III. LEGAL FRAMEWORK

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

Apart from the above, Depositories are also governed by certain provisions of:

- The Companies Act, 1956
- 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

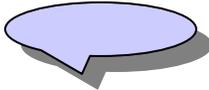
The legal framework for depository system as envisaged in the Depositories Act, 1996 provides for the establishment of single or multiple depositories. Any body to be eligible for providing depository services must be formed and registered as a company under the Companies Act, 1956 and seek registration with SEBI and obtain a Certificate of Commencement of Business from SEBI on fulfillment of the prescribed conditions. The investors opting to join depository mode are required to enter into an agreement with depository through a participant who acts as an agent of depository. The agencies such as custodians, banks, financial institutions, large

corporate brokerage firms, non-banking financial companies etc. act as participants of depositories. The companies issuing securities are also required to enter into an agreement with the Depository.

IV. THE DEPOSITORIES ACT, 1996

Objectives

The depositories legislation as per the Statement of Objects and Reasons appended to the Depositories Act, 1996 aims at providing for:



- A legal basis for establishment of depositories to conduct the task of maintenance of ownership records of securities and effect changes in ownership records through book entry;
- Dematerialisation of securities in the depositories mode as well as giving option to an investor to choose between holding securities in physical mode and holding securities in a dematerialized form in a depository;
- Making the securities fungible;
- Making the shares, debentures and any interest thereon of a public limited company freely transferable; and
- 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.

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.

However in case of fresh issue of securities all securities issued have to be in dematerialised form. However after that investor will also have the freedom to switch from depository mode to non-depository mode and *vice versa*. The decision as to whether or not to hold securities within the depository mode and if in depository mode, which depository or participant, would be entirely with the investor.

Fungibility

Section 9 states that securities in depositories shall be in fungible form.

The Act envisages that 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.

Immobilisation of securities in a depository mode refers to a situation where the depository holds securities in the form of physical paper side by side with electronic evidence of ownership. In such a case the transfers are not accompanied by physical movement of securities but securities are in existence in the custody of the depository. However, the Depositories Act, envisages dematerialisation in the depository mode. In such a case the securities held in a depository shall be dematerialized and the ownership of the securities shall be reflected through book entry only. The securities outside the depository shall be represented by physical scrips. Hence, the depository legislation envisages partial dematerialisation, i.e. a portion of the securities in dematerialized form and the other portion in physical form. Sections 153, 153A, 153B, 187B, 187C and 372 (now 372A) of Companies Act, 1956 shall not apply to a depository in respect of shares held on behalf of beneficial owners in depositories.

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. The depository as a registered owner should not have any voting rights or any other rights in respect of securities held by it. The beneficial owner is entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository.

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.

Every beneficial owner should give intimation of such pledge or hypothecation to the depository participant and such depository is required to make entries in its records accordingly. Any entry in the records of a depository should be evidence of a pledge or hypothecation.

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

Section 14 of the Act provides that 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 fulfilment 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.

Depositories to indemnify loss in certain cases

Any loss caused to the beneficial owner due to the negligence of the depository or the participant, would be indemnified by the depository to such beneficial owner. Where the loss due to the negligence of the participant is indemnified by the depository, the depository has the right to recover the same from such participant.

Power of SEBI

Section 18 of the Act provides that SEBI in the public interest or in the interest of investors may by order in writing call upon any issuer, depository, participant or beneficial owner to furnish in writing such information relating to the securities held in a depository as it may require; or authorise any person to make an enquiry or inspection in relation to the affairs of the issuer, beneficial owner, depository or participant, who shall submit a report of such enquiry or inspection to it within such period as may be specified in the order.

Sub-section (2) to Section 18 provides that every director, manager, partner, secretary, officer or employee of the depository or issuer or the participant or beneficial owner shall on demand produce before the person making the enquiry or inspection all information or such records and other documents in his custody having a bearing on the subject matter of such enquiry or inspection.

If after making or causing to be made an enquiry or inspection, SEBI is satisfied that it is necessary in the interest of investors, or orderly development of securities market; or to prevent the affairs of any depository or participant being conducted in the manner detrimental to the interests of investors or securities market, SEBI may issue such directions to any depository or participant or any person associated with the securities market; or to any issuer as may be appropriate in the interest of investors or the securities market.

Power of Board to give Directions

Section 19 provides that SEBI after making an enquiry or inspection and if satisfied may issue appropriate directions

- (a) to any depository or participant or any person associated with the securities market; or
- (b) to any issuer

in the interest of investors or the securities market or to prevent the affairs of any depository or participant being conducted in the manner detrimental to the interests of investors or the securities market.

Penalty for failure to furnish information/return etc.

Section 19A provides that any person, who is required under Depositories Act or any rules or regulations or bye-laws made there under—

- (a) to furnish any information, document, books, returns or report to the Board, fails to furnish the same within the time specified therefor fails to furnish the same within specified time;
- (b) to file any return or furnish any information, books or other documents within the time specified therefor in the regulations or bye-laws, fails to file return or furnish the same within the time specified therefor, fails to file such return or furnish the required information within the specified time;
- (c) to maintain books of account or records, fails to maintain the same;

he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure to enter into agreement

Section 19B provides that if a depository or participant or any issuer or its agent or any person, who is a registered intermediary and is required under this Act or any rules or regulations made there under, to enter into an agreement, fails to enter into such agreement, such intermediary shall be liable to a penalty of 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

Section 19C provides that if any depository or participant or any issuer or its agent or any person, who is registered as a registered intermediary, after having been called upon by the SEBI in writing, to redress the grievances of the investors, fails to redress such grievances within the time specified, such depository or participant or issuer or its agents or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for delay in dematerialisation or issue of certificate of securities

Section 19D provides that if any issuer or its agent or any person, who is a

registered intermediary, fails to dematerialise or issue the certificate of securities on opting out of a depository by the investors, within the time specified under this Act or regulations or bye-laws made there under or abets in delaying the process of dematerialisation or issue the certificate of securities on opting out of a depository of securities, such intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure to reconcile records

Section 19E provides that if a depository or participant or any issuer or its agent or any person, who is a registered intermediary, fails to reconcile the records of dematerialised securities with all the securities issued by the issuer as specified in the regulations, such intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure to comply with directions issued by Board under section 19 of the Act

Section 19F requires that if any person fails to comply with the directions issued by SEBI under section 19, within the time specified by it, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for contravention where no separate penalty has been provided

Section 19G provides that whoever fails to comply with any provision of this Act, the rules or the regulations or bye-laws made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.

Power to adjudicate

Section 19H provides that for the purpose of adjudging SEBI shall appoint any officer not below the rank of a Division Chief of SEBI to be 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. While holding an inquiry, the adjudicating officer shall have power 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 in the opinion of the adjudicating officer, 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 of any of the sections specified in this Act, 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 adjudicating officer

Section 19 I requires that while adjudging the quantum of penalty under section 19H, 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.

Crediting sums realized by way of penalties to Consolidated Fund of India

Section 19J provides that all sums realised by way of penalties under this Act shall be credited to the Consolidated Fund of India.

Offences

Section 20 provides that without prejudice to any award of penalty by the adjudicating officer under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations or bye-laws made there under, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees, or with both. If any person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years, or with fine, which may extend to twenty-five crore rupees, or with both.

Offences by companies

Section 21 provides that where an offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. The proviso to the section also provides that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence. Where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Cognizance of offences by courts

Section 22 provides that no court shall take cognizance of any offence punishable under this Act or any rules or regulations or bye-laws made there under except on a complaint made by the Central Government or State Government or the Securities and Exchange Board of India or by any person. No court inferior to that of a Court of Session shall try any offence punishable under this Act.

Composition of certain offences

Section 22A provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.

Power to grant immunity

Section 22B empowers the Central Government to grant immunity, on

recommendation by the Board, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made there under, has made a full and true disclosure in respect of alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made there under or also from the imposition of any penalty under this Act with respect to the alleged violation. No such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity. Recommendation of the Board under this sub-section is not binding upon the Central Government.

The immunity granted to a person may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

Appeal to Securities Appellate Tribunal

Section 23A provides that, any person aggrieved by an order of SEBI or by an adjudicating officer under this Act may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter. However, no appeal shall lie to the Securities Appellate Tribunal from an order made by SEBI with the consent of the parties. Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made by SEBI is received by the person and it shall be in such form and be accompanied by such fee as may be prescribed:

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

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.

The Securities Appellate Tribunal shall send a copy of every order made by it to SEBI and parties to the appeal. 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.

Procedure and powers of Securities Appellate Tribunal

Section 23B provides that 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.

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.

Appeal to Supreme Court

Section 23F provides that 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 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.

Right to Legal Representation



Section 23C provides that the appellant may either appear in person or authorise one or more Chartered Accountants or Company Secretaries or Cost Accountants, in practice or Legal Practitioners or any of its officers to present his/its case before the Securities Appellate Tribunal.

Limitations

Section 23 D provides that the provisions of the Limitation Act, 1963 (36 of 1963) shall, as far as may be, apply to an appeal made to a Securities Appellate Tribunal.

Civil Court not to have jurisdiction

Section 23 E provides that No Civil Court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Securities Appellate Tribunal is

empowered by or under this Act to determine and no injunction can be granted by any court or other authority in respect of any action taken or to be taken. In pursuance of any power conferred by or under this Act.

Areas on which Rules may be Framed by the Central Government

The Central Government under Section 24, may frame Rules to provide, *inter alia*, for:

- the manner of inquiry under Section 19H(1).
- the time within which an appeal may be preferred from the orders of SEBI under Section 23(1).
- the form in which an appeal may be preferred and the fees payable in respect of such appeal.
- the procedure for disposing of an appeal.
- the form in which an appeal may be filed before the Securities Appellate Tribunal under Section 23A and the fees payable in respect of such appeal.

Power of SEBI to Make Regulations

Section 25 of the Depositories Act, 1996 read with Section 30 of SEBI Act, 1992 empowers SEBI to make regulations for carrying out the purposes of the Act, by notification in the Official Gazette. The regulations may, *inter alia*, provide for:

- The requirements to be complied with by a person for seeking registration as a Depository with SEBI under SEBI Act, 1992.
- The requirements for registration of a person as a participant under SEBI Act.
- Determination of any form in which records may be maintained by a Depository. As per Section 2(1)(i) of the Act, 'record' includes the records maintained in the form of books or stored in a computer or in such other form as may be determined by regulations.
- The requirements for grant of certificate of commencement of business by depositories and the form in which the certificate of commencement of business has to be issued.
- The manner in which the certificate of security shall be surrendered to the issuer by any investor who is desirous of availing depository services.
- The manner in which the issuer has to cancel the certificates of securities received by it for cancellation and its intimation to the depository.
- The manner in which the depository has to register transfer of security in the name of the transferee on receipt of the intimation from a participant and where the beneficial owner or a transferee seeks to have custody of security, the manner in which the depository shall inform the issuer.
- Where a person opts to hold a security with a depository in the event of a public issue, the manner in which the issuer is required to intimate the depository the details of allotment of the security.
- The requirements to be complied with by a beneficial owner for creating with the previous approval of depository, pledge or hypothecation in respect of a security owned by him through depository.

- The conditions and the fees payable with respect to the issue of certificate of securities to the beneficial owner where the beneficial owner seeks to opt out of the depository.
- The rights and obligations of the depositories, participants, and the issuers whose securities are dealt with by a depository.
- The eligibility criteria for admission of securities into the depository.

V. BYE-LAWS OF A DEPOSITORY

Depository is required to frame its bye-laws with the prior approval of SEBI, consistent with the provisions of the Act and the regulations made by SEBI thereunder. SEBI has, however, the power to direct the depository to amend or revoke any bye-laws already made, wherever it considers expedient to do so. If the depository fails or neglects to comply with the directions of SEBI, SEBI may make the bye-laws or amend or revoke the bye-laws on its own.

Contents of the bye-laws

As per Sub-section 2 of Section 26 of the Act, the bye-laws of a depository would include:

- the eligibility criteria for admission and removal of securities in the depository.
- the conditions subject to which the securities shall be dealt with.
- the eligibility criteria for admission of any person as a participant.
- the manner and procedure for dematerialisation of securities.
- the procedure for transactions within the depository.
- the manner in which securities are to be dealt with or withdrawn from a depository.
- the procedure for ensuring safeguards to protect the interests of participants and beneficial owners.
- the conditions of admission into and withdrawal from a participant by a beneficial owner.
- the procedure for conveying information to the participants and beneficial owners on dividend declaration, shareholder meetings and other matters of interest to the beneficial owners.
- the manner of distribution of dividends, interest and monetary benefits received from the company among beneficial owners.
- the manner of creating pledge or hypothecation in respect of securities held with a depository.
- *inter-se* rights and obligations among the depository, issuer, participants and beneficial owners.
- the manner and the periodicity of furnishing information to SEBI, issuer and other persons.
- the procedure for resolving disputes involving depository, issuer company or a beneficial owner.

- the procedure for proceeding against the participant committing breach of the regulations and provisions for suspension and expulsion of participants from the depository and cancellation of agreements entered with the depository.
- the internal control standards including procedure for auditing, reviewing and monitoring.

Applicability of Section 372A of Companies Act on a Depository

The name of the depository is entered in the records of an issuer as a registered owner in respect of securities held by it on behalf of the beneficial owners. It is possible that a registered owner (Depository) can hold 100% of the securities of a company. This will, however, not contravene Section 372A of the Companies Act, 1956, as the registered owner does not have any economic or voting right in respect of these securities.

Membership Rights in Respect of Securities held by a Depository

The depository as a registered owner shall not have any voting rights or any other rights in respect of securities held by it on behalf of the beneficial owners. The beneficial owner shall be entitled to all the rights and benefits (including the right to vote) and be subjected to all the liabilities in respect of securities held by a depository.

Evidentiary Value of the Records of the Depository

Section 15 of the Act treats depository as a bank for the purposes of the Bankers' Books Evidence Act, 1891. The ownership records of securities maintained by depositories, whether maintained in the form of books or machine readable forms, shall be accepted as *prima facie* evidence in all legal proceedings.

VI. SEBI (DEPOSITORIES AND PARTICIPANTS) REGULATIONS, 1996

The Depositories Act requires that the registration of the depository, depository participant and the custodian, is mandatory with the Securities and Exchange Board of India. These market intermediaries can function or commence business only after registration from SEBI has been obtained and requisite fee paid to SEBI. The requirement of registration is a continuing one and the moment the registration is cancelled or revoked or surrendered, the person shall cease to act as such.

SEBI had issued SEBI (Depositories and Participants) Regulations, 1996 on 16th May, 1996 which apply to depositories and its participants.

These regulations also contain provisions for operations and functioning of depositories, form for application and certificates used and schedule of fees for participants, etc. It also contains provisions for registration of depository and depository participants, rights and obligations of various users and constituents, inspection and procedure for action in case of default.

Entities desiring to become depository participants must apply to the depository and are required to be recommended to SEBI by the depository. If approved and registered by SEBI, the depository participant can be admitted on the depository. The depository has to formulate its own set of criteria for selection of participants. Every participant holding a certificate is required at all times to abide by the specified Code of Conduct.

The regulations require the depository to list out, through its Bye-laws, the securities which are eligible to be admitted to the depository for dematerialisation. Equity shares, debentures, warrants, bonds, units of mutual funds, etc. are part of the list of eligible securities. The depository is empowered to set its own criteria for selection of securities and make securities eligible to be maintained in the form of electronic holdings on the depository.

Further, the regulations stipulate that agreements should be entered into by the following entities:

- depository and every participant
- participant and every client
- depository, issuer company and the Registrar

The draft of these agreements are to be included in the Bye-laws and to be approved by SEBI.

The depository is required to ensure that sufficient safeguards are in place to protect the data available with it and with the participants. To reduce risk in operations, the regulations stipulate that adequate insurance cover be provided by the depository and by the depository participants as well.

The regulations also require for reconciliation to be carried out on a daily basis. Further, the depository and the registrar will also reconcile balances on a daily and a periodic basis.

Rights and Obligations of Depositories and its Constituents

Regulations deal with rights and obligations of depositories and every depository has to state in its bye-laws the eligible securities for dematerialisation which include shares, scrips, stock, bonds, debentures stock, etc., and include units of mutual funds, rights under collective investment schemes and venture capital funds, commercial paper, certificate of deposit, securitised debt, money market instruments and even unlisted securities.

Every depository is required to enter into an agreement with the issuer in respect of securities disclosed as eligible to be held in demat form. No agreement is required to be entered into where the depository itself is an issuer of securities.

The depository is also required to enter into a tripartite agreement with the issuer, its transfer agent and itself where company has appointed a transfer agent. Every depository is required to maintain continuous connectivity with issuers, registrars and transfer agents, participants and clearing house or clearing corporations. Depositories should take adequate measures including insurance to protect the interest of the beneficial owners.

Every depository is required to maintain the following records and documents namely:

- records of securities dematerialised and rematerialised;
- the names of the transferor, transferee, and the dates of transfer of securities;

- a register and an index of beneficial owners;
- details of holding of the securities of the beneficial owners as at the end of the each day;
- records of instruction(s) received from and sent to participants, issuers' agents and beneficial owners;
- records of approval, notice, entry and cancellation of pledge or hypothecation, as the case may be;
- details of participants;
- details of securities declared to be eligible for dematerialisation in the depository; and
- such other records as may be specified by SEBI for carrying on the activities as a depository.

Every depository has to intimate SEBI the place where the records and documents are maintained.

Subject to the provisions of any other law, the depository shall preserve records and documents for a minimum period of five years.

Participants are required to enter into an agreement with beneficial owners. It is required that separate accounts are to be opened by every participant in the name of each of the beneficial owner and the securities of each beneficial owners are to be segregated and shall not be mixed up with the securities of other beneficial owners or with the participant's own securities. The participants are obliged to reconcile the records with every depository on a daily basis. Participants are required to maintain the following records for a period of five years—

- records of all the transactions entered into with a depository and with a beneficial owner;
- details of security dematerialised, rematerialised on behalf of beneficial owners with whom it has entered into an agreement;
- records of instructions received from beneficial owners and statements of account provided to beneficial owners; and
- records of approval, notice, entry and cancellation of pledge or hypothecation as the case may be.

VII. AUDIT UNDER SEBI (DEPOSITORIES AND PARTICIPANTS) REGULATIONS, 1996

Regulation 55A of SEBI (Depositories and Participants) Regulations, 1996 provides that every issuer shall submit audit report on a quarterly basis to the concerned stock exchanges audited by a practicing Company Secretary or a qualified Chartered Accountant, for the purposes of reconciliation of the total issued capital, listed capital and capital held by depositories in dematerialized form, the details of changes in share capital during the quarter and the in-principle approval obtained by the issuer from all the stock exchanges where it is listed in respect of such further issued capital.

The audit report is required to give the updated status of the register of members of the issuer and confirm that securities have been dematerialized as per requests within 21 days from the date of receipt of requests by the issuer and where the dematerialization has not been effected within the said stipulated period, the report would disclose the reasons for such delay.

The issuer is under an obligation to immediately bring to the notice of the depositories and the stock exchanges, any difference observed in its issued, listed, and the capital held by depositories in dematerialized form.

VIII. INTERNAL AUDIT OF OPERATIONS OF DEPOSITORY PARTICIPANTS

The two Depository service providers in India, viz., National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Limited (CDS) have allowed Company Secretaries in Whole-time Practice to undertake internal audit of the operations of Depository Participants (DPs).



NSDL has vide its circular No. NSDL/SG/II/010/99 dated 26th March 1999 notified amendment of its Bye Law 10.3.1 of Chapter 10 as follows:

10.3.1 "Every Participant shall ensure that an internal audit in respect of the operations of the Depository is conducted at intervals of not more than three months by a qualified Chartered Accountant or **a Company Secretary holding a certificate of Practice** and a copy of the internal audit report shall be furnished to the Depository."



CDSL has vide its letter dated September 28, 1999 notified amendment of its Bye Laws 16.3.1 as follows:

16.3.1 "Every Participant shall ensure that an internal audit shall be conducted in respect of the participant's operations relating to CDS by a qualified Chartered Accountant in accordance with the provisions of the Chartered Accountants Act, 1949 or by **a Company Secretary in practice** in accordance with the provisions of the Company Secretaries Act, 1980, at such intervals as may be specified by CDS from time to time. A copy of Internal Audit report shall be furnished to CDS."

IX. CONCURRENT AUDIT

National Securities Depository Limited vide its Circular No. NSDL/POLICY/2006/0021 dated June 24, 2006 provides for concurrent audit of the Depository Participants. The Circular provides that w.e.f. August 1, 2006, the process of demat account opening, control and verification of Delivery Instruction Slips (DIS) is subject to Concurrent Audit. Depository Participants have been advised to appoint a firm of qualified Chartered Accountant(s) or Company Secretary(ies) holding a certificate of

practice for conducting the concurrent audit. However, the participants in case they so desire, may entrust the concurrent audit to their Internal Auditors.

In respect of account opening, the auditor should verify all the documents including KYC documents furnished by the Clients and verified by the officials of the Participants. The scope of concurrent audit with respect to control and verification of DIS cover the areas given below:

(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 pre-printed 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.

The Concurrent Auditor should conduct the audit in respect of all accounts opened, DIS issued and controls on DIS as mentioned above, during the day, by the next working day. In case the audit could not be completed within the next working day due to large volume, the auditor should ensure that the audit is completed within a week's time.

Any deviation and/or non-compliance observed in the aforesaid areas should be mentioned in the audit report of the Concurrent Auditor. The Management of the Participant should comment on the observations made by the Concurrent Auditor.

The Concurrent Audit Report should be submitted to NSDL, on a quarterly basis, in a hard copy form.

If the Auditor for Internal and Concurrent Audit is the same, consolidated report may be submitted.

X. ESTABLISHMENT OF CONNECTIVITY WITH NSDL AND CDSL

To enhance the efficiency of the stock market, rolling settlement were introduced by SEBI. The stocks which were not compulsory rolling settlement were traded under

compulsory rolling settlement. To facilitate the settlement, SEBI prescribed the compulsory dematerialized trading by companies through connectivity with both the depositories NSDL and CDSL.

The stock exchanges may consider shifting the trading of securities of the Companies who have established connectivity with both the depositories to rolling settlement subject to the following:

- (a) At least 50% of non-promoter holdings as per clause 35 of Listing Agreement are in demat mode before shifting the trading in the securities of the company from Trade for Trade Segment (TFTS) to Rolling settlement.

For this purpose, the listed companies are required to obtain a certificate from its Registrar and Transfer Agent (RTA) and submit the same to the stock exchange/s. However, if an issuer-company does not have a separate RTA, it may obtain a certificate in this regard from a practicing Company Secretary/Chartered Accountant and submit the same to the stock exchange/s.

- (b) There are no other grounds/reasons for continuation of the trading in TFTS.

The Stock Exchanges are also required to report to SEBI, the action taken in this regard in their Monthly/Quarterly Development Report.

XI. APPOINTMENT OF COMMON AGENCY FOR SHARE REGISTRY WORK

In many cases the issuer companies are having an internal department or a division (by whatever name called) for handling of physical share work and an out side agency for handling the work of electronic connectivity. This kind of arrangement is leading to delay in dematerialisation, non-reconciliation of share holding due to lack of proper co-ordination among the concerned agencies or departments, which is adversely affecting the interest of the investors.

SEBI therefore vide its circular D&CC/FITTC/CIR-15/2002 dated December 27, 2002 decided that all the work related to share registry in terms of both physical and electronic should be maintained at a single point i.e. either in-house by the company or by a SEBI registered R & T Agent.

Further SEBI vide its circular D&CC/FITTC/CIR – 17/2002 dated December 31, 2002 directed all the registrars and share transfer agents (RSTA) that:

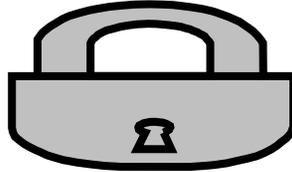
1. They shall maintain records of all the shares dematerialised, rematerialised and details of all securities declared to be eligible for dematerialisation in the depositories and ensure that dematerialisation of shares shall be confirmed/created only after an in-principle approval of the stock exchange/s where the shares are listed and the admission of the said share with the depositories have been granted.
2. They shall have proper systems and procedures in place to verify that the securities tendered for dematerialisation have not been dematerialised earlier.
3. They shall ascertain, reconcile daily and confirm to the depositories that the total number of shares held in NSDL, CDSL and in the physical form tallies with the admitted, issued and listed capital of the issuer company; and

4. They shall confirm that the dematerialisation requests have been processed within 21 days and shall also state the reasons for shares pending confirmation for more than 21 days from the date of request.

LESSON ROUND UP



- The legal framework for depository system as envisaged in the Depositories Act, 1996 provides for the establishment of single or multiple depositories.
- There are two Depositories functioning in India, namely the National Securities Depository Limited (NSDL) and the Central Depository Services (India) Limited (CDSL).
- All the securities held by a depository are dematerialized and are in a fungible form.
- In the depository system, the ownership and transfer of securities takes place by means of electronic book entries.
- Dematerialisation is a process by which the physical share certificates of an investor are taken back by the Company and an equivalent number of securities are credited his account in electronic form at the request of the investor.
- A Depository Participant (DP) is the representative (agent) of the investor in the depository system providing the link between the Company and investor through the Depository.
- SEBI (Depositories and Participants) Regulations, 1996 regulates the function of Depositories and participants.
- Regulation 55A of SEBI (Depositories and Participants) Regulations, 1996 provides that every issuer shall submit audit report on a quarterly basis to the concerned stock exchanges audited by a practicing Company Secretary or a qualified Chartered Accountant, for the purposes of reconciliation of the total issued capital, listed capital and capital held by depositories in dematerialized form, the details of changes in share capital during the quarter and the in-principle approval obtained by the issuer from all the stock exchanges where it is listed in respect of such further issued capital.
- Both the Depositories in India have allowed Company Secretaries in Whole-time Practice to undertake internal audit of the operations of Depository Participants (DPs).
- Concurrent Audit – Depository Participants are subject to concurrent audit by a Practising Company Secretary or qualified Chartered Accountant. Concurrent Audit includes audit of process of demat account opening, control and verification of delivery instruction slips.

SELF TEST QUESTIONS

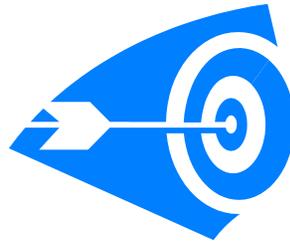
(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Briefly outline the concept of Depository system in India.
2. Give an overview of the major provisions of the Depositories Act, 1996.
3. Enumerate the provisions relating to enquiry, inspection and penalties under the Depositories Act, 1996.
4. Explain in detail the provisions of Section 26 relating to power of depositories to make bye-laws under the Depositories Act, 1996.
5. Outline the Appeal Procedure under the Depositories (Appeal to Securities Appellate Tribunal) Rules, 2000.
6. Give an overview of the rights and obligations of Depositories, Participants and issuers under SEBI (Depositories and Participants) Regulations, 1996.
7. Write short note on:
 - (a) Dematerialisation charges.
 - (b) Models of Depository.
 - (c) Internal Audit of Depository Participants.
 - (d) Secretarial Audit relating to Reconciliation of total admitted capital to total issued and paid up capital.
 - (e) Concurrent Audit.

PART B — ISSUE MANAGEMENT AND COMPLIANCES

STUDY XIV

PUBLIC ISSUE OF SECURITIES



LEARNING OBJECTIVES

The study will enable the students to understand

- Procedure for making an IPO/FPO
- Overview of SEBI (Employee Stock Option and Employee Stock purchase scheme) 1999.
- Preferential allotment of shares etc.
- SEBI (Delisting of Equity Shares) Regulations, 2009.

INTRODUCTION

I. ISSUE OF EQUITY SHARES

The important aspects of SEBI (ICDR) Regulations, with reference to issue of equity shares are as under:

Applicability of the regulations

These regulations shall apply to the following:

- (a) a public issue
- (b) a rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more
- (c) a preferential issue
- (d) an issue of bonus shares by a listed issuer
- (e) a qualified institutions placement by a listed issuer
- (f) an issue of Indian Depository Receipts.

Eligibility Norms for Public Issue

Unlisted Company

An unlisted company can make an initial public offering (IPO) of equity shares or any other security which may be converted into or exchanged with equity shares at a

later date, only if it meets all the following conditions:

- (a) The company has net tangible assets of at least Rs. 3 crores in each of the preceding 3 full years (of 12 months each), of which not more than 50% is held in monetary assets;
- (b) The company has a track record of distributable profits in terms of Section 205 of the Companies Act, 1956, for at least three (3) out of immediately preceding five (5) years;
- (c) The company has a net worth of at least Rs. 1 crore in each of the preceding 3 full years (of 12 months each);
- (d) The aggregate of the proposed issue and all previous issues made in the same financial year in terms of size, does not exceed five (5) times its pre-issue net worth as per the audited balance sheet of the last financial year.
- (e) In case the company has changed its name within the last one year, at least 50% of the revenue for the preceding 1 full year is earned by the company from the activity suggested by the new name; and

Listed Company

A listed company shall be eligible to make a public issue of equity shares or any other security which may be converted into or exchanged with equity shares at a later date: the aggregate of the proposed issue and all previous issues made in the same financial year in terms of size, issue size does not exceed 5 times its pre-issue networth as per the audited balance sheet of the last financial year.

However, in case there is a change in the name of the issuer company within the last 1 year reckoned from the date of filing of the offer document, the revenue accounted for by the activity suggested by the new name is not less than 50% of its total revenue in the preceding 1 full-year period

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, as under:

- (a) (i) The issue is made through the book-building process, with at least 50% of net offer to public) being allotted to the Qualified Institutional Buyers (QIBs), failing which the full subscription monies shall be refunded.

OR

- (a) (ii) The "project" has at least 15% participation by Public Financial Institutions/ Scheduled Commercial Banks, of which at least 10% comes from the appraiser(s). In addition to this, at least 10% of the issue size shall be allotted to QIBs, failing which the full subscription monies shall be refunded

AND

- (b) (i) The minimum post-issue face value capital of the company shall be Rs. 10 crores.

OR

- (b) (ii) There shall be a compulsory market-making for at least 2 years from the date of listing of the shares, subject to the following:
- (a) Market makers undertake to offer buy and sell quotes for a minimum depth of three hundred specified securities;
 - (b) Market makers undertake to ensure that the bid-ask spread difference between quotations for sale and purchase for their quotes shall not at any time exceed 10%;
 - (c) The inventory of the market makers, as on the date of allotment of securities, shall be at least 5% of the proposed issue of the company.

In addition to satisfying the aforesaid eligibility norms, the company shall also satisfy the criteria of having at least 1000 prospective allottees in its issue.

Public Issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus. For raising capital from the public by the issue of shares, a public company has to comply with the provisions of the Companies Act, the Securities Contracts (Regulation) Act, 1956 including the Rules made thereunder and the guidelines and instructions issued by the concerned Government authorities, the Stock Exchanges and SEBI etc.

A company can raise funds from the primary market through different method.

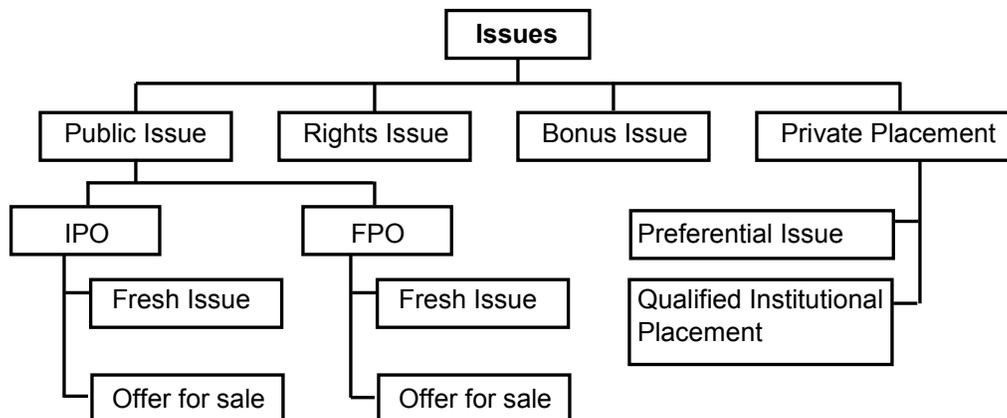
- (a) **Public issue:** When an issue/offer of securities is made to new investors for becoming part of shareholders' family of the issuer it is called a public issue. Public issue can be further classified into Initial public offer (IPO) and Further public offer (FPO). The significant features of each type of public issue are illustrated below:
- (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. The issuer is required to comply with various provisions which *inter alia* include pricing, disclosures in the notice, lock in etc., in addition to the requirements specified in the Companies Act.

(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.



Here —“Qualified Institutional Buyer” means:

- (i) a mutual fund, venture capital fund and foreign venture capital investor registered with the Board;
- (ii) a foreign institutional investor and sub-account (other than a sub-account which is a foreign corporate or foreign individual), registered with the Board;
- (iii) a public financial institution as defined in section 4A of the Companies Act, 1956;
- (iv) a scheduled commercial bank;
- (v) a multilateral and bilateral development financial institution;
- (vi) a state industrial development corporation;

- (vii) an insurance company registered with the Insurance Regulatory and Development Authority;
- (viii) a provident fund with minimum corpus of twenty five crore rupees;
- (ix) a pension fund with minimum corpus of twenty five crore rupees;
- (x) National Investment Fund set up by resolution no. F. No. 2/3/2005-DDII dated November 23, 2005 of the Government of India published in the Gazette of India;
- (xi) insurance funds set up and managed by army, navy or air force of the Union of India;
- (xii) insurance funds set up and managed by the Department of Posts, India.

Meaning of Draft offer Document, Letter of offer and Red herring Prospectus

<i>Draft Offer Documents</i>	<i>Offer Document</i>	<i>RHP (Red Herring Prospectus)</i>
-Draft Offer document" 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. An offer document covers all the relevant information to help an investor to make his/her investment decision.	-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. This means that 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. An RHP for an FPO can be filed with the ROC without the price band and the issuer, in such a case will notify the floor price or a price band by way of an advertisement one day prior to the opening of the issue. In the case of book-built issues, it is a process of price discovery and the price cannot be determined until the bidding process is completed. Hence, such details are not shown in the Red Herring prospectus filed with ROC in terms of the provisions of the Companies Act. Only on completion of the bidding process, the details of the final price are included in the offer document. The offer document filed thereafter with ROC is called a prospectus.

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 allotting the shares in Dematerialised Form.

With the repeal of Capital Issues (Control) Act, 1947 all the guidelines, notifications, circulars etc. issued by the office of the Controller of Capital Issues have become defunct. Earlier, such companies were required to conform to the guidelines issued by SEBI vide its order dated 11.6.1992 called the Guidelines for Disclosure and Investor Protection, 1992

SEBI had issued a compendium containing consolidated Guidelines, circulars, instructions relating to issue of capital effective from January 27, 2000. The compendium titled SEBI (Disclosure and Investor Protection) Guidelines, 2000 replaced the original Guidelines issued in June 1992 and clarifications thereof. On August 26, 2009 SEBI rescinded the SEBI (DIP) Guidelines, 2000 and notified SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 in order to bring more clarity to the provisions of the rescinded SEBI Guidelines by removing the redundant provision and modifying certain provisions on account of changes necessitated due to market design.

Debarment

An issuer can not make a public issue or rights issue of specified securities if the issuer, any of its promoters, promoter group or directors or persons in control of the issuer are debarred from accessing the capital market by SEBI. If any of the promoters, directors or person in control of the issuer was or also is a promoter, director or person in control of any other company which is debarred from accessing the capital market under any order or directions made by SEBI.

Filing of offer document

An issuer company can not 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.

However, if SEBI specifies changes or issues observations on the draft Prospectus within 30 days from the date of receipt of the draft Prospectus by SEBI the issuer company or the Lead Manager to the Issue shall carry out such changes in the draft Prospectus or comply with the observations issued by SEBI before filing the Prospectus with ROC.

SEBI may specify changes or issue observations, if any, on the draft prospectus within 30 days from the later of the date of receipt of the draft offer document or the date of receipt of satisfactory reply from the lead merchant bankers. Where SEBI has sought any clarification or additional information from them or the date of receipt of clarification or information from any regulator or agency, where SEBI has sought any clarification or information from such regulator or agency or the date of receipt of a copy of in-principal approval letter issued by the recognized stock exchanges.

The lead merchant banker should while filing the offer document with SEBI, file a copy of such document with the recognized stock exchanges where the specified

securities are proposed to be listed and a soft copy of the offer document should also be furnished to SEBI.

Issue of securities in dematerialised form

A company can not 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.

Partly Paid-up Shares

These Regulations also require that all the existing partly paid-up shares must be made fully paid or the subscription money be forfeited if the investor fails to pay call money within 12 months. A company can not make a public or rights issue of securities unless firm arrangements of finance through verifiable means towards 75% of the stated means of finance, excluding the amount to be raised through proposed Public/Rights issue, have been made.

Fast Track Issues (FTIs)

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, it has been decided by SEBI 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.

Accordingly the provisions relating to filing of offer document are not applicable to public issue of securities by a listed issuer company or a rights issue of securities by a listed issuer company, where the aggregate value of such securities, including premium, if any, exceeds Rs. 50 lacs, if the following conditions are satisfied:

- (a) The shares of the company have been listed on any stock exchange having nationwide terminals for a period of at least three years immediately preceding the reference date;
- (b) The ~~average~~ market capitalisation of public shareholding” of the company is at least Rs. 5,000 crores for a period of one year up to the end of the quarter preceding the month in which the proposed issue is approved by the Board of Directors/shareholders of the issuer; Average market capitalisation of public shareholding has been defined to mean the sum of daily market capitalization of ~~public~~ shareholding” for a period of one year up to the end of the quarter preceding the month in which the proposed issue was approved by the Board/shareholders, as the case may be, divided by the number of trading days. For this purpose, ~~public~~ shareholding” shall have the same meaning as assigned to it in clause 40A of the Listing Agreement.

However, for issuers whose public shareholding is less than 15% of its issued equity capital, the annualized trading turnover of its equity shares has been at least 2% of the weighted number of equity shares available as free float during such six months period.

- (c) The annualized trading turnover of the shares of the company during six calendar months immediately preceding the month of the reference date has been at least two per cent of the weighted average number of shares listed during the said six months period;
- (d) The company has redressed at least 95% of the total shareholder/investor grievances or complaints received till the end of the quarter immediately preceding the month of the reference date;
- (e) The company has complied with the listing agreement for a period of at least three years immediately preceding the reference date;
However, in case of non-compliance with the equity listing agreement during the immediately preceding last three years adequate disclosures are made in the offer document regarding such non-compliance;
- (f) The impact of auditors' qualifications, if any, on the audited accounts of the company in respect of the financial years for which such accounts are disclosed in the offer document does not exceed 5% of the net profit/loss after tax of the company for the respective years.
- (g) No prosecution proceedings or show cause notices issued by the Board are pending against the company or its promoters or whole time directors as on the reference date; and
- (h) The entire shareholding of the promoter group is held in dematerialised form as on the reference date.



Reference date means in case of a public issue of securities by a listed company satisfying all the requirements specified in this clause, the date of filing of red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with ROC; and in case of a rights issue of securities by a listed company satisfying all the requirements specified in this clause, where the aggregate value of such securities, including premium, if any, exceeds Rs. 50 lacs, the date of filing of letter of offer with Designated Stock Exchange.

A listed issuer company satisfying all the requirements specified in this clause and filing a red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with ROC or letter of offer with Designated Stock Exchange, as the case may be, shall simultaneously with such filing or as soon thereafter as reasonably practicable, but in any case not later than the opening of the issue, file a copy thereof with SEBI.

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, subject to the following:

- (a) retail individual investors or retail individual shareholders or employees entitled for reservation making an application for a value of not more than two lakh rupees, can be offered specified securities at a price lower than the price at which net offer is made to other categories of applicants.

However, such difference shall not be more than 10% of the price at which specified securities are offered to other categories of applicants.

- (b) in case of a book built issue, the price of the specified securities offered to an anchor investor should not be lower than the price offered to other applicants;

If the issuer opts for alternate method of book building, the issuer can offer specified securities to its employees at a price, lower than floor price and the difference between such price and floor price shall not be more than 10%.

- (c) in case of a composite issue, the price of the specified securities offered in the public issue can be different from the price offered in rights issue and justification for such price difference should be given in the offer document.

Price and price band

- (1) The issuer can mention a price or price band in the draft prospectus (in case of a fixed price issue) and floor price or price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies.

However, the prospectus registered with the Registrar of Companies should contain only one price or the specific coupon rate, as the case may be.

- (2) If the floor price or price band is not mentioned in the red herring prospectus, the issuer should announce the floor price or price band at least 2 working days before the opening of the bid (in case of an initial public offer) and at least 1 working day before the opening of the bid (in case of a further public offer), in all the newspapers in which the pre issue advertisement was released.
- (3) The announcement should contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the prospectus.
- (4) The cap on the price band shall be less than or equal to one hundred and twenty per cent of the floor price.
- (5) The floor price or the final price should not be less than the face value of the specified securities. "Cap on the price band" includes cap on the coupon rate in case of convertible debt instruments.

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 Rs. 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 Rs. 10/- per share.

It may be noted that 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 intra-structure sector.

- (ii) The disclosure about the face value of shares (including the statement about the issue price being \times times of the face value) shall be made in the advertisement, offer documents and in application forms in identical font size as that of issue price or price band.

Promoters' Contribution

Promoters' contribution in any issue shall be in accordance with the following provisions as on (i) the date of filing red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with ROC or letter of offer with Designated Stock Exchange, as the case may be, in case of a fast track issue; and (ii) the date of filing draft offer document with the Board, in any other case.

Promoters' contribution

Unlisted Company	In case of Public Issue	Not less than 20% of the post-issue capital
Listed Company	In case of Public Issue	To the extent of 20% of the proposed issue or 20% of the post-issue capital
Listed Company	Composite Issue*	20% of the proposed public issue or 20% of the post-issue capital.

* Rights issue component of the composite issue shall be excluded while calculating the post-issue capital.

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.

However, where the promoters' contribution has been brought prior to the public

issue and has already been deployed by the company, the company shall give the cash flow statement in the offer document disclosing the use of such funds received as promoters' contribution.

If the promoters' minimum contribution exceeds Rs.100 crores, the promoters shall bring in Rs.100 crores before the opening of the issue and the remaining contribution shall be brought in by the promoters in advance on pro-rata basis before the calls are made on public.

Exemption from Requirement of Promoters' Contribution

- In case of a further public offer, where the equity shares of the same class which are proposed to be allotted pursuant to conversion or exchange of convertible securities offered through the offer or are proposed to be allotted in the offer have been listed and are not infrequently traded in a recognized stock exchange for a period of at least 3 years and the issuer has a track record of dividend payment for at least immediately preceding three years.
- In case of companies where no identifiable promoter or promoter group exists.
- In case of rights issues.

However, in all the above cases the promoters shall disclose their existing shareholding and the extent to which they are participating in the proposed issue in the offer document.

Lock-in-Requirements

- The promoters contribution 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.

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. However, 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 a foreign venture capital investor for a period of one year prior to the date of filing the draft prospectus with SEBI.

If the shares held by promoter(s) are lent to the Stabilizing Agent (SA) as prescribed, they should be exempted from the lock-in requirements specified above, for the period starting from the date of such lending and ending on the date on which

they are returned to the same lender(s). However, the securities should be locked-in for the remaining period from the date on which they are returned to the lender.

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, 1997, as applicable.

The securities held by promoters can be transferred to another promoter or any person of the promoter group or a new promoter or a person in control of the issuer and securities held by persons other than promoters can be transferred to any other person holding the securities which are locked-in along with the securities proposed to be transferred, subject to the compliance of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. However, the lock-in on such securities shall continue for the remaining period with the transferee and such transferee shall not be eligible to transfer them till the lock-in-period stipulated has expired.

The securities which are subject to lock-in shall carry inscription non-transferable along with duration of specified non-transferable period mentioned in the face of the security certificate. Further, the shares held by the promoters during lock-in-period are allowed to be pledged with the Banks or Financial Institutions as collateral security for loans granted by such Banks or Financial Institutions provided that the pledge of shares is one of the terms of sanction of loan.

Underwriting

Underwriting means an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them.

- (1) Where the issuer making a public issue (other than through the book building process) or rights issue, desires to have the issue underwritten, it shall appoint the underwriters in accordance with SEBI (Underwriters) Regulations, 1993.
- (2) Where the issuer makes a public issue through the book building process, such issue shall be underwritten by book runners or syndicate members.
However, fifty per cent of the net offer to public proposed to be compulsorily allotted to qualified institutional buyers cannot be underwritten.
- (3) The issuer shall enter into underwriting agreement with the book runner, who in turn shall enter into underwriting agreement with syndicate members, indicating therein the number of specified securities which they shall subscribe to at the predetermined price in the event of under subscription in the issue.
- (4) If syndicate members fail to fulfill their underwriting obligations, the lead book runner shall fulfill the underwriting obligations.
- (5) The book runners and syndicate members shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.
- (6) A copy of the syndicate agreement shall be filed with the Board before the opening of bids.

- (7) In case of every underwritten issue, the lead merchant banker or the lead book runner shall undertake minimum underwriting obligations as specified in the SEBI (Merchant Bankers) Regulations, 1992.
- (8) Where 100% of the offer through offer document is underwritten, the underwriting obligations shall be for the entire 100% of the offer through offer document and shall not be restricted upto the minimum subscription level.

In respect of an underwritten issue, the lead merchant banker shall ensure that the relevant details of underwriters are included in the offer document as follows:

-Underwriting of the issue:

- (a) Names and addresses of the underwriters and the amount underwritten by them
- (b) Declaration by board of directors of the issuer company that the underwriters have sufficient resources to discharge their respective obligations.”

In case of under subscription at an issue, the Lead Merchant Banker responsible for underwriting arrangements shall invoke underwriting obligations and ensure that the underwriters pay the amount of devolvement and the same shall be incorporated in the inter-se allocation of responsibilities accompanying the due diligence certificate submitted by the Lead Merchant Banker to the Board.

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. However this condition will not apply to Infrastructure company on satisfying the specified requirements and a government company, statutory authority or corporation or any special purpose vehicle set up and controlled by one or more of them, which is engaged in infrastructure sector.



Infrastructure company means an enterprise wholly engaged in the business of (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining any infrastructure facility.

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. However the company should make arrangements for monitoring of the use of proceeds of the issue by one of the scheduled commercial banks or by a public financial institutions named in the offer document as bankers to the issuer and copy of the monitoring report must be filed with SEBI by such monitoring agency in the format specified on half yearly basis till the completion of the project for the purpose of record.

Despatch of Issue Material

The lead merchant banker must ensure that for public issues offer documents and other issue materials including forms for ASBA are dispatched to the designated stock exchanges, syndicate members, underwriters, bankers to the issue, investors associations, self certified syndicate banks, etc. in advance as agreed upon. In the case of rights issues also, lead merchant banker must ensure that the abridged letters of offer along with composite application form are dispatched through registered post or speed post to all shareholders at least 3 days before the date of opening of the issue. Where a specific request for letter of offer is received from any shareholder, the lead Merchant Banker shall ensure that the letter of offer is made available to such shareholder.

Issue Opening Date

Subject to the compliance with sub-section (4) of Section 60 of the Companies Act, 1956 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.

Section 60(4) of Companies Act, 1956 provides that—

No prospectus shall be issued more than 90 days after the date on which a copy thereof is delivered for registration, and if a prospectus is so issued, it shall be deemed to be a prospectus, a copy of which has not been delivered under this section to the Registrar. 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.

Share Application Forms

Every application form including application supported by blocked amount forms distributed must be accompanied by a copy of the abridged prospectus. The application form including application supported by blocked amount forms may be stapled to form part of the Abridged prospectus or may be a perforated part of abridged prospectus. Enough space shall be provided in the application form to enable the investors to file in various details like name, address etc. The application forms to subscribe the shares or debentures of the company should contain necessary instructions for the applicants to mention the application number on the backside of the instrument making payment of application money such as cheques, drafts etc. so as to avoid misuse of the payment instruments.

It is also mandatory for applicants to provide information in the application forms relating to Banks Account Number and the name of the bank with whom such account is held with a view to enable the printing the said details in the refund orders or for refunds through Electronic Clearing System. However in case of an issue of securities which is wholly required to be made in the dematerialized form, it would not be necessary to require bank account details in the application form. In such a case, the application form shall contain a statement that the bank account details of the applicant would be taken from the data provided by him to the depository. In respect of applications irrespective of the amount, the applicant or in case of applications in joint names, each of the applicant mention his/her permanent account number and income tax circle, ward, district or the fact of non-allotment of PAN/GIR number as the case may be. Applications not complying with the provisions are liable to be rejected.

Introduction of ASBA

In its continuing endeavour to make the existing public issue process more efficient, SEBI has introduced a supplementary process of applying in public issues, viz., the "Applications Supported by Blocked Amount (ASBA)" process.

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. The main features of ASBA process are as follows:

SCSB: 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.

A SCSB shall identify its Designated Branches (DBs) at which an ASBA investor shall submit ASBA and shall also identify the Controlling Branch (CB) which shall act as a coordinating branch for the Registrar of the issue, Stock Exchanges and Merchant Bankers. The SCSB, its DBs and CB shall continue to act as such, for all issues to which ASBA process is applicable. The SCSB may identify new DBs for the purpose of ASBA process and intimate details of the same to SEBI, after which SEBI will add the DB to the list of SCSBs maintained by it. The SCSB shall communicate the following details to Stock Exchanges for making it available on their respective websites; these details shall also be made available by the SCSB on its website:

- (i) Name and address of all the SCSB.
- (ii) Addresses of DBs and CB and other details such as telephone number, fax number and email ids.
- (iii) Name and contacts details of a nodal officer at a senior level from the CB.

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 through 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.

