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**STUDY MATERIAL**

**EXECUTIVE PROGRAMME**

**SECURITIES LAWS  
AND CAPITAL MARKETS**

**MODULE 2  
PAPER 6**



**THE INSTITUTE OF  
Company Secretaries of India**

**भारतीय कम्पनी सचिव संस्थान**

**IN PURSUIT OF PROFESSIONAL EXCELLENCE**

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# **EXECUTIVE PROGRAMME**

## **SECURITIES LAWS AND CAPITAL MARKETS**

The securities markets are vital to the growth, development and strength of market economies and the maturity of an economy are decided based on the robustness of securities market of an economy. Considering that the Securities market is the core area of practice for the Company Secretaries, it becomes very important for the professionals to be fully aware of various laws and regulations, both for practice and guiding the Board of Directors on securities laws related matters. The securities market is governed by various regulations enacted in the course of time by the competent legislative body and regulating bodies. This study is divided into two Parts, Part I deals with Securities Laws and Part II deals with Capital Market & Intermediaries.

Part I of the Study provides an in depth analysis of the legal principles applicable to listed companies in addition to the Companies Act, 2013. The Regulatory Body Securities Exchange Board of India (SEBI) having extended SEBI's jurisdiction over corporates in the issuance of capital and transfer of securities, during the course of time has come out with several regulations for smooth functioning of the market, thereby also giving paramount importance to the stakeholders. Therefore, this study discusses various legislative and regulatory guidance such as Securities Contracts (Regulation) Act, 1956, Depositories Act, 1996, SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, SEBI (Prohibition of Insider Trading) Regulations, 2015, etc.

Part II of the study deals with analyses of the secondary market or the capital market, which is the bridge between the investors and the corporates. There are several intermediaries and institutions involved in dealing with the capital market. SEBI has also jurisdiction over all such intermediaries and persons associated with the securities market. In connection with the same, SEBI has regulated their functioning through various regulations, which have been discussed in this part.

In the era of plethora of legislations, rules, and regulations, a Company Secretary professional is expected to be well aware of these rules and principles, as these compliances make the functioning of the markets smooth while violations leads to severe penalties.

This study material is published to aid the students in preparing the paper on Securities Laws and Capital Markets for Executive Programme. It is part of the educational kit and takes the students step by step through each phase of preparation emphasizing key concepts, principles, legal fundamentals and procedures. Company Secretaryship being a professional course, the examination standards are set very high, with focus on knowledge of concepts, their application, procedures and case laws, for which sole reliance on the contents of this study material may not be enough. This study material may, therefore, be regarded as the basic material and must be read alongwith the Bare Acts, Rules, Regulations, Case Law.

The legislative changes made upto April 01, 2018 have been incorporated in the study material. The students to be conversant with the amendments to the laws made upto six months preceding the date of examination. It may happen that some developments might have taken place during the printing of the study material and its supply to the students. The students are therefore advised to refer to the updations at the Regulator's website, Supplement relevant for the subject issued by ICSI and ICSI Journal Chartered Secretary and other publications for updation of study material.

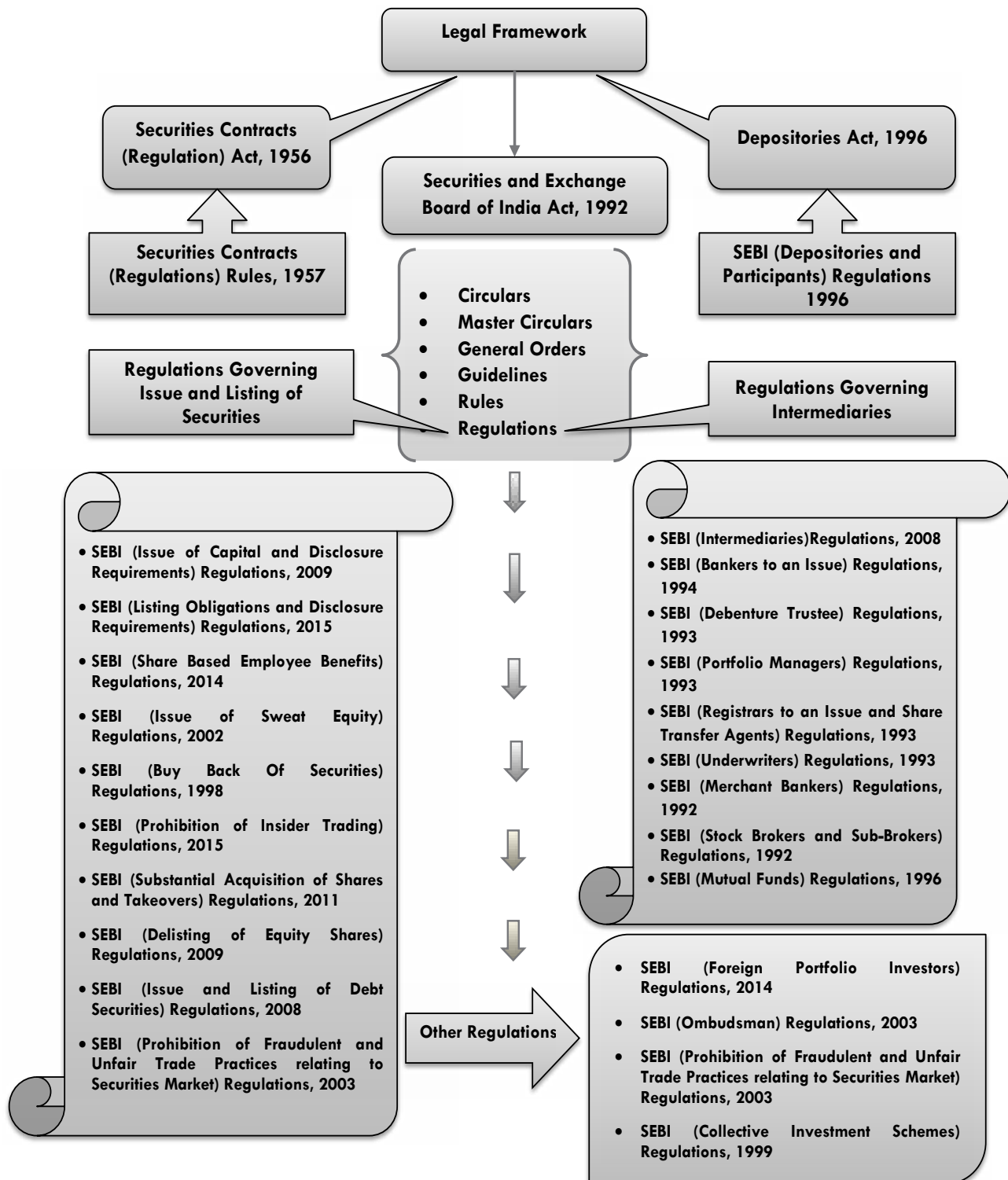
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Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same is brought to its notice for issue of corrigendum in the e-bulletin 'Student Company Secretary'.

## LEGAL AND REGULATORY FRAMEWORK

The Legal and Regulatory Framework of Securities Laws and Capital Markets in India is given below :



# EXECUTIVE PROGRAMME

## Module 2

### Paper 6

#### SECURITIES LAWS AND CAPITAL MARKETS (MAX MARKS 100)

#### SYLLABUS

##### Objective

**Part I** To provide expert knowledge in the legislations, rules and regulations governing the entities listed on the stock exchanges.

**Part II** To provide the basic understanding of the working of capital markets in India.

#### PART I : SECURITIES LAWS (70 MARKS)

##### Detailed Contents

1. **Securities Contracts (Regulation) Act, 1956** : Objectives of the SCR Act, Rules and Regulations made there under; Important Definitions; Recognized Stock Exchange, Clearing Corporation; Public issue and listing of securities; Rules relating to Public Issue and Listing of Securities under Securities Contracts (Regulation) Rules, 1957.
2. **Securities and Exchange Board of India Act, 1992**: Objective; Powers and functions of SEBI; Securities Appellate Tribunal; Penalties and appeals.
3. **Depositories Act, 1996** : Depository System in India; Role & Functions of Depositories; Depository Participants; Admission of Securities; Dematerialization & Re-materialisation; Depository Process; Inspection and Penalties; Internal Audit and Concurrent Audit of Depository Participants.
4. **An Overview of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.**
5. **An Overview of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.**
6. **An Overview of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.**
7. **SEBI (Buyback of Securities) Regulations, 1998** : Conditions of buy-back; Buy back Methods: Tender Offer, Open Market (Book building and Stock Exchange); General obligations; Penalties.
8. **SEBI (Delisting of Equity Shares) Regulations, 2009** : Delisting of Equity Shares; Voluntary Delisting; Exit Opportunity; Compulsory Delisting.
9. **An Overview of SEBI (Share Based Employee Benefits) Regulations, 2014.**
10. **An Overview of SEBI (Issue of Sweat Equity) Regulations, 2002.**
11. **SEBI (Prohibition of Insider Trading) Regulations, 2015** : Unpublished price sensitive information (UPSI); Disclosures; Codes of fair disclosure and conduct; Penalties and Appeals.
12. **Mutual Funds** : Types of Mutual Funds and Schemes; Key players in Mutual Funds: Sponsor, Asset Management Company, Trustee, Unit holder, Evaluating performance of Mutual funds- Net Asset Value, Expense Ratio, Holding Period Return.

- 13. Collective Investment Schemes :** Regulatory Framework; Restrictions on Business Activities; Submission of Information and Documents; Trustees and their Obligations.
- 14. SEBI (Ombudsman) Regulations, 2003 :** Procedure for Redressal of Grievances; Implementation of the Award; Display of the particulars of the Ombudsman, SCORES, SEBI (Informal Guidance) Scheme, 2003.

**Case Laws, Case Studies & Practical Aspects**

**PART II: CAPITAL MARKET & INTERMEDIARIES (30 MARKS)**

**15. STRUCTURE OF CAPITAL MARKET**

**I. Primary Market**

- (a) Capital Market Investment Institutions-Domestic Financial Institutions (DFI), Qualified Institutional Buyers (QIB), Foreign Portfolio Investors (FPI), Private Equity, Angel Funds, HNIs, Venture Capital, Pension Funds, Alternative Investment Funds.
- (b) Capital Market Instruments-Equities, Preference Shares, Shares with Differential Voting Rights, Corporate Debt, Non-Convertible Debentures (NCD), Partly, Fully and Optionally Convertible Debentures, Bonds, Foreign Currency Convertible Bonds (FCCB), Foreign Currency Exchangeable Bonds (FCEB) Indian Depository Receipts (IDR), Derivatives, Warrants;
- (c) Aspects of Primary Market- book building, ASBA, Green Shoe Option.