ASBA Process: An ASBA investor submits an ASBA physically or electronically through the internet banking facility, to the SCSB with whom the bank account to be blocked, is maintained. The SCSB then blocks the application money in the bank account specified in the ASBA, on the basis of an authorization to this effect given by the account holder in the ASBA. The application money remains blocked in the bank account till finalisation of the basis of allotment in the issue or till withdrawal/failure of the issue or till withdrawal/rejection of the application, as the case may be. The application data shall thereafter be uploaded by the SCSB in the electronic bidding system through a web enabled interface provided by the Stock Exchanges. Once the basis of allotment is finalized, the Registrar to the Issue sends an appropriate request to the SCSB for unblocking the relevant bank accounts and for transferring the requisite amount to the issuer's account. In case of withdrawal/failure of the issue, the amount shall be unblocked by the SCSB on receipt of information from the pre-issue merchant bankers.

Obligations of the Issuer: The issuer shall ensure that adequate arrangements are made by the Registrar to the Issue to obtain information about all ASBAs and to treat these applications similar to non-ASBA applications while finalizing the basis of allotment, as per the procedure specified in the Guidelines.

Applicability of ASBA process: ASBA process is applicable to all book-built public issues which provide for not more than one payment option to the retail individual investors.

The details of the role and responsibilities of Stock Exchanges, intermediaries, viz., Registrars to the issue, Merchant Banker(s) and Stock Exchanges in the ASBA process have also been prescribed by SEBI.

Minimum Number of Share Applications and Application Money

The minimum application value shall be within the range of Rs. 5,000 to Rs. 7,000. The issuer company, in consultation with the merchant banker, shall stipulate the minimum application size (in terms of number of specified securities) falling within the aforesaid range of minimum application value and make upfront disclosures in this regard, in the offer document.

Thus, the minimum application value shall be with reference to the issue price of the specified securities and not with reference to the amount payable on application.

Assuming an issue is being made at a price of Rs. 390 per equity share. In this case, the issuer in consultation with the lead merchant banker can determine the minimum application lot within the range of 13—17 equity shares (in value terms

between Rs. 5,000—Rs. 7,000), as explained hereunder:

Options	I	II	III	IV	V
Lot Size @ Rs. 390/- per share	13 shares	14 shares	15 shares	16 shares	17 shares
Application / Bid amount for 1 lots	5070	5469	5850	6240	6630
Application / Bid amount for 2 lots	10140	10920	11700	12480	13260
Application / Bid amount for 4 lots	20280	21840	23400	24960	26520
Application / Bid amount for 8 lots	40560	43680	46800	49920	—
Application / Bid amount for 9 lots	45630	49140	—	—	—

Applications can be made in multiples of the minimum size /value so stipulated in the offer document by the issuer and merchant banker within the range of Rs. 5000-7000.

The minimum application moneys to be paid by an applicant along with the application money shall not be less than 25% of the issue price.

In case of an offer for sale, the issue price payable for each specified securities shall be brought in at the time of application.

Issue of Advertisements

Advertisement includes notices, brochures, pamphlets, circulars show cards, catalogues, hoardings, placards, posters, insertion in newspapers, pictures, films, cover pages of offer documents or any other print medium radio, television programmes through any electronic medium.

Pre-issue advertisement

The issuer company shall soon after receiving final observations, if any, on the offer document from SEBI, make an advertisement in an English National daily with wide circulation, one Hindi National newspaper and a regional language newspaper with wide circulation at the place where the registered office of the issuer is situated, in the prescribed format, subject to section 66 of the Companies Act, 1956. In case of a fast track issue, the advertisement shall be made before the issue opening date.

Post-issue Advertisements

The post-issue Lead Merchant Banker is required to ensure that in all issues, advertisement giving details relating to oversubscription, basis of allotment, number, value and percentage of applications, number, value and percentage of successful allottees, date of completion of despatch of refund orders or instructions to self certified syndicate banks by the registrar, date of despatch of certificates and date of filing of listing application is released within 10 days from the date of completion of the various activities at least in an English National Daily with wide circulation, one Hindi National Paper and a Regional language daily circulated at the place where

registered office of the issuer company is situated. Post-issue Lead Merchant Banker is required to ensure that issuer company/advisors/brokers or any other entity connected with the issue do not publish any advertisement stating that the issue has been oversubscribed or indicating investors' response to the issue, during the period when the public issue is still open for subscription by the public. Advertisement stating that "the subscription to the issue has been closed" may be issued after the actual closure of the issue.

Mandatory Collection Centres

The Regulations require a minimum number of collection centres for an issue of capital to be at the four metropolitan centre viz. Mumbai, Delhi, Kolkata and Chennai and at all such centres where the stock exchanges are located in the region in which the registered office of the company is situated. In addition, all designated branch of self certified syndicate banks, as displayed on the websites of such banks and of the Board, shall be deemed to be mandatory collection centres. However the issuer company is free to appoint as many collection centres as it may deem fit in addition to the above minimum requirement.

Minimum Subscription

The minimum subscription to be received in an issue should not be less than ninety percent of the offer through offer document. 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. The requirement is also not applicable to an eligible infrastructure company, provided disclosures regarding the alternate source of funding is made in the prospectus.

For Non-underwritten Public Issues

If the company does not receive the minimum subscription of 90% of the issued amount on the date of closure of the issue, or if the subscription level falls below 90% after the closure of issue on account of cheques having being returned unpaid or withdrawal of applications, the company would refund the entire subscription amount received. If there is a delay beyond 8 days after the company becomes liable to pay the amount, the company is required to pay interest as per Section 73 of the Companies Act 1956.

For Underwritten Public Issues

If the company does not receive the minimum subscription of 90% of the net offer to public including devolvement of Underwriters within 60 days from the date of closure of the issue, the company would refund the entire subscription amount received. If there is a delay beyond 8 days after the company becomes liable to pay

the amount, the company is required to pay interest prescribed under Section 73 of the Companies Act 1956.

For Composite Issues

The Lead Merchant Banker would ensure that the requirement of "minimum subscription" is satisfied both jointly and severally, i.e., independently for both rights and public issues and if the company does not receive the minimum subscription in either of the issues the company would refund the entire subscription received.

Restrictions on Further Issue of Capital

These Regulations prohibit a company from making any further issue of capital by way of bonus shares, qualified institutions placement, preferential allotment, rights issue or public issue or otherwise, during the period commencing from submission of offer document to SEBI on behalf of the company for public or rights issue till the securities referred to in the said offer document have been listed or application moneys have been refunded on account of non-listing or under subscription etc. if any, unless full disclosures regarding the total capital to be raised from such further issues are made in the draft offer document. However, in case of a fast track issue, no such further issue of capital shall be made during the period between filing of the red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with ROC or the letter of offer with Designated Stock Exchange and listing of the specified securities offered in the issue or refund of application moneys, unless full disclosures regarding the total capital proposed to be so raised are made in the offer document.

Proportionate Allotment

The allotment to applicants other than anchor investor shall be on a proportionate basis within the specified categories rounded off to the nearest integer subject to a minimum allotment being equal to the minimum application size as fixed and disclosed by the issuer.

Basis of Allotment

In a public issue of securities, the Executive Director/Managing Director of the Designated Stock Exchange along with the post issue Lead Merchant Banker and the Registrars to the Issue shall be responsible to ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the guidelines. However in case of book building portion of a book built public issue, SEBI (ICDR) Regulations, shall be applicable.

The listed company would ensure that all steps for completion of the necessary formalities for listing and commencement of trading at all stock exchanges where the securities are to be listed have been taken within 7 working days of finalisation of basis of allotment.

Coordination with Intermediaries

The Post-issue lead merchant banker shall maintain close co-ordination with the Registrars to the Issue and arrange to depute its officers to the offices of various intermediaries at regular intervals after the closure of the issue to monitor the flow of

applications from collecting bank branches, and/or self certified syndicate banks processing of the applications including application form for applications supported by blocked amount and other matters till the basis of allotment is finalised, despatch of security certificates and refund orders are completed and securities are listed.

Any act of omission or commission on the part of any of the intermediaries noticed during such visits shall be duly reported to SEBI.

In case there is a development on underwriters, the merchant banker is required to ensure that the notice for development containing the obligation of the issuer is issued within a period of 10 days from the date of closure of the issue.

In case of undersubscribed issues, the merchant bank is required to furnish information in respect of underwriters who have failed to meet their underwriting development to SEBI in the format specified in these regulations.

The post-issue merchant banker is required to confirm to the bankers to the issue by way of copies of listing and trading approval that all formalities in connection with the issue have been completed and that the banker is free to release the money to the issuer or refund it in case of failure of the issue.

Reservation on competitive basis

(1) In case of an issue made through the book building process, the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of the following categories of persons:

- (a) employees, in case of new issuer, persons who are in the permanent and full time employment of the promoting companies excluding the promoters and an immediate relative of the promoter of such companies.
- (b) shareholders (other than promoters) of:
 - (i) listed promoting companies, in case of a new issuer; and
 - (ii) listed group companies, in case of an existing issuer:

However, if the promoting companies are designated financial institutions or state and central financial institutions, the shareholders of such promoting companies shall not be eligible for the reservation on competitive basis;

- (c) persons who, as on the date of filing the draft offer document with SEBI, are associated with the issuer as depositors, bondholders or subscribers to services of the issuer making an initial public offer. However, the issuer shall not make the reservation to the issue management team, syndicate members, their promoters, directors and employees and for the group or associate companies of the issue management team and syndicate members and their promoters, directors and employees.

(2) In case of an issue made other than through the book building process, the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of the following categories of persons:

- (a) employees and in case of new issuer, persons who are in the permanent and

full time employment of the promoting companies excluding the promoters and an immediate relative of the promoter of such companies.

- (b) shareholders (other than promoters) of:
- (i) listed promoting companies, in case of a new issuer; and
 - (ii) listed group companies, in case of an existing issuer:

However, if the promoting companies are designated financial institutions or state and central financial institutions, the shareholders of such promoting companies shall not be eligible for the reservation on competitive basis;

(3) In case of a further public offer (not being a composite issue), the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of retail individual shareholders of the issuer.

- (4) The reservation on competitive basis shall be subject to following conditions:
- (a) the aggregate of reservations for employees shall not exceed 5% of the issue size;
 - (b) reservation for shareholders shall not exceed 10% of the issue size;
 - (c) reservation for persons who as on the date of filing the draft offer document with SEBI have business association as depositors, bondholders and subscribers to services with the issuer making an initial public offer shall not exceed 5% of the issue size;
 - (d) no further application for subscription in the net offer to public category shall be entertained from any person (except an employee and retail individual shareholder) in favour of whom reservation on competitive basis is made;
 - (e) any unsubscribed portion in any reserved category may be added to any other reserved category and the unsubscribed portion, if any, after such *inter-se* adjustments among the reserved categories shall be added to the net offer to the public category;
 - (f) in case of under-subscription in the net offer to the public category, spill-over to the extent of under-subscription shall be permitted from the reserved category to the net public offer category;
 - (g) value of allotment to any employee made shall not exceed two lakh rupees.

(5) In the case of reserved categories, a single applicant in the reserved category may make an application for a number of specified securities which exceeds the reservation.



-Reservation on competitive basis" means reservation wherein specified securities are allotted in portion of the number of specified securities applied for in respect of a particular reserved category to the number of specified securities reserved for that category.

Allocation in net offer to public

A person should not make an application in the net offer to public category for

that number of specified securities which exceeds the number of specified securities offered to public.

In an issue made through the book building process, the allocation in the net offer to public category should be made as follows:

- (a) not less than 35% to retail individual investors;
- (b) not less than 15% to non-institutional investors;
- (c) not more than 50% to qualified institutional buyers, five per cent of which shall be allocated to mutual funds. However, in case of an issue made through book building process at least 50% of the net offer to public shall be allotted to qualified institutional buyers.

Further, where the issuer is required to allocate 60% of the net offer to public to qualified institutional buyers in terms of the provisions of sub-clause (b) of clause (2) of rule 19 of Securities Contracts (Regulations) Rules, 1957, allocation to retail individual investors and non-institutional investors shall be 30% and 10% respectively. In addition to 5% allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

In an issue made through the book building process, the issuer may allocate upto 30% of the portion available for allocation to qualified institutional buyers to an anchor investor in accordance with the conditions specified in this regard in Schedule XI.

(4) In an issue made other than through the book building process, allocation in the net offer to public category shall be made as follows:

- (a) minimum 50% to retail individual investors; and
- (b) remaining to:
 - (i) individual applicants other than retail individual investors; and
 - (ii) other investors including corporate bodies or institutions, irrespective of the number of specified securities applied for;
- (c) the unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in the other category.

For the above purpose if the retail individual investor category is entitled to more than 50% on proportionate basis, the retail individual investors shall be allocated that higher percentage.

Offer Document to be Made Public

The draft offer document filed with SEBI shall be made public for comments, if any, for a period of 21 days from the date of filing the offer document with SEBI by hosting it on the websites of the SEBI, recognized stock exchanges where specified securities are proposed to be listed and merchant bankers associated with the issue.

After a period of 21 days from the date the draft offer document was made public, the Lead Merchant Bankers shall file with SEBI a statement giving information

of the comments received by them or issuer during that period and the consequential changes, if any, to be made in the draft offer document.

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.

MOUs should not contain any clauses contrary to the provision of the Companies Act, 1956 and SEBI (Merchant Bankers) Rules and Regulations, 1992 so as to diminish the liabilities and obligations of the lead merchant banker or the issuer company. Lead manager is required to exercise due diligence. The standard of due diligence shall be such that merchant banker shall satisfy himself about all aspects of offering, veracity and adequacy of disclosure in offer document. 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. In case of a fast track issue, *inter se* allocation of responsibilities is not required to be submitted. In case of a debenture issue, the lead merchant banker shall also furnish to SEBI a due diligence certificate given by the debenture trustee in the prescribed format alongwith the draft offer document.

In case of fast track issue, the lead manager shall furnish a due diligence certificate in the prescribed format along with a copy of red herring prospectus, prospectus or letter of offer as the case may be.

In addition to the due diligence certificate to be furnished alongwith the draft prospectus, lead managers are also required to –

- (i) Certify that all the amendments suggested/observations made by SEBI have been given effect to in the prospectus,
- (ii) Furnish a fresh due diligence certificate at the time of filing the prospectus with the Registrar of Companies,
- (iii) Furnish a fresh certificate immediately before the opening of the issue that no corrective action is needed, and
- (iv) Furnish a fresh and final compliance certificate before the issue is closed for subscription.

Allotment of Securities

The company agrees that as far as possible allotment of securities offered to the public shall be made within 15 days of the closure of public issue. The company further agrees that it 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. However applications received after the closure of issue. However, applications received after the closure of issue in fulfillment of underwriting obligations to meet the minimum subscription requirement, shall not be entitled for the said interest.

Despatch of Letter of Allotment and Share Certificates

The Company shall take such steps as are necessary to ensure the completion of allotment and despatch of letters of allotment and refund orders to the applicants including NRIs soon after the basis of allotment has been approved by the stock exchanges and in any case not later than the statutory time limit and in the event of failure to do so pay interest to the applicants as provided under the Companies Act, 1956.

Compliance Officer

Every company making a public issue is required to appoint a compliance officer and intimate the name of the compliance officer to SEBI. Compliance Officer shall directly liaise with SEBI with regard to compliance with various laws, rules regulations, and other directives issued by SEBI and investor complaints related matters. He is also required to co-ordinate with regulatory authorities in various matters and provide necessary guidance so as to ensure compliance internally and ensure that observations made/deficiency pointed out by SEBI do not recur. In terms of Clause 47 of the listing Agreement of Stock Exchanges, Compliance Officer shall be Company Secretary of the Company, who shall be responsible for ensuring the correctness, authenticity and comprehensiveness of the information, statements, reports etc. filled under corporate filing and dissemination system as specified in Clause 52(1)(b) of the listing agreement.

Redressal of Investors Grievances

These Regulations make it necessary for companies to assign high priority to investor grievances and ensure that all preventive steps have been taken to minimise the number of complaints. Proper grievance monitoring and redressal system should be set in consultation with the lead merchant banker and Registrar to an issue and necessary measures to resolve the grievances quickly and lead merchant banker should closely associate with the post issue refund and allotment activities and regularly monitor investor grievances arising therefrom.

The offer documents shall necessarily disclose the arrangements or any mechanism evolved by the company for redressal of investor grievances.

1. The company shall disclose the time normally taken by it for disposal of various types of investor grievances.
2. Similar disclosure shall be made in regard to the listed companies under the same management within the meaning of Section 370(1B) of the Companies Act for the period of 3 years prior to the date of filing of the offer documents with ROC/Stock Exchange.

Powers of SEBI

Chapter XI of SEBI Regulations empowers SEBI to issue directions to the persons concerned, the stock exchanges and the intermediaries.

In case of the violation of these guidelines, SEBI has been empowered to direct the persons concerned to refund any money collected under an issue to the investors with or without requisite interest as the case may be and not to access the capital market for a particular period. In respect of violations by stock exchanges, SEBI can direct the exchange concerned not to list or permit trading in the securities and to forfeit the security deposit by the issuer company. In case of violations by intermediaries, SEBI may suspend or cancel the certificate of registration of any intermediary who fails to exercise due diligence or fails to comply with the obligations entrusted under the guidelines or who is alleged to have updated any of these guidelines. SEBI is under an obligation to follow the specified procedures provided under the regulations dealing with such intermediaries.

Disclaimer Clause of SEBI

SEBI notified the format of issue advertisement in Schedule XIII of SEBI (ICDR) Regulations. This provide for inclusion of SEBI Disclaimer Clause which reads as under:

–Disclaimer Clause of SEBI – SEBI only gives its observations on the offer documents and this does not constitute approval of either the issue or the offer document.”

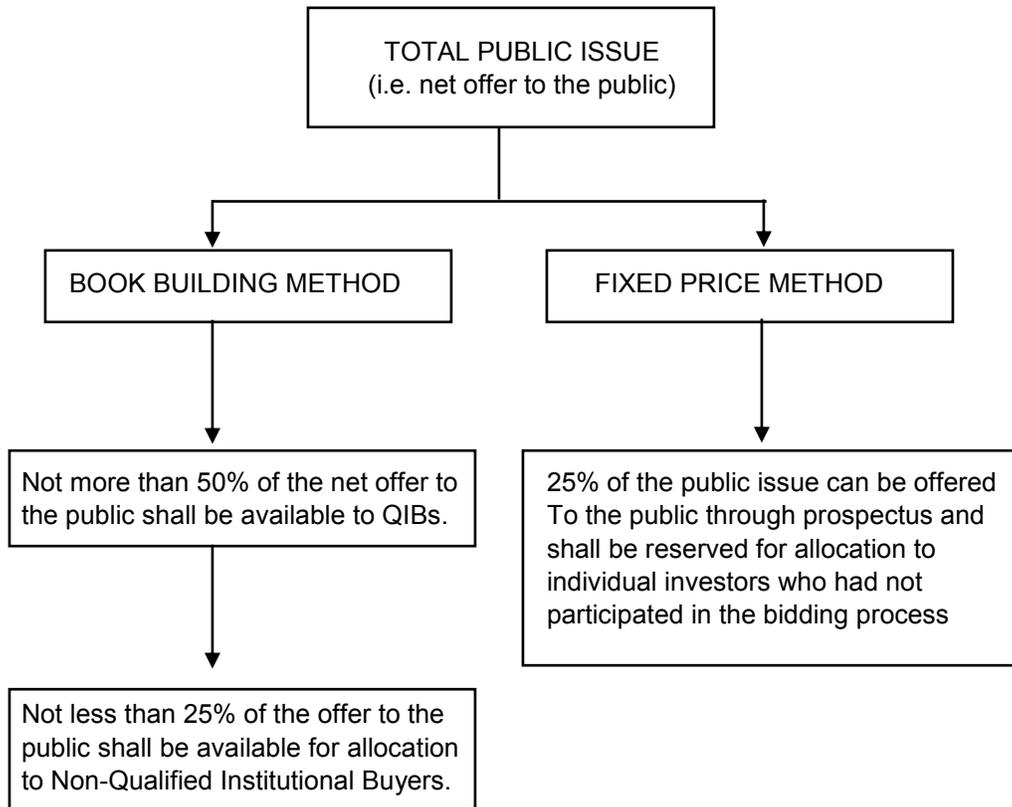
Book Building

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.

The book building process in India is very transparent. All investors including small investors can see on an hourly basis where the book is being built before applying. According to this method , share prices are determines on the basis of real demand for the shares at various price levels in the market.

Difference between Fixed Price Process and Book Building Process

<i>Features</i>	<i>Fixed Price process</i>	<i>Book Building process</i>
<i>Pricing</i>	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 is known.
<i>Demand</i>	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.
<i>Payment</i>	Payment if made at the time of subscription wherein refund is given after allocation.	Payment only after allocation

Offer to Public through Book Building Process

1. An issuer company may, subject to the requirements specified make an issue of securities to the public through a prospectus through 100% of the net offer to the public through book building process.
2. Reservation to the extent of percentage specified in these Regulations can be made only to the following categories
 - (a) permanent employees of the issuer company and in the case of a new company the permanent employees of the promoting companies';
 - (b) shareholders of the promoting companies in the case of a new company and shareholders of group companies in the case of an existing company' either on a competitive basis' or on a firm allotment basis'.
 - (c) persons who, on the date of filing of the draft offer document with the Board, have business association, as depositors, bondholders and subscribers to services, with the issuer making an initial public offering, provided that allotment to such persons shall not exceed 5% of the issue size.

However, no reservation can be made for the issue management team, syndicate members, their promoters, directors and employees and for the

group/associate companies of issue management team and syndicate members and their promoters, directors and employees.

3. The issuer company is required to enter into an agreement with one or more of the Stock Exchange(s) which have the requisite system of on-line offer of securities. The agreement would cover *inter-alia*, the rights, duties, responsibilities and obligations of the company and stock exchange (s) *inter se*. The agreement may also provide for a dispute resolution mechanism between the company and the stock exchange.

The company may also apply for listing of its securities on an exchange other than the exchange through which it offers its securities to public through the on-line system.

4. The Lead Merchant Banker shall act as the Lead Book Runner. In case the issuer company appoints more than one merchant banker, the names of all such merchant bankers who have submitted the due diligence certificate to SEBI, may be mentioned on the front cover page of the prospectus. A disclosure to the effect that "the investors may contact any of such merchant bankers, for any complaint pertaining to the issue" is required to be made in the prospectus, after the "risk factors."
5. The lead book runner/issuer may designate, in any manner, the other Merchant Bankers if the inter-se allocation of responsibilities amongst the merchant bankers is disclosed in the prospectus on the page giving the details of the issue management team and a co-ordinator has been appointed amongst the lead book runners, for the purpose of co-ordination with SEBI. However the names of only those merchant bankers who have signed the inter-se allocation of responsibilities would be mentioned in the offer document on the page where the details of the issue management team is given.
6. The primary responsibility of building the book is of the Lead Book Runner. The Book Runner(s) may appoint those intermediaries who are registered with SEBI and who are permitted to carry on activity as an 'Underwriter' as syndicate members. The Book Runner(s)/syndicate members shall appoint brokers of the exchange, who are registered with SEBI, for the purpose of accepting bids, applications and placing orders with the company and ensure that the brokers so appointed are financially capable of honouring their commitments arising out of defaults of their clients/investors, if any. However, in case of application supported by blocked amount, self certified banks shall accept and upload the details of such application in electronic bidding system of the stock exchange.
7. The brokers, and self certified syndicate banks accepting applications and application monies, are considered as 'bidding/collection centres'. The broker/s so appointed, shall collect the money from his/their client for every order placed by him/them and in case the client/investors fails to pay for shares allocated as per the Guidelines, the broker shall pay such amount.
8. In case of Applications Supported by Blocked Amount, the Self Certified Syndicate Banks shall follow the procedure specified by SEBI in this regard.

The company shall pay to the broker/s/Self Certified Syndicate Banks a commission/fee for the services rendered by him/them. The exchange shall ensure that the broker does not levy a service fee on his clients/investors in lieu of his services.

The draft prospectus containing all the disclosures except that of price and the number of securities to be offered to the public shall be filed by the Lead Merchant Banker with SEBI. The total size of the issue shall be mentioned in the draft prospectus.

9. The red herring prospectus shall disclose, either the floor price of the securities offered through it or a price band along with the range within which the price can move, if any.

However, the issuer may not disclose the floor price or price band in the red herring prospectus if the same is disclosed in case of an initial public offer, at least two working days before the opening of the bid and in case of a further public offer, at least one working day before the opening of the bid, by way of an announcement in all the newspapers in which the pre-issue advertisement was released by the issuer or the merchant banker;

Further, the announcement shall contain the relevant financial ratios, computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the offer document.

Where the issuer opts not to make the disclosure of the price band or floor price in the red-herring prospectus in terms of the foregoing proviso, the following shall be additionally disclosed in the red-herring prospectus:

- (a) a statement that the floor price or price band, as the case may be, shall be disclosed at least two working days (in case of an initial public offer) and at least one working day (in case of a further public offer) before the opening of the bid;
- (b) a statement that the investors may be guided in the meantime by the secondary market prices in case of public offer;
- (c) names and editions of the newspapers where the announcement of the floor price or price band would be made;
- (d) names of websites (with address), journals or other media in which the said announcement will be made.

Where the issuer decides to opt for price band instead of floor price, the lead book runner shall ensure compliance with the following conditions:

- (a) The cap of the price band should not be more than 20% of the floor of the band; i.e., cap of the price band shall be less than or equal to 120% of the floor of the price band
- (b) The price band can be revised during the bidding period in which case the maximum revision on either side shall not exceed 20% i.e floor of price band can move up or down to the extent of 20% of floor of the price band disclosed in the red herring prospectus and the cap of the revised price band will be fixed in accordance with Clause (a) above;

- (c) Any revision in the price band shall be widely disseminated by informing the stock exchanges, by issuing press release and also indicating the change on the relevant website and the terminals of the syndicate members.
 - (d) In case the price band is revised, the bidding period shall be extended for a further period of three days, subject to the total bidding period not exceeding ten working days.
 - (e) The manner in which the shortfall, if any, in the project financing, arising on account of lowering of price band to the extent of 20% will be met shall be disclosed in the red herring prospectus. It shall also be disclosed that the allotment shall not be made unless the financing is tied up.
10. In case of appointment of more than one Lead Merchant Banker or Book Runner for book building, the rights, obligations and responsibilities of each should be delineated. In case of an under subscription in an issue, the shortfall shall have to be made good by the Book Runner(s) to the issue and the same shall be incorporated in the *inter se* allocation of responsibility as provided in the Guidelines.
 11. The issuer company shall circulate the application forms to the Brokers
 12. The pre-issue obligations and disclosure requirements shall be applicable to issue of securities through book building unless stated otherwise in these regulations.
 13. The Book Runner(s) and the issuer company shall determine the issue price based on the bids received through the syndicate members and self certified syndicate banks.
 14. Retail individual investors may bid at "cut off" price instead of their writing the specific bid prices in the bid forms.
 15. On determination of the price, the number of securities to be offered shall be determined i.e. issue size divided by the price which has been determined.
 16. Once the final price (cut-off price) is determined all those bidders whose bids have been found to be successful shall become entitled for allotment of securities.
 17. No incentive, whether in cash or kind, shall be paid to the investors who have become entitled for allotment of securities.
 18. The broker may collect an amount to the extent of 100% of the application money as margin money from the clients/investors before he places an order on their behalf. The margin collected from categories other than Qualified Institutional Buyers shall be uniform across the book runner(s)/syndicate members/self certified syndicate banks, for each such category.
 19. The broker/syndicate member shall collect an amount of not less than ten percent of the application money as margin money in respect of bids placed by qualified institutional buyers and not less than twenty five percent of the application money from the Anchor Investors shall be taken as margin money.
 20. Bids for securities beyond the investment limit prescribed under relevant

laws shall not be accepted by the syndicate members/brokers from any category of clients/investors.

21. The lead book runner may reject a bid placed by a qualified institutional buyer for reasons to be recorded in writing provided that such rejection shall be made at the time of acceptance of the bid and the reasons therefor shall be disclosed to the bidders. Necessary disclosures in this regard shall also be made in the offer document.
22. On determination of the entitlement, the information regarding the same i.e. the number of securities which the investor becomes entitled shall be intimated immediately to the investors.
23. The final prospectus containing all disclosures as per these Guidelines including the price and the number of securities proposed to be issued shall be filed with the Registrar of Companies.
24. Arrangement shall be made by the issuer for collection of the applications by appointing mandatory collection centres as per these Regulations.
25. The bidding terminals shall contain an online graphical display of demand and bid prices updated at periodic intervals not exceeding 30 minutes. The book running lead manager shall ensure the availability of adequate infrastructure with syndicate members for data entry of the bids in a timely manner.
26. The investors who had not participated in the bidding process or have not received intimation of entitlement of securities may also make an application.

Anchor investors

–Anchor investor” means a qualified institutional buyer 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:

- (a) Allocation to Anchor Investors shall be on a discretionary basis and subject to a minimum number of 2 such investors for allocation of upto Rs. 250 crore and 5 such investors for allocation of more than Rs. 250 crore.
- (b) Upto thirty per cent of the portion available for allocation to qualified institutional buyers shall be available to anchor investor(s) for allocation/allotment (–anchor investor portion”).
- (c) One-third of the anchor investor portion shall be reserved for domestic mutual funds.
- (d) The bidding for Anchor Investors shall open one day before the issue opening date.
- (e) Anchor Investors shall pay on application the same margin which is payable by other categories of investors, the balance to be paid within two days of the date of closure of the issue.
- (f) Allocation to Anchor Investors shall be completed on the day of bidding by Anchor Investors.
- (g) If the price fixed as a result of book building is higher than the price at which the allocation is made to Anchor Investor, the Anchor Investor shall bring in

the additional amount. However, if the price fixed as a result of book building is lower than the price at which the allocation is made to Anchor Investor, the excess amount shall not be refunded to the Anchor Investor and the Anchor Investor shall take allotment at the price at which allocation was made to it.

- (h) The number of shares allocated to Anchor Investors and the price at which the allocation is made, shall be made available in public domain by the merchant banker before opening of the issue.
- (i) There shall be a lock-in of 30 days on the shares allotted to the Anchor Investor from the date of allotment in the public issue.
- (j) Neither the merchant bankers nor any person related to the promoter/promoter group/merchant bankers in the concerned public issue can apply under Anchor Investor category. The parameters for selection of Anchor Investor shall be clearly identified by the merchant banker and shall be available as part of records of the merchant banker for inspection by SEBI.
- (k) The applications made by qualified institutional buyers under the Anchor Investor category and under the Non Anchor Investor category may not be considered as multiple applications.

Additional Disclosures in case of Book Building

Apart from meeting the disclosure requirements as specified in these Guidelines, the following disclosures shall be suitably made:

- (i) The particulars of syndicate members, brokers, self certified syndicate banks, registrars, bankers to the issue, etc.
- (ii) The following statement shall be given under the 'basis for issue price':

"The issue price has been determined by the Issuer in consultation with the Book Runner(s), on the basis of assessment of market demand for the offered securities by way of Book-building."
- (iii) The following accounting ratios shall be given under the basis for issue price for each of the accounting periods for which the financial information is given:
 1. EPS, pre-issue, for the last three years (as adjusted for changes in capital).
 2. P/E pre-issue
 3. Average return on net-worth in the last three years.
 4. Net-Asset value per share based on last balance sheet.
 5. Comparison of all the accounting ratios of the issuer company as mentioned above with the industry average and with the accounting ratios of the peer group (i.e companies of comparable size in the same industry. (Indicate the source from which industry average and accounting ratios of the peer group has been taken)
 6. The accounting ratios disclosed in the offer document shall be calculated after giving effect to the consequent increase of capital on account of compulsory conversions outstanding, as well as on the assumption that

the options outstanding, if any, to subscribe for additional capital shall be exercised)

- (iv) The proposed manner of allocation among respective categories of investors, in the event of under subscription.

Procedure for bidding

The process of bidding should be in compliance of the following requirements:

- (a) Bidding process shall be only through an electronically linked transparent bidding facility provided by recognised stock exchange (s).
- (b) The lead book runner shall ensure the availability of adequate infrastructure with syndicate members for data entry of the bids in a timely manner.
- (c) The syndicate members shall be present at the bidding centres so that at least one electronically linked computer terminal at all the bidding centres is available for the purpose of bidding.
- (d) During the period the issue is open to the public for bidding, the applicants may approach the stock brokers of the stock exchange/s through which the securities are offered under on-line system or Self Certified Syndicate Banks, as the case may be, to place an order for bidding for the specified securities.
- (e) Every stock broker shall accept orders from all clients/investors who place orders through him and every Self Certified Syndicate Bank shall accept Applications Supported by Blocked Amount from ASBA investors.
- (f) Applicants who are qualified institutional buyers shall place their bids only through the stock brokers who shall have the right to vet the bids;
- (g) The bidding terminals shall contain an online graphical display of demand and bid prices updated at periodic intervals, not exceeding thirty minutes.
- (h) At the end of each day of the bidding period, the demand including allocation made to anchor investors, shall be shown graphically on the bidding terminals of syndicate members and websites of recognised stock exchanges offering electronically linked transparent bidding facility, for information of public.
- (i) The investors may revise their bids;
- (j) The issuer may decide to close the bidding by qualified institutional buyers one day prior to the closure of the issue subject to the following conditions:
 - (i) bidding shall be kept open for a minimum of three days for all categories of applicants;
 - (ii) disclosures are made in the red herring prospectus regarding the issuer's decision to close the bidding by qualified institutional buyers one day prior to closure of issue.
- (k) The qualified institutional buyers shall not withdraw their bids after closure of bidding.
- (l) The identity of qualified institutional buyers making the bidding shall not be made public.

- (m) The stock exchanges shall continue to display on their website, the data pertaining to book built issues in an uniform format, inter alia giving category-wise details of bids received, for a period of at least three days after closure of bids.

Alternate method of book building

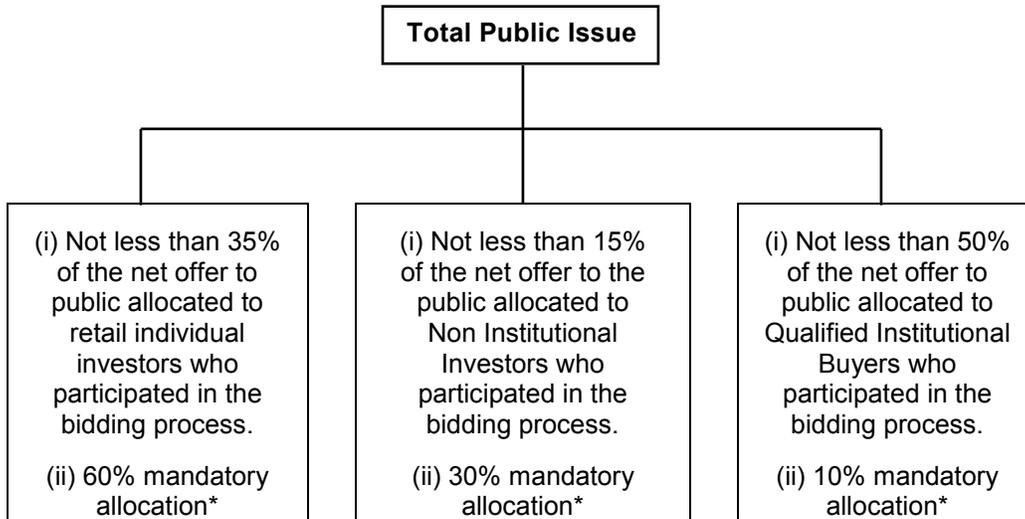
In case of further public offers, the issuer may opt for an alternate method of book building, subject to the following:

- (a) Issuer shall follow the procedure laid down in Part A of Schedule XI of SEBI (ICDR) Regulations, 2009.
- (b) The issuer may mention the floor price in the red herring prospectus or if the floor price is not mentioned in the red herring prospectus, the issuer shall announce the floor price at least one working day before opening of the bid in all the newspapers in which the pre-issue advertisement was released.
- (c) Qualified institutional buyers shall bid at any price above the floor price.
- (d) The bidder who bids at the highest price shall be allotted the number of securities that he has bided for and then the bidder who has bided at the second highest price and so on, until all the specified securities on offer are exhausted.
- (e) Allotment shall be on price priority basis for qualified institutional buyers.
- (f) Allotment to retail individual investors, non-institutional investors and employees of the issuer shall be made proportionately .
- (g) Where, however the number of specified securities bided for at a price is more than available quantity, then allotment shall be done on proportionate basis.
- (h) Retail individual investors, non-institutional investors and employees shall be allotted specified securities at the floor price .
- (i) The issuer may:-
 - (A) place a cap either in terms of number of specified securities or percentage of issued capital of the issuer that may be allotted to a single bidder;
 - (B) decide whether a bidder be allowed to revise the bid upwards or downwards in terms of price and/or quantity;
 - (C) decide whether a bidder be allowed single or multiple bids.

Maintenance of Books and Records

A final book of demand showing the result of the allocation process shall be maintained by the book runner/s. The Book Runner/s and other intermediaries in the book building process associated shall maintain records of the book building prices. SEBI has the right to inspect the records, books and documents relating to the Book building process and such person shall extend full cooperation.

All references mentioned above with respect to draft prospectus shall be construed as having been made to red herring prospectus' in application to fast track issues.

Allocation/allotment Procedure**100% of the Net offer to the public through 100% book building process**

*In case of issue made under Rule 19(2)(b) of Securities Contract Regulation Rules, 1957

The issuer can allocate upto 30% of the portion available for allocation to QIB, to an anchor investor in accordance with these regulations.

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.

GSO in the system of IPO using book-building method was recognised by SEBI in India through its new guidelines on 14th August 2003 (vide SEBI/ CFD/DIL/DIP/ Circular No. 11). ICICI bank has used Green Shoe Option in the first time in case of its public issue through book building mechanism in India.

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.

The company should appoint one of the merchant bankers or book runners, amongst the issue management team, as the “stabilising agent” (SA), who will be responsible for the price stabilisation process, if required. The SA shall enter into an agreement with the issuer company, prior to filing of offer document with SEBI, clearly stating all the terms and conditions relating to this option including fees charged/expenses to be incurred by SA for this purpose.

The SA should also enter into an agreement with the promoter(s) or pre-issue shareholders who will lend their shares under the provisions of this scheme,

specifying the maximum number of shares that may be borrowed from the promoters or the shareholders, which shall not be in excess of 15% of the total issue size.

The details of the agreements mentioned above should be disclosed in the draft prospectus, the draft Red Herring prospectus, Red Herring prospectus and the final prospectus. The agreements should also be included as material documents for public inspection. The lead merchant banker or the Lead Book Runner, in consultation with the SA, shall determine the amount of shares to be over-allotted with the public issue, subject to the maximum number specified above.

The draft prospectus, draft Red Herring prospectus, the Red Herring prospectus and the final prospectus should contain the following additional disclosures:

- (a) Name of the SA.
- (b) The maximum number of shares (as also the percentage vis-a-vis the proposed issue size) proposed to be over-allotted by the company.
- (c) The period, for which the company proposes to avail of the stabilisation mechanism.
- (d) The maximum increase in the capital of the company and the shareholding pattern post issue, in case the company is required to allot further shares to the extent of over-allotment in the issue.
- (e) The maximum amount of funds to be received by the company in case of further allotment and the use of these additional funds, in final document to be filed with ROC.
- (f) Details of the agreement/arrangement entered into by SA with the promoters to borrow shares from the latter which *inter alia* shall include name of the promoters, their existing shareholding, number and percentage of shares to be lent by them and other important terms and conditions including the rights and obligations of each party.
- (g) The final prospectus shall additionally disclose the exact number of shares to be allotted pursuant to the public issue, stating separately therein the number of shares to be borrowed from the promoters and over-allotted by the SA, and the percentage of such shares in relation to the total issue size.

In case of an initial public offer by a unlisted company, the promoters and pre-issue shareholders and in case of public issue by a listed company, the promoters and pre-issue shareholders holding more than 5% shares, may lend the shares subject to the provisions of this scheme. The SA should borrow shares from the promoters or the pre-issue shareholders of the issuer company or both, to the extent of the proposed over-allotment. However, the shares so referred shall be in dematerialized form only.

The allocation of these shares should be pro rata to all the applicants.

The stabilisation mechanism should be available for the period disclosed by the company in the prospectus, which shall not exceed 30 days from the date when trading permission was given by the exchange(s).

The SA should open a special account with a bank to be called the –Special Account for GSO proceeds of..... company” (hereinafter referred to as the GSO Bank Account) and a special account for securities with a depository participant to be called the –Special Account of GSO shares of..... company” (hereinafter referred to as the GSO Demat Account).

The money received from the applicants against the over-allotment in the green shoe option should be kept in the GSO Bank Account, distinct from the issue account and shall be used for the purpose of buying shares from the market, during the stabilisation period.

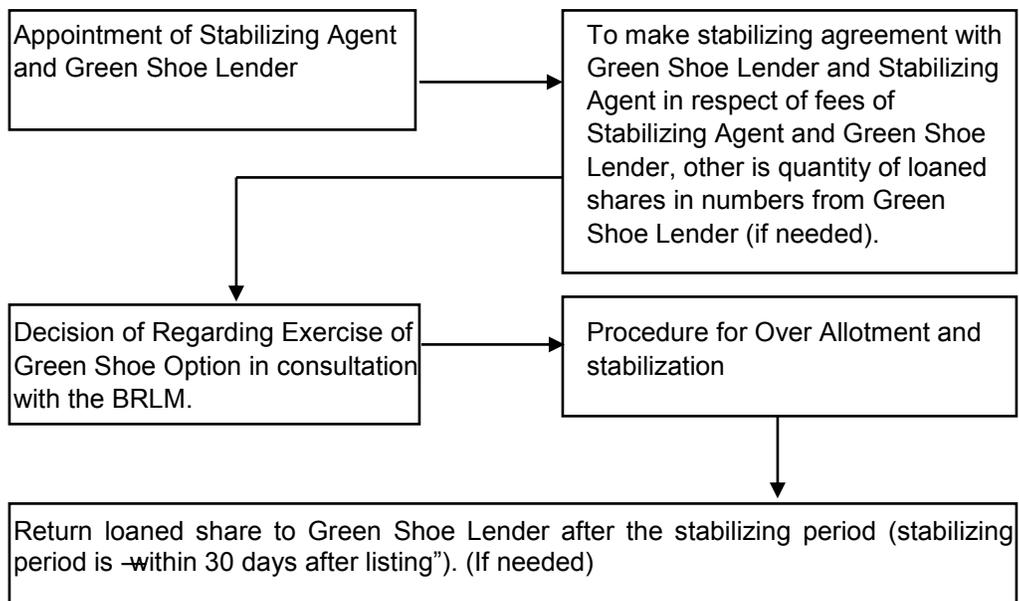
The shares bought from the market by the SA, if any during the stabilisation period, should be credited to the GSO Demat Account.

The shares bought from the market and lying in the GSO Demat Account should be returned to the promoters immediately, in any case not later than 2 working days after the close of the stabilisation period.

The prime responsibility of the SA should be to stabilise post listing price of the shares. To this end, the SA should determine the timing of buying the shares, the quantity to be bought, the price at which the shares are to be bought etc.

On expiry of the stabilisation period, in case the SA does not buy shares to the extent of shares over-allotted by the company from the market, the issuer company shall allot shares to the extent of the shortfall in dematerialized form to the GSO Demat Account, within five days of the closure of the stabilisation period. These shares shall be returned to the promoters by the SA in lieu of the shares borrowed from them and the GSO Demat Account shall be closed thereafter. The company shall make a final listing application in respect of these shares to all the exchanges where the shares allotted in the public issue are listed. The provisions relating to preferential issues shall not be applicable to such allotment.

Framework of Exercising Green Shoe Option



Procedure for over allotment and stabilization

If Green Shoe Lender receives the receipt of instruction from the stabilizing agent on or prior to bid/issue closing date, Green Shoe Lender will transfer the loaned Shares to the GSO Demat Account.



The money received from the applications for Equity Shares in the Issue against the over allotment shall be kept in the GSO Bank Account, which is a distinct account separate from the Public Issue Account and shall be used only for the purpose of stabilization of the post listing price of the Equity Shares.



Upon such allocation, the Stabilizing Agent shall transfer the Over-Allotment Shares from the GSO Demat Account to the respective depository accounts of successful Bidders.



The Stabilizing Agent shall solely determine the timing of buying the Equity Shares, the quantity to be bought and the price at which the Equity Shares are to be bought from the market for the purposes of stabilization of the post-listing price of the Equity Shares.



The Equity Shares purchased from the market by the Stabilizing Agent, if any, shall be credited to the GSO Demat Account and shall be returned to the Green Shoe Lender immediately on the expiry of the Stabilization Period but in no event later than the expiry of two working days thereafter. (It is applicable when Green Shoe Lender has sent the loaned share to Stabilizing agent after the receipt of instruction from Stabilizing Agent after the close of issue.)

The shares returned to the promoters as above, as the case may be, shall be subject to the remaining lock-in-period as provided in lock-in or pre-issue share capital of an unlisted company.

The SA shall remit an amount equal to (further shares allotted by the issuer company to the GSO Demat Account) (issue price) to the issuer company from the GSO Bank Account. The amount left in this account, if any, after this remittance and deduction of expenses incurred by the SA for the stabilisation mechanism, shall be transferred to the investor protection fund(s) established by SEBI. The GSO Bank Account shall be closed soon thereafter.

The SA should submit a report to the stock exchange(s) on a daily basis during the stabilisation period. The SA should also submit a final report to SEBI in the format specified in Schedule XII. This report shall be signed by the SA and the company. This report shall be accompanied with a depository statement for the "GSO Demat Account" for the stabilisation period, indicating the flow of the shares into and from the account. The report shall also be accompanied by an undertaking

given by the SA and countersigned by the depository(ies) regarding confirmation of lock-in on the shares returned to the promoters in lieu of the shares borrowed from them for the purpose of the stabilisation.

The SA shall maintain a register in respect of each issue having the green shoe option in which he acts as a SA. The register shall contain the following details of:

- in respect of each transaction effected in the course of the stabilising action, the price, date and time.
- the details of the promoters from whom the shares are borrowed and the number of shares borrowed from each; and
- details of allotments made.

The register must be retained for a period of at least three years from the date of the end of the stabilising period.

For the aforesaid, over allotment shall mean an allotment or allocation of shares in excess of the size of a public issue, made by the SA out of shares borrowed from the promoters or the pre-issue shareholders or both, in pursuance of green shoe option exercised by the company in accordance with the provisions of the scheme.

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. Such grading is assigned on a five-point point scale with a higher score indicating stronger fundamentals.

IPO grading is different from an investment recommendation. Investment recommendations are expressed as buy, hold or sell and are based on a security specific comparison of its assessed fundamentals factors (business prospects, financial position etc.) and market factors (liquidity, demand supply etc.) to its price. On the other hand, IPO grading is expressed on a five-point scale and is a relative comparison of the assessed fundamentals of the graded issue to other listed equity securities in India.

As the IPO grading does not take cognizance of the price of the security, it is not an investment recommendation. Rather, it is one of the inputs to the investor to aiding in the decision making process.

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.

SEBI has been taking a pioneering role in investor protection by increasing disclosure levels by entities seeking to access equity markets for funding. This has

caused India to be amongst one of the more transparent and efficient capital markets in the world. However, these disclosures demand fairly high levels of analytical sophistication of the reader in order to effectively achieve the goal of information dissemination.

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. Moreover, such a service would be particularly useful for assessing the offerings of companies accessing the equity markets for the first time where there is no track record of their market performance.

As mentioned above, the IPO grade assigned to any issue represents a relative assessment of the 'fundamentals' of that issue in relation to the universe of other listed equity securities in India. This grading can be used by the investor as tool to make investment decision. The IPO grading will help the investor better appreciate the meaning of the disclosures in the issue documents to the extent that they affect the issue's fundamentals. Thus, IPO grading is an additional investor information and investment guidance tool. IPO grading is optional.

Procedure for IPO grading

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

SEBI does not play any role in the assessment made by the grading agency. The grading is intended to be an independent and unbiased opinion of that agency.

It is intended that IPO fundamentals would be graded on a five point scale from grade 5 (indicating strong fundamentals) to grade 1 (indicating poor fundamentals). The grade would be read as: "Rating Agency name" IPO Grade 1 viz. CARE IPO Grade 1, CRISIL IPO Grade 1 etc.

The assigned grade would be a one time assessment done at the time of the IPO and meant to aid investors who are interested in investing in the IPO. The grade will not have any ongoing validity.

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.

- Seek 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.

Though this process will ideally require 2-3 weeks for completion, it may be a good idea for companies to initiate the grading process about 6-8 weeks before the targeted IPO date to provide sufficient time for any contingencies.

PROCEDURE FOR ISSUE OF SECURITIES

In the light of the provisions of the Companies Act and the guidelines issued by Government/SEBI under the Securities Contract (Regulations) Rules, 1956 and SEBI Act, 1992, the procedure for issue of securities to be followed by companies is given below. This procedure should be read along with the relevant SEBI guidelines and provisions of the other Acts.

I. Issue of Shares to the Public

A company proposing to raise resources by a public issue should first select the type of securities i.e. shares and/or debentures to be issued by it. In case the company has applied for financial assistance to any of the financial/investment institutions, the requirement of the funds to be raised from the public is to be decided in consultation with the said institution while appraising the project of the company. The decision regarding the issue of shares to be made at par or premium should be taken. The various steps involved in public issue of shares are enumerated below:

1. Compliance with SEBI Regulations

Before making any issue of capital, it is to be ensured that the proposed issue complies with the eligibility norms and other provisions of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

2. Holding of general meeting

A general meeting of the shareholders (annual or extraordinary) is to be convened for obtaining their consent to the proposed issue of shares if the articles so require. In case the proposed issue requires any increase in authorised share capital (Section 94), alteration in capital clause of the Memorandum of Association (Section 16), alteration of the articles of association (Section 31) etc. the approvals for the same should also be obtained at the General Meeting.

3. Intimation to Stock Exchange

A copy of the Memorandum and Articles of Association of the company is to be sent to the Stock Exchanges where the shares are to be enlisted, for approval [Section 73(1)].