**II. Secondary Market**

Development of Stock market in India; Stock market & its operations, Trading Mechanism, Block and Bulk deals, Grouping, Basis of Sensex, Nifty; Suspension and Penalties; Surveillance Mechanism; Risk management in Secondary market, Impact of various Policies on Stock Markets such as Credit Policy of RBI, Fed Policy, Inflation index, CPI, WPI, etc.

- 16. Securities Market Intermediaries :** Primary Market and Secondary Market Intermediaries: Role and Functions, Merchant Bankers, Stock Brokers, Syndicate Members, Registrars and Transfer Agents, Underwriters, Bankers to an Issue, Portfolio Managers, Debenture Trustees, Investment Advisers, Research Analysts, Market Makers, Credit Rating Agencies; Internal Audit of Intermediaries by Company Secretary in Practice.

**Case Laws, Case Studies & Practical Aspects.**

# LESSON WISE SUMMARY

## SECURITIES LAWS AND CAPITAL MARKETS

### PART I – SECURITIES LAWS

#### Lesson 1 – Securities Contracts (Regulation) Act, 1956

Stock Market plays a significant role in the development of Economy. Stock Market facilitates mobilization of funds from small investors and channelizes these resources into various development needs of various sectors of the economy. The Securities Contracts (Regulation) Act, 1956 (SCRA) is an important piece of legislation which regulates the stock exchanges and contracts in securities.

The SCRA was enacted to prevent undesirable exchanges in securities and to control the working of stock exchange in India. It came into force on February 20, 1957. This Act gives powers to regulate and govern the stock exchanges and their working. There are certain powers which are delegated to SEBI under this Act.

The Government of India promulgated the Securities Contracts (Regulations) Rules, 1957 (SCRR) for carrying into effect the objects of the SCRA.

The SCRA and SCRR also prescribes the conditions for listing of securities on the stock exchanges. It also provides for amount of public holding required in every public company seeking listing.

This lesson will give an insight into the various Powers of Central Government, Stock Exchange and SEBI under the SCRA Act, the penal provisions, procedures, offences, the procedure for appeal to SAT, Right of Investors and various listing and delisting provisions under Securities Contract (Regulations) Rules, 1957 etc. At the end of this lesson, the student will be able to understand:

- Registration of stock exchange(s);
- Powers of Central Government in various cases;
- Powers of Recognised Stock Exchange to make rules and bye-laws;
- Powers of SEBI under SCRA;
- Clearing Corporation and its functions;
- Issue of securities to the Public;
- Delisting of securities from recognised stock exchange;
- Procedure to file an appeal to Securities appellate tribunal;
- Various penalties for various offences as prescribed under the Act; and
- Requirements for listing of securities with recognised stock exchange;

#### Lesson 2 – Securities and Exchange Board of India Act, 1992

With an aim to regulate the securities market in India, the Govt. of India set up a regulatory body i.e. SEBI in 1988. It became an autonomous body by The Government of India on 12 April 1992 and given statutory powers in 1992 with SEBI Act, 1992 being passed by the Indian Parliament.

The Preamble of the Securities and Exchange Board of India is “to protect the interests of investors in securities



and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto”.

The SEBI Act is the main Act from which several other Rules and Regulations have originated. The Act constitutes a Board (“the SEBI”) to protect the investors’ interest in securities and to promote the development and to regulate the securities market. The SEBI replaces the erstwhile Controller of Capital Issues. The SEBI has various powers under the Act including to issue various Regulations to better regulate the securities market and for better investor protection. It governs and regulates the market intermediaries. It has wide powers of investigation, survey, search and seizure, powers to impound documents, take statements on oath, etc. Thus, the powers enshrined in the SEBI are of a very wide amplitude. It also has powers to issue “directions, e.g., cease and desist” orders, by virtue of which, it can prohibit any person or intermediary from carrying out certain operations. The Act provides for stringent penalties for different types of offences and violations.

The objective of this lesson, is to provide a broader information regarding various powers and functions of SEBI, various stringent penalties for protecting the interest of investors and and inspection of various regulated entities, etc. to the students. At the end of this lesson, the student will able to understand :

- Powers and functions of SEBI;
- Conditions for offer of collective investment scheme by a company;
- Investigations procedure by the SEBI;
- Various penalties imposed by the SEBI for various failures, default, non-disclosure and other offenses;
- Procedure & Conditions for registration of an intermediaries; and
- Formation of the Securities Appellant Tribunal, its compositions, tenure, requirements for appeal and its powers.

### **Lesson 3 – Depositories Act, 1996**

A Depository is an organization like a Central Bank where the securities of a shareholder are held in the electronic form at the request of the shareholder through the medium of a Depository Participant. A DP can be a bank, financial institution, a broker, or any entity eligible as per SEBI norms and is responsible for the final transfer of shares from the depository to investors. The investor, at the end of a transaction receives a confirmation from the depository.

In India, there is Depository System for securities trading in which book entry is done electronically and no paper work is involved. The physical form of securities is extinguished and shares or securities are held in an electronic form. Before the introduction of the depository system through the Depository Act, 1996, the process of sale, purchase and transfer of securities was a huge problem, and there was no safety at all.

The Depositories Act, 1996 provides a legal framework for establishment of depositories to facilitate holding of securities including shares in the demat form (electronic form) and to effect transfer of securities through book entry. The Act establishes the depository system in India by providing for setting up of one or more depositories to enable the investors to hold securities in non-physical form (known as dematerialized form) and to affect transfer of securities by way of book entries in accounts maintained by the depository.

Every depository is required to be registered with SEBI and will have to obtain a Certificate for commencement of business on fulfillment of the prescribed conditions. There are two types of depositories in India, namely National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL). The functioning of Depository and its constituents in India is primarily governed by the Depository Act 1996, SEBI (Depository & Participant) Regulations, 1996 Bye-laws and business rules of respective depositories.

The operational and functional issues relating to depository system have been discussed in this lesson to

give an idea of the practical implications of various statutory and regulatory provisions. Further, a Practising Company Secretary has been recognised by SEBI for various types of Audit of Depository participants.

At the end of this lesson, the student will be able to understand :

- Basics of depository and its benefits;
- Models of depository and its functions;
- Process of dematerialisation and rematerialisation of securities;
- Securities which are eligible to be issued in depository mode;
- The concept of fungibility and rights of depository & beneficial owner;
- The applicability of SEBI (Depositories and Participants) Regulations, 1996;
- Audit of depositories i.e., Internal Audit and Concurrent Audit by a Practising Company Secretary; and
- Audit of Reconciliation of Share Capital by a Practising Company Secretary.

#### **Lesson 4 – An Overview of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009**

The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (the ICDR Regulations) were notified with the objective to bring more clarity to the provisions of the rescinded SEBI DIP Guidelines by removing the redundant provisions and modifying certain provisions on account of changes necessitated due to market design.

SEBI's emphasis on disclosure based regulation has witnessed a proliferation of disclosure norms for various types of capital raising activities by Indian companies. SEBI has gradually expanded the disclosure norms and prospectus requirements, culminating in the presently applicable SEBI ICDR Regulations. It lays down guidelines relating to conditions for various kinds of issues including public and rights issue. The ICDR Regulations provide detailed provisions relating to public issue such as conditions relating to an IPO and Further Public Offer (FPO), conditions relating to pricing in public offerings, conditions governing promoter's contribution, restriction on transferability of promoter's contribution, minimum offer to public, reservations, manner of disclosures in offer documents, etc.

At the end of this lesson, the student will be able to understand:

- Types of Issue;
- Concept of draft offer document, letter of offer and red herring prospectus;
- Contribution of promoters in case of Public Issue & exemption from the same;
- Concept of underwriting, Opening of Public issue & Minimum Subscription;
- Minimum number of share applications and application money;
- Pre-issue advertisement & Post issue advertisement;
- Restriction on further issue of capital & Reservation on competitive basis; and
- Detailed procedure for issue of securities by companies.

#### **Lesson 5 – An Overview of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015**

Listing agreement means where the 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.

It is a basic document which is executed between companies and the stock exchange when companies are listed on the stock exchange. Listing Agreement entered into by listed companies with the stock exchanges prescribes initial and continuous disclosure norms. The modifications to provisions of Listing Agreement are prescribed by SEBI. The Listing Agreement has been modified from time to time to align with the regulatory requirements arising out of the dynamic changes in the capital market.

With a view to consolidate and streamline the provisions of existing listing agreements for different segments of the capital market and to align the provision relating to listed entities with the Companies Act 2013, SEBI has notified the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 hereinafter referred as 'Listing Regulations'.

The SEBI Listing Regulations lay down the broad principles for periodic disclosures to be given by the listed entities operating in different segments of the capital markets. The Listing Regulations have been structured to provide ease of reference by consolidating into one single document across various types of securities listed on the Stock Exchanges.

This lesson will give an overview of :

- Obligations of listed entities;
- Various compliances & disclosures required to be made by the listed entities;
- Types of Board committee under listing regulations;
- Concept of Vigil Mechanism and Related Party Transactions; and
- Role of Company Secretary as a compliance officer as per listing regulations.

## **Lesson 6 – An Overview of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011**

One of the most popular modes of corporate expansion is by the acquisition of an existing company. However, when the company being acquired is a listed company, then along with the promoters' stake, there are a lot of other interests, such as, public shareholders, financial institutions, foreign shareholders, etc. It is essential that all these shareholders also get a fair deal in case of an acquisition. To address all such concerns, SEBI has framed the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997 which have evolved significantly over the years and notified the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 ('SAST Regulations') repealing the old regulation, providing for Acquisition of shares and takeover of listed companies popularly known as "Takeover Code".

Takeover code prescribes a systematic framework for acquisition of stake in listed companies. By these laws the regulatory system ensures that the interests of the shareholders of listed companies are not compromised in case of an acquisition or takeover. It also protect the interests of minority shareholders, which is also a fundamental attribute of corporate governance principle.

After going through this lesson, the students will have the knowledge about the various procedural aspects of takeover by an acquirer and target company with respect to acquisitions and takeover. At the end of this lesson, the student will have the conceptual clarity about the following aspects of SEBI Takeover Code:

- Triggering point while making an open offer by an acquirer;
- Open offer to the public;
- Concept of Public announcement i.e., timing of Public announcement & Detailed Public announcement;
- Procedural compliances related to letter of offer, opening of the offer etc.;
- Obligations of the acquirer and target company;

- Various disclosures requirements;
- Exemptions available to the acquirer in case of open offer; and
- Practical aspects of takeover.

## **Lesson 7 – SEBI (Buy-Back of Securities) Regulations, 1998**

Buy-back of securities is a corporate financial strategy which involves capital restructuring and is resorted to by companies to achieve the varied objectives of increasing earnings per share, averting hostile takeovers, improving returns to stakeholders and realigning the capital structure.

Buy-back of securities, like any other transaction of corporate restructuring, brings into play several issues, both financial and non-financial, and the process of buy-back needs to be structured in a way that all the issues are taken care of favourably.

The concept of buy-back was introduced in the Companies Act, 1956 by the Companies (Amendment) Act, 1999 by the insertion of Sections 77A, 77AA and 77B. Consequently, SEBI also issued the SEBI (Buy-Back of Securities) Regulations, 1998 on 14th November 1998. These regulations are applicable to the buyback of securities of a company listed on a stock exchange. Under the Companies Act, 2013 buyback is governed by sections 68, 69 and 70 and listed companies are governed by the SEBI (Buy-Back of Securities) Regulations, 1998.

This lesson will give an insight to the students into various methods of buy back available, prohibitions, objectives and process of buy back etc. At the end of this lesson, the student will be able to understand:

- Methods of buy back of securities;
- Procedure for buyback of securities from existing or security shareholders, from open market and from odd-lot holders;
- Compliances related to extinguishing of bought back securities; and
- Obligations of the company and Merchant Banker.

## **Lesson 8 – SEBI (Delisting of Equity Shares) Regulations, 2009**

With the new trends towards regulatory simplification to facilitate growth of businesses, barriers to free entry and exit to companies could ultimately prove to be prohibitive in terms of loss of Capital, resources and expertise. Internationally, stock exchanges do not impose any restriction on de-listing and allow de-listing subject to certain conditions such as minimum notice period for the company, exit offers to investors, etc.

Similarly in India, SEBI (Delisting of Equity Shares) Regulations, 2009 (the delisting regulations) gives an option to the listed company to either get itself delisted from all the recognised stock exchanges where it is listed through reverse book building or only from some of the stock exchanges and continue to be listed on the exchanges having nationwide terminals through a simplified process. Additionally, these regulations provide simplified procedure for delisting of shares of smaller companies.

In order to provide a statutory backing for the delisting framework, the Government has also notified delisting rules under Rule 21 of Securities Contract (Regulations) Rules, 1957 (the SCR Rules) dealing primarily with substantive aspect on delisting. The Delisting Regulations deal with the delisting of equity shares exclusively, as against the erstwhile Delisting Guidelines which dealt with securities generally.

This lesson will make the student acquainted with the various provisions of delisting, reasons for delisting and the various requirements to be complied with. At the end of this lesson, the student will be able to understand:

- Agencies involved in delisting process and their Role;

- Concept of voluntary delisting and its different modes;
- Comprehensive procedure for delisting of equity shares from all the stock exchanges or few stock exchange;
- Meaning of small companies and how it can voluntary delist its equity shares;
- Compulsory delisting of shares and its detailed procedure; and
- Special powers of the recognised stock exchange in case of delisting of equity shares.

## **Lesson 9 – SEBI (Share Based Employee Benefits) Regulations, 2014 – An Overview**

In this very dynamic era, most of the organisations are faced with a persistent challenge of attracting and retaining talented employees. Equity based compensation or stock based incentive schemes are widely used by the organisations in India and across the globe for their perceived benefits to both employer and employees in the long run.

The Securities and Exchange Board of India (SEBI), in the year 1999, had framed “Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999” (hereinafter “existing guidelines”) which provides for the stock based incentive schemes to employees. On 28th October, 2014, SEBI had notified **Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014** (hereinafter “Regulations”) repealing the existing guidelines. These Regulations apply to ESOS, ESPS, General Employee Benefit Schemes (GEBS), Retirement Benefit Schemes (RBS) and SAR Schemes of the listed companies.

This lesson will enable the students to learn the various provisions of SEBI (Share Based Employee Benefits) Regulations, 2014. At the end of this lesson, the student will able to:

- Understand the provisions of Companies Act, 2013 with respect to Employee stock option;
- Specify the companies eligible to issue ESOP/ESPS/GEBS/RBS/SARS;
- Familiarize with the types of schemes offered by the listed company;
- Understand the full procedure for issue of fresh shares for ESOPs;
- Determine the implementation of scheme through trust;
- Understand the concept of compensation committee & cases where shareholders’ approval required;
- Explain the administration of specific schemes like ESOS/ESPS/GEBS/RBS/SARS;
- Specify the provisions of SEBI LODR which is applicable to ESOP/ESPS; and
- Role of company secretary in issue of ESOP/ESPS/GEBS/RBS/SARS.

## **Lesson 10 – SEBI (Issue of Sweat Equity) Regulations, 2002 – An Overview**

Sweat equity shares refers to equity shares given to the company’s employees on favourable terms, in recognition of their work. Sweat equity shares is one of the modes of making share based payments to employees of the company. The issue of sweat equity shares allows the company to retain the employees by rewarding them for their services.

Further, Sweat equity shares enables greater employee stake and interest in the growth of an organization as it encourages the employees to contribute more towards the company in which they feel they have a stake.

Issue of sweat equity is governed by the provisions of section 54 of the Companies Act, 2013, relevant rules and SEBI (Issue of Sweat Equity) Regulations, 2002. These regulations applicable to issue of sweat equity shares by the listed companies. At the end of this lesson, the student will able to:

- Correlate the provision of companies act with SEBI Issue of Sweat Equity Regulations;
- Specify the eligible person for issue of sweat equity shares;
- Understand the requirement of shareholders' approval by passing special resolution;
- Determine the pricing of sweat equity shares and its accounting treatment & valuation IPRs; and
- Enumerate the ceiling on Managerial remuneration & Lock-in of sweat equity shares.

## **Lesson 11 – SEBI (Prohibition of Insider Trading) Regulations, 2015**

In India, insider trading is not only a tort i.e. a civil wrong but also a crime. The SEBI Act does not define the term by itself although it refers to the term “insider trading” in many provisions. However, using the powers to make regulations and in discharge of its functions, SEBI has made regulations prohibiting insider trading in the form of the PIT Regulations, 1992. The PIT Regulations, 1992 have had their challenges in their drafting, interpretation and reach. So, SEBI notified and issued SEBI (Prohibition of Insider Trading) Regulations, 2015 repealing the SEBI (Prohibition of Insider Trading) Regulations, 1992. The objective of these regulations is to strengthen the legal and enforcement framework, align Indian regime with international practices, provide clarity with respect to the definitions and concepts, and facilitate legitimate business transactions.

At present, insider trading of securities by directors and key managerial personnel shall be administered by the SEBI Regulations. These regulations are comprehensive and covering all the provisions of insider trading of securities. At the end of this lesson, the student will be able to:

- Understand the important definitions i.e., Connected person, Person deemed to be connected person, Insider, Unpublished price sensitive information;
- Explain the information/communication related to company which shall not be provide to any person;
- Elucidate trading when in possession of Unpublished price sensitive information;
- Understand the concept of trading plans;
- Specify the disclosures of trading and interest by certain persons;
- Familiarize with the code of Fair disclosure and conduct; and
- Understand the various penalties for violations under SEBI Act.

## **Lesson 12 – Mutual Funds**

A mutual fund allows a group of investors to pool their money together with a predetermined investment objective. The mutual fund will have a fund manager who is responsible for investing the gathered money into specific securities (stocks or bonds). When an investor, invest in a mutual fund, buying units or portions of the mutual fund and thus on investing becomes a shareholder or unit holder of the fund.

Mutual funds are considered as one of the best available investments as compare to others they are very cost efficient and also easy to invest in, thus by pooling money together in a mutual fund, investors can purchase stocks or bonds with much lower trading costs than if they tried to do it on their own. But the biggest advantage to mutual funds is diversification, by minimizing risk & maximizing returns. A mutual fund is the most suitable investment scope for common people as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively lower cost.

The mutual fund industry in India began in 1963 with the formation of the Unit Trust of India (UTI) as an initiative of the Government of India and Reserve Bank of India. Much later, in 1987, SBI Mutual Fund became the first non-UTI mutual fund in India. In 1996, SEBI had formulated the regulation on Mutual Fund i.e., SEBI (Mutual Fund) Regulations, 1996, which for the first time, established a comprehensive regulatory framework for the



mutual fund industry. Since then, several mutual funds have been set up by the private and joint sectors.

Mutual fund provides the information about the investment particulars of the corpus (company and sector-wise), credit ratings, market value of investments, NAVs, returns, repurchase and sale price of the schemes. At the end of this lesson, the student will be able to:

- Familiarize with the structure of mutual fund and understand the risks associated with Mutual fund;
- Specify the types of Mutual fund in India;
- Determine the key players of the Mutual Fund;
- Understand the concept of Sponsor, Asset Management Company (AMC), Trustee and Unit Holder;
- Meaning of Net Asset Value, Expense Ratio and Holding Period Return; and
- Correlate the compliances of SEBI Mutual Funds Regulations with SEBI LODR.

### **Lesson 13 – Collective Investment Schemes**

A CIS is any scheme or arrangement which pools funds from investors and involves a corpus amount of ₹ 100 crore or more. Every CIS has to compulsorily register itself with SEBI, file offer documents for its schemes and obtain a credit rating from a recognised rating agency, before it launches a scheme.

Collective Investment Scheme are regulated by SEBI (Collective Investment Scheme) Regulations, 1999 which was notified on October 15, 1999. These regulations define Collective Investment Management Company to mean a company incorporated under the Companies Act, 2013 and registered with SEBI under these regulations, whose object is to organize, operate and manage a collective investment.

This lesson will give an overview of collective investment scheme, listing of schemes and its winding up etc. At the end of this lesson, the student will be able to:

- Understand the business activities which are restrictions under CIS regulation;
- Understand the compliances related to quarterly report of CIS;
- Determine the obligations of collective investment management company (CIMC), trustee;
- Understand the conditions of the termination of the agreement with the CIMC; and
- Specify the procedure for allotment, transfer of units and winding up of scheme.

### **Lesson 14 – SEBI (Ombudsman) Regulations, 2003**

Ombudsman in its literal sense is an independent person appointed to hear and act upon citizen's complaint about government services. In this regard, SEBI had notified the SEBI (Ombudsman) Regulations, 2003 on August 21, 2003 which deals with establishment of office of Ombudsman, powers and functions of Ombudsman, procedure for redressal of Grievances and implementation of the award. This lesson also covers provisions related to SEBI Complaints Redress System (SCORES), and SEBI (Informal Guidance) Scheme, 2003.

SCORES is a web based centralized grievance redress system of SEBI which enables investors to lodge and follow up their complaints and track the status of redressal of such complaints online from the above website from anywhere.