4. Appointment of managers to the issue

Company issuing shares is to appoint one or more Merchant Bankers to act as managers to the public issue. The company should enter into a memorandum of understanding with the managers to the issue and decide the fees payable to them. Lead Managers are free to negotiate with the Managements their fee for handling the issue. If more than one Merchant Bankers are associated with the issue, the *inter-se* allocation of responsibility of each of them, shall be disclosed in the offer document.

5. Appointment of various other agencies

The company should in consultation with the Managers to the issue, decide upon the appointment of the following other agencies:

- (a) Registrars to the Issue; (b) Collecting bankers to the Issue; (c) Advisors to the

Issue; (d) Underwriters to the Issue; (e) Brokers to the Issue; (f) Printers; (g) Advertising Agents, Self Certified Syndicate Banks, etc.

These agencies should be registered with SEBI wherever Registration is a condition for handling work by any of these agencies.

Consent of the aforesaid persons should be obtained in writing for acting in their respective capacities for filing, with the Registrar of Companies alongwith the prospectus.

6. Drafting of prospectus

Next step is to draft a prospectus in accordance with Schedule II of the Companies Act and an abridged prospectus as required under Section 56(3) of the Act. The prospectus should contain the disclosures as required by SEBI Regulations under Schedule VIII.

7. Approval of prospectus

The draft offer document alongwith the application form for issue of shares should be got approved by the solicitors/legal advisors of the company to ensure that it contains all disclosures and information as required by various statutes, rules, notifications, etc. The managers to the issue should also verify and approve the draft prospectus. The financial institutions providing loan facilities generally stipulate that the prospectus should be got approved by them. The company should in such a case, forward a copy of the draft prospectus for their verification and approval as well. The approval of underwriters should also be taken if they so require.

A copy of the draft offer document is also to be forwarded to the Registrar of Companies for its scrutiny and approval.

Merchant Bankers, acting as the Lead Manager to ensure that an offer document contain the disclosure requirements as specified by SEBI from time to time for the issue of securities. Also to ensure that an offer document provides a true, correct and fair view of the state of affairs of the company which are adequate for the investors to arrive at a well informed investment decision. The Merchant Bankers are required to submit the draft of the offer document along with Due Diligence Certificate to SEBI in the form specified within six weeks before the issue is scheduled to open for subscription. Further, they are held responsible for ensuring the compliance with SEBI Rules, Regulations, Guidelines and requirements for other laws, for the time being in force. A check list containing aspects related to prospectus is given as under.

1. Check that a merchant banker holding a valid certificate of registration has been appointed to manage the issue and the lead merchant banker exercises the due diligence to satisfy himself about all the aspects of offering, veracity and adequacy of disclosures in the offer documents.
2. Check that a Memorandum of Understanding (MOU) has been entered into between lead merchant bankers and the issuer company specifying their mutual rights, liabilities and obligations relating to the issues.
3. Check that MOU does not contain any clause contrary to the provisions of

the Companies Act, 1956 and SEBI (Merchant Bankers) Rules and Regulations, 1992 so as to diminish the liabilities and obligations of the lead merchant banker and issuer company.

4. Check that a draft offer document 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 Regulation, 1992 has been submitted to SEBI at least 30 days prior to the filing of prospectus with Registrar of Companies.
5. Check that the draft of offer document involving amount upto Rs. 50 crores has been referred to concerned regional offices of SEBI under the jurisdiction of which registered office of issuer company falls.
6. Check that a copy of the draft offer document has been filed simultaneously with all the Stock Exchanges where listing is sought for clearance and in principle approval of stock exchange for listing of securities has been obtained and furnished to SEBI within 30 days of filing of the draft offer document with the stock exchanges.
7. Check that the lead manager has handed over not less than 10 copies of the draft offer document to dealing offices of SEBI, 3 copies to Primary Market Department, SEBI Head Office and 25 copies to the Stock Exchange(s) where the issue is proposed to be listed.

Ensure that the lead merchant banker has also submitted the draft offer document on a computer floppy to the dealing officer of SEBI and Primary Market Department, SEBI Head Office. Also ensure that in case of issues made through book building process, the merchant banker has submitted a printed as well as soft copy of the offer document incorporating the Board's observations and also a bid cum application form to the Primary Market Department, SEBI head office atleast five days before opening of bidding.

8. Check that draft offer document filed with SEBI has been made public for a period of 21 days from the date of filing the offer document with SEBI. The lead managers/stock exchanges can charge an appropriate sum to the person requesting copy(ies) of draft prospects.
9. Check that after a period of 21 days from the date, draft offer document was made public, the lead manager has filed with SEBI a statement:
 - (a) giving a list of complaints received by it,
 - (b) a statement by it whether it is proposed to amend the draft prospectus or not, and
 - (c) highlighting the amendments.
10. Check that the lead merchant bankers have furnished to SEBI, a due diligence certificate alongwith draft offer document and has —
 - (a) Issued a certificate to SEBI that all the amendments suggested/ observations made by SEBI have been given effect to in the offer documents.

- (b) Furnished a fresh due diligence' certificate to SEBI at the time of filing of prospectus with the Registrar of Companies as per format specified.
 - (c) Furnished a fresh certificate immediately before the opening of the issue that no corrective action is needed.
 - (d) Furnished a fresh certificate after the issue has opened but before the issue is closed for subscription.
11. Check that the particulars as per audited statements contained in the offer document are not more than six months old from the issue opening date.
 12. However, in case of a Government company auditors' report in the offer document shall not be more than six months from the date of filing the offer document with the ROC or stock exchanges as the case may be.
 13. SEBI may within 30 days from the date of submission of draft offer document specify changes. Check that the changes specified by SEBI are duly considered by the merchant bankers before filing of the offer document with ROC.
 14. Check that the offer document or letter of offer has been filed with ROC or stock exchanges.
 15. Check that the two copies of final printed copy of the final offer document have been sent to dealing offices of SEBI at least within three days of filing offer document with Registrar of Companies/Stock Exchange as the case may be.
 16. Check that lead merchant banker has also submitted one final printed copy of the final offer document alongwith the computer floppy containing the final prospectus/letter of offer to Primary Market Department, SEBI, Mittal Court, A Wing, Ground Floor, Nariman Point, Mumbai.
 17. Check that the public issue offer documents and other issue material has been despatched to the various stock exchanges, brokers, underwriters, bankers/self certified syndicate banks to the issue etc. in advance as agreed upon.
 18. Check that 20 copies of the prospectus and application form has been despatched in advance of the issue opening date to various Investor Associations.
 19. Check that the following details about themselves certified as correct have been included by the lead merchant bankers in all the forwarding letters of offer document filed with any Department/office of SEBI.
 - (i) Registration number
 - (ii) Date of Registration/Renewal of Registration
 - (iii) Date of expiry of registration
 - (iv) If applied for renewal, date of application
 - (v) Any communication from the Board prohibiting from acting as a merchant banker
 - (vi) Any inquiry/investigation being conducted SEBI.

20. Also ensure that in the forwarding letters, the following details about the issuer company have been included while filing offer documents for public/ rights issue/buy-back/takeovers:
- (i) Whether any promoter/director/group/associate company/entity of the issuer company and/or any company/entity with which any of the above is associated as promoter/director/partner/proprietor, is/was engaged in securities related business and registered with SEBI.
 - (ii) If any one or more of these persons/entities are/were registered with SEBI, their respective registration numbers.
 - (iii) If registration has expired, reasons for non-renewal.
 - (iv) Details of any enquiry/investigation conducted by SEBI at any time.
 - (v) Penalties imposed by SEBI which includes deficiency/warning letter, adjudication proceedings, suspension/cancellation/prohibitory order.
 - (vi) Outstanding fees payable to SEBI by these entities, if any.

8. Approval of board of directors to prospectus and other documents

After the concerned parties/agencies have approved the draft prospectus and the application form, the board of directors of the company should approve the final draft before filing with the Registrar of Companies. The company should, therefore, hold the meeting of the board of directors to transact the following business:

- (a) to approve and accept consent letters received from various parties agencies to act in their respective capacities;
- (b) to approve and accept appointment of underwriters, brokers bankers to the issue registrar to the issue, solicitors and advocates to the issue, etc.
- (c) to accept the Auditors' Report for inclusion in the prospectus;
- (d) to approve the date of opening of subscription list as also earliest and latest dates for closing of subscription list with the authority in favour of any director for earlier closing if necessary.
- (e) to approve draft prospectus/draft abridged prospectus and the draft share application form.
- (f) to authorise filing of the prospectus signed by all the directors or their constituted attorneys with the Registrar of Companies.
- (g) to authorise any officer of the company to deliver the prospectus for registration with the Registrar of Companies and to carry out the corrections, if any, at the office of the Registrar of Companies.
- (h) to approve the format of the statutory announcement.

9. Making application to Stock Exchange(s) for permission to listing

Before filing prospectus with the Registrar of Companies the company should submit an application(s) to the Stock Exchange(s) for enlistment of securities offered to the public by the said issue [Section 73(1)]. The fact that an application(s) has/have been made to the Stock Exchange(s) must be stated in the prospectus.

10. Printing and distribution of prospectus and application forms

After receipt of the intimation from Registrar of Companies regarding registration of prospectus, the company should take steps to issue the prospectus within 90 days of its registration with ROC [Section 64(4) of Companies Act]. For the purpose, the first step is to get adequate number of prospectuses and application forms printed. The provisions of Section 56(3) of the Companies Act should be kept in view in this regard which provide that no one shall issue any form of application for shares in or debenture of a company unless the form is accompanied by a memorandum containing such salient features of a prospectus as may be prescribed. The Department has prescribed Form 2A as the memorandum containing salient features of prospectus. This means the share application form should be accompanied by Form 2A containing the abridged prospectus being attached to it along a perforated line. The Department of Company Affairs has issued two circulars on this bearing Nos. 1/92 dated 9.1.1992 and 3/92 dated 10.4.1992 and has allowed companies to print two application forms accompanying the abridged prospectus being attached to it along the perforated line bearing separate printed number. Two forms have been allowed to be printed alongwith one abridged prospectus to avoid excess printing cost involved in printing one application form with one abridged prospectus.

At least 2 weeks before the announcement is made in any newspaper, journal etc. requisite number of copies of the prospectus and application forms accompanied by the abridged prospectus should be distributed to the brokers, underwriters, merchant bankers, lead managers, bankers etc. to the issue.

11. Pricing

12. Promoters contribution and lock-in-period

13. Underwriting

14. Mandatory Collection Centres

15. Certificate relating to promoters' contribution

SEBI Regulations require that atleast one day prior to the date of opening of the issue, a certificate from the Chartered Accountant to the effect that the promoters' contribution in its entirety has been brought in advance before the public issue opens should be forwarded to it. The certificate should be accompanied by a list of names and addresses of friends, relatives and associates who have contributed to the promoters' quota, along with the amount of subscription made by each of them.

16. Coordination with the bankers to the issue

The date of opening and closing of the subscription list should be intimated to all the collecting and controlling branches of the bank with whom the company has entered into an agreement for the collection of application forms. Further, the company should ensure that a separate bank account is opened for the purpose of collecting the proceeds of the issues as required by Section 73 of the Companies Act and furnish to the controlling branches the resolution passed by the Board of directors for opening bank account.

17. Minimum subscription

18. Allotment of shares

A return of allotment in Form No. 2 of the Companies (Central Government's) General Rules and Forms, 1956 should be filed with the Registrar of Companies within 30 days of the date of allotment along with the fees as prescribed in Schedule X of the Act.

19. Filing of other Forms with Registrar of Companies

- (i) Along with Form No. 2, Form No. 3 showing particulars of contracts relating to shares has also to be filed, where a company allots shares for consideration other than cash without entering into any written agreement.
- (ii) Form No. 4 containing the statement of the amount or rate percentage of the commission payable on shares together with a copy of the contract for payment of commission, if any, should be filed with the Registrar before such commission is paid.

20. Refund orders

The company shall disclose the mode in which it shall made refunds to applicants in the prospectus and abridged prospectus.

21. Issuance of share certificates

As per Section 113 the company should deliver the share certificates within 3 months after the allotment of shares.

III. RIGHTS ISSUE

Rights issue as identified in the SEBI Regulations is an issue of capital under Section 81(1) of the Companies Act, 1956 to be offered to the existing shareholders of the company through a letter of offer.

These regulations are not applicable to the rights issue where the aggregate value of securities offered does not exceed Rs. 50 lakhs.

- A listed issuer company can not make any rights issue of securities, where the aggregate value of such securities, including premium, if any, exceeds Rs. 50 lacs unless a draft letter of offer has been filed with the Board, through a Merchant Banker, at least 30 days prior to the filing of the letter of offer with the Designated Stock Exchange (DSE).

However, in case of the rights issue where the aggregate value of the securities offered is less than Rs.50 Lakhs, the company shall prepare the letter of offer in accordance with the disclosure requirements specified in these guidelines and file the same with the Board for its information and for being put on the SEBI website.

- An issuer company can not make any public issue of securities, unless a letter of offer has been filed with SEBI through a Merchant Banker, at least 30 days prior to the filing of the Prospectus with the Registrar of Companies (ROC).

However, if SEBI specifies changes or issues observations on letter of offer within 30 days from the date of receipt of the draft Prospectus by SEBI the

issuer company or the Lead Manager to the Issue shall carry out such changes or comply with the observations issued by SEBI before filing the letter of offer with ROC.

- SEBI may specify changes or issue observations, if any, on the letter of offer only after receipt of copy of in-principle approval from all the stock exchanges on which the issuer company intends to list the securities proposed to be offered through the letter of offer.
- A Company can not make a rights issue of equity share or any security convertible at later date into equity share, unless all the existing partly paid-up shares have been fully paid or forfeited.
- A company can not make a rights issue of securities unless firm arrangements of finance through verifiable means towards 75% of the stated means of finance, excluding the amount to be raised through proposed Public/Rights issue, or through identifiable internal accruals have been made.
- A listed company whose equity shares are listed on a stock exchange, may freely price its equity shares and any security convertible into equity at a later date, offered through a rights issue.
- In case of a rights issue, issue price or price band may not be disclosed in the draft letter of offer filed with SEBI. The issue price may be determined anytime before fixation of the record date, in consultation with the Designated Stock Exchange
- 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:
- In case of rights issue the promoters shall disclose their existing shareholding and the extent to which they are participating in the proposed issue, in the offer document.
- A company can not make an issue of security through a public or rights issue unless a Memorandum of Understanding has been entered into between a lead merchant banker and the issuer company specifying their mutual rights, liabilities and obligations relating to the issue.
- In case a rights issue is managed by more than one Merchant Banker the rights, obligations and responsibilities of each merchant banker shall be demarcated as specified in Chapter VI.
- In the case of rights issues, lead merchant banker shall ensure that the abridged letters of offer are dispatched to all shareholders at least three days before the date of opening of the issue.

However, if a specific request for letter of offer is received from any shareholder, the Lead Merchant Banker shall ensure that the letter of offer is made available to such shareholder.
- A disclosure to the effect that the securities offered through this rights issue shall be made fully paid up or may be forfeited within 12 months from the date of allotment of securities in the manner specified in these Regulations.

- A company can not make any further issue of capital during the period commencing from the submission of offer document to SEBI on behalf of the company for rights issues, till the securities referred to in the said offer document have been listed or application moneys refunded on account of non-listing or under subscription etc. unless full disclosures regarding the total capital to be raised from such further issues are made in the draft offer document.
- A Company can not pending conversion of Fully Convertible Debentures (FCDs) or Partly Convertible Debentures (PCDs), issue any shares by way of rights unless similar benefit is extended to the holders of such FCDs or PCDs, through reservation of shares in proportion to such convertible part of FCDs/ PCDs.
- The share so reserved may be issued at the time of conversion(s) of such debentures on the same terms on which the rights issue was made.
- The Lead Merchant Banker shall ensure that in case of a rights issue, an advertisement giving the date of completion of despatch of letters of offer, shall be released in at least in an English National Daily with wide circulation, one Hindi National Paper and a Regional language daily circulated at the place where registered office of the issuer company is situated at least 3 days before the date of opening of the issue
- An issuer company shall not withdraw rights issue after announcement of record date in relation to such issue.
- In cases where the issuer has withdrawn the rights issue after announcing the record date, the issuer company shall not make an application for listing of any securities of the company for a minimum period of 12 months from the record date.

However, shares resulting from the conversion of PCDs/ FCDs/ Warrants issued prior to the announcing of the record date in relation to rights issue may be granted listing by the concerned Stock exchange
- Rights issues shall be kept open for at least 15 days and not more than 30 days.
- The quantum of issue whether through a rights or a public issue, shall not exceed the amount specified in the prospectus/ letter of offer.

However, an oversubscription to the extent of 10% of the net offer to public is permissible for the purpose of rounding off to the nearer multiple of 100 while finalising the allotment.
- If the issuer company does not receive the minimum subscription of ninety per cent. of the issue (including devolvement of underwriters where applicable), the entire subscription shall be refunded to the applicants within fifteen days from the date of closure of the issue.
- If there is delay in the refund of subscription by more than 8 days after the company becomes liable to pay the subscription amount (i.e. fifteen days after closure of the issue), the issuer company will pay interest for the delayed period, at rates prescribed under sub-sections (2) and (2A) of Section 73 of the Companies Act, 1956.

- The time period for finalization of basis of allotment in the rights issues is 15 days from the date of closure of the issue.
- The issuer company may utilise the funds collected in the rights issue only after the basis of allotment is finalized.

Steps involved in issue of Rights Shares

The various steps involved for issue of rights share are enumerated below:

1. Check whether the rights issue is within the authorised share capital of the company. If not, steps should be taken to increase the authorised share capital.
2. In case of a listed company, notify the stock exchange concerned the date of Board Meeting at which the rights issue is proposed to be considered at least 2 days in advance of the meeting.
3. Rights issue shall be kept open for at least 15 days and not more than 30 days.
4. Convene the Board meeting and place before it the proposal for rights issue.
5. The Board should decide on the following matters:
 - (i) Quantum of issue and the proportion of rights shares.
 - (ii) Alteration of share capital, if necessary, and offering shares to persons other than existing holders of shares in terms of Section 81(1A).
 - (iii) Fixation of record date.
 - (iv) Appointment of merchant bankers and underwriters (if necessary).
 - (v) Approval of draft letter of offer or authorisation of managing director/ company secretary to finalise the letter of offer in consultation with the managers to the issue, the stock exchange and SEBI. The letter of offer should conform to the disclosures prescribed in Form 2A under Section 56(3) of the Companies Act (memorandum containing the salient features of prospectus) also contents as specified in SEBI guidelines. Full justification and parameters used for issue price should clearly be mentioned in the letter of offer.
6. Immediately after the Board Meeting notify the concerned Stock Exchanges about particulars of Board's decision.
7. If it is proposed to offer shares to persons other than the shareholders of the company, a General Meeting has to be convened and a resolution is to be passed for the purpose in terms of Section 81(1A) of the Companies Act.
8. Forward 6 sets of letter of offer to concerned Stock Exchange(s).
9. Despatch letters of offer to shareholders by registered post.
10. Check that an advertisement giving date of completion of despatch of letter of offer has been released in at least an English National Daily, one Hindi National Paper and a Regional Language Daily where registered office of the issuer company is situated.

11. Check that the advertisement contains the list of centres where shareholders or persons entitled to rights may obtain duplicate copies of composite application forms in case they do not receive original application form alongwith the prescribed format on which application may be made.
12. The applications of shareholders who apply both on plain paper and also in a composite application form are liable to be rejected.
13. Make arrangement with bankers for acceptance of share application forms.
14. Prepare a scheme of allotment in consultation with Stock Exchange.
15. Convene Board Meeting and make allotment of shares.
16. Make an application to the Stock Exchange(s) where the company's shares are listed for permission of listing of new shares.

IV. BONUS SHARES

A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares. The issue of bonus shares by a company is a common feature. When a company is prosperous and accumulates large distributable profits, it converts these accumulated profits into capital and divides the capital among the existing members in proportion to their entitlements. Members do not have to pay any amount for such shares. They are given free. The bonus shares allotted to the members do not represent taxable income in their hands. [*Commissioner of Income Tax, Madras v. A.A.V. Ramchandra Chettiar* (1964) 1 Mad CJ 281]. Issue of bonus shares is a bare machinery for capitalizing undistributed profits. The vesting of the rights in the bonus shares takes place when the shares are actually allotted and not from any earlier date.

Advantages of Issuing Bonus Shares

1. Fund flow is not affected adversely.
2. Market value of the Company's shares comes down to their nominal value by issue of bonus shares.
3. Market value of the members' shareholdings increases with the increase in number of shares in the company.
4. Bonus shares is not an income. Hence it is not a taxable income.
5. Paid-up share capital increases with the issue of bonus shares.

Pursuant to the provisions of Section 78 of the Companies Act, 1956, securities premium account can be used in paying up unissued shares of the company to be issued to its members as fully-paid bonus shares. Other free reserves created from out of the profits actually earned during earlier years like general reserve, capital redemption reserve account [Section 80(5)], devolvement rebate reserve etc. can be utilised by company for issue of fully paid bonus shares to its members.

There are no guidelines on issuing bonus shares by private or unlisted companies. However, SEBI has notified Regulations for Bonus Issue which are contained in Chapter IX of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 with regard to bonus issues by listed companies.

When a company has accumulated free reserves and is desirous of bridging the gap between the capital and fixed assets, it issues bonus shares to its equity shareholders. Such an issue would not place any fresh funds in the hands of the company. On the contrary, after a bonus issue it would become necessary for the company to earn more to effectively service the increased capital. The shareholder will, however, be benefitted by way of increased return on investment and increased number of shares in their hands.

The following conditions must be satisfied before issuing bonus shares:

- (a) Bonus Issue must be authorised by the articles of the company. Such a provision is generally there in articles of almost all the companies as they adopt Table A of Schedule 1 of the Act (Regulation 96).
- (b) Bonus Issue must be sanctioned by shareholders in general meeting on recommendation of the Board of directors of the company.
- (c) Regulations issued by SEBI must be complied with.
- (d) Authorised Capital must be increased where necessary.

SEBI Regulations pertaining to Bonus Issue

1. Rights of FCD/PCD holders

The proposed bonus issue should not dilute the value or rights of the fully or partly convertible debentures.

If the conversion of FCD/PCD is pending, the reservation of shares out of bonus issue is to be made in proportion to the convertible part of FCD's or PCD's. The shares so reserved may be issued at the time of conversion of such debentures on the same terms on which the rights or bonus issues were made.

2. Out of Free Reserves

The bonus issue is to be made out of free reserves built out of the genuine profits or securities premium collected in cash only.

3. Revaluation Reserves

The reserves created by revaluation of fixed assets should not be capitalised. These reserves are in fact capital reserves. However, if the assets are subsequently sold and the profits are realised, such profits could be utilised for capitalisation purposes. In fact the Government has in the past approved issue of bonus shares out of capital reserves representing realised capital profits.

Although, bonus guidelines do not apply to existing private/closely held and unlisted companies, the Department of Company Affairs has vide its Circular No. 9/94 dated 6.9.1994 prohibited these Companies from issuing bonus shares out of the reserves created by revaluation of fixed assets.

4. Bonus Issue not to be in lieu of Dividend

Bonus issue should not be made in lieu of dividend.

5. Fully Paid Shares

If there are any partly paid-up shares outstanding on the date of allotment, these shares should be made fully paid-up before the bonus issue is made.

6. No Default in respect of Fixed Deposits/Debentures

The company should not have defaulted in the payment of any interest or principal in respect of its fixed deposits, debt securities issued by it.

7. Statutory Dues of the Employees

The company should not have defaulted in the payment of its statutory dues to the employees such as contribution to provident fund, gratuity, bonus.

8. Implementation of Proposal within fifteen days

A company which announces bonus should implement bonus issue within fifteen days issue after the approval of board of directors and does not require shareholders' approval for capitalisation of profits or reserves for making bonus issue as per the Articles of Association and shall not have the option of changing the decision.

However, where the company is required to seek shareholders' approval for capitalisation of profits or reserves for making bonus issue as per the Articles of Association, the bonus issue should be implemented within two months from the date of the meeting of the board of directors wherein the decision to announce bonus was taken subject to shareholders' approval.

9. Provision in Articles of Association

The Articles of Association of the Company should provide for capitalisation of reserves and if not a General Body Meeting of the company is to be held and a special resolution making provisions in the Articles of Association for capitalisation should be passed.

10. Authorised Capital

If consequent upon the issue of bonus shares, the subscribed and paid-up capital of the company exceed the authorised share capital, a General Meeting of the company should be held to pass necessary resolution for increasing the authorised capital.

Steps in Issue of Bonus Shares

A company issuing bonus shares should ensure that the issue is in conformity with the Regulations for bonus issue laid down by SEBI (ICDR) Regulations, 2009.

The procedure for issue of bonus shares by a listed company is enumerated below:

1. Ensure that if conversion of FCDs/PCDs is pending, similar benefit has been extended to the holders of such FCDs/PCDs, through reservation of shares in proportion of such convertible part of FCDs/PCDs. The shares so reserved may be issued at the time of conversion(s) of such debentures on the same terms on which the bonus issue was made.
2. Ensure that bonus issue has been made out of free reserves built out of the genuine profits or securities premium collected in cash only.
3. Ensure that reserves created by revaluation of fixed assets are not capitalised.

4. Ensure that the company has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it or in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.
5. Ensure that the bonus issue is not made in lieu of dividend.
6. There should be a provision in the articles of association of the company permitting issue of bonus shares; if not, steps should be taken to alter the articles suitably.
7. The share capital as increased by the proposed bonus issue should be well within the authorised capital of the company; if not, necessary steps have to be taken to increase the authorised capital.
8. Finalise the proposal and fix the date for the Board Meeting for considering the proposal and for authorising the taking up of incidental and attendant matters.
9. If there are any partly paid-up shares, ensure that these are made fully paid-up before the bonus issue is recommended by the Board of directors.
10. The date of the Board Meeting at which the proposal for bonus issue is proposed to be considered should be notified to the Stock Exchange(s) where the company's shares are listed.
11. Hold the Board Meeting and get the proposal approved by the Board.
12. The resolution to be passed at the General Meeting should also be approved by the Board in its meeting. The intention of the Board regarding the rate of dividend to be declared in the year after the bonus issue should be indicated in the resolution for bonus issue to be passed by members in general meeting.
13. Immediately after the Board meeting intimate the Stock Exchange(s) regarding the outcome of the Meeting.
14. Ensure that the company has announced bonus issue after the approval of Board of Directors and did not require shareholders' approval for capitalization of profits or reserves for making bonus issue as per the Article of Association, had implemented bonus issue within fifteen days from the date of approval of the issue by the board of directors of the company and must not have the option of changing the decision.

However, where the company was required to seek shareholders' approval for capitalization of profits or reserves for making bonus issue as per the Article of Association, the bonus issue has implemented within two months from the date of the meeting of the Board of Directors where in the decision to announce bonus was taken subject to shareholders' approval.
15. Arrangements for convening the general meeting should then be made keeping in view the requirements of the Companies Act, with regard to length of notice, explanatory statement etc. Also three copies of the notice should be sent to the Stock Exchange(s) concerned.
16. Hold the general meeting and get the resolution for issue of bonus shares passed by the members. A copy of the proceedings of the meeting is to be forwarded to the concerned Stock Exchange(s).

17. In consultation with the Regional Stock Exchange fix the date for closure of register of members or record date and get the same approved by the Board of directors. Issue a general notice under Section 154 of Companies Act in respect of the fixation of the record date in two newspapers one in English language and other in the language of the region in which the Registered Office of the company is situated.
18. Give 7 days notice to the Stock Exchange(s) concerned before the date of book closure/record date.
19. After the record date process the transfers received and prepare a list of members entitled to bonus shares on the basis of the register of members as updated. This list of allottees is to be approved by the Board or any Committee thereof. The list usually serves as allotment list and on this basis the allotment is to be made to the eligible members.
20. File return of allotment with the Registrar of Companies within 30 days of allotment (Section 75 of the Companies Act). Also intimate Stock Exchange(s) concerned regarding the allotments made.
21. Ensure that the allotment is made within fifteen days of the date on which the Board of directors approved the bonus issue.
22. Get the share certificates printed, prepared and issued to the allottees as per the provisions of Companies (Issue of Share Certificates) Rules, 1960.
23. Submit an application to the Stock Exchange(s) concerned for listing the bonus shares allotted.

V. PREFERENTIAL ISSUE BY EXISTING LISTED COMPANIES

Preferential issue means issuance of equity shares to promoter group or selected investors. It covers allotment of fully convertible debentures, partly convertible debentures or any other financial instruments that could be converted into equity shares at a later date. The investors could be institutional investors, private equity investors, high net-worth individuals, or companies.

Preferential issue is one of the key sources of funding for companies. It has its own advantages and disadvantages. One of the biggest advantages of a preferential issue is that the company can raise money quickly and cheaply compared with other means of raising money, say IPO or issue of shares on a rights basis.

On the other hand, preferential issues and private placement is only for selected class of investors and not for the retail investors. It is like a wholesale market, where institutions with financial clout are allowed to participate. This deprives investment opportunity to the retail investors.

SEBI (ICDR) Regulations, 2009 regarding Preferential Issue

1. Applicability

The preferential issue of equity shares/Fully Convertible Debentures (FCDs)/ Partly Convertible Debentures (PCDs) or any other financial instruments which would be converted into or exchanged with equity shares at a later date, by listed companies whose equity share capital is listed on any stock exchange, to any select

group of persons under Section 81(1A) of the Companies Act 1956 on private placement basis is governed by these Regulations.

2. Pricing of the issue

(i) Where the equity shares of the company have been listed on a stock exchange for a period of six months or more as on the relevant date, the issue of equity shares on preferential basis is being made at a price not less than higher of the following:

(a) The average of the weekly high and low of the closing prices of the related equity shares quoted on the stock exchange during the six months preceding the relevant date;

OR

(b) the average of the weekly high and low of the closing prices of the related equity shares quoted on a stock exchange during the two weeks preceding the relevant date.

(ii) Where the equity shares of a company have been listed on a stock exchange for a period of less than six months as on the relevant date, the issue of shares on preferential basis has been made at a price not less than the higher of the following:

(a) The price at which shares were issued by the company in its IPO or the value per share arrived at in a scheme of arrangement under Section 391 to 394 of the Companies Act, 1956, pursuant to which shares of the company were listed , as the case may be;

OR

(b) The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the period shares have been listed preceding the relevant date;

OR

(c) The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.”

Where the price of the equity shares is determined in terms of provision (ii), such price shall be recomputed by the issuer on completion of six months from the date of listing on a recognized stock exchange with reference to the average of weekly high and low of the closing prices of the related equity shares quoted on the recognized stock exchange during these six months and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.

An issue of shares on preferential basis to Qualified Institutional Buyers not exceeding five in numbers all be made at a price not less than the average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

[relevant date means the date thirty days prior to the date on which the meeting of general body of shareholders is held, in terms of Section 81(1A) of the Companies Act, 1956.]

3. Upfront Payment on warrants

- (i) An amount equivalent to at least twenty five per cent of price of shares fixed should be paid on the date of their allotment.
- (ii) This amount would be adjusted against the price payable subsequently on acquisition of shares by exercising an option for the purpose.
- (iii) If the option to acquire shares is not exercised, the amount so paid would stand forfeited.

4. Disclosures

The explanatory statement to the notice for the general meeting contains the details about the objects of the issue through preferential offer, intention of promoters/directors/key management persons to subscribe to the offer, shareholding pattern before and after the offer, proposed time within which the allotment shall be complete, identity of the proposed allottees and the percentage of post-preferential issue capital that may be held by them.

5. Tenure of Convertible Securities

The tenure of the convertible securities of the issuer does not exceed beyond 18 months from the date of their allotment.

6. Lock-in-period

- (i) The specified securities allotted on a preferential basis to the promoter or promoter group and the equity shares allotted to such promoter or promoter group pursuant to exercise of options attached to warrants issued on preferential basis are subjected to lock in period of three years from the date of their allotment.

However, not more than 20% of the total capital of the company, should be locked in for a period of three years from the date of allotment.

Further the equity shares allotted in excess of twenty percent pursuant to exercise of options attached to warrants issued on preferential basis to promoter/promoter group of the issuer, should be locked-in for a period of one year from the date of their allotment

- (ii) The specified securities allotted on preferential basis and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to any person other than the promoter/promoter group of the issuer should be locked in for a period of one year from the date of their allotment.
- (iii) Shares acquired by conversion of the convertible instruments other than warrants should be locked in for a period as reduced by the extent the convertible instrument other than warrants have already been locked in.
- (iv) The lock-in period in respect of shares issued on preferential basis pursuant to a scheme approved under Corporate Debt Restructuring framework of

Reserve Bank of India, shall commence from the date of allotment and has been continued for a period of one year and in case of allotment of partly paid up shares the lock-in period shall commence from the date of allotment and continue for a period of one year from the date when shares become fully paid up.

- (v) No listed company shall make preferential issue of equity shares/ warrants/ convertible instruments to any person unless the entire shareholding of such persons in the company, if any, is held by him in dematerialized form.
- (vi) The entire pre preferential allotment shareholding of such allottees shall be under lock-in from the relevant date upto a period of six months from the date of preferential allotment.
- (vii) The shares/ warrants/ convertible instruments shall be issued on preferential basis, the shareholders who have sold their shares during the six months period prior to the relevant date shall not be eligible for allotment of shares on preferential basis.

SEBI may, on application made by the issuer in respect of the preferential allotment of shares fully convertible debentures and partly convertible debentures, grant extension from the requirements of this above para if the Board has granted relaxation to the company in terms of Regulation 29A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

- For computation of 20% of total capital of the company, the amount of minimum promoters' contribution held and locked-in as per the guidelines shall be taken into account.
- The minimum promoters' contribution is not to be put under fresh lock-in even though it is considered for computing the requirement of 20% of the total capital of the company, in case the said minimum promoters contribution is free of lock-in at the time of preferential issue.
- Shares/instruments subject to lock-in can be transferred to and amongst promoter/promoter group or to new promoters or persons in control of the company subject to continuation of the lock-in in the hands of transferees for the remaining period and compliance of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, if applicable.

7. Shareholders Resolutions

- (i) Allotment pursuant to any resolution passed at a meeting of shareholders of a company granting consent for preferential issues of any financial instrument shall be completed within a period of fifteen days from the date of passing of the resolution.

However, where any application for exemption for the allotment on preferential basis is pending on account of pendency of any approval of such allotment by any regulatory authority or the Central Government; the allotment shall be completed within 15 days from the date of such approval.

However, SEBI has granted relaxation to the issuer in terms of Regulation 29A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, the preferential allotment of shares, fully convertible

debentures and partly convertible debentures, shall be made by it within such time as may be specified by SEBI in its order granting relaxation.

- (ii) The equity shares and securities convertible into equity shares at a later date, allotted in terms of the above said resolution shall be made fully paid up at the time of their allotment

However payment in case of warrants shall be made in terms of these Regulations.

- (iii) Nothing contained in the above mentioned shall apply in case of allotment of shares and securities convertible into equity shares at a later date on preferential basis pursuant to a scheme of Corporate Debt Restructuring framework specified by the Reserve Bank of India.
- (iv) If allotment of instruments and dispatch of certificates is not completed within fifteen days from the date of such resolution, a fresh consent of the shareholders shall be obtained.

8. Compliance Certificate

- (i) A certificate is obtained from the statutory auditors of Issuer Company certifying that the preferential issue of instruments is being made in accordance with the requirements of SEBI Regulations.
- (ii) The auditor certificate shall be placed before the meeting of shareholders convened to consider the proposed issue.

9. Submission of Valuation Report

In case of preferential allotment of shares to promoters, their relatives, associates and related entities, for consideration other than cash, valuation of assets in consideration for which the shares are proposed to be issued, shall be done by an independent qualified valuer. The valuation report has been submitted to the exchanges on which shares of issuer company are listed..

10. Use of Issue Proceeds

The details of all monies utilised out of the preferential issue proceeds should be disclosed under an appropriate head in the balance sheet of the company indicating the purpose for which such monies have been utilised. The details of unutilised monies should also be disclosed under a separate head in the balance sheet of the company indicating the form in which such utilised monies have been invested.

11. Other Requirements

- A listed company shall not make any preferential issue of specified securities unless it is in compliance with the conditions for continuous listing.
- A listed company shall not make any preferential allotment of specified securities unless it has obtained the Permanent Account Number of the proposed allottees.

Non-applicability

- (1) These regulations are not applicable in case of the following:
 - (a) pursuant to conversion of loan or option attached to convertible debt

instruments in terms of Sub-sections (3) and (4) of Sections 81 of the Companies Act, 1956.

- (b) pursuant to a scheme approved by a High Court under Section 391 to 394 of the Companies Act, 1956.
- (c) in terms of the rehabilitation scheme approved by the Board of Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985.

(2) Pricing and lock-in provisions of ICDR Regulations shall not apply to equity shares allotted to any financial institution within the meaning of sub-clauses (ia) and (ii) of Clause (h) of Section 2 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993.

(3) Disclosure and pricing relating to a preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, where the Board has granted relaxation to the issuer in terms of Regulation 29A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, if adequate disclosures about the plan and process proposed to be followed for identifying the allottees are given in the explanatory statement to notice for the general meeting of shareholders.

VI. 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.



SEBI has issued SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 according to which Employee Stock Option Scheme means a scheme under which 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.

The operation of the ESOP Scheme would have to be under the superintendence and direction of a Compensation Committee of the Board of directors in which there would be a majority of independent directors. With the

specific approval of the shareholders, the scheme would be allowed to cover the employees of a subsidiary or a holding company.

Directors' report shall contain the following disclosures:

- (i) the total number of shares covered by the ESOP as approved by the shareholders;
- (ii) the pricing formula;
- (iii) options granted, options vested, options exercised, options forfeited, extinguishment or modification of options, money realised by exercise of options, total number of options in force, employee-wise details of options granted to senior managerial personnel and to any other employee who receive a grant in any one year of options amounting to 5% or more of options granted during that year.
- (iv) Fully diluted earning per share (EPS) computed in accordance with International Accounting Standards.

SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999

In November 1997, SEBI constituted a Group to review the existing regulations relating to Employee Stock Options Plans (ESOP) and recommend changes thereto.

The Group submitted its report in June 1999 and has recommended Guidelines to be called SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. The Guiding Principles for the Group in recommending the guidelines is the important role that Employee Stock Options play in rewarding and motivating employees, in attracting and retaining the best talent, and in ensuring employee commitment and performance. In several knowledge based industries. India's competitive strength is derived from the skills and talent of its people and Employee Stock Options are critical of the success of Indian companies in the global market place.

The Group also took note of the fact that the typical employee in India is not a hard-nosed investor. To bring a significant number of employees on board a stock option scheme, has to be sufficiently attractive to convince the average skeptical employee. While a liberal stock option scheme would lead to earning dilution for existing shareholders, it could be beneficial.

The Guidelines as made effective by SEBI since 19th June, 1999 as amended, are reproduced hereunder:

I. Employee Stock Option

1. Eligibility to Participate

- (i) An employee is eligible to participate in Employee Stock Option Scheme (ESOS) of the company.

Explanation: Where such employee is a director nominated by an institution as its representative on the Board of Directors of the company –

- (i) the contract/agreement entered into between the institution nominating

its employee as the director of a company and the director so appointed shall, *inter-alia*, specify the following:

- (a) whether options granted by the company under its ESOS can be accepted by the said employee in his capacity as director of the company;
 - (b) that options, if granted to the director, shall not be renounced in favour of the nominating institution; and
 - (c) the conditions subject to which fees, commissions, ESOSs, other incentives, etc. can be accepted by the director from the company.
- (ii) The employee should not be a promoter or belongs to the promoter group.
 - (iii) A director who either himself or through his relative or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company can not participate as he is not eligible to participate in the scheme.

2. Compensation Committee

- (i) The disclosures, as specified in Schedule IV are required to be made by the company to the prospective option guarantees.
- (ii) The company is required to constitute a Compensation Committee for administration and superintendence of the scheme.
- (iii) The Compensation Committee must be a Committee of the Board of Directors consisting of a majority of independent directors.
- (iv) The Compensation Committee should formulate the detailed terms and conditions of the scheme including:
 - (a) The quantum of option to be granted under the scheme per employee and in aggregate;
 - (b) The conditions under which option vested in employees may lapse in case of termination of employment for misconduct;
 - (c) The exercise period within which the employee should exercise the option and that option would lapse on failure to exercise the option within the exercise period;
 - (d) The specified time period within which the employee shall exercise the vested options in the event of termination or resignation of an employee;
 - (e) The right of an employee to exercise all the options vested in him at one time or at various points of time within the exercise period;
 - (f) The procedure for making a fair and reasonable adjustment to the number of options and to the exercise price in case of corporate actions such as rights issues, bonus issues, merger, sale of division and others. In this regard, the following actions should be taken into consideration by the compensation Committee:
 - (i) The number and the price of ESOS shall be adjusted in a manner such that total value of ESOS remains the same after the corporate action.

- (ii) For this purpose global best practices in this area including the procedures followed by the derivatives markets in India and abroad shall be considered
- (iii) The vesting period and the life of the options shall be left unaltered as far as possible to protect the rights of option holders
- (g) The grant, vest and exercise of option in case of employees who are on long leave; and
- (h) The procedure for cashless exercise of options.
- (v) Suitable policies and systems are required to be framed by the compensation committee to ensure that there is no violation of the following by any employee —
 - (a) Securities and Exchange Board of India (Insider Trading) Regulations, 1992; and
 - (b) Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations.

3. Shareholders' approval

- (i) the approval of shareholders of the company is required to be obtained by passing a special resolution in general meeting.
- (ii) explanatory statement to the notice and the resolution proposed to be passed in general meeting for scheme containing the following information is required to be sent:
 - (a) the total number of options to be granted;
 - (b) identification of classes of employees entitled to participate in the scheme;
 - (c) requirements of vesting and period of vesting;
 - (d) maximum period within which the option shall be vested;
 - (e) exercise price or pricing formula;
 - (f) exercise period and process of exercise;
 - (g) the appraisal process for determining the eligibility of employees to the scheme;
 - (h) maximum number of options to be issued per employee and in aggregate;
 - (i) a statement to the effect that the company shall conform to the accounting policies specified by SEBI in regard to ESOS;
 - (j) the method which the company uses to value its options, i.e., whether fair value or intrinsic value;
 - (k) in case the company calculates the employees compensation cost using the intrinsic value of the stock options, the difference between the employees compensation cost so computed and employee compensation cost that shall have been recognized, if it had used the fair

value of the options, shall be disclosed in the directors report and also the impact of this difference on profits and on EPS of the company shall be disclosed in directors report.

- (iii) approval of shareholders by way of a separate resolution in the general meeting is to be obtained by company in case of —
 - (a) grant of option to employees of subsidiary or holding company and,
 - (b) grant of option to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option.

4. Variation of terms of ESOS

- (i) the company should not vary the terms of the Scheme in any manner which may be detrimental to the interests of the employees.
- (ii) However, if such variation is not prejudicial to the interests of the option holders, the company is required to pass a special resolution in a general meeting to vary the terms of scheme.
- (iii) The provisions of clause 3(iii) as above shall apply to such variation of terms as they apply to the original grant of option.
- (iv) the notice for passing special resolution for variation of terms of ESOS is required to be sent.
- (v) the notice should disclose full details of the variation, the rationale therefor and the details of the employees who are beneficiary of such variation.
- (vi) The companies should be given an option to reprice the options which are not exercised if ESOSs were rendered unattractive due to fall in the price of shares in the market. The Company must ensure that such re-pricing should not be detrimental to the interest of employees and approval of shareholders in General Meeting has been obtained for such pricing.

5. Pricing

The companies granting option to its employees pursuant to the scheme have the freedom to determine the exercise price subject to adherence to the accounting policies. In case the company calculates the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that shall have been recognised if it had used the fair value of the options, is required to be disclosed in the Director's Report and also the impact of this difference on profits and on Earnings per Share of the company shall also be disclosed in the Director's Report.

6. Lock-in-period and rights of the option-holder

- (i) There should exist a minimum period of one year between the grant of options and vesting of option.

However, where options are granted by a company under an ESOS in lieu of

options held by the same person under an ESOS in another company which has merged or amalgamated with the first mentioned company, the period during which the options granted by the transferor company were held by him shall be adjusted against the minimum vesting period required under this clause.

- (ii) The company has the freedom to specify the lock-in-period for the shares issued pursuant to exercise of option.
- (iii) The employee does not have the right to receive any dividend or to vote or in any manner enjoys the benefits of a shareholder in respect of option granted to him, till shares are issued on exercise of option.

7. Consequence of failure to exercise option

- (i) Amount payable by the employee, if any, at the time of grant of option can be forfeited by the company if the option is not exercised by the employee within the exercise period; or
- (ii) The amount is required to be refunded to the employee if the option is not vested due to non-fulfilment of condition relating to vesting of option as per the Scheme.

8. Non-transferability of option

- (i) Option granted to an employee is not transferable to any person.
- (ii) (a) No person other than the employee to whom the option is granted is entitled to exercise the option.

(b) Under the cashless system of exercise, the company may itself fund or permit the empanelled stock brokers to fund the payment of exercise price which shall be adjusted against the sale proceeds of some or all the shares, subject to the provisions of the Companies Act, 1956.
- (iii) The option granted to the employee can not pledged, hypothecated, mortgaged or otherwise alienated in any other manner.
- (iv) In the event of the death of employee while in employment, all the options granted to him till such date are vested in the legal heirs or nominees of the deceased employee.
- (v) In case the employee suffers a permanent incapacity while in employment, all the option granted to him as on the date of permanent incapacitation, shall vest in him on that day.
- (vi) If an employee resigns or is terminated, all options not vested as on that day expire. However, the employee subject to the terms and conditions formulated by compensation committee, is entitled to retain all the vested options.
- (vii) The options granted to a director, who is an employee of an institution and has been nominated by the said institution, shall not be renounced in favour of the institution nominating him.

9. Disclosure in the Directors' Report

The Board of Directors are required to disclose either in the Directors Report or in the Annexure to the Director's Report, the following details of the Scheme:

- (a) options granted;
- (b) the pricing formula;
- (c) options vested;
- (d) options exercised;
- (e) the total number of shares arising as a result of exercise of option;
- (f) options lapsed;
- (g) variation of terms of options;
- (h) money realised by exercise of options;
- (i) total number of options in force;
- (j) employee-wise details of options granted to—
 - (i) senior managerial personnel;
 - (ii) any other employee who receives a grant in any one year of option amounting to 5% or more of option granted during that year;
 - (iii) identified employees who were granted option, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;
- (k) diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of option calculated in accordance with Accounting Standard (AS) 20 'Earning Per Share'.
- (l) Where the company has calculated the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that shall have been recognised if it had used the fair value of the options, shall be disclosed. The impact of this difference on profits and on EPS of the company shall also be disclosed.
- (m) Weighted-average exercise prices and weighted-average fair values of options shall be disclosed separately for options whose exercise price either equals or exceeds or is less than the market price of the stock.
- (n) A description of the method and significant assumptions used during the year to estimate the fair values of options, including the following weighted average information:
 - (1) risk-free interest rate,
 - (2) expected life,
 - (3) expected volatility,
 - (4) expected dividends, and
 - (5) the price of the underlying share in market at the time of option grant.

Until all options granted in the three years prior to the IPO have been exercised or have lapsed, disclosures shall be made either in the Directors' Report or in an Annexure thereto of the information specified above in respect of such options also and of the impact on the profits and on the EPS of the company if the company had followed the accounting policies specified in these guidelines in respect of such options.

10. Accounting Policies

The company is required to pass a resolution for the scheme complies with the accounting policies specified by SEBI in regard to the Scheme under Schedule I of SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.

11. Certificate from Auditors

Board of Directors of the company are required to present before the shareholders at each AGM, a certificate from the auditors of the company that the Scheme has been implemented in conformity with these guidelines and in accordance with the resolution of the company in the general meeting.

II. Employees Stock Purchase Scheme (ESPS)

1. Eligibility to participate in the scheme

- (i) 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.
- (iii) A director who either by himself or through his relatives or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company can not participate, as he is not eligible to participate in the scheme.

2. Shareholder Approval

- (i) The Scheme should be approved by the shareholders by passing a special resolution in the meeting of the general body of shareholders.
- (ii) The explanatory statement to the notice is required to be sent to the shareholders and it should specify the following—
 - (a) the price of the shares and also the number of shares to be offered to each employee;
 - (b) the appraisal for determining the eligibility of employee for the scheme;
 - (c) total number of shares to be granted.

- (iii) The number of shares offered may be different for different categories of employees.
- (iv) The special resolution must state that the company should conform to the accounting policies as specified in schedule II of SEBI (Employee Stock Option Scheme and Stock Purchase Scheme) Guidelines, 1999.
- (v) Approval of shareholders must be obtained by way of separate resolution in the general meeting in case of —
 - (a) allotment of shares to employees of subsidiary or holding company and;
 - (b) allotment of shares to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of allotment of shares.

3. Pricing and Lock-in-Period

- (i) The company has the freedom to determine price of shares to be issued under an ESPS, provided they comply with the accounting policies specified.
- (ii) The shares issued under an ESPS are subject to lock-in for a minimum period of one year from the date of allotment.
- (iii) If the scheme is part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employees under the scheme are not subject to any lock-in-period.

4. Disclosure and Accounting Policies

- (i) The Director's Report or Annexure thereto should contain, *inter alia*, the following disclosures:
 - (a) the details of the number of shares issued in the scheme;
 - (b) the price at which such shares are issued;
 - (c) employee-wise details of the shares issued to:
 - (i) senior managerial personnel;
 - (ii) any other employee who is issued shares in any one year amounting to 5% or more shares issued during that year;
 - (iii) identified employees who were issued shares during any one year equal to or exceeding 1% of the issued capital of the company at the time of issuance;
 - (d) diluted Earning Per Share (EPS) pursuant to issuance of shares under the scheme; and
 - (e) consideration received against the issuance of shares.
- (ii) Every company passing a resolution for the scheme must comply with the accounting policies as specified in Schedule II to SEBI (Employee Stock Option Scheme and Employee Stock Purchase) Guidelines, 1999.