SEBI (Informal Guidance) Scheme, 2003 deals with various aspects such as the nature of request fees to be accompanied along with letter disposal of requests, SEBI discretion not request and certain types of request and confidentiality of requests, etc.

In this lesson, a student will be able to know about SCORES, SEBI Ombudsman Regulations and Informal Guidance Scheme, etc. At the end of this lesson, the student will be able to know:

- How to file a complaint in SCORES site;
- When a case can be referred for arbitration;
- Concept of Ombudsman and its powers & functions;
- Procedure for redressal of grievance; and
- Concept of Informal Guidance.

## **PART II – CAPITAL MARKET AND INTERMEDIARIES**

### **Lesson 15 – Structure of Capital Market**

Capital is one of the important factors of production in any economy. A well organized financial system provides adequate capital formation through savings, finance and investments. An investment depends upon Savings and in turn Savings depends upon earnings of an individual or profits of the organization. This system may be viewed as a set of sub-systems with so many elements which are interdependent and interlinking with each other to produce the purposeful result within the boundary. Hence, the term system in the context of finance means a set of complex and closely connected financial institutions, instruments, agents, markets and so on which are interdependent and interlinking with each other to produce the economic growth within the country.

In any economy, financial Institutions play an important role because all the financial dealings and matters are handled and monitored by such Institutions. In the primary market, there are four key players: corporations, institutions, investment banks, and public accounting firms. Institutions invest capital in corporations that seek to expand and grow their businesses, while corporations issue debt or equity to the institutions in return for their capital investment. Investment banks are hired to match institutions and corporations based on their risk profile and investment style. Finally, public accounting firms are responsible for the preparation, review, and auditing of financial statements, tax work, consulting on accounting systems, M&A, and capital raising.

A second important division falls between the stock markets is capital market instruments. Capital Market Instruments are responsible for generating funds for companies, corporations and sometimes governments. These are used by the investors to make a profit out of their respective markets.

Secondary Market refers to a market where securities are traded after being initially offered to the public in the primary market and/or listed on the Stock Exchange. Majority of the trading is done in the secondary market. Secondary market comprises of equity markets and the debt markets. There are many other factors also such as integration with global financial market, policy decision which affect the working of stock markets.

At the end of this lesson, the student will be able to understand:

- Different categories of Investment Institutions in detail;
- Various Capital Markets Instruments;
- Book building, Application Supported by Block Amount, Green Shoe Option etc.; and
- Concept of Secondary Market & its trading mechanism etc.

### **Lesson 16 – Securities Market Intermediaries**

Intermediaries are service providers and are an integral part of any financial system. The objective of these intermediaries is to smoothen the process of investment and to establish a link between the investors and the users of funds. The Market Regulator, i.e., SEBI regulates various intermediaries in the primary and secondary markets through its Regulations for these respective intermediaries. These Regulations also empower SEBI to inspect the functioning of these intermediaries and to collect fees from them and to impose penalties on erring entities.

At the end of this lesson, the student have an overview about various types of intermediaries operating in Capital Market and its role & responsibility, Internal Audit of Intermediaries by company secretary in practice.



## LIST OF RECOMMENDED BOOKS

### PAPER 6 : SECURITIES LAWS AND CAPITAL MARKETS

#### READINGS

1. Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110034.
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4. Taxmann : SEBI Manual
5. Shashi K Gupta : Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Nishja Aggarwal Ram Road, 24, Daryaganj, New Delhi -110002  
Neeti Gupta

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[www.nseindia.com](http://www.nseindia.com)  
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#### JOURNALS

1. SEBI and Corporate Laws : Taxmann, 59/32, New Rohtak Road, New Delhi-110005.
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., Mahindra Towers, Worli, Mumbai-400018.

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

# ARRANGEMENT OF STUDY LESSON

## Module-2 Paper-6

### Securities Laws and Capital Markets

#### PART I – SECURITIES LAWS

S.No.	Lesson Tittle
1.	Securities Contracts (Regulations) Act, 1956
2.	Securities and Exchange Board of India Act, 1992
3.	Depositories Act, 1996
4.	An Overview of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009
5.	An Overview of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
6.	An Overview of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
7.	SEBI (Buy-Back of Securities) Regulations, 1998
8.	SEBI (Delisting of Equity Shares) Regulations, 2009
9.	SEBI (Share Based Employee Benefits) Regulations, 2014 – An Overview
10.	SEBI (Issue of Sweat Equity) Regulations, 2002 – An Overview
11.	SEBI (Prohibition of Insider Trading) Regulations, 2015
12.	Mutual Funds
13.	Collective Investment Schemes
14.	SEBI (Ombudsman) Regulations, 2003

#### PART II – CAPITAL MARKET AND INTERMEDIARIES

S.No.	Lesson Tittle
15.	Structure of Capital Market
16.	Securities Market Intermediaries

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# Lesson 1

## Securities Contracts (Regulation) Act, 1956

### LESSON OUTLINE

- Introduction
- I. Securities Contracts (Regulation) Act, 1956
- Non-applicability
- Definitions
- Recognition of Stock Exchanges
- Withdrawal of Recognition
- Powers of Central Government
- Powers of Recognised Stock Exchange
- Clearing Corporation
- Punishments for Contraventions
- Powers of SEBI
- Public Issue and Listing of Securities
- Exclusion of Spot Delivery Contracts
- Contracts in Derivatives
- Conditions for Listing
- Delisting of Securities
- Right of Appeal to SAT
- Penalties
- Factors to be taken into account by the Adjudicating Officer
- Crediting sum realised by way of penalties to Consolidated Fund of India
- Offences
- Composition of Certain Offences
- Offences by Companies
- Certain Offences to be Cognizable
- Cognizance of Offences by courts
- Special provisions related to Commodity Derivatives
- II. Securities Contracts (Regulations) Rules, 1957
- LESSON ROUND UP
- GLOSSARY
- SELF-TEST QUESTIONS

### LEARNING OBJECTIVES

Stock Market plays a significant role in development of Economy. Stock Market facilitates mobilization of funds from small investors and channelizes these resources into various development needs of various sectors of the economy. In order to prevent undesirable transactions in securities by regulating the business of dealing therein, and by providing for certain other matters connected therewith, the Securities Contracts (Regulation) Act, 1956 was enacted by Parliament. The Government promulgated the Securities Contracts (Regulations) Rules, 1957 for carrying into effect the objects of the Securities Contracts (Regulation) Act.

After going through this lesson, the student will be able to know about the Powers of Central Government, Stock Exchange and SEBI under the SCRA Act, the penal provisions, procedures, offences, procedure for appeal to SAT, Right of Investors, and Securities Contracts (Regulations) Rules, 1957 etc.

## INTRODUCTION

The stock exchanges suffer from certain limitations and require strict control over their activities in order to ensure safety in dealings thereon. Hence, in 1956, the Securities Contracts (Regulation) Act was passed which provided for recognition of stock exchanges by the Central Government.

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

As a condition of recognition, a stock exchange complies with the requirements prescribed by the Central Government. The stock exchanges frame, their own listing regulations in consonance with the minimum listing criteria set out in Securities Contracts (Regulations) Rules, 1957.

The Government promulgated the Securities Contracts (Regulation) Rules, 1957 for carrying into effect the objects of the Securities Contracts (Regulation) Act. These rules provide among other things, for the procedure to be followed for recognition of Stock Exchanges; Submission of periodical returns and annual reports by recognised stock exchanges; inquiry into the affairs of stock exchanges and their members ; and requirements for listing of securities. The rules are statutory and they constitute a code of standardised regulations uniformly applicable to all the recognised stock exchanges.

Under SCR Rules, Government and Securities and Exchange Board of India (SEBI) issue notifications, guidelines, and circulars which need to be complied with by market participants. Most of the powers under the SCRA are exercisable by Department of Economic Affairs (DEA) while a few others by SEBI. The powers of the DEA under the SCRA are also concurrently 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 Reserve Bank of India (RBI).

## I. SECURITIES CONTRACTS (REGULATION) ACT, 1956

The Securities Contracts (Regulation) Act, 1956, extends to the whole of India and came into force on 20th 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.

## NON-APPLICABILITY

Section 28 provides that 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.

## DEFINITIONS

Section 2 of this Act contains definitions of various terms used in the Act. Some of the important definitions are given below:

### Securities include

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;

Explanation : “Securities” shall not include any unit linked insurance policy or scripts or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such person and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938;

- (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

“Contract” means a contract for or relating to the purchase or sale of securities.

### Corporatisation

“Corporatisation” means the succession of a recognised stock exchange, being a body of individuals or a society registered under the Societies Registration Act, 1860 (21 of 1860), by another stock exchange, being a company incorporated for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities carried on by such individuals or society.

### Demutualisation

“Demutualisation” means the segregation of ownership and management from the trading rights of the members of a recognised stock exchange in accordance with a scheme approved by the Securities and Exchange Board of India.

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### Spot delivery contract

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

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, 2013 whether under a scheme of corporatisation and demutualisation or otherwise,

for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

### Recognised Stock Exchange

Recognised Stock Exchange means a stock exchange which is for the time being recognised by the Central Government.

### Government security

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 clause (2) of section 2 of the Public Debt Act, 1944.

### Derivative

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.
- (c) Commodity derivatives; and
- (d) such other instruments as may be declared by the Central Government to be derivatives.

## RECOGNITION OF STOCK EXCHANGES

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

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.

Section 4A of the Act provides that on and from the appointed date, all recognized stock exchanges (if not corporatized and demutualised before the appointed date) shall be corporatized and demutualised in accordance with the provisions contained in Section 4B.

Further SEBI may, if it is satisfied that any recognized stock exchange was prevented by sufficient cause from being corporatized and demutualised on or after the appointed date, specify another appointed date in respect of that recognized stock exchange and such recognized stock exchange may continue as such before such appointed date.

## WITHDRAWAL OF RECOGNITION

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 recognized stock exchange has not been corporatized or demutualised or it fails to submit the scheme

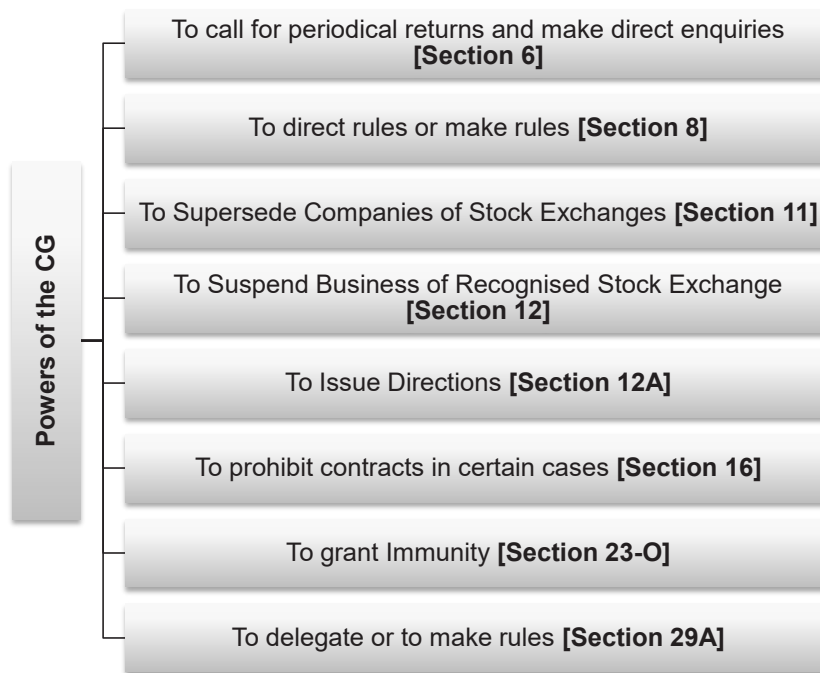
## 6 EP-SLCM

within the specified time therefore or the scheme has been rejected by the SEBI, the recognition granted to such stock exchange, shall, 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.

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.

### POWERS OF CENTRAL GOVERNMENT



#### To call for periodical returns and make direct enquiries

Every recognised stock exchange shall furnish to SEBI, such periodical returns relating to its affairs as may be prescribed.

Every such stock exchange and every member thereof shall maintain and preserve for 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.

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.

#### To Direct Rules or make Rules

Section 8 deals with the power of 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, 2013 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.

#### **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, 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.

The governing body of which is superseded, the person or persons appointed shall hold office for such period as may be specified in the notification published 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 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 vest or re-vest, as the case may be, in the governing body so re-constituted;

However, until a governing body is so re-constituted, the person or persons appointed, shall continue to exercise and perform their powers and duties.

### To Suspend Business of Recognised Stock Exchange

If in the opinion of the Central Government, an emergency has arisen, 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;

However, 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.

### To Issue Directions

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.

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 13 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.

However, 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.

**Explanation:** The power to issue directions under this section shall include and always be deemed to have been included the power to direct any person, who made profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations made thereunder, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contraventions.

### To Prohibit Contracts in Certain Cases

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.

### To Grant Immunity

Section 23-O deals with the 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 SEBI are not binding upon the Central Government.

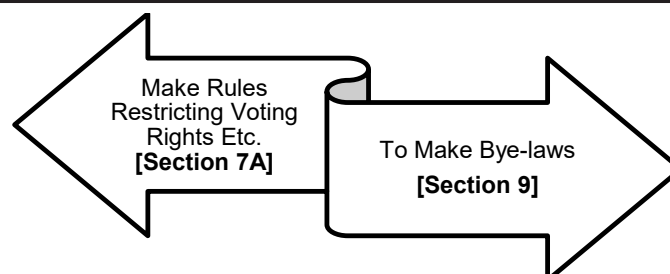
(2) An immunity granted to a person as mentioned above may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such 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.

### To Delegate or to Make Rules

Section 30 empowers the Central Government to make rules for the purpose of carrying into effect the objects of this Act by notification in the Official Gazette.

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.

## POWERS OF RECOGNISED STOCK EXCHANGE





#### To make Rules restricting Voting Rights etc.

Section 7A of the Act stipulates that 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).

Powers have been delegated concurrently to SEBI also.

#### To Make Bye-Laws

Any recognised stock exchange may, subject to the previous approval of SEBI, make bye-laws for the regulation and control of contracts.

### 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, 2013, for the purpose of –

- (a) the periodical settlement of contracts and differences thereunder;
- (b) the delivery of, and payment for, securities;
- (a) any other matter incidental to, or connected with, such transfer.

Every clearing corporation shall, for the purpose of transfer of the duties and functions of a clearing house to a clearing corporation, make bye-laws and submit the same to the SEBI for its approval.

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.

### PUNISHMENTS FOR CONTRAVENTIONS

The bye-laws made 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.
- (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 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.

## POWERS 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.

### To make Regulations

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 all or any of the following matter namely :

- (a) 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;
- (b) the eligibility criteria and other requirements under Section 17A;
- (c) The terms determined SEBI for settlement of proceeding under sub-section (2) of section 23JA and
- (d) any other matter which is required to be, or may be, specified by regulations or in respect of which provision is to be made by regulation.

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.

### To Adjudicate

Section 23-I deals with power to adjudicate by SEBI.

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, he may impose such penalty as he thinks fit in accordance with the provisions of this Act.

SEBI may call for and examine the record of any proceedings under this section and if it considers that the order passed by the adjudicating officer is erroneous to the extent it is not in the interests of the securities market, it may, after making or causing to be made such inquiry as it deems necessary, pass an order enhancing the quantum of penalty, if the circumstances of the case so justify. However, no such order shall be passed unless the person concerned has been given an opportunity of being heard in the matter.

Further, nothing contained in this sub-section shall be applicable after an expiry of a period of three months from the date of the order passed by the adjudicating officer or disposal of the appeal, whichever is earlier.

### LICENSING OF DEALERS IN CERTAIN AREAS

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 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 above 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.

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 fulfil 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 percent 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, *mutatis 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, or
- (c) between such parties and on such terms as the Central Government may, by notification in the official Gazette, specify, in accordance with the rules and bye-laws of such stock exchange.

## **CONDITIONS FOR LISTING**

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.

## **DELISTING OF SECURITIES**

Section 21A provides that a recognised stock exchange may delist the securities, after recording the reasons therefor, from any recognised stock exchange on any of the ground or grounds as may be prescribed under this Act.

The securities of a company shall not be delisted unless the company concerned has been given a reasonable opportunity of being heard.

A listed company or an aggrieved investor may file an appeal before the Securities Appellate Tribunal (SAT) against the decision of the recognised stock exchange delisting the securities within fifteen days from the date of the decision of the recognised 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 TO SAT AGAINST REFUSAL TO LIST SECURITIES OF PUBLIC COMPANIES 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 40 of the Companies Act, 2013, 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 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 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 off the appeal finally within six months from the date of receipt of the appeal.

The Act prescribes various penalties against persons who might be found guilty of offences under section 23 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 17A 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 byelaws 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.

## PENALTIES

### 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 shall not be less than 5 lakh rupees and which may extend to 25 crore rupees.

### Penalty for contravention where no separate penalty has been provided.

- Where contravenues of 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 shall not be less than 1 lakh rupees and which may extend to 1 crore rupees.

### Penalty for failure to furnish information, return, etc.

- Any person, who is required under this Act or any rules made thereunder, fails to furnish any information, document, books, returns or report to a recognised stock exchange or fail to maintain books of account or records, as per the listing agreement or conditions, or bye-laws of a recognised stock exchange, shall be liable to a penalty which shall not be less than 1 lakh rupees and which may extend to one crore rupees for each day during which such failure continues.

### Penalty for failure by any person to enter into an agreement with clients.

- Any person, who is required under this Act or any bye-laws of a recognised stock exchange made thereunder, fails to enter into an agreement with his client, then he shall be liable to a penalty which shall not be less than 1 lakh rupees which may extend to one crore rupees for each day during which such failure continues.

### Penalty for failure to redress investors' grievances.

- 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, shall be liable to a penalty which shall not be less than 1 lakh rupees and which may extend to one crore rupees for each day during which such failure continues.



**Penalty for failure to segregate securities or moneys of client or clients.**

- Any person, who is registered as a stock broker or sub-broker with SEBI, 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 which shall not be less than 1 lakh rupees and which may extend to one crore rupees.

**Penalty for failure to comply with provision of 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, he shall be liable to a penalty which shall not be less than 5 lakh rupees and which may extend to 25 crore rupees.

**Penalty for excess dematerialisation or delivery of unlisted securities**

- If any company 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 which shall not be less than 5 lakh rupees and which may extend to 25 crore rupees.

**FACTORS TO BE TAKEN INTO ACCOUNT BY THE ADJUDICATING OFFICER**

Section 23J provides for the 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 –

- the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
- the amount of loss caused to an investor or group of investors as a result of the default;
- the repetitive nature of the default.

**Settlement of Administrative and Civil Proceedings**

Section 23JA states that any person, against whom any proceedings have been initiated or may be initiated under section 12A or section 23-I, may file an application in writing to SEBI proposing for settlement of the proceedings initiated or to be initiated for the alleged defaults.

SEBI may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may be determined by SEBI in accordance with the regulations made under the SEBI Act, 1992.

For the purpose of settlement under this section, the procedure as specified by SEBI under the SEBI Act, 1992 shall apply.

No appeal shall lie under section 23L against any order passed by SEBI or adjudicating officer, as the case may be, under this section.

### Recovery of Amounts

Section 23JB deals with recovery of amounts. If a person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any direction of SEBI for refund of monies or fails to comply with a direction of disgorgement order issued under Section 12A or fails to pay any fees due to SEBI, the Recovery Officer may draw up under his signature a statement in the specified form specifying the amount due from the person (such statement being hereafter in this Chapter referred to as certificate) and shall proceed to recover from such person the amount specified in the certificate by one or more of the following modes, namely:-

- (a) attachment and sale of the person's movable property;
- (b) attachment of the person's bank accounts;
- (c) attachment and sale of the person's immovable property;
- (d) arrest of the person and his detention in prison;
- (e) appointing a receiver for the management of the person's movable and immovable properties,

### 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.

### OFFENCES

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.

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.

### 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.

However, any such person shall not be 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.



(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**

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.

#### **Establishment of Special Courts**

Section 26A lays down the provisions for establishment of special courts by Central Govt. for the purpose of speedy trial.

- (a) The Central Government may, for the purpose of providing speedy trial of offences under this Act, by notification, establish or designate as many Special Courts as may be necessary.
- (b) A Special Court shall consist of a single judge who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working.
- (c) A person shall not be qualified for appointment as a judge of a Special Court unless he is, immediately before such appointment, holding the office of a Sessions Judge or an Additional Sessions Judge, as the case may be.

#### **Offences triable by Special Courts**

All offences committed under this Act, shall be taken cognizance of and triable by the Special Court established for the area in which the offence is committed or where there are more Special Courts than one for such area, by such one of them as may be specified in this behalf by the High Court concerned.