5. Preferential Allotment

Nothing in these guidelines applies to shares issued to employees in compliance with the Securities and Exchange Board of India Guidelines on Preferential Allotment.

6. Listing

- (i) The shares arising pursuant to an ESOS and shares issued under an ESOS are required to be listed immediately upon exercise in any recognized stock exchange where the securities of the company are listed subject to compliance of the following:
 - (a) The ESOS/ESOS is in accordance with these Guidelines.
 - (b) In case of an ESOS the company has also filed with the concerned stock exchanges, before the exercise of option, a statement as per Schedule V and has obtained in-principle approval from such Stock Exchanges.
 - (c) As and when ESOS/ESOS are exercised the company has notified the concerned Stock Exchanges as per the statement as per Schedule VI.
- (ii) The shares arising after the IPO, out of options granted under any ESOS framed prior to its IPO shall be listed immediately upon exercise in all the recognised stock exchanges where the equity shares of the company are listed subject to compliance with SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 wherever applicable.
- (iii) No listed company shall make any fresh grant of options under any ESOS framed prior to its IPO and prior to the listing of its equity shares unless:
 - (a) such pre-IPO scheme is in conformity with these guidelines; and,
 - (b) such pre-IPO scheme is ratified by its shareholders in general meeting subsequent to the IPO.

However, the ratification under item (b) may be done any time prior to grant of new options under such pre-IPO scheme.
- (iv) No change shall be made in the terms of options issued under such pre-IPO schemes, whether by repricing, change in vesting period or maturity or otherwise, unless prior approval of the shareholders is taken for such change.

However, this shall not apply to any adjustments for corporate actions made in accordance with these guidelines.
- (v) For listing of shares issued pursuant to ESOS or ESOS the company is required to obtain the in-principle approval from Stock Exchanges where it proposes to list the said shares.
- (vi) The listed companies is required to file the ESOS or ESOS Schemes through EDIFAR filing.
- (vii) When holding company issues ESOS/ESOS to the employee of its subsidiary, the cost incurred by the holding company for issuing such options/shares is required to be disclosed in the notes to accounts of the financial statements of the subsidiary company. If the subsidiary reimburses the cost incurred by the holding company in granting options to the employees of the subsidiary, both the subsidiary as well as the holding company shall disclose the payment or receipt, as the case may be, in the notes to accounts to their financial statements.
- (x) The company is required to appoint a registered Merchant Banker for the

implementation of ESOS and ESPS as per these guidelines till the stage of framing the ESOS/ESPS and obtaining in-principal approval from the stock exchanges.

7. ESOS/ESPS Through Trust Route

In case ESOS/ESPS are administered through a Trust Route, the accounts of the company shall be prepared as if the company itself is administering the ESOS/ESPS.

VII. SEBI (DELISTING OF EQUITY SHARES) REGULATIONS, 2009

SEBI in exercise of the powers conferred by Section 31 read with Section 21A of the Securities Contracts (Regulation) Act, 1956, Section 30, sub-section (1) of Section 11 and sub-section (2) of Section 11A of SEBI Act, 1992 made the SEBI (Delisting of Equity Shares) Regulations, 2009.

Applicability

Delisting of equity shares of a company from all or any of the recognised stock exchanges where such shares are listed.

Non Applicability

These regulation shall not be applicable in case of delisting -

Under a scheme sanctioned by the Board for Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985 or by the National Company Law Tribunal under section 424D of the Companies Act, 1956, if such scheme lays down any specific procedure to complete the delisting; or provides an exit option to the existing public shareholders at a specified rate.

Circumstances where delisting is not applicable

- 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.

No promoter shall

- Directly or indirectly employ the funds of the company to finance an exit opportunity or an acquisition of shares made pursuant to provided under these regulation.
- Employ any device, scheme or artifice to defraud any shareholder or other person; or
- Engage in any transaction or practice that operates as a fraud or deceit upon any shareholder or other person; or

- Engage in any act or practice that is fraudulent, deceptive or manipulative in connection with such delisting

1. VOLUNTARY DELISTING

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 under these regulations.

Delisting from only some of the recognised stock exchanges

A company may delist its equity shares from one or more recognised stock exchanges where they are listed and continue their listing on one or more other recognised stock exchanges, if after the proposed delisting the equity shares would –

- remain listed on any recognised stock exchange which has nationwide trading terminals, no exit opportunity needs to be given to the public shareholders; and,
- not remain listed on any recognised stock exchange having nation wide trading terminals, exit opportunity shall be given to all the public shareholders holding the equity shares sought to be delisted.



Recognised stock exchange having nation wide trading terminals' means the Bombay Stock Exchange Limited, the National Stock Exchange of India Limited or any other recognised stock exchange which may be specified by SEBI in this regard.

Procedure for delisting

In case of no exit opportunity

- (1) It shall be approved by a resolution of the board of directors of the company in its meeting;
- (2) The company shall give a public notice of the proposed delisting in at least one English national daily with wide circulation, one Hindi national daily with wide circulation and one regional language newspaper of the region where the concerned recognised stock exchanges are located;
- (3) The company shall make an application to the concerned recognised stock exchange regarding this:
- (4) The fact of delisting shall be disclosed in the first annual report of the company prepared after the delisting.
- (5) The public notice shall mention the names of the recognised stock exchanges from which the equity shares of the company are intended to be delisted, the reasons for such delisting and the fact of continuation of listing of equity shares on recognised stock exchange having nation wide trading terminals.
- (6) An application shall be disposed of by the recognised stock exchange within

a period not exceeding thirty working days from the date of receipt of such application complete in all respects.

In case of exit opportunity

Except where the equity shares would remain listed on any recognised stock exchange which has nationwide trading terminals and no exit opportunity needs to be given to the public shareholders, any company desirous of delisting its equity shares-

- (1) Obtain the prior approval of the board of directors of the company in its meeting;
- (2) Obtain the prior approval of shareholders of the company by special resolution passed through postal ballot, after disclosure of all material facts in the explanatory statement sent to the shareholders in relation to such resolution;

However, the special resolution shall be acted upon if and only if the votes cast by public shareholders in favour of the proposal amount to at least two times the number of votes cast by public shareholders against it.

- (3) Make an application to the concerned recognised stock exchange for in-principle approval of the proposed delisting and accompanied by an audit report as required under regulation 55A of SEBI (Depositories and Participants) Regulations, 1996 in respect of the equity shares sought to be delisted, covering a period of six months prior to the date of the application.
- (4) An application shall be disposed of by the recognised stock exchange within a period not exceeding thirty working days from the date of receipt of such application complete in all respects
- (5) The recognised stock exchange shall not unfairly withhold such application, but may require the company to satisfy it as to -
 - (a) Compliance with these regulations
 - (b) The resolution of investor grievances by the company;
 - (c) Payment of listing fees to that recognised stock exchange;
 - (d) The compliance with any condition of the listing agreement with that recognised stock exchange having a material bearing on the interests of its equity shareholders;
 - (e) Any litigation or action pending against the company pertaining to its activities in the securities market or any other matter having a material bearing on the interests of its equity shareholders;
 - (f) Any other relevant matter as the recognised stock exchange may deem fit to verify.
- (6) Within one year of passing the special resolution, make the final application to the concerned recognised stock exchange in the form specified by the recognised stock exchange and shall be accompanied with such proof of having given the exit opportunity in accordance with these regulations as the recognised stock exchange may require.

However, in case of special passed before the commencement of these regulations, final application shall be made within a period of one year from the date of passing of special resolution or six months from the commencement of these regulations, whichever is later.

Public Announcement

- The promoters of the company shall upon receipt of in-principle approval for delisting from the recognised stock exchange, make a public announcement which contains all material information and shall not contain any false or misleading statement, in at least one English national daily with wide circulation, one Hindi national daily with wide circulation and one regional language newspaper of the region where the concerned recognised stock exchange is located.
- The public announcement shall also specify a date, being a day not later than thirty working days from the date of the public announcement, which shall be the 'specified date' for determining the names of shareholders to whom the letter of offer shall be sent.
- Before making the public announcement, the promoter shall appoint a merchant banker registered with SEBI and such other intermediaries as are considered necessary to ensure compliance with these regulations.
- No promoter shall appoint any person as a merchant banker if such a person is an associate of the promoter.

Escrow account

- Before making the public announcement the promoter shall open an escrow account and deposit therein the total estimated amount of consideration calculated on the basis of floor price and number of equity shares outstanding with public shareholders.
- On determination of final price the promoter shall forthwith deposit in the escrow account such additional sum as may be sufficient to make up the entire sum due and payable as consideration in respect of equity shares outstanding with public shareholders.
- The escrow account shall consist of either cash deposited with a scheduled commercial bank, or a bank guarantee in favour of the merchant banker, or a combination of both.

Letter of offer

- The promoter shall despatch the letter of offer to the public shareholders of equity shares, not later than forty five working days from the date of the public announcement, so as to reach them at least five working days before the opening of the bidding period.
- The letter of offer shall be sent to all public shareholders whose names appear on the register of the company or depository as on the date specified in the public announcement .
- The letter of offer shall contain all the disclosures made in the public

announcement and such other disclosures as may be necessary for the shareholders to take an informed decision.

- The letter of offer shall be accompanied with a bidding form for use of public shareholders and a form to be used by them for tendering shares.

Bidding period

- The date of opening of the offer shall not be later than fifty five working days from the date of the public announcement.
- The offer shall remain open for a minimum period of three working days and a maximum period of five working days,

Book building process

- All public shareholders of the equity shares which are sought to be delisted shall be entitled to participate in the book building process.
- A promoter or a person acting in concert with any of the promoters shall not make a bid in the offer.
- Any holder of depository receipts issued on the basis of underlying shares held by a custodian and any such custodian shall not be entitled to participate in the offer and this shall not affect if the holder of depository receipts exchanges such depository receipts with shares of the class that are proposed to be delisted.

Offer price

The offer price shall be determined through book building process after fixation of floor price and disclosure of the same in the public announcement and the letter of offer.

- (I) In case of frequently traded shares—

The floor price shall not be less than the average of the weekly high and low of the closing prices of the equity shares of the company during the twenty six weeks or two weeks preceding the date on which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered, whichever is higher, as quoted on the recognised stock exchange where the equity shares of the company are most frequently traded;

- (II) In case of infrequently traded shares—

The floor price shall be determined by the promoter and the merchant banker taking into account the following factors:

- (a) the highest price paid by the promoter for acquisitions, if any, of equity shares of the class sought to be delisted, including by way of allotment in a public or rights issue or preferential allotment, during the twenty six weeks period prior to the date on which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered and after that date upto the date of the public announcement; and,
- (b) Other parameters including return on net worth, book value of the shares of

the company, earning per share, price earning multiple vis-à-vis the industry average

(III) Where the equity shares are frequently traded in some recognised stock exchanges and infrequently traded in some other recognised stock exchanges where they are listed, the highest of the prices arrived at in accordance with clauses (I) and (II) above.



Equity shares shall be deemed to be infrequently traded, if on the recognised stock exchange, the annualised trading turnover in such shares during the preceding six calendar months prior to month in which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered, is less than five per cent. (by number of equity shares) of the total listed equity shares of that class and the term frequently traded shall be construed accordingly.

Promoter not to accept the offer price

The promoter is not bound to accept the equity shares at the offer price determined by the book building process. If the promoter decides not to accept the offer price so determined,-

- (a) the promoter shall not acquire any equity shares tendered pursuant to the offer and the equity shares deposited or pledged by a shareholder shall be returned or released to him within ten working days of closure of the bidding period;
- (b) the company shall not make the final application to the exchange for delisting of the equity shares;
- (c) the promoter may close the escrow account .
- (d) in a case where the public shareholding at the opening of the bidding period was less than the minimum level of public shareholding required under the listing agreement, the promoter shall ensure that the public shareholding shall be brought up to such minimum level within a period of six months from the date of closure of the bidding through any of following ways-
 - By issue of new shares by the company
 - By the promoter making an offer for sale of his or,
 - By the promoter making sale of his holdings through the secondary market in a transparent manner.

Minimum number of equity shares to be acquired

An offer shall be deemed to be successful if post offer the shareholding of the promoter (along with the persons acting in concert) taken together with the shares accepted through eligible bids at the final price determined, reaches the higher of –

- (a) ninety per cent. of the total issued shares of that class excluding the shares which are held by a custodian and against which depository receipts have been issued overseas; or

- (b) the aggregate percentage of pre offer promoter shareholding (along with persons acting in concert with him) and fifty per cent of the offer size.

Closure of offer

Within eight working days of closure of the offer, the promoter and the merchant banker shall make a public announcement in the newspapers regarding:-

- (i) the success of the offer along with the final price accepted by the acquirer; or
- (ii) the failure of the offer; or
- (iii) rejection of the final price discovered under Schedule II, by the promoters.

Failure of offer

(1) Where the offer is rejected or is not successful as, the offer shall be deemed to have failed and no equity shares shall be acquired pursuant to such offer.

(2) Where the offer fails –

- (a) the equity shares deposited or pledged by a shareholder shall be returned or released to him within ten working days from the end of the bidding period;
- (b) no final application shall be made to the exchange for delisting of the equity shares; and
- (c) the escrow account opened shall be closed.

Payment of consideration

1. The promoter shall immediately on ascertaining success of the offer, open a special account with a banker to an issue registered with SEBI and transfer thereto, the entire amount due and payable as consideration in respect of equity shares tendered in the offer, from the escrow account.
2. All the shareholders whose equity shares are verified to be genuine shall be paid the final price stated in the public announcement within ten working days from the closure of the offer.

Return of equity shares

The equity shares deposited or pledged by a shareholder shall be returned or released to him, within ten working days from the closure of the offer, in cases where the bids pertaining thereto have not been accepted.

Right of remaining shareholders to tender equity shares

(1) Where, pursuant to acceptance of equity shares tendered in terms of these regulations, the equity shares are delisted, any remaining public shareholder holding such equity shares may tender his shares to the promoter upto a period of at least one year from the date of delisting and, in such a case, the promoter shall accept the shares tendered at the same final price at which the earlier acceptance of shares was made.

(2) The payment of consideration for shares accepted shall be made out of the balance amount lying in the escrow account.

(3) The amount in the escrow account or the bank guarantee shall not be released to the promoter unless all payments are made in respect of shares tendered.

2. COMPULSORY DELISTING

What is 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



By stock exchange

A recognised stock exchange may, by order, delist any equity shares of a company on any ground prescribed in the rules made under section 21A of the Securities Contracts (Regulation) Act, 1956.

However, no order shall be made under this sub-regulation unless the company concerned has been given a reasonable opportunity of being heard.

The decision on delisting shall be taken by a panel to be constituted by the recognised stock exchange consisting of –

- (a) two directors of the recognised stock exchange (one of whom shall be a public representative);
- (b) one representative of the investors;
- (c) one representative of the Ministry of Corporate Affairs or Registrar of Companies; and
- (d) the Executive Director or Secretary of the recognised stock exchange.

Before making an order the recognised stock exchange shall give a notice in one English national daily with wide circulation and one regional language newspaper of the region where the concerned recognised stock exchange is located, of the proposed delisting, giving a time period of not less than fifteen working days from the notice, within which representations may be made to the recognised stock exchange by any person who may be aggrieved by the proposed delisting and shall also display such notice on its trading systems and website.

The recognised stock exchange shall while passing any order consider the representations, if any, made by the company as also any representations received in response to the notice given and shall comply with the criteria specified in Schedule III which is given below—

SCHEDULE III

CRITERIA FOR COMPULSORY DELISTING

1. The recognised stock exchange shall take all reasonable steps to trace the

promoters of a company whose equity shares are proposed to be delisted, with a view to ensuring compliance with sub-regulation (3) of regulation 23.

2. The recognised stock exchange shall consider the nature and extent of the alleged non-compliance of the company and the number and percentage of shareholders who may be affected by such non-compliance.

3. The recognised stock exchange shall take reasonable efforts to verify the status of compliance of the company with the office of the concerned Registrar of Companies.

4. The names of the companies whose equity shares are proposed to be delisted and their promoters shall be displayed in a separate section on the website of the recognised stock exchange for a brief period of time. If delisted, the names shall be shifted to another separate section on the website.

5. The recognised stock exchange shall in appropriate cases file prosecutions under relevant provisions of the Securities Contracts (Regulation) Act, 1956 or any other law for the time being in force against identifiable promoters and directors of the company for the alleged non-compliances.

6. The recognised stock exchange shall in appropriate cases file a petition for winding up the company under section 433 of the Companies Act, 1956 (1 of 1956) or make a request to the Registrar of Companies to strike off the name of the company from the register under section 560 of the said Act.

The provisions related to exit opportunity shall not be applicable to a compulsory delisting made by a recognised stock exchange under this Chapter.

Where the recognised stock exchange passes an order it shall,—

- (a) forthwith publish a notice in one English national daily with wide circulation and one regional language newspaper of the region where the concerned recognised stock exchange is located, of the fact of such delisting, disclosing therein the name and address of the company, the fair value of the delisted equity shares determined and the names and addresses of the promoters of the company who would be liable under these regulations and
- (b) inform all other stock exchanges where the equity shares of the company are listed, about such delisting and the surrounding circumstances.

Rights of public shareholders

Where equity shares of a company are delisted by a recognised stock exchange the recognised stock exchange shall appoint an independent valuer or valuers who shall determine the fair value of the delisted equity shares which the promoter of the company pay to the shareholder from the delisted shares are acquired subject to their option of retaining their shares.

The recognised stock exchange shall form a panel of expert valuers from whom the valuer or valuers shall be appointed.

Consequences

Where a company has been compulsorily delisted the company, its whole time directors, its promoters and the companies which are promoted by any of them shall not directly or indirectly access the securities market or seek listing for any equity shares for a period of ten years from the date of such delisting.

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 (Chapter IV) 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 (Chapter IV) under these regulations.

A delisting of equity shares may be made according to above mentioned provisions only if, in addition to the fulfillment of requirement where exit opportunity is required, the following conditions are fulfilled:-

- (a) the promoter appoints a merchant banker and decides an exit price in consultation with him;
- (b) the exit price offered to the public shareholders shall not be less than the price arrived at in consultation with the merchant banker;
- (c) the promoter writes individually to all public shareholders in the company informing them of his intention to get the equity shares delisted, indicating the exit price together with the justification there for and seeking their consent for the proposal for delisting;
- (d) at least ninety per cent of such public shareholders give their positive consent in writing to the proposal for delisting, and have consented either to sell their equity shares at the price offered by the promoter or to remain holders of the equity shares even if they are delisted;
- (e) the promoter completes the process of inviting the positive consent and finalisation of the proposal for delisting of equity shares within seventy five working days of the first communication made by the promoter individually to all public shareholders;
- (f) the promoter makes payment of consideration in cash within fifteen working days from the date of expiry of seventy five working days stipulated .

The communication made to the public shareholders shall contain justification for the offer price with particular reference to the applicable parameters for offer price, that consent for the proposal would include consent for dispensing with the exit price discovery through book building method.

The concerned recognised stock exchange may delist such equity shares upon satisfying itself of compliance with this regulation.

In case of Winding up, Derecognition

In case of winding up proceedings of a company whose equity shares are listed on a recognised stock exchange, the rights, if any, of the shareholders of such company shall be in accordance with the laws applicable to those proceedings.

Where SEBI withdraws recognition granted to a stock exchange or refuses renewal of recognition to it, SEBI may, in the interest of investors pass appropriate order in respect of the status of equity shares of the companies listed on that exchange.

Monitoring Compliances

The respective recognised stock exchanges shall comply with and monitor compliance with the provisions of these regulations and shall report to SEBI any instance of non-compliance which comes to their notice.

Listing

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.

However, this shall not be applicable where a recommendation for listing has been made by the Board for Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985.

While considering an application for listing of any equity shares which had been delisted the recognised stock exchange shall have due regard to facts and circumstances under which delisting was made.

An application for listing made in respect of delisted equity shares shall be deemed to be an application for fresh listing of such equity shares and shall be subject to provisions of law relating to listing of equity shares of unlisted companies.

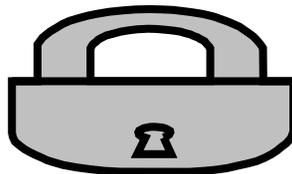
LESSON ROUND UP



- Public Issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus.
- Public Issue of shares are regulated by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

- All listed companies whose equity shares are listed on a stock exchange and unlisted companies eligible to make a public issue and desirous of getting its securities listed on a recognised stock exchange pursuant to a public issue, may freely price its equity shares or any securities convertible at a later date into equity shares.
- The promoters should contribute not less than 20% of post-issue capital, in case of a public issue by an unlisted company.
- Underwriting means an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them.
- 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.
- A merchant banker holding a valid certificate of registration is required to be appointed to manage the issue.
- Every company making a public issue is required to appoint a compliance officer and intimate the name of the compliance officer to SEBI.
- Book Building means a process undertaken by which a demand for the securities proposed to be issued by a body corporate is build up and a 'Fair Price' and 'Quantum' of securities to be issued is finally determined.
- An issuer company making a public offer of equity shares can avail of the Green Shoe Option (GSO) for stabilizing the post listing price of its shares
- IPO grading (initial public offering grading) is a service aimed at facilitating the assessment of equity issues offered to public.

SELF TEST QUESTIONS

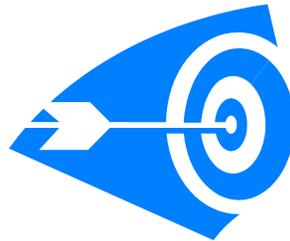


(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Discuss the various directions which SEBI can make under section 11B of SEBI Act for violation of SEBI (ICDR) Regulations, 2009.
2. What is a prospectus? Discuss broadly the disclosures to be made in prospectus.
3. Explain the various legal provisions to be complied with for further issue of capital.
4. Write a note on the work involved in making an issue of share open to the public.
5. State the Regulations relating to Issue of Bonus Shares.

6. What do you understand by Book Building? Explain briefly SEBI's Regulations for 100% book building.
 7. Explain briefly about the ASBA process. Who are the eligible investors? State.
 8. Write short notes on—
 - (a) Minimum subscription
 - (b) Anchor Investor
 - (c) Minimum promoters' contribution and lock-in-period
 - (d) Preferential allotment
 - (e) Green Shoe Option
 - (f) Employee Stock Option Scheme
 - (g) Self Certified Syndicate Bank.
 9. Distinguish between voluntary delisting of securities and compulsory delisting of securities.
 10. Briefly explain the procedure for voluntary delisting from all stock exchanges.
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STUDY XV
DEBT MARKETS



LEARNING OBJECTIVES

The study will enable the students to understand

- Development of Debt Market in India
- Debt Market Instruments
- Investors in Debt Markets
- Debt Market Intermediaries/Participants
- Regulatory Framework for Debt Markets in India
- Chronological Developments in the Corporate Bonds and Securitization Markets
- SEBI (Issue & listing of Debt Securities) Regulations, 2008
- Simplified Listing Agreement for Debt Securities
- Listing Agreement for Securitized Debt Instruments.

INTRODUCTION

Debt markets are markets for the issuance, trading and settlement in fixed income securities of various types and features. Fixed income securities can be issued by almost 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.

The trading of government securities on the Stock exchanges is currently through negotiated dealing using members of Bombay Stock Exchange (BSE) / National Stock Exchange (NSE) and these trades are required to be reported to the exchange. The bulk of the corporate bonds, being privately placed, were, however, not listed on the stock exchanges. Two Depositories, National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) maintain records of holding of securities in a dematerialised form. Records of holding of government securities for wholesale dealers like banks/Primary Dealers (PDs) and other financial institutions are maintained by the RBI.

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.

In India, there are four Credit Rating Agencies (CRAs). While RBI prescribes a minimum rating for issue of Commercial Paper, SEBI, which regulates CRAs, has stipulated that ratings are compulsory for all public issues of debentures with maturity exceeding 18 months and the government has stipulated investments by Pension funds only in debt securities that have high ratings.

I. DEBT MARKET INSTRUMENTS

Corporate Debenture

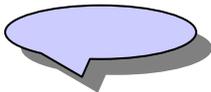


A Debenture is a debt security issued by a company, which offers to pay interest in lieu of the money borrowed for a certain period. In essence it represents a loan taken by the issuer who pays an agreed rate of interest during the lifetime of the instrument and repays the principal normally, unless otherwise agreed, on maturity.

These are long-term debt instruments issued by private sector companies, in denominations as low as Rs 1000 and have maturities ranging between one and ten years. Debentures enable investors to reap the dual benefits of adequate security and good returns. Unlike other fixed income instruments such as Fixed Deposits, Bank Deposits, Debentures can be transferred from one party to another.

Debentures can be divided into different categories on the basis of convertibility of the instrument and Security.

The debentures issued on the basis of Security includes –



- Non Convertible Debentures (NCDs)
- Partly Convertible Debentures (PCDs)
- Fully convertible Debentures (FCDs)
- Optionally Convertible Debentures (OCDs)
- Secured Debentures
- Unsecured Debentures

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. The deposits offered by NBFCs are not insured whereas the deposits accepted by most banks are insured upto a maximum of Rs.1,00,000.

Interest Based Bonds

Coupon Bonds: Coupon Bonds typically pay interest periodically at the prespecified rate of interest. The annual rate at which the interest is paid is known as the coupon rate or simply the coupon. Interest is usually paid half-yearly though in some cases it may be monthly, quarterly, annually or at some other periodicity. The dates on which the interest payments are made are known as the coupon due dates.

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 Instruments: 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. The terms of these bonds are like the bonds floated in the capital market, semi-annual or quarterly payments of interest and final bullet payment of principal.

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.

Floating Interest Rate: Floating rate of interest simply means that the rate of interest is variable. Periodically the interest rate payable for the next period is set with reference to a benchmark market rate agreed upon by both the lender and the borrower. The benchmark market rate is the State Bank of India Prime Lending Rate in domestic markets and LIBOR or US Treasury Bill Rate in the overseas markets.

Inflation linked bonds: A bond is considered indexed for inflation if the payments

on the instrument are indexed by reference to the change in the value of a general price or wage index over the term of the instrument. The options are that either the interest payments are adjusted for inflation or the principal repayment or both.

Money Market Activities

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. The call market enables the banks and institutions to even out their day to day deficits and surpluses of money. Commercial banks, Co-operative Banks and primary dealers are allowed to borrow and lend in this market for adjusting their cash reserve requirements.

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

A considerable part of the government's borrowings happen through Tbills of various maturities. Based on the bids received at the auctions, RBI decides the cut off yield and accepts all bids below this yield.

The usual investors in these instruments are banks who invest not only to part their short-term surpluses. These Tbills, which are issued at a discount, can be traded in the market. The transaction cost on Tbills is non-existent 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: After treasury bills, the next lowest risk category investment option is the certificate of deposit (CD) issued by banks and Financial Institutions. Allowed in 1989, a CD is a negotiable promissory note, secure and short term in nature i.e. upto one year. A CD is issued at a discount to the face value. The discount rate is negotiated between the issuer and the investor.

CDs are issued by banks and FIs mainly to augment funds by attracting deposits from corporates, high net worth individuals, trusts, etc. The foreign and private banks, especially, which do not have large branch networks and hence lower deposit base use this instrument to raise funds.

Commercial Papers: 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). These are basically instruments evidencing the liability of the issuer to pay the holder in due course a fixed amount i.e. face value of the instrument, on the specified due date. These are issued for a fixed period of time at a discount to the face value and mature at par.

Inter-Corporate Deposits: Apart from CPs, corporates have access to another market called the inter corporate deposits (ICD) market. 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. As ICDs are unsecured, the risk inherent is high.

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.

II. 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 etc. The individual investors invest to a great extent in Fixed Income products.

Banks: Collectively all the banks put together are the largest investors in the debt market. They invest in all instruments ranging from T-Bills, CPs and CDs to GOISECs, private sector debentures etc. Banks lend to corporate sector directly by way of loans and advances and also invest in debentures issued by the private corporate sector and in PSU bonds.

Insurance Companies: The second largest category of investors in the debt market are the insurance companies.

Provident funds: Provident funds are estimated to be the third largest investors in the debt market. Investment guidelines for provident funds are being progressively liberalized and investment in private sector debentures is one step in this direction.

Most of the provident funds are very safety oriented and tend to give much more weightage to investment in government securities although they have been considerable investors in PSU bonds as well as state government backed issues.

Mutual funds: Mutual funds represent an extremely important category of investors. World over, they have almost surpassed banks as the largest direct collector of primary savings from retail investors and therefore as investors in the wholesale debt market. Mutual funds include the Unit Trust of India, the mutual funds set up by nationalized banks and insurance companies as well as the private sector mutual funds set up by corporates and overseas mutual fund companies.

Trusts: Trusts include religious and charitable trusts as well as statutory trusts formed by the government and quasi government bodies. Religious trusts and Charitable trusts range from the very small ones to large ones.

There are very few instruments in which trusts are allowed to invest. Most of the trusts invest in CDs of banks and bonds of financial institutions and units of Unit Trust of India.

Corporate Treasuries: Corporate Treasuries have become prominent investors only in the last few years. Treasuries could be either those of the public sector units or private sector companies or any other government bodies or agencies. The treasuries of PSUs as well as the governmental bodies are allowed to invest in

papers issued by DFIs and banks as well as GOISECs of various maturities. However the orientation of the investments is mostly in short-term instruments or sometimes in extremely liquid long term instruments which can be sold immediately in the markets.

In complete contrast to public sector treasuries, those in the private sector invest in CDs of banks and CPs of other private sector companies, GOISECs as well as debentures of other private sector companies. Of late, preference shares of DFIs and open-ended mutual funds have also become popular with these treasuries.

Foreign Institutional Investors: India does not allow capital account convertibility either to overseas investors or to domestic residents. Registered FIIs are exception to this rule. FIIs have to be specifically and separately approved by SEBI for equity and debt. Each debt FII is allocated a limit every year up to which it can invest in Indian debt securities. They are also free to disinvest any of their holdings, at any point of time, without prior permission.

Retail Investors: Since January 2002, retail investors have been permitted to submit non-competitive bids at primary auction through any bank or PD.

III. 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. PDs underwrite a portion of the issue of government security that is floated for a predetermined amount. The underwriting commitment of each PD is broadly decided on the basis of its size in terms of its net owned funds, its holding strength, the committed amount of bids and the volume of turnover in securities.

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.

IV. 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”. Similar debt structure exists in case of State Government also, except for external debt component as States are not supposed to borrow directly from foreign countries/sources. This system of classification in three components has been adopted by the Ministry of Finance, Government of India, for statistical reporting purposes in line with SDDS (Special Data Dissemination Standard) of IMF.

Internal debt and external debt constitute the public debt of the Union Government and are secured under the Consolidated Fund of India. On the other

hand, “other liabilities” of the Union Government form part of the Public Account of India. The Indian Constitution under Article 292 provides for placing a limit on the public debt secured under the Consolidated Fund of India. This does not include “other liabilities” covered in the “Public Account”. There is also a similar position under Article 293 of the Indian Constitution with respect to borrowing by the States, wherein the State legislatures have powers to fix limits.

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.

Internal Debt Management Department of the RBI manages internal debt. This involves auctioning the Government debt from time to time, introduction of new instruments, smoothening the maturity structure of debt, placing of debt at market related rates and improving depth and liquidity of Government securities by developing active secondary market for them. The Public Debt Act, 1944 governs Government debt market. This legislation is proposed to be replaced by a new Government Securities Act in the near future.

Internal debt of the Union Government includes Market Loans, Special Securities issued to RBI and others, Gold Bonds, Compensation, Relief and other bonds, Treasury Bills of different maturities issued to the RBI, State Governments, commercial banks and other parties, WMA, Securities issued to International Financial Institutions, Marketable Securities and Special Union Government Securities issued against small savings. The internal debt is classified into market loans, other long and medium term borrowings and short-term borrowings and shown in the receipt budget of the Union Government.

External debt of the Union Government comprises both long-term and short-term debt consisting of multilateral and bilateral borrowings of Government, borrowings from IMF, etc.

The liabilities other than internal and external debt include other interest and non-interest bearing obligations of the Government such as Post Office Savings Deposits, deposits under small savings schemes, loans raised through Post Office cash certificates, Provident Funds, interest and non-interest bearing reserve funds of departments like Railways, Telecommunications and others and other deposits and advances, both interest and non-interest bearing.

The “other liabilities” of governments arise in government accounts more in the capacity as a banker rather than as a borrower. Hence, such borrowings are shown as part of Public Account and are not secured under the consolidated fund.

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. Apart from its role as a regulator, it has to simultaneously fulfill several other important objectives viz. managing the borrowing program of the Government of India, controlling inflation, ensuring adequate credit at reasonable costs to various sectors of the economy, managing the foreign exchange reserves of the country and ensuring a stable currency environment.

RBI controls the issuance of new banking licenses to banks; the manner in which various scheduled banks raise money from depositors; and deployment of money through its policies on CRR, SLR, priority sector lending, export refinancing, guidelines on investment assets etc.

Another major area under the control of the RBI is the interest rate policy. Earlier, it used to strictly control interest rates through a directed system of interest rates. Each type of lending activity was supposed to be carried out at a pre-specified interest rate. Over the years RBI has moved slowly towards a regime of market determined controls. RBI provides negotiated dealing system which is an electronic platform for facilitating dealing in Government Securities and money market instruments.

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.

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.

Co-ordination between RBI and Securities and Exchange Board of India (SEBI) is ensured both at policy level and at operational level. In particular, at policy level, coordination is ensured through a High Level Committee on Capital Markets (HLCC) presided by Governor - RBI, and consisting of Chairman - SEBI, Chairman - Insurance Regulatory and Development Authority (IRDA) and Finance Secretary, Government of India. The Deputy Governor of RBI is on the Board of Directors of SEBI. Further, the Standing RBI – SEBI Technical Committee consisting of officials from RBI and SEBI assists the HLCC at operational level.

V. 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.

Purpose of Issue

An issuer can make an initial public offer of convertible debt instruments without making a prior public issue of its equity shares and listing thereof.

No company can make a public issue or rights issue of convertible debt instruments unless credit rating is obtained from one or more agencies.

The company is required to give the following details of credit ratings in case of a public issue or rights issue of convertible debt instruments:

- (a) The names of all the credit rating agencies from which credit rating including unaccepted rating has been obtained for the issue of convertible debt instruments.
- (b) All the credit ratings obtained during three years prior to the filing the offer document for any of the issuer's listed convertible debt instruments at the time of accessing the market through a convertible debt instrument.

Appointment of debenture trustee

The company is required to appoint one or more debenture trustees in accordance with the provisions of section 117B of the Companies Act, 1956 and SEBI (Debenture Trustees) Regulations, 1993.

The issuer is required to disclose the complete name and address of the debenture trustee in the annual report.

Debenture Redemption Reserve

The company is required to create a debenture redemption reserve in accordance with the provisions of section 117C of the Companies Act, 1956.

Redemption

The issuer is required to redeem the convertible debt instruments in terms of the offer document.

Documents to be submitted before opening of the issue

The lead merchant bankers shall submit a due diligence certificate from the debenture trustee as per Form B of Schedule VI to SEBI along with the draft offer document.

Creation of charge

If the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it is required to ensure that-

- (i) such assets are sufficient to discharge the principal amount at all times;
- (ii) such assets are free from any encumbrance;
- (iii) where security is already created on such assets in favour of financial institutions or banks or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such financial institution, bank or lessor for a second or pari passu charge has been obtained and submitted to the debenture trustee before the opening of the issue;
- (iv) the security/asset cover is required to be arrived at after reduction of the liabilities having a first/prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.

However, the creation of fresh security and execution of fresh trust deed is not mandatory if the existing trust deed or the security documents provide for continuance of the security till redemption of secured convertible debt instruments.

Further, whether the issuer is required to create fresh security and to execute fresh trust deed or not is to be decided by the debenture trustee.

Roll over of non convertible portion of partly convertible debt instruments

The non-convertible portion of partly convertible debt instruments issued by a listed issuer, the value of which exceeds fifty lakh rupees can be rolled over without change in the interest rate, subject to compliance with the provisions of section 121 of the Companies Act, 1956 and the following conditions—

- (a) seventy five per cent. of the holders of the convertible debt instruments of the issuer have, through a resolution, approved the rollover through postal ballot.
- (b) the issuer has along with the notice for passing the resolution, sent to all holders of the convertible debt instruments, an auditors' certificate on the cash flow of the issuer and with comments on the liquidity position of the issuer.
- (c) the issuer has undertaken to redeem the non-convertible portion of the partly convertible debt instruments of all the holders of the convertible debt instruments who have not agreed to the resolution.
- (d) credit rating has been obtained from at least one credit rating agency registered with the Board within a period of six months prior to the due date of redemption and has been communicated to the holders of the convertible debt instruments, before the roll over.

Conversion of optionally convertible debt instruments into equity share capital

(1) No issuer can convert its optionally convertible debt instruments into equity shares unless the holders of such convertible debt instruments have sent their positive consent to the issuer and non-receipt of reply to any notice sent by the issuer for this purpose is not construed as consent for conversion of any convertible debt instruments.

(2) Where the value of the convertible portion of any convertible debt instruments issued by a listed issuer exceeds fifty lakh rupees and the issuer has not determined the conversion price of such convertible debt instruments at the time of making the issue, the holders of such convertible debt instruments are required to be given the option of not converting the convertible portion into equity shares.

However, where the upper limit on the price of such convertible debt instruments and justification thereon is determined and disclosed to the investors at the time of making the issue, it is not necessary to give such option to the holders of the convertible debt instruments for converting the convertible portion into equity share capital within the said upper limit.

(3) Where an option is to be given to the holders of the convertible debt instruments in terms of Para (2) and if one or more of such holders do not exercise

the option to convert the instruments into equity share capital at a price determined in the general meeting of the shareholders, the issuer is required to redeem that part of the instruments within one month from the last date by which option is to be exercised, at a price which shall not be less than its face value.

However, this provision is not applicable if such redemption is in terms of the disclosures made in the offer document.

Restriction

An issuer can not issue convertible debt instruments for financing replenishment of funds or for providing loan to or for acquiring shares of any person who is part of the same group or who is under the same management.

However, an issuer may issue fully convertible debt instruments for these purposes if the period of conversion of such debt instruments is less than eighteen months from the date of issue of such debt instruments.

Determination of coupon rate and conversion price

An issuer can determine the coupon rate and conversion price of convertible debt instruments in consultation with the lead merchant banker or through the book building process.

Minimum promoter's contribution

In case of an initial public offer of convertible debt instruments without a prior public issue of equity shares, the promoters are required to bring in a contribution of at least twenty per cent of the project cost in the form of equity shares, subject to contributing at least twenty per cent of the issue size from their own funds in the form of equity shares.

However, if the project is to be implemented in stages, the promoters' contribution is required to be with respect to total equity participation till the respective stage vis-à-vis the debt raised or proposed to be raised through the public issue.

Auditor's Certificate

The issuer is required to forward the details of utilisation of the funds raised through the convertible debt instruments duly certified by the statutory auditors of the issuer, to the debenture trustees at the end of each half-year.

Obligation of the Issuer

The issuer is required to provide a compliance certificate to the convertible debt instrument holders on yearly basis in respect of compliance with the terms and conditions of issue of convertible debt instruments as contained in the offer document, duly certified by the debenture trustee.

The issuer is also required to furnish a confirmation certificate that the security created by the issuer in favour of the convertible debt instrument holders is properly maintained and is adequate to meet the payment obligations towards the convertible debt instrument holders in the event of default.

The issuer is required to ensure that necessary cooperation with the credit rating agency(ies) has been extended in providing true and adequate information till the debt obligations in respect of the instrument are outstanding.

VI. 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. Salient features of the regulations are as follows: -

1. The special purpose distinct entity i.e. issuer shall be in the form of a trust; the trustees thereof will require registration from SEBI. The registration granted to a trustee shall be permanent subject to compliance with the provisions with the SCRR and the regulations and payment of appropriate fees.
2. If a debenture trustee registered with SEBI or a securitization company or a asset reconstruction company registered with Reserve Bank of India or National Housing Bank or the NABARD is the trustee of the issuer no registration from SEBI to act as such shall be required.
3. The securitized debt instruments issued to public or listed on recognized stock exchange shall acknowledge the beneficial interest of the investors in underlying debt or receivables assigned to the issuer. The regulations provide flexibility in terms of pay through / pass through structures and do not restrict any particular mode.
4. The assignment of assets to the issuer shall be a true sale. The debt or receivables assigned to the issuer should be expected to generate identifiable cash flows for the purpose of servicing the instrument and the originator should have valid enforceable interests in the assets and in cash flow of assets prior to securitization.
5. Originator shall be an independent entity from the issuer and its trustees and the originator and its associates shall not exercise any control over the issuer. However, the originator may be appointed as a servicer. The issuer may appoint any other person as servicer in respect of any its schemes to co-ordinate with the obligors, manage the said pool and collection there from administer the cash flows of asset pool, distribution to investors and reinvestments. The issuer shall not acquire any debt or receivables from any originator who is part of the same group or which is under the same management as the trustee. Regulations require strict segregation of assets of each scheme.
6. The issuer may offer securitised debt instruments to public for subscription through an offer document containing disclosures of all relevant material facts including financials of the issuer, originator, quality of the asset pool, disclosure of various kinds of risks, credit ratings including unaccepted ratings, arrangements made for credit enhancement, liquidity facilities availed, underwriting of the issue etc. apart from the routine disclosures relating to issue, offer period, application, etc.

7. Rating from at least two credit rating agencies is mandatory and all ratings including unaccepted ratings shall be disclosed in the offer documents. The rating rationale should include reference to the quality of the said pool and strengthen of cash flows, originator profile, payment structure, risks and concerns for investors, etc.
8. The instrument shall be in dematerialized form.
9. The draft offer document shall be filed with SEBI at least 15 days before opening of the issue.
10. In case of public issuances listing will be mandatory. The instruments issued on private placement basis may also be listed subject to the compliance of simplified provisions of the regulations. The securitised debt instruments issued to the public or listed on a recognized stock exchange in accordance with these regulations shall be freely transferable.
11. It has been proposed to introduce simplified and relaxed listing agreement. Listing of private placement is also permitted subject to the compliance of simplified provisions of the listing agreement and the regulations. The simplified listing agreement is under preparation.

VII. 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.

Definition

“Debt Securities” means a non-convertible debt securities which create or acknowledge indebtedness, and include debenture, bonds and such other securities of a body corporate or any statutory body constituted by virtue of a legislation, whether constituting a charge on the assets of the body corporate or not, but excludes bonds issued by Government or such other bodies as may be specified by SEBI, security receipts and securitized debt instruments.

“Designated Stock Exchange” means a stock exchange in which securities of the issuer are listed or proposed to be listed and which is chosen by the issuer for the purposes of a particular issue under these regulations.

“Private Placement” means an offer or invitation to less than fifty persons to subscribe to the debt securities in terms of sub-section (3) of section 67 of the Companies Act, 1956.

“Recognized Stock Exchange” means any stock exchange which is recognized under section 4 of the Securities Contracts (Regulation) Act, 1956.

ISSUE OF DEBT SECURITIES**Requirements as on the date of filing draft offer document and final offer document**

An issuer can not make any public issue of debt securities if –

1. The issuer or the person in control of the issuer, or its promoter, has been restrained or prohibited or debarred by SEBI from accessing the securities market or dealing in securities and such direction or order is in force.
2. It has made an application to one or more recognized stock exchanges for listing of such securities therein. If the application is made to more than one recognized stock exchanges, the issuer must choose one of them which has nationwide trading terminals as the designated stock exchange.

(For any subsequent public issue, the issuer can choose a different stock exchange as a designated stock exchange subject to the requirements of this regulation)

3. It has obtained in-principle approval for listing of its debt securities
4. Credit rating including the unaccepted ratings obtained from more than one credit rating agencies, registered with SEBI shall be disclosed in the offer document.
5. The issuer can not issue debt securities for providing loan to or acquisition of shares of any person who is part of the same group or who is under the same management.

Appointment of Intermediaries

1. It shall enter into an arrangement with a depository registered with SEBI in accordance with the Depositories Act, 1996 and regulations made there under.
2. The issuer shall appoint one or more merchant bankers registered with SEBI at least one of whom shall be a lead merchant banker.
3. The issuer shall appoint one or more debenture trustees in accordance with the provisions of Section 117B of the Companies Act, 1956 (1 of 1956) and Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993.

Disclosures of material information

1. The offer document must contain all material disclosures which are necessary for the subscribers of the debt securities to take an informed investment decision. The offer document contains the following:
 - (a) the disclosures specified in Schedule II of the Companies Act, 1956;
 - (b) disclosure specified in Schedule I of these regulations;
 - (c) additional disclosures as may be specified by SEBI
2. The amount of minimum subscription which the issuer seeks to raise and underwriting arrangements shall be disclosed in the offer document.

Filing

An Issuer can not make a public issue of debt securities unless-

- A draft offer document has been filed with the designated stock exchange through the lead merchant banker.
- A copy of draft and final offer document shall also be forwarded to SEBI for its records.

Responsibilities of Merchant Banker

The lead merchant banker shall ensure that—

1. The draft offer document clearly specifies the names and contact particulars of the compliance officer of the lead merchant banker and the issuer including the postal and email address, telephone and fax numbers.
2. All comments received on the draft offer document are suitably addressed and shall also furnish to SEBI a due diligence certificate as per Schedule II of these regulations prior to the filing of the offer document with the Registrar of Companies.

Mode of Disclosure

- The draft offer document shall be made public by posting it on the website of the designated stock exchange for seeking public comments for a period of seven working days from the date of filing the draft offer document with such exchange.
- The draft offer document can also be displayed on the website of the issuer, merchant bankers and the stock exchanges where the debt securities are proposed to be listed.
- The draft and final offer document shall be displayed on the websites of stock exchanges and shall be available for download in PDF / HTML formats.
- The offer document shall be filed with the designated stock exchange, simultaneously with filing thereof with the Registrar of Companies, for dissemination on its website prior to the opening of the issue.
- Where any person makes a request for a physical copy of the offer document, the same shall be provided to him by the issuer or lead merchant banker.

Prohibition of Mis-statements in the offer document

- The offer document shall not omit disclosure of any material fact which may make the statements made therein, in light of the circumstances under which they are made, misleading.
- The offer document or abridged prospectus or any advertisement issued by an issuer in connection with a public issue of debt securities shall not contain any false or misleading statement.

Advertisements

- The issuer shall make an advertisement in a national daily with wide circulation, on or before the issue opening date and such advertisement shall, amongst other things, contain the disclosures as per Schedule IV.
- The advertisement shall urge the investors to invest only on the basis of information contained in the offer document.

Misleading Advertisement

An issuer shall not issue an advertisement—

- which is misleading in material particular or which contains any information in a distorted manner or which is manipulative or deceptive or extraneous matters.
- which contain a statement, promise or forecast which is untrue or misleading and the advertisement shall be truthful, fair and clear.
- during the subscription period any reference to the issue of debt securities or be used for solicitation.

Abridged Prospectus and application forms

The issuer and lead merchant banker ensure that—

- every application form issued is accompanied by a copy of the abridged prospectus and it shall not contain any extraneous matters
- adequate space has been provided in the application form to enable the investors to fill in various details like name, address, etc.

The issuer may provide the facility for subscription of application in electronic mode.

On-Line Issuances

An issuer proposing to issue debt securities to the public through the on-line system of the designated stock exchange shall comply with the relevant applicable requirements as may be specified by SEBI.

Issue Price

The issuer may determine the price of debt securities in consultation with the lead merchant banker and the issue may be at fixed price or the price may be determined through book building process in accordance with the procedure as may be specified by SEBI.

Minimum subscription

The issuer may decide the amount of minimum subscription which it seeks to raise by issue of debt securities. In the event of non receipt of minimum subscription all application moneys received in the public issue shall be refunded forthwith to the applicants.

Optional Underwriting

A public issue of debt securities may be underwritten by an underwriter registered with SEBI.

Trust Deed

A trust deed shall—

- (1) be executed by the issuer in favour of the debenture trustee within three months of the closure of the issue.
- (2) contain such clauses as may be prescribed under section 117A of the Companies Act, 1956 and those mentioned in Schedule IV of SEBI (Debenture Trustees) Regulations, 1993.
- (3) not contain a clause which has the effect of –
 - limiting or extinguishing the obligations and liabilities of the debenture trustees or the issuer in relation to any rights or interests of the investors
 - limiting or restricting or waiving the provisions of the Act, these regulations and circulars or guidelines issued by SEBI
 - indemnifying the debenture trustees or the issuer for loss or damage caused by their act of negligence or commission or omission.

Debenture Redemption Reserve

- (1) The issuer shall create a debenture redemption reserve in accordance with the provisions of the Companies Act, 1956 and circulars issued by Central Government in this regard.
- (2) Where the issuer has defaulted in payment of interest on debt securities or redemption thereof or in creation of security as per the terms of the issue of debt securities, any distribution of dividend shall require approval of the debenture trustees.

Creation of charge

- (1) The proposal to create a charge or security, if any, in respect of secured debt securities shall be disclosed in the offer document along with its implications.
- (2) The issuer has given an undertaking in the offer document that the assets on which charge is created are free from any encumbrances and if the assets are already charged to secure a debt, the permissions or consent to create second or *pari pasu* charge on the assets of the issuer have been obtained from the earlier creditor.
- (3) The issue proceeds shall be kept in an escrow account until the documents for creation of security as stated in the offer document, are executed.

Redemption and Roll-over

- (1) The issuer shall redeem the debt securities in terms of the offer document.

- (2) An issuer desirous of rolling-over the debt securities issued by it, it shall do so only upon passing of a special resolution of holders of such securities and give twenty one days notice of the proposed roll over to them.
- (3) The notice shall contain disclosures with regard to credit rating and rationale for roll-over.
- (4) Prior to sending the notice to holders of debt securities, the issuer must file a copy of the notice and proposed resolution with the stock exchanges where such securities are listed, for dissemination of the same to public on its website.
- (5) The debt securities issued can be rolled over subject to the following conditions –
 - A special resolution has been passed by the holders of debt securities through postal ballot having the consent of not less than 75% of the holders by value of such debt securities.
 - At least one rating is obtained from a credit rating agency within a period of six months prior to the due date of redemption and is disclosed in the notice.
 - Fresh trust deed shall be executed at the time of such roll-over or the existing trust deed can be continued if the trust deed provides for such continuation.
 - Adequate security shall be created or maintained in respect of such debt securities to be rolled-over.
 - The issuer shall redeem the debt securities of all the debt securities holders, who have not given their positive consent to the roll-over.

LISTING

Mandatory Listing

- (1) An issuer shall make an application for listing to one or more recognized stock exchanges in terms of sub-section (1) of section 73 of the Companies Act, 1956.
- (2) The issuer shall comply with conditions of listing of such debt securities as specified in the Listing Agreement with the stock exchange where such debt securities are sought to be listed.

Conditions for Private Placement

1. An issuer may list its debt securities issued on private placement basis on a recognized stock exchange subject to the following conditions:
 - In compliance with the provisions of the Companies Act, 1956, rules prescribed there under and other applicable laws.
 - Credit rating has been obtained from at least one credit rating agency registered with SEBI.
 - Should be in dematerialized form.

- The disclosures as provided in regulation 21 have been made
- 2. The issuer shall comply with conditions of listing of such debt securities as specified in the Listing Agreement with the stock exchange where such debt securities are sought to be listed.
- 3. The issuer shall make disclosures as specified in Schedule I of these regulations accompanied by the latest Annual Report of the issuer.

Relaxation of strict enforcement of rule 19 of Securities Contracts (Regulation) Rules, 1957

In exercise of the powers conferred by sub-rule (7) of rule 19 of the Securities Contracts (Regulation) Rules, 1957, SEBI relaxed the strict enforcement of:

- (1) Sub-rules (1) and (3) of rule 19 of the said rules in relation to listing of debt securities issued by way of a public issue or a private placement.
- (2) Clause (b) of sub-rule (2) of rule 19 of the said Rules in relation to listing of debt securities—
 - (i) Issued by way of a private placement by any issuer.
 - (ii) Issued to public by an infrastructure company, a Government Company, a statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in infrastructure sector.

LISTING AND TRADING OF DEBT SECURITIES

Continuous Listing

- (1) All the issuers 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.
- (2) Each rating shall be periodically reviewed by the registered credit rating agency and any revision in the rating shall be promptly disclosed by the issuer to the stock exchange(s) where the debt securities are listed.
- (3) Any change in rating shall be promptly disseminated to investors and prospective investors in such manner as the stock exchange may determine from time to time.
- (4) Debenture trustee must disclose the information to the investors and the general public by issuing a press release in any of the following events:
 - (a) default by issuer to pay interest on debt securities or redemption amount;
 - (b) failure to create a charge on the assets;
 - (c) revision of rating assigned to the debt securities.

Information to be displayed on website

- The disclosures as specified in Schedule-I accompanied by the latest annual report shall be made on the web sites of stock exchanges where such

securities are proposed to be listed and shall be available for download in PDF / HTML formats.

- The issuer, the respective debenture trustees and stock exchanges shall disseminate all information and reports including compliance reports filed by the issuers and the debenture trustees regarding the debt securities to the investors and the general public by placing them on their websites.
- The information shall also be placed on the websites, if any, of the debenture trustee, the issuer and the stock exchanges.

Trading

- (1) 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.
- (2) The trades of debt securities which have been made over the counter shall be reported on a recognized stock exchange having a nation wide trading terminal or such other platform as may be specified by SEBI.
- (3) SEBI may specify conditions for reporting of trades on the recognized stock exchange or other platform

Obligations of Debenture Trustee

- (1) The debenture trustee shall prior to the opening of the public issue, furnish to SEBI a due diligence certificate as per Schedule III of these regulations.
- (2) The debenture trustee shall be vested with the requisite powers for protecting the interest of holders of debt securities including a right to appoint a nominee director on the Board of the issuer in consultation with institutional holders of such securities.
- (3) The debenture trustee shall carry out its duties and perform its functions under these regulations, the Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993, the trust deed and offer document, with due care, diligence and loyalty.
- (4) The debenture trustee shall ensure disclosure of all material events on an ongoing basis.
- (5) The debenture trustees shall supervise the implementation of the conditions regarding creation of security for the debt securities and debenture redemption reserve.

Obligations of the Issuer, Lead Merchant Banker, etc

- (1) The issuer ensure that all the material facts disclosed in the offer documents issued or distributed to the public are true, fair and adequate and there is no mis-leading or untrue statements or mis-statement in the offer document.
- (2) The Merchant Banker shall ensure verify and confirm that the disclosures made in the offer documents are true, fair and adequate and the issuer is in compliance with these regulations as well as all transaction specific

disclosures required in Schedule I of these regulations and Schedule II of the Companies Act, 1956.

- (3) The issuer shall treat the applicant in a fair and equitable manner as per the procedures as may be specified by SEBI.
- (4) In respect of assignments undertaken for issue, offer and distribution of securities to the public the intermediaries shall be responsible for the due diligence.
- (5) A person shall not employ any device, scheme or artifice to defraud in connection with issue or subscription or distribution of debt securities which are listed or proposed to be listed on a recognized stock exchange.
- (6) The issuer and the merchant banker shall ensure that the security created to secure the debt securities is adequate to ensure 100% asset cover for the debt securities.

Disclosure chart

<i>Equity already listed</i>	<i>Type of offering</i>	<i>Manner of disclosures</i>
Yes	Public offering	— Material disclosures from Sch II of Companies Act 1956 — Sch I of the draft Regulations — Simplified debt listing agreement
Yes	Private placement with listing	— Sch I of the draft Regulations — Simplified debt listing agreement — (reference to) last annual report
No	Public offering	— Material disclosures from Sch II of Companies Act 1956 — Sch I of the draft Regulations — Debt listing agreement
No	Private placement with listing	— Sch I of the draft Regulations — Debt listing agreement — (reference to) last annual report

VIII. SIMPLIFIED LISTING AGREEMENT FOR DEBT SECURITIES

Continuing with rationalization of disclosure norms for listing of debt issuances, SEBI has put in place a simplified Listing Agreement for debt securities.

The new Listing Agreement for debt securities, prepared in consultation with stock exchanges BSE and NSE is one single document replacing the existing separate listing agreements for debentures issued by way of a public issue and those that are privately placed. The disclosures in the draft listing agreement are based on the principle that if an issuer has his equity already listed such an issuer only makes minimal incremental disclosures specific to its debt issuance. Issuers who have only debt securities listed and not equity, reasonably elaborate disclosures fewer than equity though are prescribed.

The Listing Agreement has two parts; Part A is applicable where equity shares of the issuer are already listed on the exchange and continues to comply with the listing agreement for equity. Part B is applicable for issuers who do not have their equity shares already listed on the exchange. An issuer complying with Part B would move to compliance with Part A in case its equity listed at a future date. Similarly, an issuer delisting equity need to comply with Part B.

PART A

(Applicable where equity shares of the Issuer are listed)

The Issuer agrees that—

1. The Issuer agrees that in addition to the covenants in this part of this agreement executed between the Issuer and the Exchange, the issuer shall be bound by the covenants provided in the equity Listing Agreement. However, covenants in the Equity Listing Agreement, which are not applicable to issue of debt securities in terms of the SEBI (Issue of Listing of Debt Securities) Regulations 2008, shall not be applicable in respect of this Listing Agreement.

Further, the issuer who has submitted any information to the Exchange in compliance with the disclosure requirements under the equity Listing Agreement, need not re-submit any such information under this Listing Agreement without prejudice to any power conferred on the Exchange or SEBI or any other authority under any law to seek any such information from the issuer.

2. It shall forward to the debenture trustee promptly, whether a request for the same has been made or not:

- (a) a copy of the Statutory Auditors' and Directors' Annual Report, Balance Sheet and Profit & Loss Account and of all periodical and special reports at the same time as they are issued;
- (b) a copy of all notices, resolutions and circulars relating to new issue of debt securities at the same time as they are sent to shareholders/ holders of debt securities;
- (c) a copy of all the notices, call letters, circulars, proceedings, etc. of the meetings of debt security holders at the same time as they are sent to the holders of debt securities or advertised in the media;
- (d) Half-yearly certificate regarding maintenance of 100% asset cover in respect of listed debt securities, by either a practicing company secretary or a practicing chartered accountant, along with the half yearly financial results. However, submission of such half yearly certificates is not applicable in cases where an issuer is a Bank or NBFC registered with RBI or where bonds are secured by a Government guarantee.

3. It shall forward to the debenture trustee any such information sought and provide access to relevant books of accounts as required by the debenture trustee.

4. While submitting the half yearly/ annual results, it shall separately indicate the following line items after the item Earnings per Share:

- (a) debt service coverage ratio; and

- (b) interest service coverage ratio.

(Not applicable for Bank or NBFC issuers registered with RBI)

5. In respect of its listed debt securities, the Issuer agrees that it shall maintain 100% asset cover sufficient to discharge the principal amount at all times for the debt securities issued and shall disclose to the exchange on half-yearly basis and in their annual financial statements the extent and nature of security created and maintained. However, this requirement shall not be applicable in case of unsecured debt instruments issued by regulated financial sector entities eligible for meeting capital requirements as specified by respective regulators.

6. The Issuer agrees to send to the Exchange for dissemination, along with the half yearly financial results, a half- yearly communication, counter signed by trustees, containing *inter-alia* the following information:

- (a) credit rating;
- (b) asset cover available;
- (c) debt-equity ratio;
- (d) previous due date for the payment of interest/principal and whether the same has been paid or not; and
- (e) next due date for the payment of interest/principal.

7. The Issuer agrees that it shall use the services of ECS (Electronic Clearing Service), Direct Credit, RTGS (Real Time Gross Settlement) or NEFT (National Electronic Funds Transfer) for payment of interest and redemption or repayment amounts as per applicable norms of the Reserve Bank of India.

8. It shall notify the Exchange regarding expected default in timely payment of interests or redemption or repayment amount or both in respect of the debt securities as soon as the same becomes apparent.

9. Credit to demat accounts of the allottees shall be made within two working days from the date of allotment.

10. In case of listing of debt securities issued to public-

- (a) allotment of securities offered to public shall be made within 30 days of the closure of the public issue;
- (b) it shall pay interest @ 15% per annum if the allotment has not been made and/or the refund orders have not been despatched to the investors within 30 days from the date of closure of the issue.

11. In the event equity shares of the Issuer are delisted from the Exchange, the Issuer shall comply with provisions in PART B of this agreement.

PART B

(Applicable where equity shares of the Issuer are not listed on the Exchange)

The Issuer agrees that-

12. (a) it will not forfeit unclaimed interest and such unclaimed interest shall be

transferred to the 'Investor Education and Protection Fund' set up as per section 205C of the Companies Act, 1956; and

- (b) unless the terms of issue provide otherwise, the Issuer shall not select any of its listed securities for redemption otherwise than pro rata basis or by lot and shall promptly furnish to Exchange.

13. It shall forward to the debenture trustee promptly, whether a request for the same has been made or not:

- (a) a copy of the Statutory Auditors' and Directors' Annual Reports, Balance Sheets and Profit & Loss Accounts and of all periodical and special reports;
- (b) a copy of all notices, resolutions and circulars relating to new issue of security;
- (c) a copy of all the notices, call letters, circulars, proceedings, etc of the meetings of debt security holders;
- (d) a half-yearly certificate regarding maintenance of 100% asset cover in respect of listed debt securities, by either a practicing company secretary or a practicing chartered accountant, along with the half yearly financial results. However, submission of such half yearly certificates is not applicable in cases where an issuer is a Bank or NBFC registered with RBI or where bonds are secured by a Government guarantee.

14. It shall forward to the debenture trustee any such information sought and provide access to relevant books of accounts as required by debenture trustee.

15. It shall send to its holders of debt securities upon request a copy of the Director's Annual Report, Balance Sheet and Profit and Loss Account and shall also file the same with the Exchange.

16. It shall—

- (a) In respect of its listed debt securities, the Issuer agrees that it shall maintain 100% asset cover sufficient to discharge the principal amount at all times for the debt securities issued and shall disclose to the exchange on half-yearly basis and in their annual financial statements, the extent and nature of security created and maintained.
- (b) ensure timely interest/ redemption payment;
- (c) ensure that services of ECS (Electronic Clearing Service), Direct Credit, RTGS (Real Time Gross Settlement) or NEFT (National Electronic Funds Transfer) are used for payment of interest and redemption or repayment amounts as per applicable norms of the Reserve Bank of India. The Issuer shall issue 'payable-at-par' warrants/ cheques for payment of interest and redemption amount;
- (d) at all times abide by the requirements of the SEBI Act, 1992, the SCRA, 1956 and rules and the regulations made there under as applicable to further issuance, if any, of debt securities.

However, this requirement shall not be applicable in case of unsecured debt

instruments issued by regulated financial sector entities eligible for meeting capital requirements as specified by respective regulators.

17. Credit to demat accounts of the allottees shall be made within two working days from the date of allotment.

18. In case of listing of debt securities issued to public:

- (a) allotment of securities offered to public shall be made within 30 days of the closure of the public issue;
- (b) it shall pay interest @ 15% per annum if the allotment has not been made and/or the refund orders have not been despatched to the investors within 30 days from the date of closure of the issue.

19. The Issuer undertakes to promptly notify to the Exchange:

- (a) of any attachment or prohibitory orders restraining the Issuer from transferring debt securities from the account of the registered holders and furnish to the Exchange particulars of the numbers of securities so affected and the names of the registered holders and their demat account details;
- (b) of any action which will result in the redemption, conversion, cancellation, retirement in whole or in part of any debt securities;
- (c) of any action that would effect adversely payment of interest on debt securities;
- (d) of any change in the form or nature of any of its debt securities that are listed on the Exchange or in the rights or privileges of the holders thereof and make an application for listing of the said securities as changed, if the Exchange so requires;
- (e) of any other change that would affect the rights and obligations of the holders of debt securities;
- (f) of any expected default in timely payment of interest or redemption or repayment amount or both in respect of the debt securities listed on the Exchange as soon as the same becomes apparent;
- (g) of any other information not in the public domain necessary to enable the holders of the listed securities to clarify its position and to avoid the creation of a false market in such listed securities;
- (h) the date of the meetings of its Board of Directors at which the recommendation or declaration of issue of debt securities or any other matter affecting the rights or interests of holders of debt securities is proposed to be taken up, at least two days in advance;
- (i) of any changes in the General Character or nature of business / activities, disruption of operation due to natural calamity, revision in ratings and commencement of commercial production / commercial operations;
- (j) of any events such as strikes and lock outs which have a bearing on the interest payment/ principal repayment capacity;

- (k) of any details of any letter or comments made by debenture trustees regarding payment/non-payment of interest on due dates, payment/nonpayment of principal on the due dates or any other matter concerning the security, Issuer and /or the assets along with its comments thereon, if any;
- (l) delay/ default in Payment of Interest / Principal Amount for a period of more than three months from the due date;
- (m) failure to create charge on the assets within the stipulated time period; and
- (n) any other information having bearing on the operation/performance of the Issuer as well as price sensitive information.

19A. Statement of deviations in use of issue proceeds-

- (a) The company agrees to furnish to the stock exchange on a half yearly basis, a statement indicating material deviations, if any, in the use of proceeds of issue of debt securities from the objects stated in the offer document.
- (b) The information shall be furnished to the stock exchange along with the half-yearly financial results furnished to the stock exchange and shall also be published in the newspapers simultaneously with the half-yearly financial results.

20. The Issuer agrees to close transfers or fix a record date for purposes of payment of interest and payment of redemption or repayment amount or for such other purposes as the Exchange may agree to or require and to give to the Exchange the notice in advance of at least seven clear working days, or of as many days as the Exchange may from time to time reasonably prescribe, stating the dates of closure of transfers (or, when transfers are not to be closed, the date fixed for taking a record of its debt security holders) and specifying the purpose or purposes for which the transfers are to be closed (or the record is to be taken).

21. The Issuer agrees:

- (a) to intimate to the Exchange, of its intention to raise funds through new debt securities either through a public issue or on private placement basis (if it proposes to list such privately placed debt securities on the Exchange) prior to issuing such securities;
- (b) to make an application to the Exchange for the listing of such new issue of debt securities and to submit such provisional documents as required by the Exchange;
- (c) to ensure that any scheme of arrangement/ amalgamation/ merger/ reconstruction/ reduction of capital to be presented to any Court or Tribunal does not in any way violate, override or circumscribe the provisions of securities laws or the Exchange requirements;
- (d) that no material modification shall be made to the structure of the debenture in terms of coupon, conversion, redemption, or otherwise without prior approval of the Exchanges where the debt securities are listed. The issuer shall make an application to the exchange only after the approval of the Board of Directors and the debenture trustee.

21A. The issuer agrees that it shall be a condition precedent for issuance of new

debt securities that it shall deposit before the opening of subscription list and keep deposited with the Exchange (in cases where the debt securities are offered for subscription whether through an offer document or otherwise) an amount calculated at the rate of 1% (one per cent) of the amount of debt securities offered for subscription to the public, as the case may be for ensuring compliance by the company, within the prescribed or stipulated period, of all prevailing requirements of law and all prevailing listing requirements and conditions as mentioned in, and refundable or forfeitable in the manner stated in the Rules, Bye-laws and Regulations of the Exchange for the time being in force. However, 50% (fifty per cent) of the security deposit should be paid to the Exchange in cash. The balance amount can be provided for by way of a bank guarantee. Further that the amount to be paid in cash is limited to Rs.3 crores.

22. The Issuer agrees and undertakes to designate the Company Secretary or any other person as Compliance Officer who:

- (a) shall be responsible for ensuring compliance with the regulatory provisions applicable to such issuance of debt securities and report the same at the meeting of Board of Directors/ Council of Issuer held subsequently;
- (b) shall directly report to SEBI, Stock Exchanges, Registrar of Companies, etc., and investors on the implementation of various clauses, rules, regulations and other directives of these authorities;
- (c) shall be responsible for filing the information in the CorpFiling or any other platform as may be mandated by SEBI from time to time. The compliance officer and the Issuer shall ensure the correctness and authenticity of the information filed in the system and that it is in conformity with applicable laws and terms of the Listing Agreement;
- (d) shall monitor the designated e-mail ID of the grievance redressal division which shall be exclusively maintained for the purpose of registering complaints by investors. The company shall display the email ID and other relevant details prominently on their websites and in the various materials / pamphlets/ advertisement campaigns initiated by them for creating investor awareness.

23. The Issuer agrees that it will pay to the Exchange fees as prescribed by the Exchange, and thereafter, so long as the securities continued to be listed on the Exchange, it will pay to the Exchange on or before April 30, in each year an Annual Listing Fee computed on the basis of the securities of the Issuer which are outstanding as on March 31 and listed on the Exchange. The Issuer also agrees that it shall pay the additional fee, at the time of making application for listing of debt securities arising out of further issue.

24. The Issuer agrees and undertakes, as a pre-condition for continued listing of securities, hereunder, to comply with any regulations, requirements, practices and procedures as may be laid down by the Exchange for the purpose of dematerialisation of securities hereunder in pursuance of the prevailing statutes and/or statutory regulations, to facilitate scripless trading.

25. the Issuer agrees to comply with the provisions of the relevant Acts, Rules,

Regulations and guidelines issued by SEBI and also such other guidelines as may be issued from time to time by the Government, Reserve Bank of India.

26. The Issuer agrees to comply with such provisions as may be specified by the Exchange for clearing and settlement of transactions in debt securities.

27. The Issuer agrees to send the following to its holders of debt securities and also to the Exchange for dissemination:

- (a) Notice of all meetings of the debt security holders specifically stating that the provisions for appointment of proxy as mentioned in section 176 of the Companies Act, 1956, shall be applicable for such meeting;
- (b) A half-yearly communication, counter signed by debenture trustee, along with the half yearly financial results, containing, *inter alia*, following information:
 - (i) credit rating;
 - (ii) asset cover available;
 - (iii) debt-equity ratio;
 - (iv) previous due date for the payment of interest/ principal and whether the same has been paid or not; and
 - (v) next due date for the payment of interest/ principal.

28. Annual Disclosure in Annual Report

A. With respect to Parent and Subsidiary companies The Issuer shall make annual disclosures as under:

Sl.	In the books of an Issuer who is a	Disclosures of amounts at the year end and the maximum amount of loans/ advances/ investments outstanding during the year.
1.	Parent	Loans and advances in the nature of loans to subsidiaries by name and amount. Loans and advances in the nature of loans to associates by name and amount. Loans and advances in the nature of loans where there is— (i) no repayment schedule or repayment beyond seven years; or (ii) no interest or interest below section 372A of Companies Act by name and amount. Loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount.
2.	Subsidiary	Same disclosures as applicable to the parent company in the accounts of subsidiary company.
3.	Parent	Investments by the loanee (borrower) in the shares of parent company and subsidiary company, when the company has made a loan or advance in the nature of loan.

B. Cash Flow Statement

The Issuer agrees to give cash flow statement, alongwith the Balance Sheet and Profit and Loss Account, which are prepared in accordance with the Accounting Standard on Cash Flow Statement (AS-3) issued by the Institute of Chartered Accountants of India.

29. Half-yearly Financial Results*A. General*

- (a) The Issuer agrees to furnish un-audited or audited financial results on a half yearly basis preferably in the format prescribed within 45 days from the end of the half year to the Exchange. Un-audited financial results shall be accompanied by limited review report prepared by the statutory auditors of the company (or in case of public sector undertakings, by any practicing Chartered Accountant).
- (b) Such half-yearly results should have been taken on record by the Board of Directors/ Council of Issuer as the case may be or its Sub Committee and signed by the Managing Director / Executive Director.
- (c) The Issuer shall, within 48 hours of the conclusion of the Board/Council or its Sub Committee Meeting, publish the financial results in at least one English daily newspaper circulating in the whole or substantially the whole of India.

B. Results for the last half year

- (a) The issuer agrees that if it intimates in advance to the Stock Exchange/s that it would publish/ furnish to the Exchanges its annual audited results within 60 days from the end of the financial year, un-audited financial results for the last half year accompanied by limited review report by the auditors need not be published/ furnished to Exchanges. The audited results for the year shall be published/ furnished to the Exchanges in the same format as is applicable for half-yearly financial results.
- (b) The issuer agrees that if it opts to submit un-audited financial results for the last half year accompanied by limited review report by the auditors, it shall also submit audited financial results for the entire financial year, as soon as they are approved by the Board of Directors.

C. Qualifications in Audit Reports

The issuer agrees that qualifications in Audit Reports that have a bearing on the interest payment/redemption or principal repayment capacity of the company are appropriately and adequately addressed by the Board of Directors while publishing the accounts for the said period.

30. The Issuer agrees that it shall file the information, statements and reports etc in such manner and format and within such time as may be specified by SEBI or the stock exchange as may be applicable.

IX. LISTING AGREEMENT FOR SECURITIZED DEBT INSTRUMENTS

To improve the secondary market liquidity for securitized debt instruments and to enhance information available in the public domain on performance of asset pools on which securitized debt instruments are issued, SEBI vide its circular No Cir./IMD/DF/5/2011 dated March 16, 2011 put in place a Listing Agreement for securitized debt instruments.

In respect of listed securitized debt instruments, it is clarified that Special Purpose Distinct Entity (SPDEs) which make frequent issues of securitized debt instruments are permitted to file umbrella offer documents on the lines of a 'shelf prospectus'. In order to ensure uniform market convention for secondary market trades of securitized debt instruments, Actual/ Actual day count convention, shall be mandatory for all listed securitized debt instruments. The Listing Agreement places the burden of disclosures on the Special Purpose Distinct Entity (SPDE) which is the issuer of securitized debt and disclosure of pool level, tranche level and select loan level information. The Highlights of the Listing Agreement for Securitised Debt Instruments are as follows:

1. The Special Purpose Distinct Entity (SPDE) requires:

- to intimate to the Exchange, of its intention to issue new securitized debt instruments either through a public issue or on private placement basis prior to issuing such securities:
- to ensure that any scheme of arrangement/ amalgamation/ merger/ reconstruction/ reduction of capital to be presented to any Court or Tribunal does not in any way violate, override or circumscribe the provisions of securities laws or the Exchange requirements;
- no material modification should be made in terms of coupon, conversion, redemption, or otherwise without prior approval of the Exchanges.
- to abide by the requirements of the SEBI Act, 1992, the Securities Contracts(Regulation) Act,1956 and rules and the regulations made thereunder.

2. The SPDE either by itself or through the servicer ensure timely interest/ redemption payment; make credit enhancement available for listed securitized debt instruments at all times; ensure that services of ECS, Direct Credit, RTGS or NEFT are used for payment of interest and redemption or repayment amounts as per applicable norms of the Reserve Bank of India and if not possible to make payment through electronic means, the SPDE is required to issue 'payable-at-par' warrants/ cheques for payment of interest and redemption amount;

3. The SPDE will not forfeit unclaimed interest and principal and such unclaimed interest and principal should be, after a period of seven years, transferred to the SEBI (Investor Protection and Education Fund).

4. The SPDE undertakes to designate any person as Compliance Officer who would be responsible for ensuring compliance with the regulatory provisions applicable; directly report to the SEBI, Stock Exchanges, Registrar of Companies, etc., and investors on the implementation of various clauses, rules, regulations and other directives of these authorities; for filing the information in any electronic

platform as may be mandated by SEBI from time to time; monitor the designated e-mail ID of the grievance redressal division and also ensure the correctness and authenticity of the information filed in the system and that it is in conformity with applicable laws and terms of the Listing Agreement;

5. The SPDE requires to credit the demat accounts of the allottees within two working days from the date of allotment.

6. The SPDE ensures that:

- (a) allotment of securities offered to public should be made in accordance with Regulation 31 of the SEBI (Public Offer and Listing of Securitized Debt Instruments) Regulations, 2008.
- (b) it shall pay interest @ 15% per annum if the allotment has not been made and/or the refund orders have not been despatched to the investors within the period specified above.

7. The SPDE either by itself or through the sponsor, deposit before the opening of subscription list and keep deposited with the Exchange (in cases where the securitized debt instruments are offered for subscription whether through an offer document or otherwise) an amount calculated at the rate of 1% of the amount of securitized debt instruments offered for subscription to the public within the prescribed or stipulated period. However, 50% of the above mentioned security deposit should be paid to the Exchange in cash and the amount to be paid in cash is limited to Rs. 3crores. The balance amount can be provided for by way of a bank guarantee.

8. The SPDE either by itself or through the sponsor, pay to the Exchange fees as prescribed by the Exchange as soon as its securitized debt instruments are listed on the Exchange and thereafter, so long as the securities continued to be listed on the Exchange, it will pay to the Exchange on or before April 30, in each year an Annual Listing Fee computed on the basis of the securities of the SPDE which are outstanding as on March 31 and listed on the Exchange.

9. The SPDE undertakes as a pre-condition for continued listing to comply with any regulations, requirements, practices and procedures as may be laid down by the Exchange for the purpose of dematerialisation of securities to facilitate dematerialized trading.

10. The SPDE closes, transfers or fix a record date for purposes of payment of interest and payment of redemption or repayment amount or for such other purposes and to give to the Exchange the notice in advance of at least seven clear working days, or of as many days as the Exchange may from time to time reasonably prescribe, stating the dates of closure of transfers and specifying the purpose or purposes for which the transfers are to be closed.

11. The SPDE requires complying with such provisions as specified by the Exchange for clearing and settlement of transactions in securitized debt instruments.

12. In addition to the foregoing provisions the SPDE agrees to comply with the provisions of the relevant Acts including the SEBI Act, 1992, SEBI (Public Offer and

Listing of Securitised Debt Instruments) Regulations, 2008, Securities Contracts (Regulation) Act, 1956, the Securities Contracts (Regulation) Rules, 1957 and guidelines issued by SEBI and also such other guidelines as may be issued from time to time by the Government, Reserve Bank of India.

13. The SPDE is required to notify the Exchange of:

- any attachment or prohibitory orders restraining the SPDE from transferring securitized debt instruments from the account of the registered holders and furnish to the Exchange particulars of the numbers of securitized debt instruments so affected and the names of the registered holders and their demat account details;
- any action which will result in the redemption, conversion, cancellation, retirement in whole or in part of any securitized debt instruments;
- any action that would affect adversely payment of interest;
any change in the form or nature of any of its securitized debt instruments or in the rights or privileges of the holders ;
- any other change that would affect the rights and obligations of the holders;
- any expected default in timely payment of interest or redemption or repayment amount or both;
- any other information not in the public domain necessary to enable the holders to clarify its position and to avoid the creation of a false market in such listed securities;
- the date of the meetings of its Trustees at which the recommendation or declaration of issue of securitized debt instruments or any other matter affecting the rights or interests of holders is proposed to be taken up, at least two days in advance;
- any changes in the General Character or nature of business / activities, disruption of operation due to natural calamity, revision in ratings, etc.;
- delay/ default in Payment of Interest / Principal Amount to the investors for a period of more than three months from the due date; and any other information having bearing on the operation/performance of the SPDE as well as price sensitive information.

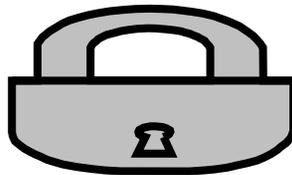
14. The SPDE is required to provide at the request of the investor or the Exchange, loan level information without disclosing particulars of individual borrowers.

15. The SPDE is required to furnish statements on a monthly basis in the format specified within 7 days from the end of the month/ actual payment date and where periodicity of the receivables is not monthly, reporting should be made for such relevant periods.

16. The SPDE need to file the information, statements and reports, etc in such manner and format and within such time as may be specified by SEBI or the stock exchange as may be applicable.

LESSON ROUND UP

- Debt markets are markets for the issuance, trading and settlement in fixed income securities of various types and features. Fixed income securities can be issued by almost 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.
- Investors in debt market are the entities who invest in such fixed income instruments. The investors in such instruments are generally Banks, Financial Institutions, Mutual Funds, Insurance companies, Provident Funds etc.
- Primary dealers (PDs) act as underwriters in the primary market, and as market makers in the secondary market. PDs underwrite a portion of the issue of government security that is floated for a predetermined amount.
- 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 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. 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. 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.

SELF TEST QUESTIONS

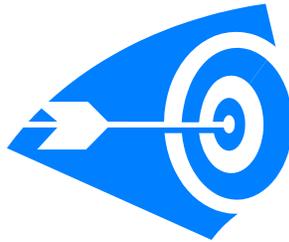
(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. The debt market in India comprises mainly of two segments viz., the Government securities market and the corporate securities market – Discuss.

2. Explain roll over of non-convertible portion of partly convertible debt instruments under SEBI (ICDR) Regulations, 2009.
 3. Explain the Regulatory Framework of Debt Market in India.
 4. Briefly discuss the role of Company Secretary as Compliance Officer in Listing of Debt Securities.
 5. Give an overview of various debt market instruments in India.
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STUDY XVI

**RESOURCE MOBILISATION IN
INTERNATIONAL CAPITAL MARKET**



LEARNING OBJECTIVES

The study will enable the students to understand

- Concept of Global Depository Receipts
- Overview of FCCB and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993
- Procedure for issuance of GDRs/FCCBs/FCEBs
- External Commercial Borrowings

INTRODUCTION

India Inc. though slowly but surely embarked on the global path leading to the emergence of the Indian multinational companies. An acquisition led strategy coupled with strong performance has become a sustainable strategy for Indian companies going global. The Indian corporate sector has indeed taken a giant leap particularly after globalisation and deregulation. Known only for spices, cotton and cheap labour India has completely transformed its image into one of the fastest growing economies of the world-fourth in terms of purchasing power parity and tenth most industrialized economy. The metamorphosis to globally competitive and fastest growing economy has been fuelled by meticulous strategy and vision of Indian corporate sector and commitment by the Government in providing conducive environment for corporates to develop and grow.

With each passing day, Indian businesses are acquiring companies abroad, becoming world popular suppliers and are recruiting staff cutting across nationalities. This may be exemplified by the fact that Tata Motors sells its passenger-car Indica in the UK through a marketing alliance with Rover and has acquired a Daewoo Commercial Vehicles unit giving it access to markets in Korea and China. Ranbaxy is the ninth largest generics company in the world generating an impressive 76 per cent of its revenues from overseas. Asian Paints is amongst the 10 largest decorative paints makers in the world with manufacturing facilities across 24 countries. Bharat Forge a small auto components company is the world's second largest forging maker. Essel Propack is the world's largest manufacturers of lamitubes – tubes used to package toothpaste, with 17 plants spread across 11 countries. About 80 percent

of revenues for Tata Consultancy Services comes from overseas operations. Infosys has 30 marketing offices across the world and 26 global software development centres in the US, Canada, Australia, UK and Japan.

As far as acquisition led strategies of Indian companies are concerned – the Reliance Industries acquired Flag Telcom Bermuda for US\$ 212 million, and Trevira, Germany for US\$ 95 million; Tata Motors acquired Daewoo, Korea for US\$ 118 million; Tata Steel acquired Corus Group for US\$ 12.2 billion; Infosys Technologies acquired Expert Information Services, Australia for US\$ 3.1 million; Wockhardt acquired CP Pharmaceuticals UK for US\$ 18 million; Cadila Health acquired Alpharma SAS France for US\$ 5.7 million; Hindalco acquired Straits Ply, Australia for US\$ 56.4 million; Wipro acquired Nerve Wire Inc. US for US\$ 18.5 million; Aditya Birla acquired Doshiquiao Chem, China for US\$ 8.5 million; Allanda based Novelis for US \$ 6 billion and United Phosphorus acquired Oryzalin Hirbicide, US for US\$ 21.3 million.

Having explained the one side of the coin, let us now consider the other one. The process of economic liberalization has led the markets for consumer products ranging from soft drinks to ice creams to washing machines to refrigerators taken off fuelled by increasing purchasing power and a growing middle class. Indian firms in these industries enjoy tremendous opportunities for long-term growth in sales and profits, for victory on an unprecedented scale. Unfortunately, many Indian firms are managing to snatch defeat from the jaws of victory as they have to compete with MNCs who have deep financial muscles.

In this context, Indian companies often argue that they cannot compete against MNCs because the MNCs command much larger resources and have strong financial backing. It is argued that the MNC can afford to and does lose money for a long time in order to develop its long-term competitive position and that the Indian firm cannot sustain.

There are series of problems emanating from this argument. Given the size and efficiency of capital markets, competitive advantage does not come from the accessibility of capital, rather capital flows to those firms with a competitive advantage.

In the past, Indian capital markets were quite thin and meager and access to capital was rather restricted. In that environment, access to capital was a source of competitive advantage. This is one of the major reasons why conglomerates thrived in India. However, today capital markets in India are quite large and much more efficient compared to its earlier days. Indian firms need to better utilize local and foreign capital markets and the firms need to convince the capital markets that they have a strategy for building, sustaining and exploiting competitive advantage which will help them compete MNCs and result in earning their return on investment greater than the cost of capital.

Many Indian companies are themselves responsible for the lack of capital to sustain a fight against MNCs. Indian firms tend to be too diversified and are thus spread out too thinly in terms of financial capital and managerial resources. Indian firms need to restructure and focus their capital on fewer industries where they have a competitive advantage and can compete aggressively in those industries. Indian

companies are also probably overestimating the deep pockets of the MNCs. A multinational company may have more capital resources than the Indian company but since it is competing in several countries it cannot concentrate all its resources on India alone.

In this direction, the Government has taken a number of policy initiatives to allow Indian companies to raise resources from the International markets. Consequently raising funds through Euro Issues has become popular with the companies and investors both. Indian companies found this route very attractive and today more and more companies are trying this avenue to raise funds. Two principal forms of international offering made by companies for tapping the international capital markets are foreign Currency convertible bonds (FCCBs) and Equity Share through Depository Receipts.

The FCCBs are unsecured, carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company. Interest and redemption price (if conversion option is not exercised) is payable in dollars. Interest rates are very low by Indian domestic standards. FCCBs shall be denominated in any freely convertible Foreign Currency. However, it must be kept in mind that FCCB issue proceeds need to conform to ECB end use requirements.

FCCBs have been popular with issuers. Local debt markets can be restricted with comparatively short maturities and high interest rates. On the other hand straight equity may cause a dilution in earnings, and certainly a dilution in control, which many shareholders, especially major family shareholders, would find unacceptable. Thus the low coupon security which defers shareholder's dilution for several years can be attractive to an issuer.

Foreign investors also prefer FCCBs because of the Dollar denominated servicing, the conversion option and, the arbitrage opportunities presented by conversion of the FCCBs into equity at a discount on prevailing Indian market price.

In addition, 25% of the FCCB proceeds can be used for general corporate restructuring.

The major drawbacks of FCCBs are that the issuing company cannot plan its capital structure as it is not assured of conversion of FCCBs. Moreover, the projections for cash outflow at the time of maturity cannot be made.

Depository Receipt (DR) is a negotiable instrument evidencing a fixed number of equity shares of the issuing company generally denominated in US dollars. Depository Receipts are commonly used by those companies which sell their securities in international market and expand their shareholdings abroad. These securities are listed and traded in International Stock Exchanges. These can be either American Depository Receipts (ADR) or Global depository Receipt (GDR). ADRs are issued in case the funds are raised through retail market in United States. In case of GDR issue, the invitation to participate in the issue cannot be extended to retail US investors but under Rule 144A of Securities Act, 1933 of USA, Qualified Institutional Buyers (QIBs) can participate in such a deal. QIBs are the institutional investors who have atleast USD 100 Million under their portfolio to invest.

While DRs denominated in any freely convertible Foreign Currency, generally in US dollar, are issued by the depository in the international market, the underlying shares denominated in Indian Rupees are issued in the domestic market by the issuing company. These shares issued by the company are custodised in the home market with the local bank called custodian.

An investor has an option to convert the GDR into a fixed number of equity shares of issuer company after a cooling period. He can do so by advising the depository. The depository, in turn, will instruct the custodian about cancellation of GDR and release the corresponding shares in favour of the non-resident investor, or being sold directly on behalf of the non-resident or being transferred in the books of accounts of the issuing company in the name of the non-resident. Once the underlying shares are released, the same cannot be recustodised. In addition, shares acquired in open market cannot be custodised.

Until such conversion, the GDRs, which are negotiable, are traded on an Overseas Stock Exchange, entitled for dividend in dollar but they carry no voting rights. On conversion of the GDR into equity shares, the said shares carry voting rights, yield rupee dividend and are tradable on Indian Stock Exchanges like any other equity shares.

ADR/GDR are reckoned as part of Foreign Direct Investment (FDI). Accordingly, such issue would need to conform to the existing FDI Policy and only in areas where FDI is permissible.

Two way fungibility in ADR/GDR issue of the Indian Company has also been introduced. Two way fungibility implies that an investor who holds ADR/GDR can cancel them with the depository and sell the underlying shares in the market. The company can then issue fresh ADR/GDR to the extent of shares cancelled. The key benefit of the two way fungibility are improvement in liquidity and elimination of arbitrage.

Transfer of GDRs is effected through the mechanism of international clearing systems (Euroclear and Cedel). GDRs issued to Qualified Institutional Buyers in the United States of America are to be settled through a Depository Trust Company in New York.

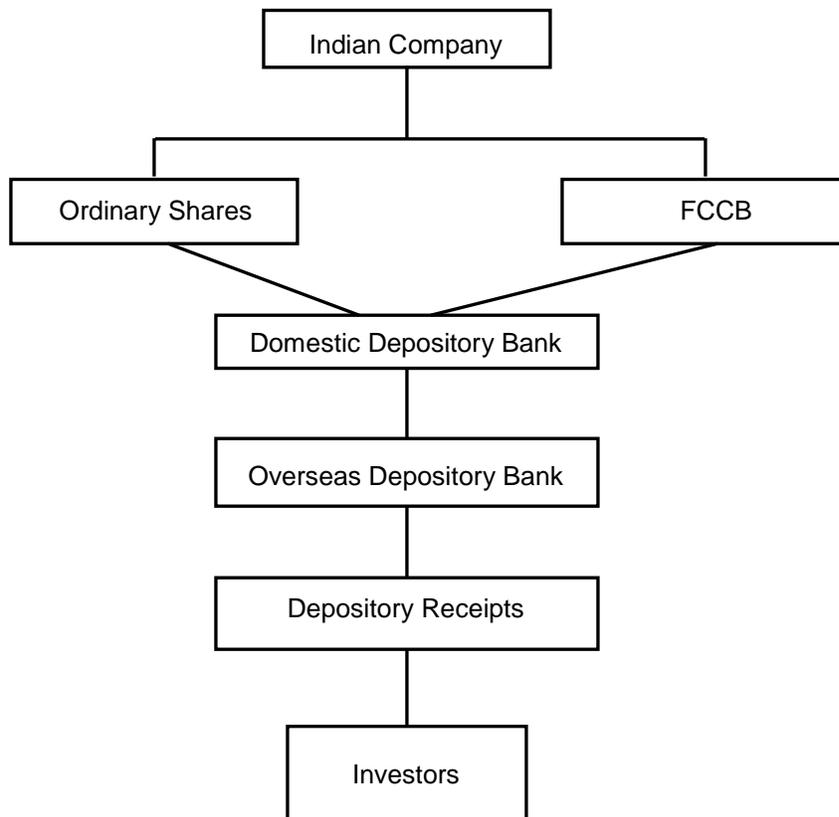
I. FCCB AND ORDINARY SHARES (THROUGH DEPOSITORY RECEIPT MECHANISM) SCHEME, 1993

Important Definitions

In this scheme, unless the context otherwise requires,-

- *Domestic Custodian Bank* has been defined to mean a banking company which acts as a custodian for the ordinary shares or foreign currency convertible bonds of an Indian Company which are issued by it against global Depository receipts or certificates;
- *Foreign Currency Convertible Bonds* has been defined to mean bonds issued in accordance with this scheme and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments;

- *Global Depository Receipts* has been defined to mean any instrument in the form of a Depository receipt or certificate (by whatever name it is called) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company;
- *Issuing Company* has been defined to means an Indian Company permitted to issue Foreign Currency Convertible Bonds or ordinary shares of that company against Global Depository Receipts;
- *Overseas Depository Bank* has been defined to mean a bank authorised by the issuing company to issue global Depository receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company.



Eligibility for issue of Convertible Bonds or Ordinary Shares of Issuing Company

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, 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.

Unlisted Indian Companies issuing Global Depository Receipts/Foreign Currency Convertible Bonds are required to simultaneously list in the Indian Stock Exchange(s). The unlisted companies issuing Global Depository Receipts/Foreign Currency Convertible Bonds that have taken verifiable "effective steps," before 31st August, 2005 have been exempt from the requirement of prior or simultaneous listing provided these companies complete their issues latest by 31st December, 2005. "Effective steps," for the above purpose, have been clarified that—

- (a) the company has completed due diligence and filed offering circular in the overseas exchange(s); or
- (b) the approval of overseas exchange(s) has been obtained; or
- (c) the payment of listing fees is made; or
- (d) the approval of the Reserve Bank of India under Foreign Exchange Management Act, 1999, where applicable, for meeting issue related expenses has been obtained.

It is clarified that private placements of issues, where no offering circular was placed before the overseas exchange(s), does not qualify for "effective steps."

Erstwhile Overseas Corporate Bodies (OCBs) who are not eligible to invest in India through the portfolio route and entities prohibited to buy, sell or deal in securities by SEBI are not eligible to subscribe to

- (i) Foreign Currency Convertible Bonds and
- (ii) Ordinary Shares through Global Depository Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

An issuing company seeking permission is required to have a consistent track record of good performance (financial or otherwise) for a minimum period of three years, on the basis of which an approval for finalising the issue structure would be issued to the company by the Department of Economic Affairs, Ministry of Finance. On completion of finalisation of issue structure in consultation with the Lead Manager to the issue, the issuing company is required to obtain the final approval for proceeding ahead with the issue from the Department of Economic Affairs.

The Foreign Currency Convertible Bonds shall be denominated in any freely convertible foreign currency and the ordinary shares of an issuing company shall be denominated in Indian rupees.

An issuing company issuing ordinary shares or bonds under the Scheme is required to deliver the ordinary shares or bonds to a Domestic Custodian Bank who

will, in terms of agreement, instruct the Overseas Depository Bank to issue Global Depository Receipt or Certificate to non-resident investors against the shares or bonds held by the Domestic Custodian Bank. A Global Depository Receipt may be issued in the negotiable form and may be listed on any international stock exchanges for trading outside India.

The provisions of any law relating to issue of capital by an Indian company are applicable in relation to issue of Foreign Currency Convertible Bonds or the ordinary shares of an issuing company and the issuing company is required to obtain the necessary permission or exemption from the appropriate authority under the relevant law relating to issue of capital.

Limits of foreign investment in the issuing company

The ordinary shares and Foreign Currency Convertible Bonds issued against the Global Depository Receipts are treated as direct foreign investment in the issuing company. The aggregate of the foreign investment made either directly or indirectly (through Global Depository Receipts Mechanism) should not exceed 51% of the issued and subscribed capital of the issuing company. However, the investments made through Offshore Funds or by Foreign Institutional Investors do not form part of the prescribed limit.

Issue structure of the Global Depository Receipts

(1) A Global Depository Receipt may be issued for one or more underlying shares or bonds held with the Domestic Custodian Bank.

(2) The Foreign Currency Convertible Bonds and Global Depository Receipts may be denominated in any freely convertible foreign currency.

(3) The ordinary shares underlying the Global Depository Receipts and the shares issued upon conversion of the Foreign Currency Convertible Bonds to be denominated only in Indian currency.

(4) The following issues are to be decided by the issuing company with the Lead Manager to the issue, namely:

- (i) public or private placement;
- (ii) number of Global Depository Receipts to be issued;
- (iii) the issue price;
- (iv) Listed Companies – The pricing should not be less than the higher of the following two averages:
 - (a) The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date;
 - (b) The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

The “relevant date” means the date thirty days prior to the date on which the meeting of the general body of shareholders is held, in terms of section 81 (IA) of the Companies Act, 1956, to consider the proposed issue.

(ca) (i) Listed companies – The companies issuing Global Depository Receipts that have taken verifiable “effective steps,” before 31st August, 2005 has been exempt from the requirement of the above mentioned pricing guidelines provided these companies complete their issues latest by 31st December, 2005.

- (v) Unlisted Companies – The pricing should be in accordance with Reserve Bank of India Regulations notified under Foreign Exchange Management Act, 1999.
- (vi) the rate of interest payable on Foreign Currency Convertible Bonds; and
- (vii) the conversion price, coupon, and the pricing of the conversion options of the Foreign Currency Convertible Bonds.
 - (a)(i) (a) Listed Companies – The conversion price of the Foreign Currency Convertible Bonds should be in accordance with above mentioned pricing guidelines.
 - (a)(i) (a) Listed Companies- The companies issuing Foreign Currency Convertible Bonds that have taken verifiable “effective steps,” before 31st August, 2005 would be exempt from the requirement of the pricing guidelines at para 5(4)(e)(i) provided these companies complete their issues latest by 31st December,2005.
 - (b) Unlisted Companies – The conversion price of the Foreign Currency Convertible Bonds should be in accordance with Reserve Bank of India Regulations notified under Foreign Exchange Management Act, 1999.

(5) There is no lock-in-period for the Global Depository Receipts issued under the scheme.

Listing of the Global Depository Receipts

The Global Depository Receipts issued under the scheme may be listed on any of the Overseas Stock Exchanges, or Over the Counter Exchanges or through Book Entry Transfer Systems prevalent abroad and such receipts may be purchased, possessed and freely transferable by a person who is a non-resident.

Transfer and redemption

A non-resident holder of Global Depository Receipts may transfer those receipts, or may ask the Overseas Depository Bank to redeem those receipts. In the case of redemption, Overseas Depository Bank shall request the Domestic Custodian Bank to get the corresponding underlying shares released in favour of the non-resident investor, for being sold directly on behalf of the non-resident, or being transferred in the books of account of the issuing company in the name of the non-resident.

In case of redemption of the Global Depository Receipts into underlying shares, a request for the same is to be transmitted by the Overseas Depository Bank to the Domestic Custodian Bank of India, with a copy of the same being sent to the issuing

company for information and record. On redemption, the cost of acquisition of the shares underlying the Global Depository Receipts shall be reckoned as the cost on the date on which the Overseas Depository Bank advises the Domestic Custodian Bank for redemption. The price of the ordinary shares of the issuing company prevailing in the Bombay Stock Exchange or the National Stock Exchange on the date of the advice of redemption shall be taken as the cost of acquisition of the underlying ordinary shares.

For the purposes of conversions of Foreign Currency Convertible Bonds, the cost of acquisition in the hands of the non-resident investors would be the conversion price determined on the basis of the price of the shares at the Bombay Stock Exchange, or the National Stock Exchange, on the date of conversion of Foreign Currency Convertible Bonds into shares.

Taxation on Foreign Currency Convertible Bonds

(1) Interest payments on the bonds, until the conversion option is exercised, are subject to deduction of tax at source at the rate of ten per cent.

(2) Tax on dividend on the converted portion of the bond is subject to deduction of tax at source at the rate of ten per cent.

(3) Conversion of Foreign Currency Convertible Bonds into shares does not give rise to any capital gains liable to income-tax in India.

(4) Transfers of Foreign Currency Convertible Bonds made outside India by a non-resident investor to another non-resident investor does not give rise to any capital gains liable to tax in India.

Taxation on shares issued under Global Depository Receipt Mechanism

(1) Under the provisions of the Income-tax Act, income by way of dividend on shares is taxed at the rate of 10 per cent. The issuing company is required to transfer the dividend payments net after deducting tax at source to the Overseas Depository Bank.

(2) On receipt of these payments of dividend after taxation, the Overseas Depository Bank is required to distribute them to the non-resident investors proportionate to their holdings of Global Depository Receipts evidencing the relevant shares. The holders of the Depository Receipts may take credit of the tax deducted at source on the basis of the certification by the Overseas Depository Bank, if permitted by the country of their residence.

(3) All transactions of trading of the Global Depository Receipts outside India, among non-resident investors, are free from any liability to income tax on India on Capital Gains therefrom.