#### **Application of Code to proceeding before special court**

The Code of Criminal Procedure, 1973 shall apply to the proceeding before a special court and for the purposes of the said provisions, the special court shall be deemed to be Court of Session and the person conducting prosecution before a special court shall be deemed to be a public prosecutor within the meaning of the Code of Criminal Procedure, 1973. The persons conducting prosecution should have been in practice as an Advocate for not less than seven years or shall have held a post, for a period of not less than seven years, under the Union or a State, requiring special knowledge of law.

#### **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 above paragraph 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 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 and 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 Investment 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.

#### **SPECIAL PROVISIONS RELATED TO COMMODITY DERIVATIVES**

Section 30A deals with following special provisions relating to commodity derivatives:-

- (1) This Act shall not apply to non-transferable specific delivery contracts. However, no person shall organise or assist in organising or be a member of any association in any area to which the provisions of section 13 have been made applicable (other than a stock exchange) which provides facilities for the performance of any non-transferable specific delivery contract by any party thereto without having to make or receive actual delivery to or from the other party to the contract or to or from any other party named in the contract.
- (2) Where in respect of any area, the provisions of section 13 have been made applicable in relation to commodity derivatives for the sale or purchase of any goods or class of goods, the Central Government may, by notification, declare that in the said area or any part thereof as may be specified in the notification

all or any of the provisions of this Act shall not apply to transferable specific delivery contracts for the sale or purchase of the said goods or class of goods either generally, or to any class of such contracts in particular.

- (3) If the Central Government is of the opinion that in the interest of the trade or in the public interest it is expedient to regulate and control non-transferable specific delivery contracts in any area, it may, by notification in the Official Gazette, declare that all or any of the provisions of this Act shall apply to such class or classes of non-transferable specific delivery contracts in such area in respect of such goods or class of goods as may be specified in the notification, and may also specify the manner in which and the extent to which all or any of the said provisions shall so apply.

## II. SECURITIES CONTRACTS (REGULATIONS) 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.

### Requirements of Listing of Securities with recognised Stock Exchanges

This is one of the most important provisions 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, 2013, 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 SEBI;
  - 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;

However, 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.

#### Rule 19(2)

Sub-rule 2 of Rule 19 provides that 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;

However, 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.

## Rule 19(2)(b)

The minimum offer and allotment to public in terms of an offer document shall be-

- (i) at least twenty five per cent of each class or kind of equity shares or debenture convertible into equity shares issued by the company, if the post issue capital of the company calculated at offer price is less than or equal to one thousand six hundred crore rupees;
- (ii) at least such percentage of each class or kind of equity shares or debentures convertible into equity shares issued by the company equivalent to the value of four hundred crore rupees, if the post issue capital of the company calculated at offer price is more than one thousand six hundred crore rupees but less than or equal to four thousand crore rupees;
- (iii) at least ten percent of each class or kind of equity shares or debentures convertible into equity shares issued by the company, if the post issue capital of the company calculated at offer price is above four thousand crore rupees.

However, the company referred to in sub-clause (ii) or sub-clause (iii), shall increase its public shareholding to at least twenty five per cent within a period of three years from the date of listing of the securities, in the manner specified by the Securities and Exchange Board of India.

## Conditions precedent to submission of application for listing by Stock Exchange

Sub-rule (3) of Rule 19 deals with the conditions required to be fulfilled by a company precedent to listing 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, subdivision, 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.

#### Application for listing of new securities

An application for listing shall be necessary in respect of the following:

- (a) all new issues of any class or kind of securities of a company to be offered to the public;
- (b) all further issues of any class or kind of securities of a company if such class or kind of securities of the company are already listed on a recognised stock exchange. [Rule 19(4)]

#### 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;

However, no such action shall be taken by a stock exchange without affording 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;

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 prefer an appeal to the Securities Appellate Tribunal constituted under section 15K of the SEBI Act, 1992 and the procedure laid down under the Securities Contracts (Regulation) (Appeal to Securities Appellate Tribunal) Rules, 2000 shall apply to such appeal. The Securities Appellate Tribunal may, after giving the stock exchange an opportunity of being heard, vary or set aside the decision of the stock exchange and its orders 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 the Securities Appellate Tribunal restore or re-admit to dealings any securities suspended or withdrawn from the list.

All requirements with respect to listing prescribed by these rules shall, so far as they may be, also apply to a public sector company.

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. [Rule 19(5)]

### Continuous Listing Requirement

Rule 19A (1) stipulates that every listed company other than public sector company shall maintain public shareholding of at least 25%. However, any listed company which has public shareholding below 25%, shall increase its public shareholding to at least twenty five per cent, within a period of four years from the date of commencement of amendment to the said rules in 2014, in the manner specified by SEBI.

Explanation : For the purposes of this sub-rule, a company whose securities has been listed pursuant to an offer and allotment made to public in terms of sub-clause (ii) of clause (b) of sub-rule (2) of rule 19, shall maintain minimum 25% public shareholding from the date on which the public shareholding in the company reaches the level of 25% in terms of said sub-clause.

Sub-rule (2) provides that where the public shareholding in a listed company falls below 25 % at any time, such company shall bring the public shareholding to 25% within a maximum period of twelve months from the date of such fall in the manner specified by SEBI.

Where the public shareholding in a listed company falls below 25% in consequence to SCRR Amendment Rules, 2015, such company shall increase its shareholding to atleast 25%, in the manner specified by SEBI within a period of three years, as the case may be, from the date of notification of:

- (a) the Depository Receipts Scheme, 2014, in cases where the public shareholding falls below 25% as a result of such Scheme;
- (b) SEBI (Share Based Employee Benefits) Regulations, 2014, in cases where the public shareholding falls below 25%, as a result of such regulations.

### Delisting of securities

Rule 21 deals with delisting of Securities. A recognized stock exchange may, without prejudice to any other action that may be taken under the Act or under any other law for the time being in force, delist any securities listed thereon on any of the following grounds in accordance with the regulations made by SEBI, namely:—

- (a) the company has incurred losses during the preceding three consecutive years and it has negative network;
- (b) trading in the securities of the company has remained suspended for a period of more than six months;
- (c) the securities of the company have remained infrequently traded during the preceding three years;
- (d) the company or any of its promoters or any of its director has been convicted for failure to comply with

any of the provisions of the Act or SEBI Act, 1992 or the Depositories Act, 1996 or rules, regulations, agreements made thereunder, as the case may be and awarded a penalty of not less than rupees one crore or imprisonment of not less than three years;

- (e) the addresses of the company or any of its promoter or any of its directors, are not known or false addresses have been furnished or the company has changed its registered office in contravention of the provisions of the Companies Act, 2013, or;
- (f) shareholding of the company held by the public has come below the minimum level applicable to the company as per the listing agreement under the Act and the company has failed to raise public holding to the required level within the time specified by the recognized stock exchange.

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

(2) If the securities is delisted under clause (1),

- (a) the company, promoter and director of the company shall be jointly and severally liable to purchase the outstanding securities from those holders who wish to sell them at a fair price determined in accordance with regulations made by SEBI, under the Act; and
- (b) the said securities shall be delisted from all recognized stock exchanges.

(3) A recognized stock exchange may, on the request of the company, delist any securities listed thereon in accordance with the regulations made under the Act by SEBI, subject to the following conditions, namely :

- (a) the securities of the company have been listed for a minimum period of three years on the recognized stock exchange;
- (b) the delisting of such securities has been approved by the two-third of public shareholders; and
- (c) the company, promoter and/or the director of the company purchase the outstanding securities from those holders who wish to sell them at a price determined in accordance with regulations made by SEBI under the Act.

However, the condition at (c) may be dispensed with by SEBI if the securities remain listed at least on the National Stock Exchange of India Limited or the Bombay Stock Exchange Limited.

## LESSON ROUND UP

- 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.
- Section 2 of this Act contains definitions of various terms used in the Act.
- Section 17A of the Act provides for public issue and listing of securities.
- The Act prescribes various penalties against persons who might be found guilty of offences under the Act.
- 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 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.

- The Government promulgated the Securities Contracts (Regulations) Rules, 1957 for carrying into effect the object of the SCRA Act, 1956.
- Rule 19 dealt with the requirement with respect to the listing of securities on a recognised stock exchange.
- Rule 19A provides the detailed provision regarding continuous listing agreement.

## GLOSSARY

<b>Admission to Dealing</b>	The process of granting permission to the securities of a company to be listed in a Stock Exchange and to provide trading facilities for the securities in the market.
<b>Appointed date</b>	It means the date which SEBI may, by notification in the Official Gazette, appoint and different appointed dates may be appointed for different recognized stock exchanges.
<b>Commodity Derivative</b>	It means a contract - (i) for the delivery of such goods, as may be notified by the Central Government in the Official Gazette, and which is not a ready delivery contract; or (ii) for differences, which derives its value from prices or indices of prices of such underlying goods or activities, services, rights, interests and events, as may be notified by the Central Government, in consultation with SEBI, but does not include securities as referred to in sub-clauses (A) and (B) of clause (ac) of Section 2 under Securities Contracts (Regulation) Act, 1956.
<b>Dividend Payable</b>	A current liability showing the amount due to stock holders/shareholders for dividend declared but not paid.
<b>Listing Agreement</b>	An agreement which has to be entered into by companies when they seek listing for their shares on a stock exchange. Companies are called upon to keep the stock exchange fully informed of all corporate developments having a bearing on the market price of shares like dividend, rights, bonus shares, etc.
<b>Stock Exchange</b>	Anybody of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating controlling the business of buying, selling or dealing in securities.

## SELF TEST QUESTIONS

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

1. Briefly discuss the powers of stock exchange under the SCRA Act, 1956.
2. What is the remedy available to accompany if a stock exchange refuse to list its securities under SCRA Act, 1956?
3. Briefly explain the provision relating to continuous listing requirement under SCRR, 1957.
4. State the grounds on which a stock exchanges can delist the securities of a company under the SCRR, 1957.
5. What are the provisions relating to listing of securities with recognised stock exchanges?



# Lesson 2

## Securities and Exchange Board of India Act, 1992

### LESSON OUTLINE

- Introduction
- Objective of SEBI
- SEBI Act, 1992
- Composition of SEBI
- Functions and Powers of SEBI
- Registration of Intermediaries
- Prohibition of Manipulative and deceptive devices, insider trading etc.
- Penalties for failure and adjudication
- Securities Appellate Tribunal
- Powers of Central Government
- Delegation of Powers
- Appeal to the Central Government
- Bar of Jurisdiction
- Public Servants
- Offences & Punishments
- Cognizance of Offences by Courts
- Recovery of Amounts
- Consent Order
- Role of Company Secretary
- LESSON ROUND UP
- GLOSSARY
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

The first statutory regulatory body that the Government of India set up post the reforms of 1991 was the Securities and Exchange Board of India (SEBI). SEBI has been established with two objectives of protecting the interest of investors and to promote the development of and to regulate the Securities Market. Since its establishment in 1992 lot of initiatives have been taken to protect the interests of Indian investors. SEBI under the SEBI Act, 1992 has been empowered to frame subordinate legislation and to investigate wrong doing, impose relevant penalties and to conduct search and seizure operations.