(4) If any capital gains arise on the transfer of the aforesaid shares in India to the non-resident investor, he will be liable to income-tax under the provisions of the Income-tax Act. If the aforesaid shares are held by the non-resident investor for a period of more than twelve months from the date of advice of their redemption by the Overseas Depository Bank, the capital gains arising on the sale thereof will be treated as long-term capital gains and will be subject to income-tax at the rate 10 per cent under the provisions of Section 115AC of the Income-tax Act. If such shares are

held for a period of less than twelve months from the date of redemption advice, the capital gains arising on the sale thereof will be treated as short-term capital gains and will be subject to tax at the normal rates of income-tax applicable to non-residents under the provisions of the Income-tax Act.

(5) After redemption of the Depositary Receipts into underlying shares, during the period, if any, during which these shares are held by the redeeming non-resident foreign investor who has paid for these shares in foreign exchange at the time of purchase of the Global Depositary Receipt, the rate of taxation of income by way of dividends on these shares would continue to be at the rate of 10 per cent, in accordance with Section 115AC(1) of the Income-tax Act. The long term capital gains on the sale of these redeemed underlying shares held by non-resident investors in the domestic market shall also be charged to tax at the rate of 10 per cent, in accordance with the provisions of Section 115 AC(1).

(6) When the redeemed shares are sold on the Indian Stock Exchanges against payment in rupees, these shares shall go out of the purview of the Section 115 AC of the Income-tax Act and income therefrom shall not be eligible for the concessional tax treatment provided thereunder. After the transfer of shares where consideration is in terms of rupees payment, the normal tax rates would apply to the income arising or accruing on these shares.

(7) Deduction of tax at source on the amount of capital gains accruing on transfer of the shares would be made in accordance with sections 195 and 196C of the Income-tax Act.

Application of Avoidance of Double Taxation Agreement in case of Global Depositary Receipts

During the period of fiduciary ownership of shares in the hands of the Overseas Depositary Bank, the provisions of Avoidance of Double Taxation Agreement entered into by the Government of India with the country of residence of the Overseas Depositary Bank are applicable in the matter of taxation of income from dividends from underlying shares and interest on Foreign Currency Convertible Bonds.

During the period, if any, when the redeemed underlying shares are held by the non-resident investor on transfer from fiduciary ownership of the Overseas Depositary Bank, before they are sold to resident purchasers, the Avoidance of Double Taxation Agreement entered into by the Government of India with the country of residence of the non-resident investor will be applicable in the matter of taxation of income from the dividends from the said underlying shares, or interest on Foreign Currency Convertible Bonds, or any capital gain arising out of transfer of underlying shares.

II. PROCEDURE FOR ISSUANCE OF GDR/FCCBS

A. 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.

(a) Approval of Board of Directors

A meeting of Board of Directors is required to be held for approving the proposal to raise money from Euro Capital market. A board resolution is to be passed to approve the raising of finance by issue of GDRs/FCCBs. The resolution should indicate therein specific purposes for which funds are required, quantum of the issue, country in which issue is to be launched, time of the issue etc. A director/Sub-Committee of Board of Directors is also to be authorised for seeking government approval in connection with Euro issue and signing agreements with depository, organising road shows for fixation of price of GDRs. The Board meeting shall also decide and approve the notice of Extraordinary general meeting of shareholders at which special resolution is to be considered.

(b) Approval of Shareholders

Proposal for making Euro issue, as proposed by Board of Directors require approval of shareholders.

A special resolution under Section 81(1A) of the Companies Act, 1956 is required to be passed at a duly convened general meeting of the shareholders of the company. In case of Euro optionally convertible debentures, resolution is also required to be passed under Section 81(3)(b). Approvals under Sections 94, 16 and 31 of the Companies Act, 1956 may also be obtained, if required. Form No. 23 along with requisite filing fee is to be filed with ROC of the State in which the registered office of the company is situated.

(c) Approval of Ministry of Finance—“In Principle and Final”

In case of FCCB issue exceeding US \$ 100 million, the company needs to apply Ministry of Finance for approval.

With respect to ADR/GDR, guidelines issued on the subject dated 19-1-2000 brought ADR/GDR under the automatic route and therefore the requirement of obtaining approval of Ministry of Finance, Department of Economic Affairs has been dispersed with.

Further, private placement of ADR/GDR will also not require prior approval provided the issue is lead managed by investment banker.

Where the approval is required, the following procedure is required to be followed:

An eligible issuing company shall make an application to the Government of India, Ministry of Finance, Deptt. of Economic Affairs, New Delhi, for obtaining 'In-principle' approval

The application should set out in detail the following points:

- (a) Proposed project or expansion or diversification programme with details of cost of project and means of financing.
- (b) The proposed security viz. Global Depository Receipts (GDRs) or American Depository Receipts (ADRs) against underlying shares or Foreign Currency Convertible Bonds.

- (c) In the case of Bonds, particulars of redemption period, rate of interest, time of conversion of bonds to equity shares of the company, price at which such conversion will take place.
- (d) In the case of GDRs/ADRs, the price at which the equity shares will be issued.
- (e) Justification for the foreign issue.
- (f) Other details about the company such as management, financial date, capacity and its utilisation, financial results and management ratios, statutory liabilities, default in respect of interest/installments, of loans from Banks/Financial Institutions. Exports and imports and salient features of the prospective corporate plans and diversification proposals with special reference to foreign exchange requirements.

The Government of India will, if satisfied with the company's proposals, issue an approval in principle granting permission to the company to mobilise foreign currency resources for a specified amount.

On completion of finalisation of issue structure in consultation with the Lead Manager to the issue, the company should obtain the final approval from the Government.

However, in some cases Foreign Investment Promotion Board (FIPB) clearance is necessary before final approval is given by the Finance Ministry.

Both 'in principle and final' approvals are valid for 3 months respectively from the date of issue.

(d) Approval of Department of Company Affairs

The issuer company requires approval from Deptt. of Company Affairs under Section 81(3)(b), where the convertible bonds are being issued, which after such conversion are likely to increase the subscribed capital of the company.

Approval as to compliance of Section 187C, non-applicability of provisions relating to prospectus and Section 108 for transfer of shares are also sought for.

(e) Approval of Reserve Bank of India

The issuer company has to obtain approvals from Reserve Bank of India under circumstances specified under the guidelines issued by the concerned authorities from time to time.

RBI vide its press release dated January 20, 2000 granted general permissions to make an international offering of rupee denominated equity shares of the company by way of issue of ADR/GDR.

FCCB covered under the automatic route requires no RBI approval.

FCCB issue which exceeds USD 50 million but does not exceed 100 million need to apply to RBI.

(f) In-principle consent of Stock Exchanges for listing of underlying shares

The issuing company has to make a request to the domestic stock exchange for in-principle consent for listing of underlying shares which shall be lying in the custody of domestic custodian. These shares, when released by the custodian after cancellation of GDR, are traded on Indian stock exchanges like any other equity shares

(g) In-principle consent of Financial Institutions

Where term loans have been obtained by the company from the financial institutions, the agreement relating to the loan contains a stipulation that the consent of the financial institution has to be obtained. The company must obtain in-principle consent on the broad terms of the proposed issue.

B. Appointment of Intermediaries

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

(a) Lead Manager

The company has to choose a competent lead manager to structure the issue and arrange for the marketing. Lead managers usually charge a fee as a percent of the issue. The issues related to public or private placement, nature of investment, coupon rate on bonds and conversion price are to be decided in consultation with the lead manager.

(b) Co-Lead/Co-Manager

In consultation with the lead manager, the company has to appoint co-lead/co-manager to coordinate with the issuing company/lead manager to make the smooth launching of the Euro issue

(c) Overseas Depository Bank

It is the bank which is authorised by the issuing company to issue Depository Receipts against issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company.

(d) Domestic Custodian Bank

This is a banking company which acts as custodian for the ordinary shares or Foreign Currency Convertible Bonds of an Indian company, which are issued by it. The domestic custodian bank functions in co-ordination with the depository bank. When the shares are issued by a company the same are registered in the name of depository and physical possession is handed over to the custodian. The beneficial interest in respect of such shares, however, rests with the investors.

(e) Listing Agent

One of the conditions of Euro-issue is that it should be listed at one or more Overseas Stock Exchanges. The appointment of listing agent is necessary to coordinate with issuing company for listing the securities on Overseas Stock Exchanges.

(f) Legal Advisors

The issuing company should appoint legal advisors who will guide the company and the lead manager to prepare offer document, depository agreement, indemnity agreement and subscription agreement.

(g) Printers

The issuing company should appoint printers of international repute for printing Offer Circular.

(h) Auditors

The role of issuer company's auditors is to prepare the auditors report for inclusion in the offer document, provide requisite comfort letters and reconciliation of the issuer company's accounts between Indian GAAP/UK GAAP/US-GAAP and significant differences between Indian GAAP/UK GAAP/US.

(i) Underwriters

It is desirable to get the Euro issue underwritten by banks and syndicates. Usually, the underwriters subscribe for a portion of the issue with arrangements for tie-up for the balance with their clients. In addition, they will interact with the influential investors and assist the lead manager to complete the issue successfully

C. Principal Documentation

The following principal documents are involved: (i) Subscription Agreement (ii) Depository Agreement (iii) Custodian Agreement (iv) Agency Agreement (v) Trust Deed

(a) Subscription Agreement

Subscription agreement provides that Lead Managers and other managers agree, severally and not jointly, with the company, subject to the satisfaction of certain conditions, to subscribe for GDRs at the offering price set forth. It may provide that obligations of managers are subject to certain conditions precedent.

Subscription agreement may also provide that for certain period from the date of the issuance of GDR the issuing company will not (a) authorise the issuance of, or otherwise issue or publicly announce any intention to issue; (b) issue offer, accept subscription for, sell, contract to sell or otherwise dispose off, whether within or outside India; or (c) deposit into any depository receipt facility, any securities of the company of the same class as the GDRs or the shares or any securities in the company convertible or exchangeable for securities in the company of the same class as the GDRs or the shares or other instruments representing interests in securities in the company of the same class as the GDRs or the shares.

Subscription agreement also provides, an option to be exercisable within certain period after the date of offer circular, to the lead manager and other managers to purchase upto a certain prescribed number of additional GDRs solely to cover over-allotments, if any.

(b) Depository Agreement

Depository agreement lays down the detailed arrangements entered into by the company with the Depository, the forms and terms of the depository receipts which are represented by the deposited shares. It also sets forth the rights and duties of the depository in respect of the deposited shares and all other securities, cash and other property received subsequently in respect of such deposited shares. Holders of GDRs are not parties to deposit agreement and thus have no contractual rights against or obligations to the company. The depository is under no duty to enforce any of the provisions of the deposit agreement on behalf of any holder or any other person. Holder means the person or persons registered in the books of the depository maintained for such purpose as holders. They are deemed to have notice of, be bound by and hold their rights subject to all of the provisions of the deposit agreement applicable to them. They may be required to file from time to time with depository or its nominee proof of citizenship, residence, exchange control approval, payment of all applicable taxes or other governmental charges, compliance with all applicable laws and regulations and terms of deposit agreement, or legal or beneficial ownership and nature of such interest and such other information as the depository may deem necessary or proper to enable it to perform its obligations under Deposit Agreement.

The company may agree in the deposit agreement to indemnify the depository, the custodian and certain of their respective affiliates against any loss, liability, tax or expense of any kind which may arise out of or in connection with any offer, issuance, sale, resale, transfer, deposit or withdrawal of GDRs, or any offering document.

Copies of deposit agreement are to be kept at the principal office of Depository and the depository is required to make available for inspection during its normal business hours, the copies of deposit agreement and any notices, reports or communications received from the company.

(c) Custodian Agreement

Custodian works in co-ordination with the depository and has to observe all obligations imposed on it including those mentioned in the depository agreement. The custodian is responsible solely to the depository. In the case of the depository and the custodian being same legal entity, references to them separately in the depository agreement or otherwise may be made for convenience and the legal entity will be responsible for discharging both functions directly to the holders and the company.

Whenever the depository in its discretion determines that it is in the best interests of the holders to do so, it may, after prior consultation with the company terminate, the appointment of the custodian and in such an event the depository shall promptly appoint a successor custodian, which shall, upon acceptance of such appointment, become the custodian under the depository agreement. The depository shall notify

holders of such change promptly. Any successor custodian so appointed shall agree to observe all the obligations imposed on him.

(d) Agency Agreement

In case of FCCBs, the company has to enter into an agency agreement with certain persons known as conversion agents. In terms of this agreement, these agents are required to make the principal and interest payments to the holders of FCCBs from the funds provided by the company. They will also liaise with the company at the time of conversion/redemption option to be exercised by the investor at maturity.

(e) Trust Deed

In respect of FCCBs the company enters into a Covenant (known as Trust Deed) with the Trustee for the holders of FCCBs, guaranteeing payment of principal and interest amount on such FCCBs and to comply with the obligations in respect of such FCCBs

D. Pre and Post launch – Additional Key Actions

Apart from obtaining necessary approvals, appointment of various agencies and proper documentation, the following additional key actions are necessary for making the Euro-issue a success.

(i) Constitution of a Board Sub-Committee; (ii) Selection of Syndicate Members; (iii) Constitution of a task force for due diligence; (iv) Listing; (v) Offering Circular; (vi) Research papers; (vii) Pre-marketing; (viii) Timing, pricing and size of the issue; (ix) Roadshows; (x) Book building and pricing of the issue; (xi) Closing of the issue; (xii) Allotment; (xiii) Investor Relation Programme; and (xiv) Quarterly Statement.

(a) Constitution of a Board Sub-Committee

To launch a Euro-issue, the issuing company has to take a large number of decisions in time. These decisions normally fall within the power of Board of Directors. It is usually difficult to call Board Meetings frequently and to ensure presence of adequate Board Members. Thus, it is normally advisable to constitute a sub-committee of the Board with full delegation of powers with regard to Euro-issue. The delegation of powers to the Board sub-committee should normally include the following:

- Appointment of agencies
- Authority to make applications for seeking various approvals
- Authority to finalise and execute documents and agreements.
- Decisions about the timing, size and pricing of the issue
- Allotment of shares

(b) Selection of Syndicate Members

The success of any Euro-issue depends upon the well planned and coordinated efforts of the syndicate members and the company. The selection of the Syndicate

members should be made depending upon the strength and capabilities of each member in different areas of specialisation such as marketing, financial research, distribution etc. The lead manager may be entrusted with the work of selection of syndicate members. The lead manager while selecting the above members, in addition to their strength and capability, should also evaluate their standing, image, reputation, infrastructure, past experience in handling Indian Euro-issue, etc.

(c) Constitution of a task force for due diligence

The due diligence is a process in which a team consisting of legal, technical and financial experts of the lead manager meets top executives of the company and visits the sites of the company in order to understand the strengths, weaknesses, problems and opportunities of the company. The team also studies and analyses the balance sheet of the company and its subsidiaries, its financial arrangement with the group, investment pattern and also the future prospects of the company.

It also scrutinise the minutes of the company, various arrangements entered into by the company with regard to marketing, purchase, technology, ancillary units, employment, etc. and analyse the impact of litigations on the profitability of the company.

The purpose of above exercise is to draft the offering circular (prospectus) and work out marketing strategies for the Euro-issue.

(d) Listing

One of the conditions of Euro-issues is that the securities are to be listed on one or more Overseas Stock Exchanges. The issuing company has to fulfill all the requirements particularly disclosure and documentation as prescribed by the Overseas Stock Exchanges. The company shall take the help of the listing agent in getting its Euro-issue instruments listed on the Overseas Stock Exchanges.

The issuing company shall prepare the requisite documents as prescribed by the Overseas Stock exchange authorities and submit the same along with application to it after scrutinizing the application and obtain the formal listing approval shall be issued by the Overseas Stock Exchange.

The underlying shares against GDRs are to be listed on one or more Indian Stock Exchange(s) on which the company's existing shares are already listed. For this purpose, the company has to apply to the stock exchange authorities to get the shares represented by GDRs listed on the Indian Stock Exchanges. Trading of such shares on Indian Stock Exchange(s) will not commence until the period specified in the guidelines after the date of issue of the GDRs.

(e) Offering Circular

Offering Circular is a mirror through which the prospective investors can access vital information regarding the company in order to form their investment strategies. It is to be prepared very carefully giving true and complete information regarding the financial strength of the company, its past performance, past and envisaged research and business promotion activities, track record of promoters and the company, ability to trade the securities on Euro capital market.

The Offering Circular should be very comprehensive to take care of overall interests of the prospective investor. The Offering Circular for Euro-issue offering should typically cover the following contents:

- (i) Background of the company and its promoters including date of incorporation and objects, past performance, production, sales and distribution network, future plans, etc.
- (ii) Capital structure of the company-existing, proposed and consolidated.
- (iii) Deployment of issue proceeds.
- (iv) Financial data indicating track record of consistent profitability of the company.
- (v) Group investments and their performance including subsidiaries, joint venture in India and abroad.
- (vi) Investment considerations.
- (vii) Description of shares.
- (viii) Terms and conditions of global depository receipt and any other instrument issued along with it.
- (ix) Economic and regulatory policies of the Government of India.
- (x) Details of Indian securities market indicating stock exchange, listing requirements, foreign investments in Indian securities.
- (xi) Market price of securities.
- (xii) Dividend and capitalisation.
- (xiii) Securities regulations and exchange control.
- (xiv) Tax aspects indicating analysis of tax consequences under Indian law of acquisition, membership and sale of shares, treatment of capital gains tax, etc.
- (xv) Status of approvals required to be obtained from Government of India.
- (xvi) Summary of significant differences in Indian GAAP, UK GAAP and US GAAP and expert's opinion.
- (xvii) Report of statutory auditor.
- (xviii) Subscription and sale.
- (xix) Transfer restrictions in respect of instruments.
- (xx) Legal matters etc.
- (xxi) Other general information not forming part of any of the above

A copy of the Offering Circular is required to be sent to the Registrar of Companies, the Securities Exchange Board of India and the Indian Stock Exchanges for record purposes.

(f) Research Papers

Research analysts team of lead manager/co-lead manager prepares research

papers on the company before the issue. These papers are very important marketing tools as the international investors normally depend a lot on the information provided by the research analysts for making investment decisions.

(g) Pre-marketing

Pre-marketing exercise is a tool through which the syndicate members evaluate the prospects of the issue. This is normally done closer to the issue. The research analysts along with the sales force of the syndicate members meet the prospective investors during pre marketing roadshows. This enables the syndicate members to understand the market and the probable response from the prospective investors. The pre-marketing exercise helps in assessing the depth of investors' interest in the proposed issue, their view about the valuation of the share and the geographical locations of the investors who are interested in the issue. The response received during pre-marketing provides vital information for taking important decisions relating to timing, pricing and size of the issue. This would also help the syndicate members in evolving strategies for marketing the issue.

(h) Timing, pricing and size of the Issue

After pre-marketing exercise, the important decisions of timing, pricing and size of the issue are taken. The proper time of launching the issue is when the fundamentals of the company and the industry are strong and the market price of the shares are performing well at Indian Stock Exchanges. The timing should also not clash with some other major issues of the Indian as well as other country companies. The decision regarding the size of issue is inversely linked with the pricing i.e. larger the size, the comparatively lower the price or vice-versa.

(i) Roadshows

Roadshows represent meetings of issuers, analysts and potential investors. Details about the company are presented in the roadshows and such details usually include the following information about the company making the issue:

- History
- Organisational structure
- Principal objects
- Business lines
- Position of the company in Indian and international market
- Past performance of the company
- Future plans of the company
- Competition - domestic as well as foreign
- Financial results and operating performance
- Valuation of shares
- Review of Indian stock market and economic situations.

Thus at road shows, series of information presentations are organised in selected cities around the world with analysts and potential institutional investors. It is, in fact, a conference by the issuer with the prospective investors.

Road show is arranged by the lead manager by sending invitation to all prospective investors.

(j) Book building and pricing of the Issue

During road shows, the investors give indication of their willingness to buy a particular quantity at particular terms. Their willingness is booked as orders by the marketing force of lead manager and co-lead manger. This process is known as book building.

Price is a very critical element in the market mix of any product or service. This is more so in case of financial assets like stocks and bonds and specially in case of Euro issues. The market price abroad has a strong correlation to the near future earnings potential, fundamentals governing industry and the basic economic state of the country. Several other factors like prevalent practices, investor sentiment, behaviour towards issues of a particular country, domestic market process etc., are also considered in determination of issue price. Other factors such as the credit rating of the country, interest rate and the availability of an exit route are important.

(k) Closing of the Issue and Allotment

Closing is essentially an activity confirming completion of all legal documentation and formalities based on which the company issues the share certificate to the depository and deposits the same with the domestic custodian. Once the issue is closed and all legal formalities are over, the allotment is finalised. Thereafter, the company issues shares in favour of the Overseas Depository Bank and deposits the same with the domestic custodian for custody. The particulars of the Overseas Depository Bank are required to be entered into the Register of Members of the company.

(l) Investor Relation Programme

The international investors expect that the issuing company maintains contact with them after the issue. These investors always like to be informed by the company about the latest developments, the performance of the company, the factors affecting performance and the company's plans. It is, therefore, essential for the GDR issuing company to set up an investor relation programme. Good investor relation ensures goodwill towards the company and it would help the company in future fund raising efforts.

For the benefit of the students, we are giving a zist of circulars issued regarding FCCBs at the end of the chapter.

III. ISSUE OF FOREIGN CURRENCY EXCHANGEABLE BONDS (FCEB) SCHEME, 2008

Government of India, Ministry of Finance, Department of Economic affairs vide Notification G.S.R.89(E) dated February 15, 2008, notified the Issue of foreign Currency Exchangeable Bonds Scheme, 2008.

“Foreign Currency Exchangeable Bond” means a bond expressed in foreign currency, the principal and interest in respect of which is payable in foreign currency, issued by an Issuing Company and subscribed to by a person who is a resident

outside India in foreign currency and exchangeable into equity share of another company, to be called the Offered Company, in any manner, either wholly, or partly or on the basis of any equity related warrants attached to debt instruments.

“Issuing Company” means an Indian company as defined in the Companies Act, 1956 which is eligible to issue Foreign Currency Exchangeable Bond.

“Offered Company” means an Indian company as defined in the Companies Act, 1956 (1 of 1956) whose equity share/s shall be offered in exchange of the Foreign Currency Exchangeable Bond.

Eligibility Conditions and subscription of Foreign Currency Exchangeable Bonds

(1) The Issuing Company shall be part of the promoter group of the Offered Company and shall hold the equity share/s being offered at the time of issuance of Foreign Currency Exchangeable Bond.

(2) The Offered Company shall be a listed company which is engaged in a sector eligible to receive Foreign Direct Investment and eligible to issue or avail of Foreign Currency Convertible Bond or External Commercial Borrowings.

(3) An Indian Company, which is not eligible to raise funds from the Indian securities market, including a company which has been restrained from accessing the securities market by the Securities and Exchange Board of India shall not be eligible to issue Foreign Currency Exchangeable Bond.

(4) The subscriber to the Foreign Currency Exchangeable Bond shall comply with the Foreign Direct Investment policy and adhere to the sectoral caps at the time of issuance of Foreign Currency Exchangeable Bond. Prior approval of Foreign Investment Promotion Board, wherever required under the Foreign Direct Investment policy, should be obtained. Entities prohibited to buy, sell or deal in securities by Securities and Exchange Board of India will not be eligible to subscribe to Foreign Currency Exchangeable Bond.

End-use requirements

(1) The proceeds of Foreign Currency Exchangeable Bond may be invested by the issuing company in the promoter group companies. The promoter group company receiving such investments shall be required to use the proceeds in accordance with end uses prescribed under the External Commercial Borrowings policy. The promoter group company receiving such investments will not be permitted to utilize the proceeds for investments in the capital market or in real estate in India.

(2) The proceeds of Foreign Currency Exchangeable Bond may be invested by the issuing company overseas by way of direct investment including in Joint Ventures or Wholly Owned Subsidiaries subject to the existing guidelines on Indian Direct Investment in Joint Ventures or Wholly Owned Subsidiaries abroad.

Operational Procedure

(1) Prior approval of the Reserve Bank of India shall be required for issuance of Foreign Currency Exchangeable Bond.

(2) The Foreign Currency Exchangeable Bond may be denominated in any freely convertible foreign currency.

Pricing and Maturity

(1) The rate of interest payable on Foreign Currency Exchangeable Bond and the issue expenses incurred in foreign currency shall be within the all in cost ceiling as specified by Reserve Bank of India under the External Commercial Borrowings policy.

(2) At the time of issuance of Foreign Currency Exchangeable Bond the exchange price of the offered listed equity shares shall not be less than the higher of the following two:

- (i) the average of the weekly high and low of the closing prices of the shares of the offered company quoted on the stock exchange during the six months preceding the relevant date; and
- (ii) the average of the weekly high and low of the closing prices of the shares of the offered company quoted on a stock exchange during the two week preceding the relevant date.

Explanation: For the purpose of this sub-scheme, “relevant date” means, the date on when the Board of the issuing company passes the resolution authorizing the issue of Foreign Currency Exchangeable Bond.

(3) The minimum maturity of the Foreign Currency Exchangeable Bond shall be five years for purposes of redemption. The exchange option can be exercised at any time before redemption. While exercising the exchange option, the holder of the Foreign Currency Exchangeable Bond shall take delivery of the offered shares. Cash (Net) settlement of Foreign Currency Exchangeable Bonds shall not be permissible.

Mandatory Requirements

(1) The Issuing Company shall comply with the provisions of the Companies Act, 1956 and obtain necessary approvals of its Board of Directors and shareholders if applicable. The Offered Company shall also obtain the approval of its Board of Directors in favour of the Foreign Currency Exchangeable Bond proposal of the issuing company.

(2) The Issuing Company intending to offer shares of the offered company under Foreign Currency Exchangeable Bond shall comply with all the applicable provisions of the Securities and Exchange Board of India Act, Rules, Regulations or Guidelines with respect to disclosures of their shareholding in the Offered Company.

(3) The Issuing Company shall not transfer, mortgage or offer as collateral or trade in the offered shares under Foreign Currency Exchangeable Bond from the date of issuance of the Foreign Currency Exchangeable Bond till the date of exchange or redemption.

Further, the Issuing Company shall keep the offered shares under Foreign Currency Exchangeable Bond free from all encumbrances from the date of issuance of the Foreign Currency Exchangeable Bond till the date of exchange or redemption.

Retention and deployment of proceeds of Foreign Currency Exchangeable Bond

The proceeds of the Foreign Currency Exchangeable Bond shall be retained and/or deployed overseas in accordance with the policy for the proceeds of External Commercial Borrowings.

Taxation on Exchangeable Bonds

(1) Interest payments on the bonds, until the exchange option is exercised, shall be subject to deduction of tax at source as per the provisions of sub-section (1) of section 115 AC of the Income Tax Act, 1961.

(2) Tax on dividend on the exchanged portion of the bond shall be in accordance with the provisions of sub-section (1) of section 115 AC of the Income Tax Act, 1961.

(3) Exchange of Foreign Currency Exchangeable Bonds into shares shall not give rise to any capital gains liable to income-tax in India.

(4) Transfers of Foreign Currency Exchangeable Bonds made outside India by an investor who is a person resident outside India to another investor who is a person resident outside India shall not give rise to any capital gains liable to tax in India.

IV. EXTERNAL COMMERCIAL BORROWINGS (ECB)

External Commercial Borrowings availed of by residents are governed by clause (d) of sub-section 3 of section 6 of the Foreign Exchange Management Act, 1999 read with Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations 2000as amended from time to time.

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) availed of from non-resident lenders with minimum average maturity of 3 years.

ECB can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route. ECB for investment in real sector-industrial sector, infrastructure sector-in India, and specific service sectors are under Automatic Route, i.e. do not require the Reserve Bank / Government of India approval. In case of doubt as regards eligibility to access the Automatic Route, applicants may take recourse to the Approval Route.

AUTOMATIC ROUTE

The following types of proposals for ECBs are covered under the Automatic Route.

Eligible Borrowers

(1) Corporates including those in hotel, hospital, software sectors (registered under the Companies Act, 1956 except financial intermediaries, such as banks, financial institutions (FIs), Housing Finance Companies (HFCs) and Non-Banking Financial Companies (NBFCs) are eligible to raise ECB. Individuals, Trusts and Non-Profit making organizations are not eligible to raise ECB.

(2) Units in Special Economic Zones (SEZ) are allowed to raise ECB for their own requirement. However, they cannot transfer or on-lend ECB funds to sister concerns or any unit in the Domestic Tariff Area.

(3) Non-Government Organizations (NGOs) engaged in micro finance activities are eligible to avail ECB. Such NGO (i) should have a satisfactory borrowing relationship for at least 3 years with a scheduled commercial bank authorized to deal in foreign exchange and (ii) would require a certificate of due diligence on 'fit and proper' status of the Board/Committee of management of the borrowing entity from the designated Authorise Dealer bank.

Recognized Lenders

1. Eligible borrowers can raise ECB from internationally recognized sources such as (i) international banks, (ii) international capital markets, (iii) multilateral financial institutions (such as IFC, ADB, CDC, etc.), (iv) export credit agencies, (v) suppliers of equipment, (vi) foreign collaborators, and (vii) foreign equity holders (other than erstwhile Overseas Corporate Bodies).

A "foreign equity holder" to be eligible as "recognized lender" under the automatic route would require minimum holding of paid up equity in the borrower company as set out below:

- (i) For ECB up to USD 5 million - minimum paid up equity of 25 per cent held directly by the lender; and
- (ii) For ECB more than USD 5 million - minimum paid up equity of 25 per cent held directly by the lender and debt-equity ratio not exceeding 4:1 (i.e. the proposed ECB not exceeding four times the direct foreign equity holding)

2. Overseas organizations and individuals complying with following safeguards may provide ECB to Non-Government Organizations (NGOs) engaged in micro finance activities.

- (a) Overseas Organizations proposing to lend ECB would have to furnish to the Authorise Dealer bank of the borrower a certificate of due diligence from an overseas bank which in turn is subject to regulation of host-country regulator and adheres to the Financial Action Task Force (FATF) guidelines.

The certificate of due diligence should comprise the following

- (i) that the lender maintains an account with the bank for at least a period of two years,
 - (ii) that the lending entity is organised as per the local law and held in good esteem by the business/local community, and
 - (iii) that there is no criminal action pending against it.
- (b) Individual Lender has to obtain a certificate of due diligence from an overseas bank indicating that the lender maintains an account with the bank for at least a period of two years. Other evidence /documents, such as audited statement of account and income tax return which the overseas lender may furnish need to be certified and forwarded by the overseas bank.

Individual lenders from countries wherein banks are not required to adhere to Know Your Customer (KYC) guidelines are not eligible to extend ECB.

Amount and Maturity

- (1) The maximum amount of ECB which can be raised by a corporate other than those in the hotel, hospital and software sectors is USD 500 million or its equivalent during a financial year.
- (2) Corporates in the services sector viz. hotels, hospitals and software sector are allowed to avail of ECB up to USD 100 million or its equivalent in a financial year for meeting foreign currency and / or Rupee capital expenditure for permissible end-uses. The proceeds of the ECBs should not be used for acquisition of land.
- (3) NGOs engaged in micro finance activities can raise ECB up to USD 5 million or its equivalent during a financial year. Designated AD bank has to ensure that at the time of drawdown the forex exposure of the borrower is fully hedged
- (4) ECB up to USD 20 million or its equivalent in a financial year with minimum average maturity of three years.
- (5) ECB above USD 20 million or its equivalent and up to USD 500 million or its equivalent with a minimum average maturity of five years.
- (6) ECB up to USD 20 million or its equivalent can have call/put option provided the minimum average maturity of three years is complied with before exercising call/put option.

All-in-cost ceilings

All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees. However, the payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost. The all-in-cost ceilings for ECB are reviewed from time to time.

End-use

- (1) ECB can be raised only for investment [such as import of capital goods (as classified by DGFT in the Foreign Trade Policy), new projects, modernization/expansion of existing production units] in the real sector - industrial sector including small and medium enterprises (SME), infrastructure sector and specific service sectors, namely hotel, hospital and software - in India.

Infrastructure sector for the purpose of ECB is defined as (i) power, (ii) telecommunication, (iii) railways, (iv) road including bridges, (v) sea port and airport, (vi) industrial parks, (vii) urban infrastructure (water supply, sanitation and sewage projects) and (viii) mining, refining and exploration.

- (2) Overseas direct investment in Joint Ventures (JV)/Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/WOS abroad.

- (3) Utilization of ECB proceeds is permitted for first stage acquisition of shares in the disinvestment process and also in the mandatory second stage offer to the public under the Government's disinvestment programme of PSU shares.
- (4) Payment for obtaining license/permit for 3G Spectrum.
- (5) For lending to self-help groups or for micro-credit or for bonafide micro finance activity including capacity building by NGOs engaged in micro finance activities.

End-uses not permitted

- (i) For on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate.
- (ii) In real estate sector.
- (iii) For working capital, general corporate purpose and repayment of existing Rupee loans.

Guarantees

Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, Financial Institutions and Non-Banking Financial Companies (NBFCs) from India relating to ECB is not permitted.

Security

The choice of security to be provided to the lender/supplier is left to the borrower. However, creation of charge over immoveable assets and financial securities, such as shares, in favour of the overseas lender is subject to conditional.

Parking of ECB proceeds

Borrowers are permitted to either keep ECB proceeds abroad or to remit these funds to India, pending utilization for permissible end-uses. ECB proceeds parked overseas can be invested in the following liquid assets

- (i) deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/Fitch IBCA or Aa3 by Moody's,
- (ii) Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above, and
- (iii) deposits with overseas branches / subsidiaries of Indian banks abroad. The funds should be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

Prepayment

Prepayment of ECB up to USD 500 million may be allowed by Authorised Dealer banks without prior approval of the Reserve Bank subject to compliance with the stipulated minimum average maturity period as applicable to the loan.

Refinancing of an existing ECB

The existing ECB may be refinanced by raising a fresh ECB subject to the

conditions that the fresh ECB is raised at a lower all-in-cost and the outstanding maturity of the original ECB is maintained.

APPROVAL ROUTE

Eligible Borrowers

The following types of proposals for ECB are covered under the Approval Route.

1. Financial institutions dealing exclusively with infrastructure or export finance such as IDFC, IL&FS, Power Finance Corporation, Power Trading Corporation, IRCON and EXIM Bank are considered, on a case by case basis.
2. Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the Government are also permitted to the extent of their investment in the package and assessment by Reserve Bank based on prudential norms. Any ECB availed for this purpose so far will be deducted from their entitlement.
3. ECB with minimum average maturity of 5 years by Non-Banking Financial Companies (NBFCs) from multilateral financial institutions, reputable regional financial institutions, official export credit agencies and international banks to finance import of infrastructure equipment for leasing to infrastructure projects.
4. NBFCs, which are exclusively involved in financing of the infrastructure sector, can avail of ECBs from multilateral / regional financial institutions and Government owned development financial institutions for on-lending to the borrowers in the infrastructure sector.
5. Foreign Currency Convertible Bonds (FCCBs) by housing finance companies satisfying the following minimum criteria: (i) the minimum net worth of the financial intermediary during the previous three years shall not be less than Rs. 500 crore, (ii) a listing on the BSE or NSE, (iii) minimum size of FCCB is USD 100 million, (iv) the applicant should submit the purpose / plan of utilization of funds.
6. Special Purpose Vehicles, or any other entity notified by the Reserve Bank, set up to finance infrastructure companies / projects exclusively, will be treated as Financial Institutions and ECB by such entities will be considered under the Approval Route.
7. Multi-State Co-operative Societies engaged in manufacturing activity satisfying the following criteria (i) the Co-operative Society is financially solvent, and (ii) the Co-operative Society submits its up-to-date audited balance sheet.
8. SEZ developers can avail of ECBs for providing infrastructure facilities within SEZ, as defined in the extant ECB policy, viz. (i) power, (ii) telecommunication, (iii) railways, (iv) road including bridges, (v) sea port and airport (vi) industrial parks (vii) urban infrastructure (water supply, sanitation and sewage projects) and (viii) mining, refining and exploration. However,

ECB will not be permissible for development of integrated township and commercial real estate within SEZ.

9. Corporates which have violated the extant ECB policy and are under investigation by Reserve Bank and / or Directorate of Enforcement, are allowed to avail ECB only under the Approval route.
10. Cases falling outside the purview of the automatic route limits and maturity period.

Recognised Lenders

- (1) Borrowers can raise ECB from internationally recognised sources such as (i) international banks, (ii) international capital markets, (iii) multilateral financial institutions (such as IFC, ADB, CDC etc.), (iv) export credit agencies, (v) suppliers' of equipment, (vi) foreign collaborators, and (vii) foreign equity holders (other than erstwhile OCBs).
- (2) From 'foreign equity holder' where the minimum paid up equity held directly by the foreign equity lender is 25 per cent but ECBs: equity ratio exceeds 4:1 (i.e. the amount of the proposed ECB exceeds four times the direct foreign equity holding).

Amount and Maturity

Corporates can avail of ECB of an additional amount of USD 250 million with average maturity of more than 10 years under the approval route, over and above the existing limit of USD 500 million under the automatic route, during a financial year. Other ECB criteria, such as end-use, recognized lender, etc. need to be complied with. Prepayment and call/put options, however, would not be permissible for such ECB up to a period of 10 years.

All-in-cost ceilings

All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees. Moreover, the payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost. The all-in-cost ceilings for ECB are indicated from time to time.

End-use

- (1) ECB can be raised only for investment [such as import of capital goods (as classified by DGFT in the Foreign Trade Policy), implementation of new projects, modernization/expansion of existing production units] in real sector - industrial sector including small and medium enterprises (SME) and infrastructure sector - in India. Infrastructure sector for the purpose of ECB is defined as (i) power, (ii) telecommunication, (iii) railways, (iv) road including bridges, (v) sea port and airport (vi) industrial parks (vii) urban infrastructure (water supply, sanitation and sewage projects) and (viii) mining, refining and exploration;
- (2) Overseas direct investment in Joint Ventures (JV)/Wholly Owned

Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/WOS abroad.

- (3) The first stage acquisition of shares in the disinvestment process and also in the mandatory second stage offer to the public under the Government's disinvestment programme of PSU shares;
- (4) ECB can be raised by corporates engaged in the development of integrated township as defined by Ministry of Commerce and Industry, DIPP, SIA (FC Division). Integrated township includes housing, commercial premises, hotels, resorts, city and regional level urban infrastructure facilities such as roads and bridges, mass rapid transit systems and manufacture of building materials. Development of land and providing allied infrastructure forms an integrated part of township's development. The minimum area to be developed should be 100 acres for which norms and standards are to be followed as per local bye-laws/rules. In the absence of such bye-laws/rules, a minimum of two thousand dwelling units for about ten thousand population will need to be developed.
- (5) Buyback of FCCB subject to terms and conditions.

End-uses not Permitted

- (i) Utilisation of ECB proceeds is not permitted for on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate except banks and financial institutions eligible.
- (ii) Utilisation of ECB proceeds is not permitted in real estate. However, the term real estate excludes development of integrated township as defined by Ministry of Commerce and Industry, DIPP, SIA (FC Division) .
- (iii) Utilisation of ECB proceeds is not permitted for working capital, general corporate purpose and repayment of existing Rupee loans.

Guarantee

Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, financial institutions and NBFCs relating to ECB is not normally permitted. Applications for providing guarantee/standby letter of credit or letter of comfort by banks, financial institutions relating to ECB in the case of SME will be considered under the approval route on merit subject to prudential norms.

With a view to facilitating capacity expansion and technological upgradation in Indian textile industry, issue of guarantees, standby letters of credit, letters of undertaking and letters of comfort by banks in respect of ECB by textile companies for modernization or expansion of textile units will be considered under the Approval Route subject to prudential norms.

Security

The choice of security to be provided to the lender / supplier is left to the borrower. However, creation of charge over immovable assets and financial securities, such as shares, in favour of the overseas lender is subject to condition.

Parking of ECB proceeds

Borrowers are permitted to either keep ECB proceeds abroad or to remit these funds to India, pending utilization for permissible end-uses.

ECB proceeds parked overseas can be invested in the following liquid assets (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/Fitch IBCA or Aa3 by Moody's; (b) Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above, and (c) deposits with overseas branches/subsidiaries of Indian banks abroad. The funds should be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

ECB funds may also be remitted to India for credit to the borrowers' Rupee accounts with Authorised Dealer Category I banks in India, pending utilization for permissible end-uses.

Prepayment

- (i) Prepayment of ECB up to USD 500 million may be allowed by the AD bank without prior approval of Reserve Bank subject to compliance with the stipulated minimum average maturity period as applicable to the loan.
- (ii) Pre-payment of ECB for amounts exceeding USD 500 million would be considered by the Reserve Bank under the Approval Route.

Refinancing of an existing ECB

Existing ECB may be refinanced by raising a fresh ECB subject to the condition that the fresh ECB is raised at a lower all-in-cost and the outstanding maturity of the original ECB is maintained.

CONVERSION OF ECB INTO EQUITY

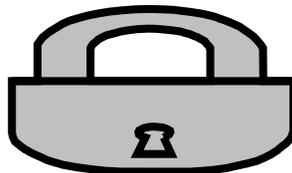
- (i) Conversion of ECB into equity is permitted subject to the following conditions:
 - (a) The activity of the company is covered under the Automatic Route for Foreign Direct Investment or Government approval for foreign equity participation has been obtained by the company, wherever applicable,
 - (b) The foreign equity holding after such conversion of debt into equity is within the sectoral cap, if any,
 - (c) Pricing of shares is as per the SEBI and erstwhile CCI guidelines/regulations in the case of listed/unlisted companies as the case may be.
- (ii) Conversion of ECB into equity may be reported in the form FC-GPR to the Regional Office concerned of the Reserve Bank as well as in form ECB-2 submitted to Reserve Bank of India within seven working days from the close of month to which it relates. Once reported, filing of ECB-2 in the subsequent months is not necessary.

LESSON ROUND UP



- Foreign Currency Convertible Bonds means bonds issued in accordance with this scheme and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments.
- Global Depository Receipts means any instrument in the form of a Depository receipt or certificate (by whatever name it is called) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company.
- Domestic Custodian Bank means a banking company which acts as a custodian for the ordinary shares or foreign currency convertible bonds of an Indian Company which are issued by it against global Depository receipts or certificates.
- Overseas Depository Bank means a bank authorised by the issuing company to issue global Depository receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company.
- The FCCBs are unsecured, carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company.
- 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.
- External Commercial Borrowings (ECB) include commercial bank loans, buyers' credit, suppliers credit, securitised instruments such as floating rate notes and fixed rate bonds.
- External Commercial Borrowings (ECB) can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route.

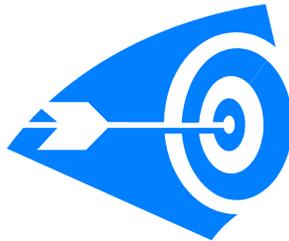
SELF TEST QUESTIONS



(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What are the various approvals required for issuance of FCCBs?
 2. What do you mean by FCEB? What are the eligibility conditions for FCEB?
 3. Describe the procedure for accessing External Commercial Borrowing through approval route?
 4. Write short notes on
 - (a) Global Depository Receipts
 - (b) Domestic Custodian Bank
 - (c) Overseas Depository
 5. What are the provisions relating to transfer/redemption of GDRs?
 6. Who are eligible to access ECBs through automatic route?
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STUDY XVII
INDIAN DEPOSITORY RECEIPTS



LEARNING OBJECTIVES

The study will enable the students to understand

- Concept of Indian Depository Receipts
- Over view of Companies (Issue of Indian Depository Receipts) Rules, 2004
- Regulations under Chapter X of SEBI (ICDR) Regulations, 2009
- Procedures for making an issue of Indian Depository Receipts
- Listing compliances for issuance of Indian Depository Receipts under listing agreement

INTRODUCTION



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. “Domestic Depository” means custodian of securities registered with SEBI and authorised 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 IDR's 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.

I. COMPANIES (ISSUE OF INDIAN DEPOSITORY RECEIPTS) RULES, 2004

The Central Government vide its powers conferred by clause (a) of sub-section (1) of section 642 read with section 605A of the Companies Act, 1956, notified Companies (Issue of Indian Depository Receipts) Rules, 2004. These rules are applicable only to those companies incorporated outside India, whether they have or have not established any place of business in India.

Important definitions

- “*Chief Accounts Officer*” under these rules means the chief accounts and financial officer of a company, by whatever name known;
- “*Depository*” means a depository as defined in clause (e) of sub-section (1) of section 2 of Depositories Act, 1996;
- “*Issuing company*” means a company incorporated outside India, making an issue of IDRs through a domestic depository;
- “*Merchant Banker*” means a Merchant Banker as defined in clause (e) of Rule 2 of SEBI (Merchant Bankers) Rules, 1992;

Eligibility for issue of IDRs

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 has a track record of distributable profits in terms of section 205 of the Companies Act, 1956, for at least three out of immediately preceding five years;
- (d) 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.

Procedure for making an issue of IDRs

An issuing company cannot raise funds in India by issuing IDRs unless it has obtained prior permission from SEBI. An application for seeking permission should be made to the SEBI at least 90 days prior to the opening date of the issue in the notified manner along with a non-refundable fee of US \$10,000. SEBI may, within 30 days of receipt of an application call for such further information, and explanations, as it may deem necessary for disposal of such application and shall dispose the application within 60 days of its receipt.

However, if within 60 days from the date of submission of application or draft prospectus, SEBI specifies any changes to be made in the draft prospectus, the prospectus shall not be filed with the SEBI or Registrar of Companies unless such changes have been incorporated therein. After the permission being granted, an applicant has to pay an issue fee of half a percent of the issue value subject to a minimum of Rs.10 lakhs where the issue is upto Rs.100 crore in Indian rupees. However where the issue value exceeds Rs.100 crore, every additional value of issue shall be subject to a fee of 0.25 percent of the issue value. The issuing company is required to obtain the necessary approvals or exemption from the appropriate authorities from the country of its incorporation and also has to appoint an overseas custodian bank, a domestic depository and a merchant banker for the purpose of issue of IDRs. The issuing company can deliver the underlying equity shares or cause them to be delivered to an Overseas Custodian Bank and the said bank shall authorize the domestic depository to issue IDRs. The issuing company,

seeking permission should obtain in-principle listing permission from one or more stock exchanges having nation wide trading terminals in India. The issuing company may appoint underwriters registered with SEBI to underwrite the issue of IDRs.

The issuing company has to file through a merchant banker or the domestic depository a due diligence report with the Registrar and also with SEBI. It is required to file a prospectus or letter of offer certified by two authorized signatories of the issuing company through a merchant banker, one of whom shall be a whole-time director and other the Chief Accounts Officer, stating the particulars of the resolution of the Board by which it was approved, with SEBI and Registrar of Companies.

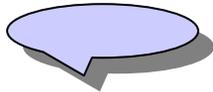
However, at the time of filing of said prospectus with the Registrar of Companies, New Delhi, a copy of approval granted by SEBI and the statement of fees paid by the Issuing Company to SEBI shall also be attached.

Other conditions for the issue of IDRs

The repatriation of the proceeds of issue of IDRs should be subject to laws for the time being in force relating to export of foreign exchange. IDR issued by any issuing company in any financial year should not exceed 25 per cent of its paid-up capital and free reserves. The IDRs issued by the issuing company are required to be denominated in Indian Rupees.

Registration of documents

The Merchant Banker for the issue of IDRs is required to submit following documents or information to SEBI and Registrar of Companies for registration namely:



- (i) instrument constituting or defining the constitution of the issuing company.
- (ii) the enactments or provisions having the force of law by or under which the incorporation of the issuing company was effected.
- (iii) if the issuing company has established place of business in India, address of its principal office in India.
- (iv) if the issuing company does not establish principal place of business in India, an address in India where the said instrument, enactments or provision or copies thereof are available for public inspection.
- (v) a certified copy of the certificate of incorporation of the issuing company in the country in which it is incorporated;
- (vi) copies of the agreements entered into between the issuing company, the overseas custodian bank and the domestic depository.
- (vii) if any document or any portion thereof required to be filed with the SEBI/ Registrar of Companies is not in English language, a translation of that document or portion thereof in English is also required to be attached duly certified and attested by the responsible officer.

The prospectus filed with SEBI and Registrar of Companies, New Delhi should

contain the particulars as prescribed and should be signed by all the whole-time directors of the issuing company and by the Chief Accounts Officer.

Conditions for the issue of prospectus and application

The application form for the securities of issuing company should not be issued unless the form is accompanied by a memorandum containing the salient features of prospectus in the specified form. An application form can be issued without the memorandum as specified, if it is issued in connection with an invitation to enter into an underwriting agreement with respect to the IDRs.

The prospectus for subscription of IDRs of the issuing company which includes a statement purporting to be made by an expert should not be circulated, issued or distributed in India or abroad unless a statement that the expert has given his written consent to the issue thereof and has not withdrawn such consent before the delivery of a copy of the prospectus to the SEBI and Registrar of Companies appears on the prospectus. The person(s) responsible for issue of the prospectus does not incur any liability by reason of any non-compliance with or contravention of any provision as regards any matter not disclosed, if he proves that he had no knowledge thereof or the contravention arose in respect of such matters which in the opinion of the Central Government were not material.

Listing of IDRs

The IDRs issued should be listed on the recognized Stock Exchange(s) in India as specified and such IDRs may be purchased, possessed and freely transferred by a person resident in India.

However, the IDRs issued by an issuing company may be purchased, possessed and transferred by a person other than a person resident in India if such Issuing Company obtains specific approval from Reserve Bank of India in this regard or complies with any policy or guidelines that may be issued by RBI on the subject matter.

Procedure for transfer and redemption

A holder of IDRs may transfer the IDRs or may ask the Domestic Depository to redeem these IDRs, subject to the provisions of the Foreign Exchange Management Act, 1999 and other laws for the time being in force whereas in case of redemption, Domestic Depository can request the Overseas Custodian Bank to get the corresponding underlying equity shares released in favour of the holder of IDRs for being sold directly on behalf of holder of IDRs, or being transferred in the books of issuing company in the name of holder of IDRs. A holder of IDRs may, at any time, nominate a person to whom his IDRs shall vest in the event of his death.