As a Company Secretary is recognised to appear as authorised representative under the SEBI Act, 1992, a student pursuing CS course needs to update with the various provisions, penalties and compliances under the SEBI Act. This lesson will describe the students about the functions and powers of SEBI; the legal process at SEBI with a focus in the enforcement process and specifically on the quasi-judicial functions like Powers of SAT, Appeal to Supreme Court, etc.

## INTRODUCTION

The 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.

## OBJECTIVE OF SEBI

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

## SEBI ACT, 1992

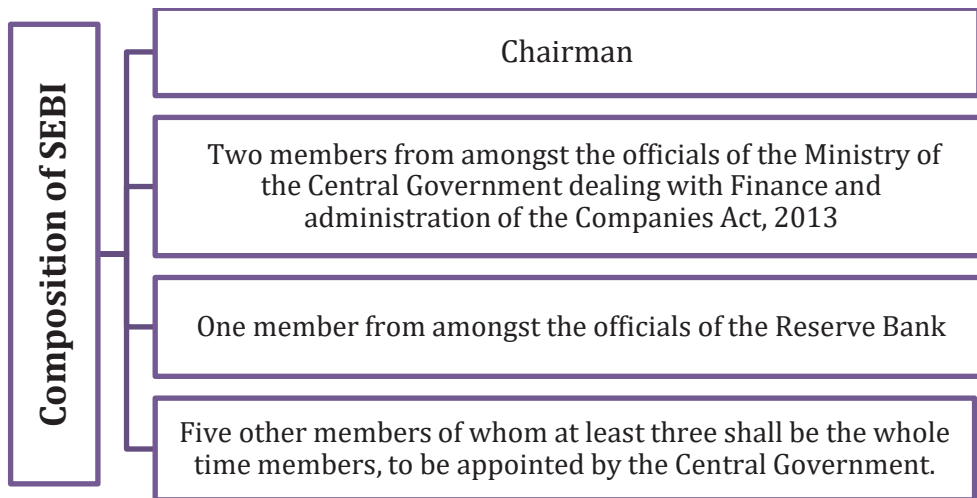
The SEBI Act, 1992 is divided into ten chapters which are discussed below:

<b>SEBI ACT, 1992</b>	<b>Chapter I</b>	Definitions of various terms
	<b>Chapter II</b>	Establishment of SEBI
	<b>Chapter III</b>	Transfer of assets, liabilities, etc., of existing SEBI
	<b>Chapter IV</b>	Powers and Functions of SEBI
	<b>Chapter V</b>	Registration Certificate
	<b>Chapter VA</b>	Prohibition of Manipulative and Deceptive Devices, Insider Trading and Substantial Acquisition of Securities or Control
	<b>Chapter VI</b>	Finance, Accounts And Audit
	<b>Chapter VIA</b>	Penalties and Adjudication
	<b>Chapter VI B</b>	Establishment, Jurisdiction, Authority and Procedure of Securities Appellate Tribunal
	<b>Chapter VII</b>	Miscellaneous

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 off 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.

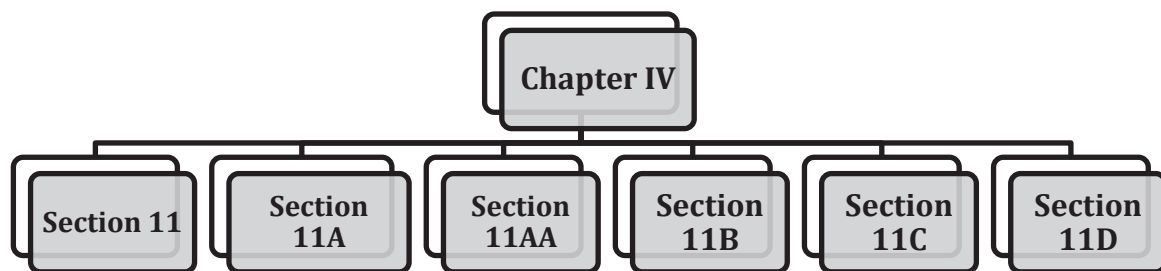
## COMPOSITION OF SEBI

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



## FUNCTIONS AND POWERS OF SEBI

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



## Functions of SEBI

- 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.

### Measures

- Regulating the business in stock exchanges and any other securities markets;
- Registering and regulating the working of intermediaries;
- Registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds;
- Promoting and regulating self-regulatory organisations;
- Prohibiting fraudulent and unfair trade practices;
- Promoting investors' education and training of intermediaries;
- Prohibiting insider trading in securities;
- Regulating substantial acquisition of shares and takeover of companies;
- Calling for information, undertaking inspection, conducting inquiries and audits of stock exchanges, mutual funds, other persons associated with the securities markets and intermediaries / self regulatory organisations in the securities market;
- Calling for information and records:
  - from any person including any bank or any authority or board or corporation established or constituted by or under any central or state Act;
  - which in the opinion of SEBI, shall be relevant to any investigation or inquiry by SEBI in respect of any transaction in securities;
  - 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;
  - to other authorities, whether in India, or outside India having functions similar to those of SEBI, in the matters relating to the prevention or detection of violation in respect of securities laws, subject to the provisions of other laws for the time being in force in this regard.

However, SEBI for the purpose of furnishing any information to any authority outside India, may enter into an arrangement or agreement or understanding with such authority with the approval of the Central Government.

- 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;
- Levying fees or other charges for carrying out the purposes of this section;
- Conducting research for the above purposes;
- Performing such other functions as may be prescribed.

Section 11(2A) prescribes that SEBI may take measures to undertake inspection of any book, or register, or other document or record of any listed public company or a public company (not being intermediaries referred to in section 12) which intends to get its securities listed on any recognised stock exchange where SEBI has



reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.

Section 11(3) of SEBI Act provides that 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 such place and such 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.
- (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, in the interest of investors or securities market take any of the following measures either pending investigation or inquiry or on completion of such investigation or enquiry namely:

- (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 of the first class having jurisdiction, 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.

However, only the bank account or accounts or any transaction entered therein, so far as it relates to the proceeds actually involved in violation of any of the provisions of this Act, or the rules or regulations made thereunder shall be allowed to be attached.

- (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.

SEBI may take any of the measures specified in clause (d) or clause (e) or clause (f) in respect of any listed public company or a public company not being an intermediary which intends to get its securities listed on any recognised stock exchange where SEBI has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market. Further, SEBI shall, either before or after passing such orders, gives an opportunity of hearing to such intermediaries or persons concerned.

Section 11(5) of the Act authorises SEBI to disgorge the amount, pursuant to direction issued under section 11B or section 12A of the Securities Contracts (Regulation) Act, 1956 or section 19 of the Depositories Act, 1996, as the case may be, shall be credited to the Investor Protection and Education Fund established by SEBI and such amount shall be utilized by SEBI in accordance with the regulations made under this Act.

### **To Regulate or Prohibit Issue of Prospectus, Offer Document or Advertisement Soliciting Money for Issue of Securities**

Section 11A(1) of SEBI Act, 1992 provides that without prejudice to the provisions of the Companies Act, 2013, SEBI may, for the protection of investors, –

- (a) specify, by regulations –
  - (i) the matters relating to issue of capital, transfer of securities and other matters incidental thereto; and
  - (ii) the manner in which such matters shall be disclosed by the companies;
- (b) by general or special orders –
  - (i) prohibit any company from issuing prospectus, any offer document, or advertisement soliciting money from the public for the issue of securities;
  - (ii) specify the conditions subject to which the prospectus, such offer document or advertisement, if not prohibited, may be issued.

Without prejudice to the provisions of section 21 of the Securities Contracts (Regulation) Act, 1956, SEBI may specify the requirements for listing and transfer of securities and other matters incidental thereto.

### **To Regulate Collective Investment Schemes**

11AA (1) of the SEBI Act, provides that any scheme or arrangement which satisfies the conditions referred to in sub-section (2) shall be a collective investment scheme. **(This section has been discussed in Lesson No. 13)**

### **Power to Issue Directions**

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, SEBI 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.

The power to issue directions under this section shall include and always be deemed to have been included the power to direct any person, who made profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations made thereunder, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention.

### **Investigations**

#### **(1) Grounds for Investigation**

- 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 SEBI 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.

**(2) Duty of officers to produce Accounts and Records**

- 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.

**(3) Powers of Investigating Authority**

- The Investigating Authority may 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.

**(4) To examine on oath**

- 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,

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.

**(5) To take notes on examination**

- Notes of any examination 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.

**(6) Seizure of Records**

- Where in the course of an investigation, the Investigating Authority has reasonable ground to believe that the books, registers, other documents and record of, or relating to any, 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 Magistrate or Judge of such during noted court in Mumbai, as may be notified by the Central Government for an order for the seizure of such books, registers, other documents and records.

- The authorised officer may requisition the services of any police officer or any office of the Central Government, or of both, to assist him for all or any of the purposes specified above and it shall be the duty of every such officer to comply with such requisition.
- After considering the application and hearing the Investigating Authority, if necessary, the Magistrate or Judge of the Designated Court, by order, authorize the investigating authority –
  - (a) to enter, with such assistance, as may be required, the place or places where such books, registers, other documents and record are kept.
  - (b) to search that place or those places in the manner specified in the order and.
  - (c) to seize books, registers and other documents and records, it consider necessary for the purpose of the investigation.

However, the Magistrate or Judge of the Designated Court shall not authorize seizure of books, registers, other documents and record of any listed public company or a public company (not being the intermediary specified under section 12) which intends to get its securities listed on any recognized 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.
- 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**

Section 11D deals with the cease and desist powers of SEBI. If SEBI 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.

### **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 the following intermediaries are required to obtain a registration certificate from SEBI to buy, sell or deal in securities :

- Stock-Broker
- Sub-Broker
- Share Transfer Agent
- Banker to an issue different market policy,
- Trustee of Trust Deed
- Registrar to an Issue
- Merchant Banker

- Underwriter
- Portfolio Manager
- Investment Adviser
- Depository Participant
- Custodian of Securities
- Foreign Institutional Investor
- Credit Rating Agency
- Such other intermediary

A person shall not 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.

It is clarified by SEBI that a collective investment scheme or mutual fund shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a component of investment besides the component of insurance issued by the insurer.