Continuous Disclosure Requirements

Every issuing company shall comply with such continuous disclosure requirements as may be specified by SEBI in this regard.

Distribution of corporate benefits

After the receipt of dividend or other corporate action on the IDRs as specified in the agreements, the Domestic Depository has to distribute them to the IDR holders in proportion to their holdings of IDRs.

Penalty

If an Issuing company or any other person contravenes any provision of these rules for which no punishment is provided in the Act, the issuing company shall be punishable with the fine which may extend to twice the amount of the IDR issue and where the contravention is a continuing one, with a further fine which may extend to five thousand rupees for every day during which the contravention continues and every officer of the company who is in default or such other person shall be punishable with the fine which may extend to one lakh rupees and where the contravention is a continuing one, with a further fine which may extend to one thousand rupees for every day, during which such contravention continues.

Disclosures

Disclosures of the following matters are to be specified in the prospectus—

General information

- (i) Name and address of the registered office of the company;
- (ii) Name and address of the Domestic Depository, the Overseas Custodian Bank with the address of its office in India, the Merchant Banker, the underwriter to the issue and any other intermediary which may be appointed in connection with the issue of IDRs;
- (iii) Names and addresses of Stock Exchanges where applications are made or proposed to be made for listing of the IDRs;
- (iv) Provisions relating to punishment for fictitious applications;
- (v) Statement/declaration for refund of excess subscription;
- (vi) Declaration about issue of allotment letters/certificates/ IDRs within the stipulated period;
- (vii) Date of opening of issue;
- (viii) Date of closing of issue;
- (ix) Date of earliest closing of the issue;
- (x) Declaration by the Merchant Banker with regard to adequacy of resources of underwriters to discharge their respective obligations, in case of being required to do so;
- (xi) A statement by the issuing company that all moneys received out of issue of IDRs shall be transferred to a separate domestic bank account, name and address of the bank and the nature and number of the account to which the amount shall be credited;
- (xii) The details of proposed utilisation of the proceeds of the IDR issue.

Capital Structure of the Company

Authorised, issued, subscribed and paid-up capital of the issuing company.

Terms of the issue

- (i) Rights of the IDR holders against the underlying securities;

- (ii) Details of availability of prospectus and forms, i.e., date, time, place etc;
- (iii) Amount and mode of payment seeking issue of IDRs; and
- (iv) Any special tax benefits for the issuing company and holders of IDRs in India.

Particulars of Issue

- (i) Objects of the issue;
- (ii) Cost of the Project, if any; and
- (iii) Means of financing the projects, if any including contribution by promoters.

Company, Management and Project

- (i) Main object, history and present business of the company;
- (ii) promoters and their background, however, in case there are no identifiable promoters, the names, addresses and other particulars as may be specified by SEBI of all the persons who hold 5% or more equity share capital of the company shall be disclosed;
- (iii) subsidiaries of the company, if any;
- (iv) particulars of the Management/Board (i.e. Name and complete address(es) of Directors, Manager, Managing Director or other principal officers of the company);
- (v) location of the project, if any;
- (vi) details of plant and machinery, infrastructure facilities, technology etc., where applicable;
- (vii) schedule of implementation of project and progress made so far, if applicable;
- (viii) nature of product(s), consumer(s), industrial users;
- (ix) particulars of legal, financial and other defaults, if any;
- (x) risk factors to the issue as perceived;
- (xi) consent of Merchant Bankers, overseas custodian bank, the domestic depository and all other intermediaries associated with the issue of IDRs; and
- (xii) the information, as may be specified by SEBI, in respect of listing, trading record or history of the Issuing Company on all the stock exchanges, whether situated in its parent country or elsewhere.

Report

- (i) Where the law of a country, in which the Issuing company is incorporated, requires annual statutory audit of the accounts of the Issuing company, a report by the statutory auditor of the Issuing company, in such form as may be prescribed by SEBI on—
 - (A) the audited financial statements of the Issuing Company in respect of three financial years immediately preceding the date of prospectus, and

- (B) the interim audited financial statements in respect of the period ending on a date which is less than 180 days prior to the date of opening of the issue, if the gap between the ending date of the latest audited financial statements disclosed under clause (A) and the date of opening of issue is more than 180 days.

However, if the gap between such date of latest financial statements and the date of opening of issue is 180 days or less, the requirement under clause (B) shall be deemed to be complied with if a statement, as may be specified by SEBI, in respect of changes in the financial position of issuing company for such gap is disclosed in the prospectus.

However, in case of an issuing company which is a foreign bank incorporated outside India and which is regulated by a member of the Bank for International settlements or a member of the International Organization of Securities Commissions which is a signatory to a Multinational Memorandum of Understanding with India, the requirement in respect of period beginning with last date of period for which the latest audited financial statements are made and the date of opening of issue shall be satisfied, if the relevant financial statements are based on limited review report of such statutory auditor.

- (ii) Where the law of the country, in which the Issuing company is incorporated, does not require annual statutory audit of the accounts of the Issuing company, a report, in such form as may be specified by SEBI, certified by a Chartered Accountant in practice within the terms and meaning of the Chartered Accountant Act, 1949 on—
 - (A) the financial Statements of the Issuing Company, in particular on the profits and losses for each of the three financial years immediately preceding the date of prospectus and upon the assets and liabilities of the Issuing Company and
 - (B) the interim financial statements in respect of the period ending on a date which is less than 180 days prior to the date of opening of the issue, if the gap between the ending date of the latest financial statements disclosed under clause (A) and the date of opening of issue is more than 180 days.

However, if the gap between such date of latest audited financial statements and the date of opening of issue is 180 days or less, the requirement under clause (B) shall be deemed to be complied with if a statement, as may be specified by SEBI, in respect of changes in the financial position of the issuing company for such gap is disclosed in the prospectus.

- (iii) The gap between date of opening of issue and date of reports under the said provisions shall not exceed 120 days.
- (iv) If the proceeds of the IDR issue are used for investing in other body(ies) corporate, then following details should be given:
 - (a) Name and address(es) of the bodies corporate;
 - (b) The reports stated in para (i) & (ii) above in respect of those bodies corporate also.

Other Information

- (i) Minimum subscription for the issue.
- (ii) Fees and expenses payable to the intermediaries involved in the issue of IDRs.

Inspection of Documents

The place at which inspection of the offer documents, the financial statements and auditor's report thereof will be allowed during the normal business hours.

Any other information as specified by SEBI from time to time.

Listing Agreement for IDRs.

II. SEBI (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2009**Applicability**

The provisions of this Chapter shall apply to an issue of Indian Depository Receipts made in terms of section 605A of the Companies Act, 1956 and Companies (Issue of Indian Depository Receipts) Rules, 2004.

Eligibility

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

- (a) the issuing company is listed in its home country;
- (b) the issuing company is not prohibited to issue securities by any regulatory body;
- (c) the issuing company has track record of compliance with securities market regulations in its home country.

Explanation: For the purpose of this regulation, the term "home country" means the country where the issuing company is incorporated and listed.

Conditions for issue of IDR

An issue of IDR shall be subject to the following conditions:

- (a) issue size shall not be less than fifty crore rupees;
- (b) procedure to be followed by each class of applicant for applying shall be mentioned in the prospectus;
- (c) minimum application amount shall be twenty thousand rupees;
- (d) at least fifty per cent. of the IDR issued shall be allotted to qualified institutional buyers on proportionate basis;
- (e) the balance fifty per cent. may be allocated among the categories of non-institutional investors and retail individual investors including employees at the discretion of the issuer and the manner of allocation shall be disclosed in the prospectus. Allotment to investors within a category shall be on proportionate basis;

However, atleast thirty percent of IDRs being offered in the public issue shall be available for allocation to retail individual investors and in case of under subscription in retail individual investor category. Spillover to the other categories to the extent of under subscription can be permitted.

- (f) at any given time, there shall be only one denomination of IDR of the issuing company.

Minimum subscription

For non-underwritten issues:

- (a) If the issuing company does not receive the minimum subscription of ninety per cent of the offer through offer document on the date of closure of the issue, or if the subscription level falls below ninety per cent. after the closure of issue on account of cheques having being returned unpaid or withdrawal of applications, the issuing company shall forthwith refund the entire subscription amount received.
- (b) If the issuing company fails to refund the entire subscription amount within fifteen days from the date of the closure of the issue, it is liable to pay the amount with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay.

For underwritten issues: If the issuing company does not receive the minimum subscription of ninety per cent. of the offer through offer document including devolvement of underwriters within sixty days from the date of closure of the issue, the issuing company shall forthwith refund the entire subscription amount received with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay beyond sixty days.

Fungibility

The Indian depository Receipts shall not be automatically fungible into underlying equity shares of issuing company.

Filing of draft prospectus, due diligence certificates, payment of fees and issue advertisement for IDR

1. The issuing company making an issue of IDR shall enter into an agreement with a merchant banker.
2. Where the issue is managed by more than one merchant banker, the rights, obligations and responsibilities, relating *inter-alia* to disclosures, allotment, refund and underwriting obligations, if any, of each merchant banker shall be predetermined and disclosed in the prospectus.
3. The issuing company shall file a draft prospectus with SEBI through a merchant banker along with the requisite fee, as prescribed in Companies (Issue of Indian Depository Receipts) Rules, 2004.
4. The prospectus filed with SEBI shall also be furnished to SEBI in a soft copy.
5. The lead merchant bankers shall:
 - (a) submit a due diligence certificate in a prescribed format to SEBI along with the draft prospectus.

- (b) certify that all amendments, suggestions or observations made by SEBI have been incorporated in the prospectus
 - (c) submit a fresh due diligence certificate, at the time of filing the prospectus with the Registrar of the Companies.
 - (d) furnish a certificate, immediately before the opening of the issue, certifying that no corrective action is required on its part.
 - (e) furnish a certificate, after the issue has opened but before it closes for subscription.
6. The issuing company shall make arrangements for mandatory collection centres.
 7. The issuing company shall issue an advertisement in one English national daily newspaper with wide circulation and one Hindi national daily newspaper with wide circulation, soon after receiving final observations, if any, on the publicly filed draft prospectus with SEBI and contain the minimum disclosures as prescribed by SEBI.

Display of bid data

The stock exchanges offering online bidding system for the book building process shall display on their website, the data pertaining to book built IDR issue, from the date of opening of the bids till at least three days after closure of bids.

Disclosures in prospectus and abridged prospectus

1. The prospectus shall contain all material disclosures which are true, correct and adequate so as to enable the applicants to take an informed investment decision.
2. Without prejudice to the generality of sub-regulation (1), the prospectus shall contain:
 - (a) the disclosures specified in Schedule to Companies (Issue of Indian Depository Receipts) Rules, 2004; and
 - (b) the disclosures in the manner as specified in these regulations.
3. The abridged prospectus for issue of Indian Depository Receipts shall contain the disclosures as specified by SEBI in these regulation.

Post-issue reports

1. The merchant banker shall submit post-issue reports to SEBI.
2. The post-issue reports shall be submitted as follows:
 - (a) initial post issue report, within three days of closure of the issue;
 - (b) final post issue report, within fifteen days of the date of finalisation of basis of allotment or within fifteen days of refund of money in case of failure of issue.

Undersubscribed issue

In case of undersubscribed issue of IDR, the merchant banker shall furnish

information in respect of underwriters who have failed to meet their underwriting devolvement to SEBI.

Finalisation of basis of allotment

The executive director or managing director of the stock exchange, where the IDR are proposed to be listed, along with the post issue lead merchant bankers and registrars to the issue shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified in this behalf by SEBI.

III. COMPLIANCES UNDER LISTING AGREEMENT FOR INDIAN DEPOSITORY RECEIPTS (IDRs)

Every issuer of an IDR has to comply with the conditions stipulated in the listing agreement for IDRs issued by SEBI. The highlights of the same are enumerated in the following table.

<i>Reference</i>	<i>Subject matter</i>	<i>Requirement</i>
Clause 1	Share allotment; advices of rights entitlement	Allotment should be made simultaneously and that in the event of its being impossible to issue letters of regret at the same time, a notice to that effect will be inserted in the press so that it will appear on the morning after the letters of allotment have been posted; advices of rights entitlement, wherever applicable, should be issued simultaneously.
Clause 2	Intimation of date of Board Meeting	The Issuer is required to notify stock exchange at least 7 days in advance of the date of the meeting of its Board of Directors at which the recommendation or declaration of a dividend or a rights issue or convertible debentures, proposal for declaration of any bonus issue etc.
Clause 3	Intimation after Board Meeting	The Issuer is required to, immediately after the meeting of its Board of Directors has been held to consider or decide the same, intimate to the Stock Exchange, (within 15 minutes of the closure of the board meeting) by phone, fax, telegram, e-mail about decision on recommendation/declaration of dividend, matters such as the total turnover, gross profit/loss, provision for depreciation, tax provisions and net profits for the year etc.,
Clause 4	Intimation to stock exchange on dividend payment	The Issuer is required to notify the stock exchange at least twenty-one days in advance of the date on and from which the dividend on shares will be payable .

<i>Reference</i>	<i>Subject matter</i>	<i>Requirement</i>
Clause 6	Intimation to Stock Exchange about increase of capital, re-issue of forfeited shares etc.,	The Issuer is required to within 15 minutes of the closure of any board meeting intimate to the Stock Exchanges by phone, fax, telegram, e-mail about short particulars of any increase of capital, short particulars of the reissues of forfeited shares or securities, or the issue of shares or securities held in reserve for future issue or the creation in any form or manner of new shares or securities or any other rights, privileges or benefits to subscribe thereto, short particulars of any other alterations of capital, including calls, any other information necessary to enable the holders of the IDRs to appraise the issuer's position and to avoid the establishment of a false market.
Clause 8	In-principal Approval	The issuer is required to obtain 'in-principle' approval for listing from the exchanges where its IDRs are listed, before issuing further IDRs.
Clause 11	Intimation to Stock exchange on matters pertaining to constitution of Board, Auditor, Compliance Officer etc.	The issuer is required to notify promptly to the stock exchange about change in the constitution of Board, Managing Director, Compliance officer, Auditor, Domestic Depository etc.,
Clause 12	Forwarding copies of notices, annual reports etc to stock exchange	Copies of all notices, resolutions and circulars relating to new issue of capital prior to their dispatch to the equity shareholders or IDR holders; copies of all the notices, call letters or any other circulars including notices of meetings at the same time as they are sent to the equity shareholders, IDR holders, debenture holders or creditors or any class of them or as they are advertised in the Press; copy of the proceedings at all Annual and Extraordinary General Meetings of the Issuer; copy of the deposit agreement as soon as it is executed; copies of all notices, circulars, etc., issued or advertised in the press etc.,

<i>Reference</i>	<i>Subject matter</i>	<i>Requirement</i>
Clause 14	Filing of shareholding pattern	The issuer is required to file with the Exchange the shareholding pattern on a quarterly basis within 15 days of end of the quarter in the prescribed form.
Clause 15		The Issuer is required to intimate to the Stock Exchanges, immediately of events such as strikes, lock outs, closure on account of power cuts, etc. and all events which will have a bearing on the performance/operations of the company as well as price sensitive information.
Clause 20	Intimation on Variation on projected and actual profitability statement	The Issuer is required furnish on a quarterly basis a statement to the stock exchange indicating the variations between projected utilisation of funds and/or projected profitability statement made by it in its prospectus or letter of offer and the actual utilisation of funds and/or actual profitability.
Clause 23	Appointment of Company Secretary, undertaking of due diligence etc.	The Issuer is required to : (a) appoint the Company Secretary of the Issuer as Compliance Officer who will directly liaise with the authorities such as SEBI, Stock Ex-changes, ROC etc., and investors with respect to implementation of various clause, rules, regulations and other directives of such authorities and investor service & complaints related matter. (b) undertake a due diligence survey to ascertain whether the RTA is sufficiently equipped with infrastructure facilities such as adequate manpower, computer hardware and software, office space, documents handling facility etc., to serve the IDR holders. (c) furnish a copy of agreement or MOU entered into with overseas custodian bank, domestic depository, merchant banker and RTA to the stock exchange
Clause 24	Corporate Governance	Requirements on (a) Composition of the Board (b) Non-executive directors' compensation and disclosures (c) Other provisions as to Board and Committees

<i>Reference</i>	<i>Subject matter</i>	<i>Requirement</i>
		(d) Code of Conduct for the Board (e) Audit Committee, its meeting powers, role (f) Subsidiary companies
		(g) Disclosures (h) CEO/CFO Certification (i) Report on Corporate Governance (j) Compliance Certificate from Practising Company Secretary or auditors

SEBI has issued Model Listing Agreement for listing of Indian Depository Receipts (IDRs) issued by issuing companies whose securities market regulators are signatories to the Multilateral Memorandum of Understanding (MMOU) of International Organization of Securities Commissions (IOSCO).

Highlights

1. The Company should for all corporate actions (except those which are not permitted by Indian laws), will treat holders of IDRs (hereinafter referred to as "IDR Holders"), in a manner equitable with the holders of its equity shares in the home country;
2. The issuing company is required to notify the stock exchange at the same time it intimates to any other exchange, where its equity shares are listed, regarding the meeting, at which matters such as the recommendation or declaration of dividend or rights issue or issue of convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of the dividend and any decision on buy back of equity shares of the issuing company, are due to be considered.
3. The issuing company is required to intimate to the stock exchange after the meeting of its Board of Directors has been held to consider or decide the following, at the same time and to the extent it intimates the same to the listing authority in its home country or other jurisdictions where its securities may be listed, by electronic filing:
 - (a) all dividends and/or cash bonuses recommended or declared or the decision to pass any dividend or cash bonus; and
 - (b) the total turnover, gross profit/loss, provision for depreciation, tax provisions and net profits for the year (with comparison with the previous year) and the amounts appropriated from reserves, capital profits, accumulated profits of past years or other special source to provide wholly or partly for any dividend, even if this calls for qualification that such information is provisional or subject to audit.
4. The issuing company is required to notify the stock exchange at least seven working days in advance of the record date for the corporate actions like rights, bonus, splits and payment of any dividend to IDR Holders. The issuing company further agrees that the process for setting a record date for any corporate action will be disclosed in the offer document and prior intimation

will be provided to the stock exchange and in the media if this process changes.

5. The issuing company is required to pay the dividend as per the timeframe applicable in its home country or other jurisdictions where its securities are listed, whichever is earlier, so as to reach the IDR Holders on or before the date fixed for payment of dividend to holders of its equity share or other securities.
6. The issuing company is required to promptly disclose to the stock exchanges the following by electronic filing:
 - (a) short particulars of any increase of capital whether by issue of bonus shares through capitalization, or by rights issue of equity shares, or in any other manner;
 - (b) short particulars of the reissues of forfeited shares or securities, or the issue of shares or securities held in reserve for future issue or the creation in any form or manner of new shares or securities or any other rights, privileges or benefits to subscribe thereto;
 - (c) short particulars of any other alterations of capital, including calls; and
 - (d) any other information necessary to enable the IDR Holders to appraise the issuing company's position and to avoid the establishment of a false market in IDRs;
7. The issuing company is required to declare that the underlying equity shares, against which the IDRs are issued, have been/will be listed in its home country before the listing of IDRs in the stock exchange;
8. The issuing company is required to obtain 'in-principle' approval for listing from the stock exchanges where its IDRs are listed, before issuing further IDRs and to make an application to the stock exchange for the listing such further IDRs;
9. The issuing company agrees that it will promptly notify the stock exchange at the same time where it notifies to comply with listing requirements of home country or other jurisdictions where its securities may be listed any change in the Board, Auditors etc.
10. The company is to required to forward the Annual Report/notices etc at the same time and as to the extent that it discloses to holders of securities in its home country or in other jurisdictions where such securities are listed.
11. The issuing company agrees to file with the stock exchange the pattern of IDR Holders on a quarterly basis within 15 days of end of the quarter in the prescribed form.
12. The issuing company is required to comply with the Corporate Governance provisions as applicable in its home country and other jurisdictions in which its equity shares are listed. Further the issuing company hereby agrees to file a comparative analysis of the corporate governance provisions that are applicable in its home country and in the other jurisdictions in which its equity shares are listed along with the compliance of the same vis-à-vis the

corporate governance provisions applicable to Indian listed companies. The said report shall be filed at the time of filing the annual reports with stock exchange.

13. The Company is required to comply with Indian GAAP or International Financial Reporting Standards (IFRS) or US GAAP in the preparation and disclosure of its financial results.

Further the Model Listing Agreement authorizes a **Company Secretary** to act as a Compliance Officer of the Issuing Company to directly liaise with various authorities and investors. Clause 26 of Model Listing Agreement read as under:

26. The issuing company agrees:

- (a) to appoint a company secretary in India who is a registered member of Institute of Company Secretaries of India to act as the Compliance Officer of the issuing company who would directly liaise with the authorities such as SEBI, the stock exchanges, Registrar of Companies etc., and investors with respect to implementation of various rules, regulations, guidelines, circulars and other directives or order of such authorities and investor service & complaints related matters;

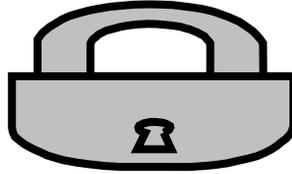
LESSON ROUND UP



- 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.
- Domestic Depository is custodian of securities registered with SEBI and authorised 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 after having obtained permission from Ministry of Finance for doing such business in India.
- Issue of IDRs are regulated by Companies (Issue of Indian Depository Receipts) Rules, 2004 and Chapter X of SEBI (ICDR) Regulations, 2009.
- The IDRs issued should be listed on the recognized Stock Exchange(s) in India as specified and such IDRs may be purchased, possessed and freely transferred by a person resident in India.
- Issuer of an IDR has to comply with the listing conditions stated in the listing agreement for IDRs

- SEBI has issued Model Listing Agreement for Listing of IDRs issued by issuing companies whose securities market regulators are signatories to MMOU of IOSCO.
- The Model Listing Agreements requires the issuer to appoint a Company Secretary as Compliance Officer.

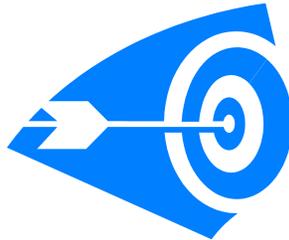
SELF TEST QUESTIONS



(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What is Indian Depository Receipts. Briefly explain the salient features of Companies (Issue of Indian Depository Receipts) Rules, 2004.
 2. What are the eligibility conditions in respect of issue of Indian Depository Receipts?
 3. What are the procedures for making an issue of Indian Depository Receipts?
 4. What are the compliances relating to corporate governance to be complied by companies issuing Indian Depository Receipts?
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STUDY XVIII
INVESTOR PROTECTION



LEARNING OBJECTIVES

The study will enable the students to understand

- Concept and need for investor protection and education
- Rights and responsibilities of investors
- Grievances of investor and redressal mechanism
- Legal framework for Investor Protection in India
- Investor Education and Protection Fund
- Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001
- SEBI (Investor Protection and Education Fund) Regulations, 2009
- Websites for investor protection
- Investor education/financial literacy

INTRODUCTION

Capital market plays an extremely 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, and provide an effective source of investment in the economy. It plays a critical role in 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.

In addition to resource allocation, 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”.

The existence of deep and broad capital market is absolutely crucial and critical in spurring the growth of our country. An essential imperative for India has been to develop its capital market to provide alternative sources of funding for companies and in doing so, achieve more effective mobilization of investors’ savings. Capital market also provides a valuable source of external finance.

For a long time, the Indian market was considered too small to warrant much attention. However, this view has changed rapidly as vast amounts of international investment have poured into our markets over the last decade. The Indian market is no longer viewed as a static universe but as a constantly evolving market providing attractive opportunities to the global investing community.

I. WHO REGULATES WHICH TYPE OF ENTITY

Given below is a list of types of intermediaries/service providers in the financial market. The names of the relevant regulatory bodies are given in the second column.

ENTITY	REGULATOR
AUDITORS	The Institute of Chartered Accountants of India/Controller & Auditor Genral of India (ICAI/CAG)
BANKS	Reserve Bank of India (RBI)
BANKS - ISSUE COLLECTION	Securities & Exchange Board of India (SEBI)
CHIT FUNDS	RBI
COMPANIES - ALL	Ministry of Corporate Affairs (MCA)/ Registrar of Companis (ROC)
COMPANIES - LISTED	MCA/ROC/SEBI/Stock Exchanges
COMPANY SECRETARIES	The Institute of Company Secretaries of India (ICSI)
CO-OPERATIVE BANKS	RBI
CREDIT RATING AGENCIES	SEBI
CUSTODIAL SERVICES	SEBI
DEBENTURE TRUSTEES	SEBI
DEPOSITORIES	SEBI
DEPOSITORY PARTICIPANTS	SEBI
FINANCIAL & INVESTMENT CONSULTANTS	—
FOREIGN BROKERS	SEBI
FOREIGN DEBT FUNDS	SEBI
FOREIGN INVESTMENT INSTITUTIONS	SEBI

INSURANCE BROKERS/ AGENTS	Insurance Regulatory & Development Authority (IRDA)
INSURANCE COMPANIES	IRDA
INVESTMENT BANKERS	SEBI
INVESTOR ASSOCIATIONS	SEBI
MUTUAL FUND BROKERS/ AGENTS	Association of Mutual Funds of India (AMFI)/ SEBI
MUTUAL FUNDS & ASSET MANAGEMENT COMPANIES	SEBI
NBFCs	RBI
NEWSPAPERS & MAGAZINES	Press Council of India (PCI)
PLANTATION COMPANIES	SEBI
PORTFOLIO MANAGERS	SEBI
PRIMARY DEALERS	RBI
RADIO	Ministry of Information & Broadcasting (MIB)
REGISTRARS & SHARE TRANSFER AGENTS	SEBI
SOLICITORS & LEGAL ADVISORS	Bar Council of India (BCI)
STOCK BROKERS	SEBI
STOCK EXCHANGES	SEBI
SUB-BROKERS	SEBI
TV	Ministry of Information & Broadcasting (MIB)
VENTURE CAPITAL FUNDS	SEBI

II. RIGHTS AND RESPONSIBILITIES OF INVESTORS

Investor Rights

The right to get

- The best price
- Proof of price/brokerage charged
- Your money/shares on time
- Shares through auction where delivery is not received
- Square up amount where delivery not received in auction

Investor Obligations

The obligation to

- Sign a proper Member- Constituent Agreement
- Possess a valid contract or purchase/sale note
- Deliver securities with valid documents and proper signatures

- Statement of Accounts from trading member

The right for redressal against

- Fraudulent price
- Unfair brokerage
- Delays in receipt of money or shares
- Investor unfriendly companies

The obligation to ensure

- To make payment on time
- To Deliver shares on time
- To send securities for transfer to the company on time
- Forwarding all the papers received from the company under objections to the broker on time

The Rights of Investor as a shareholder

To receive the share certificates, on allotment or transfer (if opted for transaction in physical mode) as the case may be, in due time.

To receive copies of the Annual Report containing the Balance Sheet, the Profit & Loss account and the Auditor's Report.

To participate and vote in general meetings either personally or through proxy.

To receive dividends in due time once approved in general meetings.

To receive corporate benefits like rights, bonus, etc. once approved.

To apply to Company Law Board (CLB) to call or direct the calling of an Annual General Meeting.

To inspect the minute books of the general meetings and to receive copies thereof.

To proceed against the company by way of civil or criminal proceedings.

To apply for the winding up of the company.

To receive the residual proceeds.

Besides the above rights, which investors enjoy as an individual shareholder, investors also enjoy the following rights as a group:

To requisition an Extra-ordinary General meeting.

To demand a poll on any resolution.

To apply to CLB to investigate into the affairs of the company.

To apply to CLB for relief in cases of oppression and/or mismanagement.

Rights of Investors as a debenture holder

To receive interest on redemption of debentures in due time.

To receive a copy of the trust deed on request.

To apply for winding up of the company if the company fails to pay its debt.

To approach the Debenture Trustee with your grievance.

You may note that the above mentioned rights may not necessarily be absolute. For example, the right to transfer securities (in physical mode) is subject to the company's right to refuse transfer as per statutory provisions.

Responsibilities of an Investor as a security holder

While you may be happy to note that you have so many rights as a stakeholder in the company that should not lead you to complacency; because you have also certain responsibilities to discharge.

To be specific

To remain informed

To be vigilant

To participate and vote in general meetings

To exercise your rights on your own or as a group.

III. COMMON GRIEVANCES OF INVESTORS

The general grievances the investors have against companies can be listed as under:

1. Furnishing inadequate information or making misrepresentation in prospectus, application forms, advertisements and rights offer documents.
2. Delay/non-receipt of refund orders, allotment letters and share certificates/debenture certificates/bonds.
3. Delay/non-receipt of share certificates/debenture certificates after transfer.
4. Delay in listing of securities with stock exchanges.
5. Delay/non-receipt of share certificates/bonds/debentures after endorsement of part payment/call money.
6. Delay/non-receipt of share certificates/bonds/debentures after sub division or consolidation.
7. Delay/non-receipt of letter of offer of rights issue.
8. Delay/non-receipt of bonus shares/right shares.
9. Delay/non-receipt of notices for meetings/annual reports.
10. Delay/non-receipt of interest warrants and dividend warrants.
11. Fixing unduly high premium on shares.
12. Difficulties in sending odd lots.
13. Obtaining undue benefits by company insiders.
14. Delay/default in payment of interest and repayment of deposits.

In respect of each of the above grievances complaints can be lodged with the Registrar of Companies, stock exchanges or SEBI as the case may be and in certain cases, they can be pursued with the Company Law Board also to obtain remedies and relief.

IV. REDRESSAL OF INVESTOR GRIEVANCES

The following table indicates nature of investors' grievances and the authorities to be approached:

<i>Nature of grievance</i>	<i>Concerned Authority</i>
<i>In case of any public issue</i>	
Non-receipt of:	
— Refund order	— SEBI
— Interest on delayed refund	— Ministry of Company Affairs
— Allotment advice	— Stock Exchange
— Share certificates	— Registrars to the Issue
— Duplicates for all of the above	
— Revalidations	
<i>In case of a listed security</i>	
Non-receipt of the certificates after:	
— transfer	— SEBI
— transmission	— Ministry of Company Affairs
— conversion	— Stock Exchange
— endorsement	
— consolidation	
— splitting	
— duplicates of securities	
Regarding listed Debentures, non-receipt of	— SEBI
— interest due	— Ministry of Company Affairs
— redemption proceeds	— The Debenture Trustees
<i>Nature of grievance</i>	<i>Can be taken up with</i>
— interest on delayed payment	— Stock Exchange
Regarding bad delivery of shares	— Bad delivery cell of the stock exchange
Regarding shares or debentures in unlisted companies	— Ministry of Company Affairs
Deposits in collective investment schemes like plantations, etc.	— SEBI
Units of Mutual Funds	— SEBI
Fixed Deposits in Banks and Finance Companies	— Reserve Bank of India
Fixed Deposits in manufacturing companies	— Ministry of Company Affairs

Investor Information Centres have been set up in every recognised stock exchange which take up all complaints regarding the trades effected in the exchange and the relevant member of the exchange.

Moreover two other avenues are always available to the investors to seek redressal of their complaints:

1. Complaints with Consumers Disputes Redressal Forum.
2. Suits in the Court of Law.

But considering the cost and time involved, the investor should better opt for these methods only as a last resort, after exhausting other simpler and direct methods of redressal of their grievances.

SEBI has issued rules, regulations and guidelines to monitor the working of various players both in the primary market and secondary market including stock exchanges and mutual funds. In particular, SEBI guidelines provide for due diligence to be carried out by each intermediary in the performance of his work.

V. 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.

1. Companies Act, 1956

Acceptance of Deposits

Section 58 A - This section provides that no Company shall invite any public deposits without issuing an advertisement in accordance with the Companies (Acceptance of Deposit) Rules, 1975. In the said advertisement the Company is under obligation to indicate its financial position as also details about the Company's business, Board Directors etc. A copy of the said advertisement has to be filed with the Registrar of Companies.

In terms of sub-section 9 where a Company fails to repay any deposit or part thereof, the Company Law Board may either on its own or on the application of the depositors, by order direct the Company to make re-payment of such deposits thereof forthwith or within such time and subject to such conditions as may be specified in the order.

Sub-section 10 provides for penalty in the case of failure to comply with any order made by the Board under sub-section 9.

Section 58AA: In this Section the Companies Act has recognized that a small depositor means a depositor who has deposited in a financial year a sum not exceeding Rs. 20,000/- in a company and includes its successors, nominees and legal representatives. This section inter alia, provides that in case of any default made by a company in the re-payment of such deposits and part thereof or interest thereon, it shall give an intimation within 60 days about such default to the Company

Law Board (CLB). It is also provided that upon default in re-payment to small depositors, no company shall accept any further deposits from small depositors until the matured deposits and interest accrued thereon have been paid fully.

Mis-statements in Prospectus

Section 63: This Section deals with criminal liability for misstatement in prospectus issued by a company. For such misstatements, the section provides for imprisonment upto 2 years which and fine which may extend to Rs. 50,000/- or with both and the offence is compoundable.

Section 68: This section deals with the penalty for fraudulently inducing persons to invest money in security of a company and provides for imprisonment upto 5 years or fine upto Rs. 1 lakh.

Non-payment of Dividend

Section 205: This section, inter alia, requires a company who has declared a dividend for any financial year to deposit the amount of such dividend (including interim dividend, if any) in separate bank account within 5 days from the date of declaration of such dividend.

Section 205A: This section provides that where a dividend has been declared by a company which has not been paid or claimed within 30 days from the date of such declaration, the company shall within 7 days of expiry of the said period of 30 days transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by a company in this behalf.

This section also provide for penalty for non complying with the above requirement and the same by way of interest @ 12% on the amount of unpaid/unclaimed dividend not transferred to the special account.

Section 205C: This section provides for establishment of Investors' Education and Protection Fund by the Central Government. Various types of unpaid/unclaimed amounts of application money/matured deposits/matured debenture etc. are to be credited to the said fund. The said accumulation in this fund are to be utilized for promotion of investors' awareness and protection of investors' interests.

Transfers and Transmission of Securities

Regarding transfers and transmissions of securities necessary provisions are available in Section 111, 111A and 113 of the Companies Act. 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 can be brought before the Company Law Board through an appeal under Section 111 and 111A. After hearing the parties Company Law Board may by order direct the company to register the transfer.

Failure to Send Financial Statements

Section 219: This section provides for the right of a member for copies of Balance-sheet and auditors Report.

Sub-section 3 makes the default in complying with this requirement punishable with fine which may extend to Rs. 5,000/-.

Besides, Section 621 of the Companies Act, 1956 permits the shareholder to proceed against the company and its officers in a court of law generally for offences committed under the Companies Act including prospectus, abridged prospectus, allotment, listing, transfer of shares, dividend payment etc. committed by the company as well as its officers under various provisions in the Act.

Protection to Debentureholders

Section 117A to 117C protect the debenture holders, and the new sections contains stringent punishments for default.

2. SEBI Act, 1992

In the preamble to the SEBI Act, 1992 two objectives are mentioned. The first objective is protecting the interest of the investors in securities and the second is to promote the development of and to regulate the securities market and for matters connected therewith or incidental thereto. Thus priority is accorded to investor protection in the SEBI Act.

Section 11 in Chapter IV of the SEBI Act lists out the functions of the SEBI. There are 15 functions provided for SEBI in this section. Section 11(2)(e) stipulates prohibition of fraudulent and unfair practices relating to securities markets as one of these functions and Section 11(2)(g) provides for prohibition of insider trading in securities. In pursuance of this provision the Board had notified the SEBI (Prohibition of fraudulent and unfair practices relating to securities markets) Regulations, 1995 on 25th October, 1995 in exercise of Section 30 of SEBI Act which empowers SEBI to make regulations for different purposes of the Act. These regulations have now been replaced with SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 w.e.f. 17.7.2003.

Section 15A to Section 15HA provide for penalty in respect of failure to furnish information, return, etc., failure by any person to enter into agreement with clients, failure to redress investors' grievances, certain defaults in case of mutual funds, failure to observe rules and regulations by an asset management company, default in case of stock brokers, insider trading, non-disclosure of acquisition of shares and takeovers, fraudulent and unfair trade practices.

Section 24 provides for punishment with imprisonment upto 10 years or with fine which may extend to Rs. 25 crores or with both. If any person contravenes or attempts to contravene or abets the contravention of the provision of SEBI Act or any rules or regulation.

As regards violation of provisions in the listing agreement, investors can forward their complaints to the stock exchanges with whom the company is listed to initiate action. The Investors are also at liberty to file complaints before the District Forum, State Commission or National Commission established under Section 9 of the Consumer Protection Act.

In the case of listed companies investors are entitled to forward their complaints

to the company and SEBI and the latter takes up the matter with the companies. SEBI has the power to take action including criminal proceeding where necessary against persons responsible for delay.

Powers under the Companies Act, 1956

SEBI has delegated powers to take action against listed companies under 45 Sections of the Companies Act in relation to issue and transfer of securities and non-payment of dividend. SEBI is empowered to deal with violations and defaults under Sections 55 to 58, 59 to 84, 108 to 110, 112 & 113, 116 to 122, 206 and 206A & 207, committed by listed companies as well as public companies which intend to make public issues and get their securities listed on any recognised stock exchange. Under Section 209A, officers of SEBI are also authorised to undertake inspection of books of the company in regard to matters covered under Section 55A, and SEBI need not give previous notice to the company in this regard.

3. Securities Contracts (Regulation) Act, 1956

Section 23 provides for penalties which may extend to 10 years or with fine which may extend to Rs. 25 crores or with both for contravention of the provisions of the Act.

Section 23A to Section 23H provide for penalty in respect of failure to furnish information, return etc., failure by any person to enter into an agreement with clients, failure to redress investor grievances, failure to segregate securities or moneys of client or clients, failure to comply with provisions of listing conditions or delisting conditions or grounds, excess dematerialization or delivery of unlisted securities, failure to furnish periodical returns, contravention with any provision of the act where no separate penalty is provided.

Section 23M provides for penalty for imprisonment for a term which may extend to 10 years or with fine which may extend to Rs. 25 crore or both for contravention or attempts to contravene or abates the contravention of the provisions of the Act or any rules or regulations or bylaws.

4. Reserve Bank of India Act, 1938

Section 45 QA of the Reserve Bank of India Act gives a depositor similar rights as are provided under Companies Act to approach CLB for payment of matured deposits in the case of NBFCs

5. Indian Penal Code

Economic Offence Wings of the Police Departments have powers under IPC to take up the cases of cheating, forgery and misappropriation etc. relating to investments.

Stock exchanges can also take up the issues pertaining to securities in terms of the conditions of listing agreement, rules and regulations

VI. 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.

(i) Activities stipulated under Rules

- Education programme through Media
- Organizing Seminars and Symposia
- Proposals for registration of Voluntary Associations or Institution or other organizations engaged in Investor Education and Protection activities
- Proposals for projects for Investors' Education and Protection including research activities and proposals for financing such projects
- Coordinating with institutions engaged in Investor Education, awareness and protection activities.

(ii) Activities undertaken by IEPF

- Educating and creating awareness among investors through Voluntary associations or organizations registered under IEPF. – 65 associations have been registered so far
- Educating investors through Media, Conducted panel discussions on DD (Delhi, Mumbai, Kolkata, Chennai and Ahmedabad), Telecast of TV Video spots on DD & private channels, print advertisement in national as well as regional newspapers. All these programmes have been undertaken in Hindi, English and regional languages
- Organizing seminars and workshops through associations registered under IEPF
- Financing research projects pertaining to investor education, awareness
- Coordinating with institutions engaged in investor education, awareness – Indian Institute of Capital Markets (IICM) has been engaged for conducting research/study on unclaimed dividend, interest etc. and also conducting "Training of Trainers" programme.

***www.iepf.gov.in* — IEPF Website Launched by Ministry of Corporate Affairs**



Financial literacy allows the investors to fully appreciate opportunities and associated risks, take informed decisions and participate actively in the economic growth of the country by converting savings into investments.

Ministry of Corporate Affairs (MCA) has set up the Investor Education and Protection Fund (IEPF) with the dedicated purpose of empowering investors through education and awareness building.

As a step towards achieving this objective, MCA on 27th September, 2007 launched a website **www.iepf.gov.in**. It would provide information about IEPF and the various activities that have been undertaken/ funded by it. This website fulfils the need for an information resource for small investors on all aspects of the financial markets and would attempt to do it in the small investors' language. Ministry of Corporate Affairs intends to cover many other areas like lifetime investment strategy, insurance, plantation companies, fixed deposits, small savings and banking. It is also proposed to introduce several investor-friendly services like online help desks, webcasts, quiz contests, investment planning worksheets, retirement planning, tax guides, working with financial advisors and investor alerts.

This website provides information on various aspects such as Role of Capital Market, IPO Investing, Mutual Fund Investing, Stock Trading, Depository Account, Debt Market, Derivatives, Indices, Indices (Comic Strip), Index Funds, Investor Grievances & Arbitration (Stock Exchanges), Investor Rights & Obligations, Dos and Don'ts etc.

***watchoutinvestors.com* — Website Sponsored by Investor Education and Protection Fund, Ministry of Corporate Affairs**

Funded by MCA

watchoutinvestors.com is a flagship website aided and sponsored by the Investor Education and Protection Fund of the Ministry of Corporate Affairs, Government of India.

A free public service...

- Arms investors with a self-defense tool to protect themselves from entities and persons who have been indicted by a regulator for an economic default and/or for non-compliance of laws/guidelines and/or who are no longer in the specified activity
- Provides a user-friendly, Quick Search leading to details of the selected entity/person

Mission

To prevent unscrupulous entities from harming investors and, in the process help build public confidence in the financial system, thereby enabling flow of public investment to the right avenues.

The website

watchoutinvestors.com has been created to provide information to the investors in respect of unscrupulous entities who have committed frauds or who have not been complying with the economic laws of the land. Many of these entities keep reappearing to harm the investors again, often with a new company or changed company names or by floating new schemes, taking advantage of short public memory and exploiting greed.

Though penal regulatory action has been taken against many of such entities,

information about such actions was scattered and was in a difficult-to-access, difficult-to-use format across a large number of sources i.e. websites, databases, publications, notifications and orders of the government and of other organizations, agencies, courts of law, tribunals and commissions. It was almost impossible for an investor to locate an indicted entity at any regulator's website and worse, the absence of a combined database of actions taken by all regulators prevented the investors from assessing the extent of defaults by a given entity.

Over several years, watchoutinvestors.com has undertaken the huge job of collating, value adding, cleaning, standardizing, reformatting and tabulating information on all regulatory actions of the past few years. This first-of-its-kind-in-the-world website is now a national web-based registry covering entities including companies intermediaries, and wherever available persons associated with such entities, who have been indicted for an economic default and/or for non-compliance of laws/guidelines and/or who are no longer in a specified activity. In fact, this site is easier to search and navigate than the official websites of the very regulatory agencies whose actions have been tracked and listed by it.

Regulators covered

The website covers the orders of several regulatory bodies, including the following:

- Bombay Stock Exchange
- Central Depository Services (India) Ltd.
- Company Law Board
- Debt Recovery Tribunals
- Employees' Provident Fund Organization
- Insurance Regulatory & Development Authority
- Ministry of Corporate Affairs, Registrars Of Companies
- National Housing Bank
- National Securities Depository Ltd.
- National Stock Exchange of India Ltd.
- Reserve Bank of India
- Securities and Exchange Board of India

Daily updation

The website is updated on a daily basis.

Why should investors use this website?

watchoutinvestors.com enables investors to do a fast, efficient and user-friendly search and provides them with the information on such entities/persons which they can use:

- before making any new investments with such entities
- for continuously reviewing their existing portfolio vis-a-vis such entities.

- for getting automatic email alerts on companies in their portfolio for new actions(mywatchout).
- when dealing with such entities in any manner

Simple search results

The search results are provided in a simple tabular format. For each entry, the reason for the action and the action taken by the regulatory body is provided in a summary form and the source document is attached, wherever available, for authenticity and details. Decisions of the higher appellate authorities are also provided. All regulatory charges and actions are rewritten in simple English, and standardized.

<i>ENTITY</i>	<i>PERSON</i>	<i>COMPETENT AUTHORITY</i>	<i>REGULATORY CHARGES</i>	<i>REGULATORY ACTION</i>
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The website also allows investors to check for dubious name changes of thousands of companies.

Increasing usage

watchoutinvestors.com is being used by lakhs of investors. The website is also helping investors indirectly by increasing usage by regulators, investment bankers, stock exchanges and law firms.

Concept, design and maintenance

Prime Investors Protection Association and League (PIPAL)

Investor Helpline

A project sponsored by Investor Education and Protection Fund (IEPF), Ministry of Corporate Affairs, Government of India. If an investor has any grievance described below, he can just Log on to: www.investorhelpline.in

Investor Helpline: A novel concept

- A free of charge, Single dedicated portal to handle investor grievances.
- Right from filing grievances to tracking status, the interaction with administrator has been made online to make it user friendly.
- Specific Forms for Different types of Grievances.

GRIEVANCE TYPES

- Non Receipt of Refund Order/ Allotment Advise related
- Non-Receipt of Dividend
- Non-Receipt of Share certificates / Units after allotment / transfer/ Bonus Transmission etc.
- Non-Receipt of Debentures / Bond Certificate or Interest / Redemption Amount

- Offer for Rights Issue
- Non-Receipt of Investments and returns thereon on Collective Investment Schemes/ Plantation Companies
- Non-Receipt of Annual Report / AGM Notice / Proxy Form
- Non-Registration of Change in Address of Investor
- Non-Receipt of Fixed / Public Deposits related amounts
- Demat related Grievances
- General Form

VII. SEBI (INVESTOR PROTECTION AND EDUCATION FUND) REGULATIONS, 2009

SEBI in exercise of the powers conferred by section 30 of SEBI Act, 1992, SEBI made the SEBI (Investor Protection and Education Fund) Regulations, 2009.

Regulation 3 of the Act lays down the establishment of the fund which shall be called the Investor Protection and Education Fund.

Regulation 4 provides for the amounts to be credited to the Fund. The following amounts shall be credited to the Fund:-

- (a) contribution as may be made by SEBI to the Fund;
- (b) grants and donations given to the Fund by the Central Government, State Government or any other entity approved by SEBI for this purpose;
- (c) proceeds in accordance with the sub-clause (ii) of clause(e) of sub-regulation (12) and the sub- regulation (13)of regulation 28 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997;
- (d) security deposits, if any, held by stock exchanges in respect of public issues and rights issues, in the event of de-recognition of such stock exchanges;
- (e) amounts in the Investor Protection Fund and Investor Services Fund of a stock exchange, in the event of de-recognition of such stock exchange;
- (f) interest or other income received out of any investments made from the Fund;
- (g) such other amount as SEBI may specify in the interest of investors.

Utilisation of Fund

The fund shall be utilised for the purpose of protection of investors and promotion of investor education and awareness in accordance with these regulations. The fund may be used for the following purposes, namely:-

- (a) Educational activities including seminars, training, research and publications, aimed at investors;
- (b) Awareness programmes including through media - print, electronic, aimed at investors;

- (c) Funding investor education and awareness activities of Investors' Associations recognized by SEBI
- (d) Aiding investors' associations recognized by SEBI to undertake legal proceedings in the interest of investors in securities that are listed or proposed to be listed;
- (e) Refund of the security deposits which are held by stock exchanges and transferred to the Fund consequent on de-recognition of the stock exchange, in case the concerned companies apply to SEBI and fulfill the conditions for release of the deposit;
- (f) Expenses on travel of members of the Committee, who are not officials of the Board, and special invitees to the meetings of the Committee, in connection with the work of the Committee;
- (g) Salary, allowances and other expenses of office of Ombudsman; and
- (h) Such other purposes as may be specified by SEBI.

Conditions for Aid

The aid shall be given by SEBI to investors' associations, in accordance with the guidelines made by it and subject to the following conditions:

- (a) that the aid shall not exceed seventy five per cent. of the total expenditure on legal proceedings;
- (b) such aid shall not be considered for more than one legal proceeding in a particular matter;
- (c) if more than one investors' association applies for seeking legal aid, the investors' association whose application is received first, shall be considered for such aid.

Constitution of the Committee

SEBI shall constitute an advisory committee for recommending investor education and protection activities that may be undertaken directly by the Board or through any other agency, for utilisation of the Fund for the purposes referred in these regulations. The Committee shall consist of the following members, namely:-

- (a) The Executive Director of SEBI in charge of Office of Investor Assistance and Education who shall be the convener of the Committee;
- (b) Two other officials of SEBI;
- (c) Five other members who have expertise about the securities market and experience in matters of investor grievance redressal or investor education.

The term of office of members shall be two years, which may be extended for a further period of two years. Any vacancy arising out of resignation, retirement or death of a member or for any other reason shall be filled by the Board for the remaining period of the term of such member. SEBI may dissolve and reconstitute the Committee if, at any time, SEBI is of the opinion that the Committee is unable to discharge the functions and duties imposed on it by or under these regulations.

Functions of the Committee

The Committee shall consider investor education and protection activities keeping in view the purposes mentioned in these regulations and submit its recommendations thereon to SEBI.

Meetings of the Committee

Meetings of the Committee shall be convened at least once in three months by the convener or in his absence, by any member nominated by the convener, on his behalf. Four members of the Committee shall constitute the quorum for the transaction of business at a meeting of the Committee. Every member, who is directly or indirectly interested in any matter coming up for consideration at a meeting of the Committee, shall disclose the nature of his interest at such meeting and such disclosure shall be recorded in the proceedings of the meeting of the Committee and such member shall not take part in any deliberation of the Committee with respect to that matter.

Expenses of the Committee

The expenses including travel and other allowances of members of the Committee, who are officials of SEBI, and invitees who are officials of SEBI shall be borne by SEBI in accordance with their entitlements. The expenses including travel and other allowances of members of the Committee, who are not officials of the Board, and invitees who are not officials of SEBI may be borne by the Fund.

Investment, maintenance of accounts and audit of accounts

SEBI shall ensure maintenance of proper and separate accounts and other relevant records in relation to the Fund giving therein the details of all receipts to, and, expenditure from, the Fund and other relevant particulars in accordance with the SEBI (Form of Annual Statement of Accounts and Records) Rules, 1994 as far as such rules apply. The accounts referred to in sub regulation (1) shall be prepared and audited before the expiry of six months from the end of each financial year. The investment of the Fund may be in the manner of investments of other funds of SEBI. The accounts of the Fund may be audited in the manner of audit of other accounts of SEBI.

Power to relax regulations

SEBI may relax the same if it is in the opinion that strict enforcement of any regulation needs to be relaxed to achieve the purpose of investor protection and education.

Delegation of powers

The powers exercisable by SEBI under these regulations shall also be exercisable by any member or officer of SEBI to whom such powers are delegated by it by means of an order made under section 19 of the SEBI Act.

VIII. OMBUDSMAN

Ombudsman in its literal sense is an independent person appointed to hear and act upon citizen's complaint about government services. This concept was invented

in Sweden and the idea has been widely adopted. For example, various banks, insurance companies have appointed Ombudsman to attend to the complaints of their customers.

SEBI has issued SEBI (Ombudsman) Regulations, 2003. Regulation 2(l) of the Regulations defines Ombudsman as under:

“Ombudsman” means any person appointed under regulation 3 of these regulations and unless the context otherwise requires, includes stipendiary Ombudsman.

Regulation 2(n) of the Regulations defines stipendiary Ombudsman as a person appointed under regulation 9 for the purpose of acting as Ombudsman in respect of a specific matter or matters in a specific territorial jurisdiction and for which he may be paid such expenses, honorarium, sitting fees as may be determined by SEBI from time to time.

The regulations further deal with establishment of office of Ombudsman, powers and functions of Ombudsman, procedure for redressal of Grievances and implementation of the award.

The term “complaint” under the Regulation means a representation in writing containing a grievance as specified in regulation 13 of these regulations; and “complainant” means any investor who lodges complaint with the Ombudsman and includes an investors association recognised by the Board.

An “investor” means a person who invests or buys or sells or deals in securities.

“listed company” has been defined in the Regulations to mean a company whose securities are listed on a recognised stock exchange and includes a public company which intends to get its securities listed on a recognised stock exchange.

Establishment of Office of Ombudsman

SEBI has been empowered to appoint, on recommendation of a Selection Committee, one or more Ombudsmen for such territorial jurisdiction as may be specified from time to time by an order. The Selection Committee referred in sub-regulation(2) should consist of the following members, namely:

- (a) an expert in the areas relating to financial market operations to be nominated by the Chairman;
- (b) a person having a special knowledge and experience of law, finance or economics, to be nominated by the Chairman.
- (c) a representative of SEBI not below the rank of Executive Director who shall be Secretary of the Selection Committee, to be nominated by the Chairman.

At the request of SEBI, the Selection Committee may also prepare a panel of persons out of which a person may be appointed as Stipendiary Ombudsman. The panel so constituted can remain in force for a maximum period of two years and shall be reconstituted from time to time. It has also been provided that any person in the existing panel shall be eligible to be included in the reconstituted panel.

Location of Office

The regulations provide that the office of the Ombudsman shall be located at the Head Office of SEBI and if more than one Ombudsman are appointed then the office of any such Ombudsman may be located at any other office of SEBI or any other place as may be specified by SEBI from time to time. The Regulations further provide that the Stipendiary Ombudsman when appointed for any specific complaint or complaints shall be located at such place as may be specified. In order to expedite disposal of complaints, the Ombudsman or Stipendiary Ombudsman, as the case may be, may hold sittings at such places within his area of jurisdiction as may be considered necessary and proper by him. SEBI may provide the premises and other infrastructure including staff or secretarial assistance for the office of Ombudsman or Stipendiary Ombudsman, as the case may be.

Eligibility Criteria for Appointment of a Ombudsman

In order to be appointed as an Ombudsman, a person is required to be—

- (i) a citizen of India;
- (ii) of high moral integrity;
- (iii) not below the age of forty five years; and
- (iv) either a retired District Judge or qualified to be appointed a District Judge, or having at least ten years experience of service in any regulatory body, or having special knowledge and experience in law, finance, corporate matters, economics, management or administration for a period of not less than ten years, or an office bearer of investors' association recognised by the Board having experience in dealing with matters relating to investor protection for a period of not less than 10 years.

However a person is not qualified to hold the office of the Ombudsman if—

1. he is an un-discharged insolvent;
2. he has been convicted of an offence involving moral turpitude;
3. he has been found to be of unsound mind and stands so declared by a competent court;
4. he has been charge sheeted for any offence including economic offences;
5. he has been a whole-time director in the office of an intermediary or a listed company and a period of at least 3 years has not elapsed.

However, the disqualification provided shall not be applicable in case of a person who has been the whole time director of a public sector bank or a public sector undertaking.

'Public Sector Bank' means –

- (i) a corresponding new bank specified in the First Schedule to the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970;
- (ii) a corresponding new bank specified in the First Schedule to the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1980;

- (iii) the State Bank of India constituted under the State Bank of India Act, 1955;
- (iv) a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959;

‘Public Sector Undertaking’ means any corporation established by or under any Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 which is owned, controlled or managed by the Central Government.”

Tenure

A person appointed as an Ombudsman will hold office for a term of three years and shall be eligible for reappointment for another period of two years. No person can hold the office of Ombudsman after attaining the age of sixty-five years. However the Board, at any time, before the expiry of the period specified may terminate the services of the Ombudsman by giving him notice of not less than three months in writing or three months salary and allowances in lieu thereof. Ombudsman also has the right to relinquish his office, at any time, before the expiry of period specified by giving to the Board notice of not less than three months in writing.

Remuneration

The salary, allowances, honorarium or fee payable to, and other terms and conditions of service of, an Ombudsman will be determined by SEBI from time to time.

Stipendiary Ombudsman

SEBI may appoint a person as a Stipendiary Ombudsman out of the panel prepared for the purpose of acting as an Ombudsman in respect of a specific matter or matters in a specific territorial jurisdiction, as may be specified in the order of appointment. A person is eligible to be appointed as Stipendiary Ombudsman if he—

- (a) has held a judicial post or an executive office under the Central or State Government for atleast ten years; or
- (b) is having experience of at least ten years in matters relating to consumer or investor protection; or
- (c) has been a legal practitioner in corporate matters for atleast 10 years; or
- (d) has served for a minimum period of ten years in any public financial institution.

The Stipendiary Ombudsman is entitled to exercise all powers and functions as are vested in a Ombudsman. The Stipendiary Ombudsman is also entitled to be paid such fees or honorarium and allowances for the services rendered by him, as may be determined by SEBI from time to time.

Territorial Jurisdiction

Every Ombudsman or Stipendiary Ombudsman exercises jurisdiction in relation to an area as may be specified by SEBI by an order.

Powers and Functions of Ombudsman

The Ombudsman has the following powers and functions:

- (a) to receive complaints against any intermediary or a listed company or both;
- (b) to consider such complaints and facilitate resolution thereof by amicable settlement;
- (c) to approve a friendly or amicable settlement of the dispute between the parties;
- (d) to adjudicate such complaints in the event of failure of settlement thereof by friendly or amicable settlement.

The Ombudsman is required to draw up an annual budget for his office in consultation with the Board and shall incur expenditure within and in accordance with the provisions of the approved budget and submit an annual report to the SEBI within three months of the close of each financial year containing general review of activities of his office. The ombudsman is also under obligation to furnish from time to time such information to SEBI as may be required by SEBI.

Procedure for Redressal of Grievance

A person may lodge a complaint on any one or more of the following grounds either to SEBI or to the Ombudsman concerned:

- (i) Non-receipt of refund orders, allotment letters in respect of a public issue of securities of companies or units of mutual funds or collective investments schemes.
- (ii) Non-receipt of share certificates, unit certificates, debenture certificates, bonus shares;
- (iii) Non-receipt of dividend by shareholders or unit-holders;
- (iv) Non-receipt of interest on debentures, redemption amount of debentures or interest on delayed payment of interest on debentures;
- (v) Non-receipt of interest on delayed refund of application monies;
- (vi) Non-receipt of annual reports or statements pertaining to the portfolios;
- (vii) Non-receipt of redemption amount from a mutual fund or returns from collective investment scheme;
- (viii) Non-transfer of securities by an issuer company, mutual fund, Collective Investment Management Company or depository within the stipulated time;
- (ix) Non-receipt of letter of offer or consideration in takeover or buy-back offer or delisting;
- (x) Non-receipt of statement of holding corporate benefits or any grievances in respect of corporate benefits, etc;
- (xi) Any grievance in respect of public, rights or bonus issue of a listed company;
- (xii) Any of the matters covered under Section 55A of the Companies Act, 1956;
- (xiii) Any grievance in respect of issue or dealing in securities against an intermediary or a listed company.

Procedure for filing a complaint

Any person who has a grievance against a listed company or an intermediary relating to any of the matters specified above may himself or through his authorised representative or any investors association recognised by the SEBI, make a complaint against a listed company or an intermediary to the Ombudsman within whose jurisdiction the registered or corporate office of such listed company or intermediary is located. The Regulations provide that if SEBI has not notified any Ombudsman for a particular locality or territorial jurisdiction, the complainant may request the Ombudsman located at the Head Office of the SEBI for forwarding his complaint to the Ombudsman of competent jurisdiction. The complaint is required to be in writing duly signed by the complainant or his authorised representative (not being a legal practitioner) in the Form specified in the Schedule to the regulations and supported by documents, if any. The Ombudsman may dismiss a complaint on any of the grounds specified under the Regulations or when such complaint is frivolous in his opinion. No complaint to the Ombudsman shall lie—

- (a) unless the complainant had, before making a complaint to SEBI or the Ombudsman concerned, made a written representation to the listed company or the intermediary named in the complaint and the listed company or the intermediary, as the case may be, had rejected the complaint or the complainant had not received any reply within a period of one month after the listed company or intermediary concerned received his representation or the complainant is not satisfied with the reply given to him by the listed company or an intermediary;
- (b) unless the complaint is made within six months from the date of the receipt of communication of rejection of his complaint by the complainant or within seven months after the receipt of complaint by the listed company or intermediary;
- (c) if the complaint is in respect of the same subject matter which was settled through the Office of SEBI or Ombudsman concerned in any previous proceedings, whether or not received from the same complainant or along with any one or more or other complainants or any one or more of the parties concerned with the subject matter;
- (d) if the complaint pertains to the same subject matter for which any proceedings before SEBI or any court, tribunal or arbitrator or any other forum is pending or a decree or award or a final order has already been passed by any such competent authority, court, tribunal, arbitrator or forum;
- (e) if the complaint is in respect of or pertaining to a matter for which action has been taken by the SEBI under Section 11(4) of the Act or Chapter VIA or Section 12(3) of the Act or any other regulations made thereunder.

Power to call for information

An Ombudsman may require the listed company or the intermediary named in the complaint or any other person, institution or authority to provide any information or furnish certified copy of any document relating to the subject matter of the complaint which is or is alleged to be in its or his possession. In the event of the failure of a listed company or the intermediary to comply with the requisition made without any sufficient cause, the Ombudsman may, if he deems fit, draw the

inference that the information, if provided or copies if furnished, would be unfavourable to the listed company or intermediary. The Ombudsman is required to maintain confidentiality of any information or document coming to his knowledge or possession in the course of discharging his duties and shall not disclose such information or document to any person except and as otherwise required by law or with the consent of the person furnishing such information or document. The Ombudsman has been empowered to disclose information or document furnished by a party in a complaint to the other party or parties, to the extent considered by him to be reasonably required to comply with the principles of natural justice and fair play in the proceedings. However these provisions shall not apply in relation to the disclosures made or information furnished by the Ombudsman to the Board or to the publication of Ombudsman's award in any journal or newspaper or filing thereof before any Court, Forum or Authority.

Settlement by Mutual Agreement

As soon as it may be practicable so to do, the Ombudsman shall cause a notice of the receipt of any complaint along with a copy of the complaint sent to the registered or corporate office of the listed company or office of the intermediary named in the complaint and endeavour to promote a settlement of the complaint by agreement or mediation between the complainant and the listed company or intermediary named in the complaint. If any amicable settlement or friendly agreement is arrived at between the parties, the Ombudsman may pass an award in terms of such settlement or agreement within one month from the date thereof and direct the parties to perform their obligations in accordance with the terms recorded in the award. For the purpose of promoting a settlement of the complaint, the Ombudsman may follow such procedure and take such actions as he may consider appropriate.

Award and Adjudication

In case the matter is not resolved by mutually acceptable agreement within a period of one month of the receipt of the complaint or such extended period as may be permitted by the Ombudsman, he may, based upon the material placed before him and after giving opportunity of being heard to the parties, give his award in writing or pass any other directions or orders as he may consider appropriate. The award on adjudication shall be made by Ombudsman within a period of three months from the date of the filing of the complaint. No award shall however be invalidated by reason alone of the fact that the award was made beyond the said period of three months. The Ombudsman should send his award to the parties to the adjudication to perform their obligations under the award.

Finality of Award

An award given by the Ombudsman shall be final and binding on the parties and persons claiming under them respectively. Any party aggrieved by the award on adjudication may within one month from the receipt of the award or corrected award may file a petition before the Board setting out the grounds for review of the award.

Review of Award

An award may be reviewed by the SEBI only if there is substantial mis-carriage of justice, or there is an error apparent on the face of the award.

Where a petition for review of the award is filed by a party from whom the amount mentioned in the award is to be paid to the other party in terms of the award, such petition shall not be entertained by the Board unless the party filing the petition has deposited with the Board seventy-five percent of the amount mentioned in the award. However SEBI may, for reasons to be recorded in writing, waive or reduce the amount to be deposited.

SEBI may review the award and pass such order as it may deem appropriate, within a period of forty five days of the filing of the petition for review. The award passed by the Ombudsman shall remain suspended till the expiry of period of one month for filing review petition or till the review petition is disposed off by the Board, as the case may be.

SEBI may determine its own procedure consistent with principles of natural justice in the matter of disposing of review petition and may dismiss the petition in limine if it does not satisfy any of the grounds specified in the Regulations.

Cost and Interest

The Ombudsman or the Board, as the case may be, have been empowered to award reasonable compensation along with interest including future interest till date of satisfaction of the award at a rate which may not exceed one percent per mensem.

The Ombudsman in the case of an award, or the Board in the case of order passed in petition for review of the award, as the case may be, may determine the cost of the proceedings in the award and include the same in the award or, in the order as the case may be. The Ombudsman or SEBI may impose cost on the complainant for filing complaint or any petition for review, which is frivolous.

Implementation of the Award

The award will be implemented by the party so directed within one month of receipt of the award from the Ombudsman or an order of SEBI passed in review petition or within such period as specified in the award or order of the Board. If any person fails to implement the award or order of the Board passed in the review petition, without reasonable cause —

- (1) he shall be deemed to have failed to redress investors' grievances and shall be liable to a penalty under Section 15C of the Act;
- (2) he shall also be liable for —
 - (a) an action under Section 11(4) of the Act ; or
 - (b) suspension or delisting of securities; or
 - (c) being debarred from accessing the securities market; or
 - (d) being debarred from dealing in securities; or dealing in securities; or
 - (e) an action for suspension or cancellation of certificate of registration; or
 - (f) such other action permissible which may be deemed appropriate in the facts and circumstances of the case.

Display of the Particulars of the Ombudsman

Every listed company or intermediary is required to display the name and address of the Ombudsman as specified by the Board to whom the complaints are to be made by any aggrieved person in its office premises in such manner and at such place, so that it is put to notice of the shareholders or investors or unit holders visiting the office premises of the listed company or intermediary. The listed company or intermediary is required to give full disclosure about the grievance redressal mechanism through Ombudsman in its offer document or client agreement. Any failure to disclose the grievance redressal mechanism through Ombudsman or any failure to display the particulars would attract the penal provisions contained in Section 15A of SEBI Act.

X. INVESTOR 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, liberalised 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.

Initiatives taken so far on financial literacy in India

Investor education forms an important part of SEBI's efforts to protect the interest of the investors in securities markets. A series of information brochures and pamphlets have been issued in the past for the benefit of the investors. These publications indicate the various risks associated with capital market investment, the rights of the investors, the responsibilities and details of the grievance redressal machinery available to them and the remedy/relief to be obtained from different agencies like SEBI, Ministry of Company Affairs, Stock Exchanges, Reserve Bank of India and Registrars to the Issue, apart from seeking relief through Consumers Disputes Redressal Forums, Company Law Board and Court of Law.

The investors associations registered with SEBI, the stock exchanges and professional bodies also conduct investor education programmes from time to time to appraise the investors of the changes in the law and regulations and the methods of protecting themselves against malpractices and delays cropping up in the market. This is further supplemented by the journals and magazines in the field of corporate investment as well as newspaper articles which highlight the newly emerging problems, pitfalls and the methods to protect.

IEPF

Ministry of Corporate Affairs has taken various initiatives to educate investors,

particularly, since 2001, the Investor Education and Protection Fund (IEPF) has been working for educating the investors and for creating greater awareness about investments in the corporate sector.

So far, it has 106 NGOs/Voluntary Organisations registered including the ICSI, and funded for the activities like organizing seminars/interactive workshops/awareness programmes, publishing magazines, pamphlets, developing websites etc.

Spots on education and awareness of investors have been telecast on the Doordarshan and private TV channels. Panel discussions on investor related issues have also been telecast over the Doordarshan. Besides, interactive workshops with NGOs/Voluntary Organisations (VOs) in this field and "Training the Trainers" programmes have been funded under the Investor Education and Protection Fund window.

Securities Market Awareness Campaign

SEBI has also launched a comprehensive securities market awareness campaign for educating investors through workshops, audio-visual clippings, distribution of educative investor materials/booklets, dedicated investor website etc. It has also recognised certain investor associations through which the investor is educated.

Financial Literacy-cum-Counselling Centre

RBI has advised State Level Bankers' Committee convenor banks to set up, on a pilot basis, a financial literacy-cum-counselling centre in any one district, and based on the experience gained, to ask the concerned lead banks to set up such centres in other districts. It has also undertaken a project on financial literacy by asking banks to introduce comic books explaining terms like inflation, how to open an account, interest rates, etc.

XI. 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, 1987.

The Guidance Scheme, further deals with various aspects such as the nature of request, fees to be accompanied alongwith 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 if the proposed transaction described in a request made under para 6 is consummated.
- 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.

The request seeking informal guidance should state that it is being made under this scheme and also state whether it is a request for a no-action letter or an interpretive letter and should be accompanied with a fee of Rs. 25,000/- and addressed to the concerned Department of SEBI. It should also describe the request, disclose and analyse all material facts and circumstances involved and mention all applicable legal provisions. SEBI may dispose off the request as early as possible and in any case not later than 60 days after the receipt of the request. The Department may give a hearing or conduct an interview if it feels necessary to do so. The requestor shall be entitled only to the reply. The internal records or views of SEBI shall be confidential.

SEBI may not respond to the following types of requests:

- (a) those which are general and those which do not completely and sufficiently describe the factual situation;
- (b) those which involve hypothetical situations;
- (c) those requests in which the requestor has no direct or proximate interest;
- (d) where the applicable legal provisions are not cited;
- (e) where a no-action or interpretive letter has already been issued by that or any other Department on a substantially similar question involving substantially similar facts, as that to which the request relates;
- (f) those cases in which investigation, enquiry or other enforcement action has already been initiated;
- (g) those cases where connected issues are pending before any Tribunal or Court and on issues which are subjudice; and,
- (h) those cases where policy concerns require that the Department does not respond.

Where a request is rejected for non-compliance, the fee if any paid by the requestor shall be refunded to him after deducting therefrom a sum of Rs. 5,000/- towards processing charges. However SEBI is not be under any obligation to respond to a request for guidance made under this scheme, and shall not be liable to disclose the reasons for declining to reply the request.

Confidentiality of Request

Any person submitting a letter or written communication under this scheme may request that it receive confidential treatment for a specified period of time not exceeding 90 days from the date of the Department's response. The request shall include a statement of the basis for confidential treatment. If the Department

determines to grant the request, the letter or written communication will not be available to the public until the expiration of the specified period. If it appears to the Department that the request for confidential treatment should be denied, the requestor will be so advised and such person may withdraw the letter or written communication within 30 days of receipt of the advise, in which case the fee, if any, paid by him would be refunded to him. In case a request has been withdrawn under clause (c), no response will be given and the letter or written communication will remain with the SEBI but will not be made available to the public. If the letter or written communication is not withdrawn, it shall be available to the public together with any written staff response.

A no-action letter or an interpretive letter issued by a Department constitutes the view of the Department but will not be binding on the Board, though the Board may generally act in accordance with such a letter. The letter issued by a Department under this scheme should not be construed as a conclusive decision or determination of any question of law or fact by SEBI. Such a letter cannot be construed as an order of the Board under Section 15T of the Act and shall not be appealable. Where a no action letter is issued by a Department affirmatively, it means that the Department will not recommend enforcement action to the Board, subject to other provisions of this scheme.

The guidance offered through the letters issued by Departments is conditional upon the requestor acting strictly in accordance with the facts and representations made in the letter. SEBI shall not be liable for any loss or damage that the requestor or any other person may suffer on account of the request not being replied or being belatedly replied or the Board taking a different view from that taken in a letter already issued under this scheme. Where the Department finds that a letter issued by it under this scheme has been obtained by the requestor by fraud or misrepresentation of facts, notwithstanding any legal action that the Department may take, it may declare such letter to be non est and thereupon the case of the requestor will be dealt with as if such letter had never been issued. Where SEBI issues a letter under this scheme, it may post the letter, together with the incoming request, on the SEBI website in accordance with the Guidance Scheme.

LESSON ROUND UP



- 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.

- 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.
- SEBI issued SEBI (Investor Protection and Education Fund) Regulations, 2009 to protect the interest of investors and provide for the utilization of the fund established under these regulations.
- In the developing countries, the growing number of investors, technically advanced financial markets, liberalised economy etc. necessitates imparting of financial education for better operation of markets and economy and in the interest of investor.
- Ministry of Corporate Affairs has taken various initiatives to educate investors, particularly, since 2001, the Investor Education and Protection Fund (IEPF) has been working for educating the investors and for creating greater awareness about investments in the corporate sector.
- www.iepf.gov.in provide information about IEPF , various activities that have been undertaken/ funded by it. It also fulfils the need for an information resource for small investors on all aspects of the financial markets and would attempt to do it in the small investors' language.
- watchoutinvestors.com is a flagship website aided and sponsored by the Investor Education and Protection Fund of the Ministry of Corporate Affairs, Government of India.
- SEBI has also launched a comprehensive securities market awareness campaign for educating investors through workshops, audio-visual clippings, distribution of educative investor materials/booklets, dedicated investor website etc.
- RBI has advised State Level Bankers' Committee convenor banks to set up, on a pilot basis, a financial literacy-cum-counselling centre in any one district, and based on the experience gained, to ask the concerned lead banks to set up such centres in other districts.
- Investor Information Centres have been set up in every recognised stock exchange which take up all complaints regarding the trades effected in the exchange and the relevant member of the exchange.

SELF TEST QUESTIONS



(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Explain the members' rights and responsibilities as an individual shareholder and as a group.

2. Outline the various statutory measures initiated by SEBI for investor protection.
 3. Discuss the common grievances faced by investors in the primary and secondary market.
 4. Outline the Grievances Redressal Mechanism prevalent in India.
 5. Explain the remedies available to investors under different enactments.
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EXECUTIVE PROGRAMME
SECURITIES LAWS AND COMPLIANCES

EP-SLC/2011

TEST PAPERS

This Test Paper set contains five test papers. Test Paper 1/2011, 2/2011, 3/2011, 4/2011 and 5/2011. The maximum time allowed to attempt each test paper is 3 hours.

Students are advised to attempt atleast **one Test Paper from Test Papers 3/2011, 4/2011 and 5/2011 i.e. either Test Paper 3/2011 or Test Paper 4/2011 or Test Paper 5/2011** and send the response sheet for evaluation to make him/her eligible for Coaching Completion Certificate. However, students may, if they so desire, send response sheets for all the test papers including Test Paper 1/2011 and 2/2011 for evaluation.

While writing answers, students should take care not to copy from the study material, text books or other publications. Instances of deliberate copying from any source, will be viewed very seriously.

W A R N I N G

It is brought to the notice of all the students pursuing Company Secretaryship Course that they should follow strict discipline while writing response sheets to various Test Papers appended at the end of this Study Material. Any attempt of unfair means by students in completing the postal coaching by way of submitting response sheets in different handwritings or by way of copying from the study material/suggested answers supplied by the Institute or from the answers of the students who have already completed the course successfully, etc., will be viewed seriously by the Institute. Students are, therefore, advised to write their response sheets in their own handwriting without copying from any original source.

Student may note that use of any malpractice while undergoing postal or oral coaching is a misconduct as per certain provisions of Company Secretaries Regulations and accordingly the registration of such students is liable to be cancelled or terminated.

EXECUTIVE PROGRAMME
SECURITIES LAWS AND COMPLIANCES
TEST PAPER 1/2011
(Based on Study Lessons I to VI)

Time allowed: 3 hours

Maximum marks: 100

Note: Attempt any five questions including Question No. 1 which is COMPULSORY.

1. Write short notes on:
 - (i) Consent Orders
 - (ii) Bills Rediscounting
 - (iii) Cumulative Preference Shares
 - (iv) Credit Watch. *(5 marks each)*
2. (a) Discuss the salient features of financial sector reforms in India. *(7 marks)*
 - (b) "A private equity fund is like a hedge fund." *(3 marks)*
 - (c) Discuss the role of Securities Market in economic growth. *(5 marks)*
 - (d) Discuss the norms for registration of portfolio managers with the Securities and Exchange Board of India (SEBI). *(5 marks)*
3. (a) Briefly explain the composition of Securities Appellate Tribunal. *(6 marks)*
 - (b) Briefly discuss the guidelines for issue of Commercial Paper. *(4 marks)*
 - (c) What is meant by 'custodian of securities'? Explain the capital adequacy norms laid down by SEBI for registration as a custodian. *(5 marks)*
 - (d) Discuss briefly the regulatory framework governing Securities Market? *(5 marks)*
4. (a) what are the restrictions on investment in Gold Exchange Traded Funds? *(5 marks)*
 - (b) What are the benefits of investing in Government Securities? *(5 marks)*
 - (c) What are the actions SEBI can take in case of default by an intermediary under the SEBI (Intermediaries) Regulations, 2008? *(5 marks)*
 - (d) What is Zero Coupon Convertible Notes? Briefly discuss. *(5 marks)*
5. (a) "Every Foreign Institutional Investor is under an obligation to keep or maintain books of accounts, records and documents". Discuss. *(6 marks)*
 - (b) Briefly explain about 'Mini Contracts on Derivatives'. *(4 marks)*
 - (c) Discuss the various advantages of convertible debentures? *(6 marks)*
 - (d) Describe the procedure for inspection of books of accounts of Banker to an Issue? *(4 marks)*

6. (a) What is sweat equity shares? What are the conditions required to be fulfilled for issuing sweat equity shares? *(5 marks)*
- (b) What are dated securities? Explain the salient features of dated securities. *(5 marks)*
- (c) What are the penalties for a person involved in insider trading under SEBI Act, 1992? *(5 marks)*
- (d) Distinguish between Money market and Capital market. *(5 marks)*
-

TEST PAPER 2/2011
(Based on Study Lessons VII to XIII)

Time allowed: 3 hours

Maximum marks:100

Note: Attempt any five questions including Question No. 1 which is COMPULSORY.

1. Write short notes on-
 - (a) Whistle Blower Policy
 - (b) Market Capitalisation
 - (c) Depository Participants
 - (d) Net Asset Value *(5 marks each)*
2.
 - (a) Discuss various types of listing? *(5 marks)*
 - (b) What is a collective Investment Vehicle? *(5 marks)*
 - (c) Discuss the various steps involved in Rumour Verification Process at Stock Exchange. *(5 marks)*
 - (d) Explain briefly the provisions related to 'escrow account' in order to make offer for buy back of shares by an Indian Company. *(5 marks)*
3.
 - (a) What are the various services provided by the Venture Capital funds in India? *(5 marks)*
 - (b) "Depository system is a boon to capital market and investors, both." Elucidate the statement and bring out the advantages of the dematerialisation of securities. *(5 marks)*
 - (c) What are the pre-requisites for 'option trading'? Explain the issues connected with option trading? *(5 marks)*
 - (d) What is bottom up and top down investing? Explain. *(5 marks)*
4.
 - (a) What are the obligations of foreign venture capital investor? *(6 marks)*
 - (b) What are the securities which are not available for Buy-back? *(4 marks)*
 - (c) Briefly explain the various Investment strategies used in the future market. *(6 marks)*
 - (d) Briefly discuss the demutualization of Stock Exchanges. *(4 marks)*
5.
 - (a) Explain the salient features of Real Estate Mutual Funds. *(7 marks)*
 - (b) What are the documents required to be submitted by a company for obtaining permission from RBI in respect of buy back of shares from non-resident shareholders? *(6 marks)*
 - (c) Define 'independent director' in terms of Clause 49 of the Listing Agreement. *(7 marks)*
6.
 - (a) What do you mean by settlement system at stock exchanges? *(5 marks)*

- (b) What are the investment objectives of a mutual fund scheme? *(5 marks)*
- (c) Briefly explain about Basket Trading System. *(5 marks)*
- (d) Briefly discuss the Risk Management System under Direct Market Access (DMA) facility. *(5 marks)*
-

TEST PAPER 3/2011

(This Test Paper is based on Entire Study Material)

Time Allowed: 3 Hours

Maximum marks: 100

PART-A

*Answer Question No.1 which is COMPULSORY
and ANY THREE of the rest from this part.*

- 1.(a) State, with reasons in brief, whether the following statements are true or false:
- (i) Consent order can take place only after filing criminal complaint by SEBI.
 - (ii) The Central Government can not privately place the government securities with the Reserve Bank of India.
 - (iii) A special delivery is one where the payment for securities is to be made on the same day or the next day.
 - (iv) A beneficial owner with a depository can claim loss to be indemnified by the depository.
 - (v) A promoter can transfer his shares during lock-in period, if shares are acquired in a preferential allotment. *(2 marks each)*
- (b) Choose the most appropriate answer from the given options in respect of the following:
- (i) The mechanism for employees to report to the management at certain events like, unethical behaviour, suspected fraud or violation of the company's code of conduct is known as-
 - (a) Whistle blower policy
 - (b) Surveillance action
 - (c) Market abuse
 - (d) Snap investigation
 - (ii) The declaration in the annual report regarding compliance with Code of conduct by the Board Members and Senior Management on annual basis shall be signed by-
 - (a) CFO
 - (b) Managing Director
 - (c) CEO
 - (d) MD & CEO
 - (iii) Market capitalisation of a listed company is computed by multiplying number of shares available for trade with:
 - (a) Face value of a share
 - (b) Market price of a share
 - (c) Issue price of a share
 - (d) Book price of a share

- (iv) A company can not buy back the securities from –
- (a) Free Reserves
 - (b) Securities Premium Account
 - (c) Borrowed money
 - (d) Proceeds of fresh issue
- (v) Duration of future contract on NSE is-
- (a) One month
 - (b) Two month
 - (c) Three month
 - (d) Six months. *(1 mark each)*
2. (a) Distinguish between any two of the following:
- (i) STP and DMA
 - (ii) Listed cleared securities and Permitted securities
 - (iii) Funds pay-in and Funds pay-out. *(4 marks each)*
- (b) Expand the following:
- (i) SCSB
 - (ii) STR
 - (iii) MTM *(1 mark each)*
- (c) Briefly explain about Exchange Traded funds. *(4 marks)*
3. (a) Write short notes on the following:
- (i) Carrot and Stick Bond
 - (ii) Growth Oriented Schemes
 - (iii) Securities Lending *(3 marks each)*
- (b) What are the obligations of a capital market intermediary under the Prevention of Money Laundering Act, 2002? *(6 marks)*
4. (a) Briefly explain clause 53 of listing agreement regarding the requirement need to be complied by a company while entering into an agreement with a media company. *(5 marks)*
- (b) “Buy-back of shares is a corporate financial strategy.” Comment. *(5 marks)*
- (c) Write a note on Internal audit of Portfolio Managers. *(5 marks)*
5. (a) Discuss the factors considered by credit rating agencies for the rating of manufacturing companies. *(5 marks)*
- (b) What action lies against SEBI registered intermediaries in case of default/violation under the SEBI Act, 1992? *(5 marks)*
- (c) “Investment in Mutual fund is risky.” Comment? *(5 marks)*

PART- B

(Answer Any Two questions from this part)

6. (a) What is an Anchor Investor? What are the provisions relating to Anchor Investor In terms of SEBI (ICDR) Regulations, 2009? *(7 marks)*
- (b) Discuss the advantages of issuing Bonus shares. *(4 marks)*
- (c) What are the provisions regarding promoters' contribution in case of a public issue? *(4 marks)*
- (d) What are the alternative eligibility norms for a company to make a public issue? *(5 marks)*
7. (a) What are the conditions for roll over of debt securities which are not convertible in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008? *(5 marks)*
- (b) Discuss the end use requirements of Foreign Currency Exchangeable Bonds (FCEB). *(5 marks)*
- (c) What is due diligence in the process of public issue of securities? Explain its scope and significance. *(5 marks)*
- (d) Explain the role of the following agencies involved in the euro issue:
- (i) Auditors
 - (ii) Overseas depository banks
 - (iii) Legal advisors
 - (iv) Domestic custodian banks
 - (v) Lead managers. *(1 mark each)*
8. (a) What are the compliances under the listing agreement for Indian Depository Receipts (IDRs) relating to appointment of Company Secretary and undertaking of due diligence of Registrar and Transfer Agent (RTA), etc? *(5 marks)*
- (b) What are the contents covered in the offering circular for euro-issue offerings? *(5 marks)*
- (c) Describe the composition of advisory committee constituted by SEBI under SEBI (Investor Protection and Education Fund) Regulations, 2009. *(5 marks)*
- (d) Discuss the role of Company Secretary under the Listing Agreement for Debt Securities. *(5 marks)*
-

TEST PAPER 4/2011

(This Test Paper is based on Entire Study Material)

Time Allowed: 3 Hours

Maximum marks 100

PART-A

*Answer Question No.1 which is COMPULSORY
and ANY THREE of the rest from this part.*

- 1.(a) State, with reasons in brief, whether the following statement are true or false:
- (i) In case of insider trading, an insider shall be liable for penalty of Rs. 25 lakhs rupees or the amount of profit made out of insider trading.
 - (ii) As per Clause 20 of the Listing Agreement a listed company can issue superior rights as to voting or dividend.
 - (iii) Commercial paper can be issued for maturities between a minimum of 3 months and maximum up to 5 years from the date of issue.
 - (iv) The settlement cycle for securities lending and borrowing mechanism is on T+3 basis.
 - (v) In case of book building the bidding terminal shall contain a physical demand and bids prices updated at periodic intervals not exceeding 20 minutes. (2 marks each)
- (b) Choose the most appropriate answer from the given options in respect of the following:
- (i) Underwriting is a technique used in issue of securities under:
 - (a) Public issue
 - (b) Rights issue
 - (c) Bonus Issue
 - (d) All the above.
 - (ii) Before 1992, the authority which used to regulate and deal with the stock market was the-
 - (a) Reserve Bank of India
 - (b) Controller of Capital Issues
 - (c) Registrar of Companies
 - (d) SEBI
 - (iii) In case of compulsory delisting, the company can not access the securities market directly or indirectly or seek listing from the date of delisting for a period of__
 - (a) 3 years
 - (b) 5 years
 - (c) 7 years
 - (d) 10 years
 - (iv) The maximum age for a person to hold the office as member of Securities Appellate Tribunal is –
 - (a) 60 years

- (b) 62 years
 - (c) 65 years
 - (d) 68 years
 - (v) For buy-back of securities through tender offer a company is required to make public announcement prior to commencement of buy-back before -
 - (a) 2 days
 - (b) 4 days
 - (c) 5 days
 - (d) 7 days

(1 mark each)
2. (a) What is the difference between Depository and Custodian? Briefly explain the Term "Establishment of connectivity with NSDL and CDSL".
(7 marks)
- (b) What do you mean by Straight Trough Processing (STP)? State the various advantages of STP.
(8 marks)
3. Distinguish between any three of the following:
 - (i) French auction and Dutch auction
 - (ii) Open Ended Scheme and Close Ended Scheme
 - (iii) Primary market and Secondary Market
 - (iv) Leveraged funds and Hedge funds.

(5 mark each)
4. (a) Discuss the role of audit committee in the context of Corporate Governance.
(8 marks)
- (b) What is a 'Self Regulatory Organisation'? What are its obligations?
(7 marks)
5. (a) Evaluate the role of SEBI in regulating financial markets in India.
(5 marks)
- (b) What is debenture trustee? Describe briefly its responsibilities and obligations.
(5 marks)
- (c) What are the restrictions on buy-back of securities?
(5 marks)

PART - B

(Answer any two questions from this part)

6. (a) Differentiate between Fixed Price process and Book building process.
(5 marks)
- (b) Briefly explain the following with reference to SEBI (ICDR) Regulations, 2009:
 - (i) Qualified Institutional Buyers
 - (ii) Green Shoe Option
 - (iii) Promoter's contribution

(5 marks each)

- 7.(a) Discuss about the intermediaries involved in Debt Market? (5 marks)
- (b) Distinguish between 'Pass through certificates' and 'Inflation linked Bonds'? (5 marks)
- (c) Discuss the role of Ombudsman in redressal of investor grievances. (5 marks)
- (d) What are the conditions for conversion of ECB into equity? (5 marks)
8. (a) Describe briefly the variations of terms of ESOS. (5 marks)
- (b) What are the approvals required for Issuance of GDRs? (5 marks)
- (c) Briefly explain the conditions required to be fulfilled for issuing IDRs in accordance with SEBI (ICDR) Regulations, 2009? (5 marks)
- (d) Briefly explain ASBA Process with regard to public issue of securities. (5 marks)
-

TEST PAPER 5/2011
(This Test Paper is based on Entire Study Material)

Time Allowed: 3 Hours

Maximum marks: 100

PART-A

*Answer Question No.1 which is COMPULSORY
and ANY THREE of the rest from this part.*

1. (a) State, with reasons in brief, whether the following statements are true or false:
- (i) CAMEL Model is used for rating of banking companies.
 - (ii) Sweat Equity shares are allotted to employees of a company as gift for their performance.
 - (iii) Participatory notes are derivative instruments.
 - (iv) The placement memorandum is issued for public circulation only.
 - (v) Shareholders of tracking stocks have a financial interest in a company as a whole. *(2 marks each)*
- (b) Choose the most appropriate answer from the given options in respect of the following:
- (i) Intermediaries which do not belong to primary market is—
 - (a) Lead Manager
 - (b) Stock Broker
 - (c) Transfer Agent
 - (d) Underwriter
 - (ii) Reinstatement of delisted securities is permitted by a stock exchange after a cooling period of ___
 - (a) Six months
 - (b) One Year
 - (c) One and a half year
 - (d) Two years.
 - (iii) In case of Euro issue, the prospective investors can access to vital information about the issuer company from_____
 - (a) Stock research report
 - (b) Offering Circular
 - (c) Quarterly results of the issuer company
 - (d) Investor relation programs.
 - (iv) In case of a public issue, the minimum application value should be in the range of-
 - (a) Rs. 3000-Rs. 5000
 - (b) Rs 5000- Rs. 7,000
 - (c) Rs. 5000- Rs. 10,000

- (d) Rs. 7000- Rs. 10,000
- (v) The number of member who are independent directors in the audit committee should be-
- (a) One third
 - (b) Two third
 - (c) Three fourth
 - (d) None of the above. *(1 mark each)*
2. (a) Write short notes on the following :
- (a) Commodity Pool
 - (b) Auction
 - (c) Fungibility
 - (d) Mortgage backed securities. *(2 marks each)*
- (b) Expand the following abbreviations:
- (i) SMILE
 - (ii) FIPB *(1 mark each)*
- (c) "The financial markets have two major components-the money market and the capital market." *(5 marks)*
3. (a) What do you understand by the following in relation to venture funds:
- (i) Incubators
 - (ii) Angel investors
 - (iii) Private equity players. *(2 marks each)*
- (b) "Every credit rating agency is required to abide by the code of conduct as per the SEBI regulations." Comment and discuss briefly the code of conduct for credit rating agencies. *(5 marks)*
- (c) List out the consequences of violation of listing agreement. *(4 marks)*
4. (a) State the penal provisions for merchant bankers upon violation of SEBI norms on issue of securities. *(5 marks)*
- (b) What is 'placement memorandum'? List out its essential contents. *(6 marks)*
- (c) What is 'margin trading facility'? State briefly the essential requirements for providing margin trading facility to the members by a stock exchange. *(4 marks)*
5. (a) How is the price determined for the buy-back of securities? *(4 marks)*
- (b) Discuss the remedy available to a company against refusal of listing by Stock exchanges. *(6 marks)*
- (c) How many depositories are there in India and name the authority regulating Depositories? *(5 marks)*

PART - B

(Answer any two questions from this part)

6. (a) What is 'Initial Public Offering' (IPO) Grading? Explain the procedure for IPO grading. *(5 marks)*
- (b) What is 'Investor Education and Protection Fund' (IEPF)? Briefly explain its activities as stipulated under the IEPF rules. *(5 marks)*
- (c) Explain the regulatory framework of debt market in India. *(5 marks)*
- (d) What is the lock-in-period and rights of option holder in case of Employee Stock Option Scheme? *(5 marks)*
7. (a) Explain the concept of road show in case of raising resources through Euro issues. *(6 marks)*
- (b) Briefly explain about the annual disclosure required to be made in the annual report by the issuer with regard to the simplified debt listing agreement. *(7 marks)*
- (c) What are the provisions relating to filing of offer document in terms of SEBI (ICDR) Regulation, 2009? *(7 marks)*
8. (a) "PAN has to be the sole identification number for all transactions in the securities market." Comment. *(5 marks)*
- (b) What are the legal provisions for investor protection with regard to ____
- (i) Mis-statements in a prospectus; and
- (ii) Failure to send financial statements. *(5 marks)*
- (c) What is 'Stipendiary Ombudsman'? What are his qualifications? *(5 marks)*
- (d) What are the requirements for making investment in Indian Depository Receipts (IDRs)? *(5 marks)*
-

EXECUTIVE PROGRAMME
SECURITIES LAWS AND COMPLIANCES

QUESTION PAPERS OF PREVIOUS SESSIONS

Question papers of immediate past two examinations of Securities Laws and Compliances paper are appended to this study material for reference of the students to familiarize with the pattern and its structure. Students may please note that answers to these questions should not be sent to the Institute for evaluation.

JUNE 2011

Time allowed : 3 hours

Maximum marks : 100

PART A

*(Answer Question No.1 which is COMPULSORY and
ANY THREE of the rest from this part.)*

1. (a) State, with reasons in brief, whether the following statements are true or false :
- (i) Every stock broker is required to appoint a compliance officer.
 - (ii) Dated securities are fixed maturity and fixed coupon securities.
 - (iii) Foreign venture capital investor means an investor incorporated and established in India.
 - (iv) Depository is required to frame its bye laws.
 - (v) The money market is a wholesale market. *(2 marks each)*
- (b) Re-write the following sentences after filling-in the blank spaces with appropriate words(s)/figure(s):
- (i) Money at call is _____ money.
 - (ii) _____ in capital market has always been high on the agenda of SEBI.
 - (iii) Buy-back of securities is a corporate financial strategy which involves _____.
 - (iv) To eliminate counter party risks, SEBI has advised _____ to set-up either trade guarantee fund or settlement guarantee fund.
 - (v) Automated screen based trading of shares on stock exchanges has resulted into _____. *(1 mark each)*

2. (a) What do you understand by 'participatory notes' ? Briefly explain the disadvantages associated with the issuance of participatory notes.
(5 marks)
- (b) Distinguish between *any three* of the following:
 (i) 'Perpetual debenture' and 'bearer debenture'.
 (ii) 'Cut-off yield' and 'cut-off price'.
 (iii) 'Straight through processing' (STP) and 'direct market access' (DMA).
 (iv) 'Forward' and 'futures'. (2 marks each)
- (c) Explain the following terms related to capital market :
 (i) Cash transaction report
 (ii) Suspicious transaction report. (2 marks each)
3. (a) Write short notes on the following:
 (i) Venture capital funds
 (ii) Offshore hedge funds
 (iii) Derivatives' contracts
 (iv) Collective investment schemes. (2 marks each)
- (b) Expand the following abbreviations:
 (i) SMILE
 (ii) NDTL
 (iii) CFDS. (1 mark each)
- (c) Discuss briefly the different surveillance systems adopted by stock exchanges. (4 marks)
4. (a) Explain the following terms related to buy-back of securities :
 (i) Letter of offer
 (ii) Specified date. (2 marks each)
- (b) List out various money market instruments. (5 marks)
- (c) What is 'short selling'? Discuss the mechanism of securities lending and borrowing scheme (SLBS). (6 marks)
5. (a) Explain briefly the various factors for judging the efficiency of mutual funds. (4 marks)
- (b) Discuss briefly the obligations and responsibilities of bankers to an issue. (5 marks)
- (c) What is Securities Appellate Tribunal (SAT)? Explain the procedure for appeal to SAT. (6 marks)

PART B

(Answer **ANY TWO** questions from this part.)

6. (a) What is 'parking' of external commercial borrowings (ECB) proceeds ?

(5 marks)

(b) What are the conditions for issue of Indian Depository Receipts (IDRs) ?
(5 marks)

(c) Briefly explain the following terms related to public issue :

(i) Pre-issue advertisement

(ii) Anchor investor

(iii) Green shoe option

(iv) IPO grading

(v) Book building.

(2 marks each)

7. (a) Who is an Ombudsman in stock market operations? Discuss his role in investors' protection.
(6 marks)

(b) List the approvals required for resource mobilisation by a company in the international capital market.
(7 marks)

(c) Discuss briefly the steps involved in the issue of bonus shares by a listed company.
(7 marks)

8. Write notes on any five of the following:

(i) Self certified syndicate bank

(ii) Debt securities

(iii) Depository agreement

(iv) Employee stock option

(v) Fixed income products

(vi) Fast track issues.

(4 marks each)

DECEMBER 2011*Time allowed : 3 hours**Maximum marks : 100***PART A**

*(Answer Question No.1 which is COMPULSORY and
ANY THREE of the rest from this part.)*

1. (a) State, with reasons in brief, whether the following statements are true or false :
 - (i) Hedge funds are similar to mutual funds.
 - (ii) Orders of SEBI are appealable before the Securities Appellate Tribunal.
 - (iii) A listed company is required to appoint compliance officer.
 - (iv) Depository participants are subjected to audit.
 - (v) Green shoe option is a stabilisation tool. *(2 marks each)*
- (b) Re-write the following sentences after filling-in the blank spaces with appropriate words(s)/figure(s):
 - (i) Clause 49 of the listing agreement deals with _____ .
 - (ii) Government securities are issued by _____ on behalf of the government.
 - (iii) Equity linked saving schemes now have lock-in-period of _____ years.
 - (iv) Mandatory client code facilitates _____ .
 - (v) Securities are traded for immediate delivery and payment in the _____ .
(1 mark each)
2. (a) Write short notes on **any four** of the following :
 - (i) Certificate of deposit
 - (ii) Hybrid instruments
 - (iii) Commodity bonds
 - (iv) Clearing corporation
 - (v) Debenture trustee. *(3 marks each)*
- (b) Expand the following abbreviations :
 - (i) ETF
 - (ii) QIP
 - (iii) ECN. *(1 mark each)*
3. (a) "Credit rating establishes a link between risk and return." Discuss. *(4 marks)*
- (b) Explain briefly the role and responsibilities of Registrar and Transfer Agent (RTA) in an IPO. *(4 marks)*

- (c) You are Company Secretary of All Season Travels Ltd., which being listed on the stock exchange after an IPO is made by the company. Your Board of directors desires to understand about the compliance requirements under Clause 41 of the listing agreement. Write a Board note on 'Clause 41 of the listing agreement'. (7 marks)
4. Comment briefly on **any five** of the following statements:
- "The securities market has two interdependent and inseparable segments."
 - "There are a large number of participants in the money market."
 - "Derivative contracts are of various types."
 - "Collective investment scheme is constituted as trust."
 - "Venture capital funds invest in all types of securities."
 - "Dematerialisation and immobilisation are distinct activities."
- (3 marks each)
5. (a) Distinguish between **any three** of the following :
- 'Spot delivery' and 'special delivery'.
 - 'Book closure' and 'record date'.
 - 'Pay-in' and 'pay-out'.
 - 'Forwards' and 'futures'.
- (3 marks each)
- (b) Explain briefly the following terms associated with securities market:
- Basket trading system
 - Trading volume
 - Trading cycle.
- (2 mark each)

PART—B

(Answer **ANY TWO** questions from this part.)

6. (a) Explain briefly **any four** of the following statements :
- "FCCB and ECB are different modes for raising foreign capital."
 - "Debt market in India comprises of two segments."
 - "IDR and GDR have distinct features."
 - "Investor Education and Protection Fund is set-up in the interest of investors."
 - "Public issue aims at selling and marketing of shares to public."
- (3 marks each)
- (b) You are Company Secretary of Golden Securities Ltd. The Board of directors wants to make a rights issue of shares to its existing shareholders in the ratio of 2 shares for every single share held by a

shareholder. Prepare a qualitative note highlighting the steps involved in the issue of rights shares. *(8 marks)*

7. (a) What is 'debt security' ? Describe the different debt market participants. *(5 marks)*
- (b) Discuss the rules for preferential issue of shares by existing listed companies. *(5 marks)*
- (c) What are the functions and powers of an Ombudsman? *(5 marks)*
- (d) Explain briefly the SEBI Regulations for book building. *(5 marks)*
8. Write notes on **any five** of the following :
- (i) Lock-in-period
 - (ii) Subscription list
 - (iii) ASBA
 - (iv) Financial literacy-cum-counselling centre
 - (v) Delisting of securities
 - (vi) Fixed income products
 - (vii) Roadshows in Euro issues. *(4 marks each)*
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