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

### **PROHIBITION OF MANIPULATIVE AND DECEPTIVE DEVICES, INSIDER TRADING ETC.**

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 a person shall not 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.

### **PENALTIES FOR FAILURES**

Chapter VIA of SEBI Act 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(ia) of the Act requires calling for information and record from any bank or any other authority or SEBI 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.

## PENALTIES AND ADJUDICATION

SI No.	Section	Particulars
1.	Section 15A	Failure to furnish information, return, etc.
2.	Section 15B	Failure by any person to enter into agreement with clients
3.	Section 15C	Failure to redress investors' grievances
4.	Section 15D	Default in case of Mutual Funds
5.	Section 15E	Failure to observe rules and regulations by an asset management company
6.	Section 15F	Default in case of stock brokers
7.	Section 15G	Insider Trading
8.	Section 15H	Non-Disclosure of Acquisition of Shares and Takeovers
9.	Section 15HA	Fraudulent and unfair trade practices
10.	Section 15HB	Contravention where no separate penalty has been provided
11.	Section 15I	Adjudications
12.	Section 15J-15JA	Factors to be taken into account by the adjudicating officer
13.	Section 15JB	Settlement of administrative and civil proceedings

### Penalty for failure to furnish information, return, etc.

- 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 SEBI, fails to furnish the same;
    - (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;
    - (c) to maintain books of accounts or records, fails to maintain the same.
- shall be liable to pay a penalty of one lakh rupees for each day during which such failure continues, subject to a maximum of One crore rupees.

### Penalty for failure by any person to enter into an agreement with clients

- Section 15B lays down that if any person who is registered as an Intermediary and is required 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.

### Penalty for failure to redress investors' grievances

- 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 in case of mutual funds

- Section 15D lays down that in case of mutual funds, if any person who is:
  - (a) required 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,
  - (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,
  - (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,
  - (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,
  - (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
  - (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
 shall be liable to a penalty which shall not be less than 1 lakh rupees and which may extend to 1 crore rupees.

### Penalty for failure to observe rules and regulations by an asset management company

- 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 which shall not be less than one lakh rupees but which may extend one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.



### Penalties for default in case of stock brokers

- Section 15F provides 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 a penalty which shall not be less than one lakh rupees but which may extend to 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 which shall not be less than one lakh rupees but which may extend to 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 anybody corporate on the basis of unpublished price sensitive information,
 he shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to 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; or
  - (iii) make a public offer by sending letter of offer to the shareholders of the concerned company; or
  - (iv) make payment of consideration to the shareholders who sold their shares pursuant to Letter of offer.
 he shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty five crore rupees or three times the amount of profits made out of such failure, whichever is higher.



**Penalty for fraudulent and unfair trade practices**

- Section 15HA provides that if any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty five crore rupees or three times the amount of profits made out of such practices, whichever is higher.

**Penalty for contravention where no separate penalty has been provided**

- Section 15HB 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 shall not be less than one lakh rupees but which may extend to one crore rupees.

**Adjudications**

Section 15-I deal with SEBI's power to adjudicate.

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.

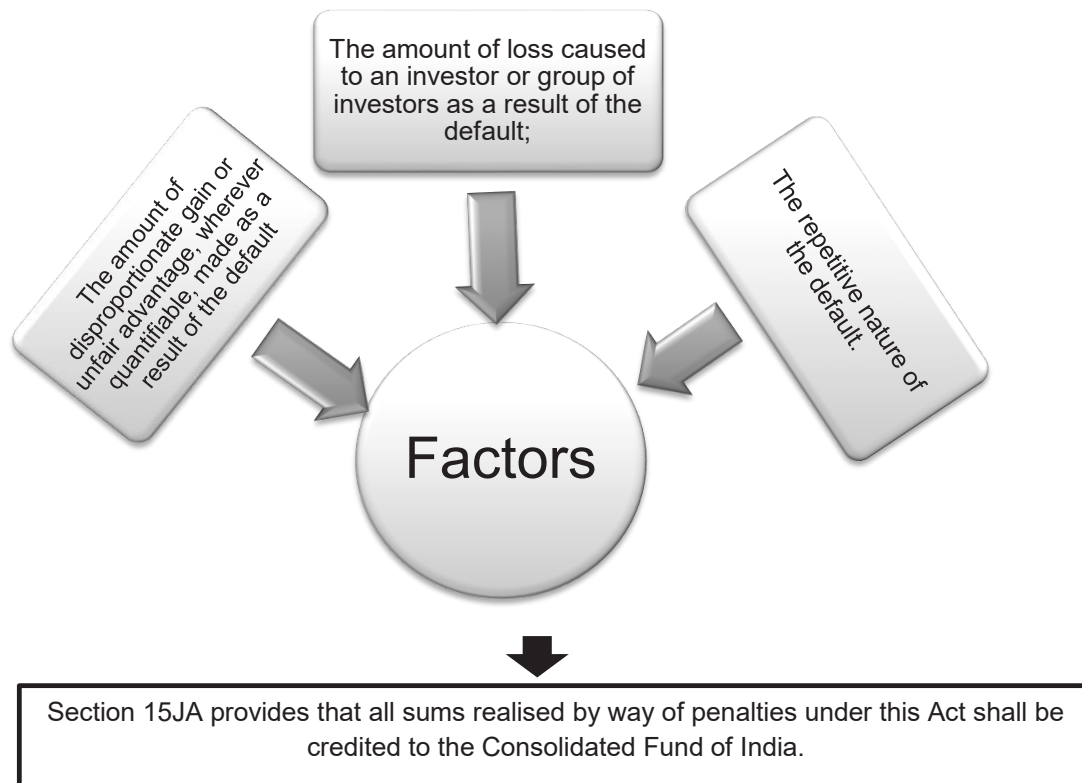
The adjudicating officer has powers to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the adjudicating officer, may be useful for or relevant to the subject matter of the inquiry 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.

SEBI may call for and examine the record of any proceedings under this section and if it considers that the order passed by the adjudicating officer is erroneous to the extent it is not in the interests of the securities market, it may, after making or causing to be made such inquiry as it deems necessary, pass an order enhancing the quantum of penalty, if the circumstances of the case so justify.

However, no such order shall be passed unless the person concerned has been given an opportunity of being heard in the matter. Further, nothing contained in this shall not be applicable after an expiry of a period of three months from the date of the order passed by the adjudicating officer or disposal of the appeal under section 15-T, whichever is earlier.

**Factors to be Taken into Account by the Adjudicating Officer**

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



### Settlement of Administrative and Civil Proceedings

Section 15JB deals with settlement of administrative and civil proceeding by SEBI. Any person against where any proceedings have been initiated or may be initiated under section 11, Section 11B, section 11D, section 12(3) or section 15-I, may file an application in writing to SEBI proposing for settlement of proceeding initiated or to be initiated for the alleged defaults. SEBI, may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such seem by the defaulter or on such other terms as may be determined by SEBI in accordance with the regulations made under this Act.

The settlement proceedings shall be conducted in accordance with the procedure specified in the regulations made under this Act. No appeal shall lie under section 15T against any order passed by SEBI or adjudicating officer as the case may be.

### 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.

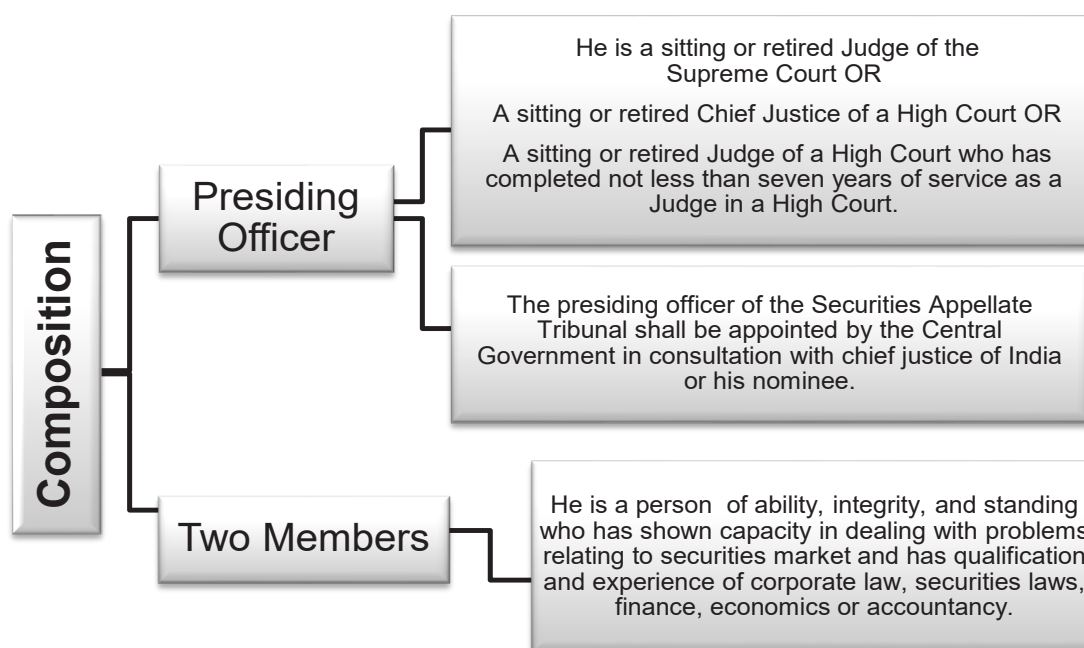
Sl. No.	Section	Particulars
1.	Section 15K	Establishment of Securities Appellate Tribunals
2.	Section 15L	Composition of Securities Appellate Tribunal
3.	Section 15M, 15MA, 15MB, 15MC	Qualification for appointment as Presiding Officer or Member of Securities Appellate Tribunal

4.	Section 15N	Tenure of office of Presiding Officer and other Members of Securities Appellate Tribunal
5.	Section 15O	Salary and allowances and other terms and conditions of service of Presiding Officers
6.	Section 15P, 15 PA	Filling up of vacancies
7.	Section 15Q	Resignation and removal
8.	Section 15R	Orders constituting Appellate Tribunal to be final and not to invalidate its proceedings
9.	Section 15S	Staff of the Securities Appellate Tribunal
10.	Section 15T	Appeal to the Securities Appellate Tribunal
11.	Section 15U	Procedure and powers of the Securities Appellate Tribunal
12.	Section 15V	Right to legal representation
13.	Section 15W	Limitation
14.	Section 15X	Presiding Officer, Members and staff of Securities Appellate Tribunals to be public servants
15.	Section 15Y	Civil Court not to have jurisdiction
16.	Section 15Z	Appeal to Supreme Court

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.

### Composition

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.



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.

### Tenure of Officer of Presiding Officer and Other Members

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.

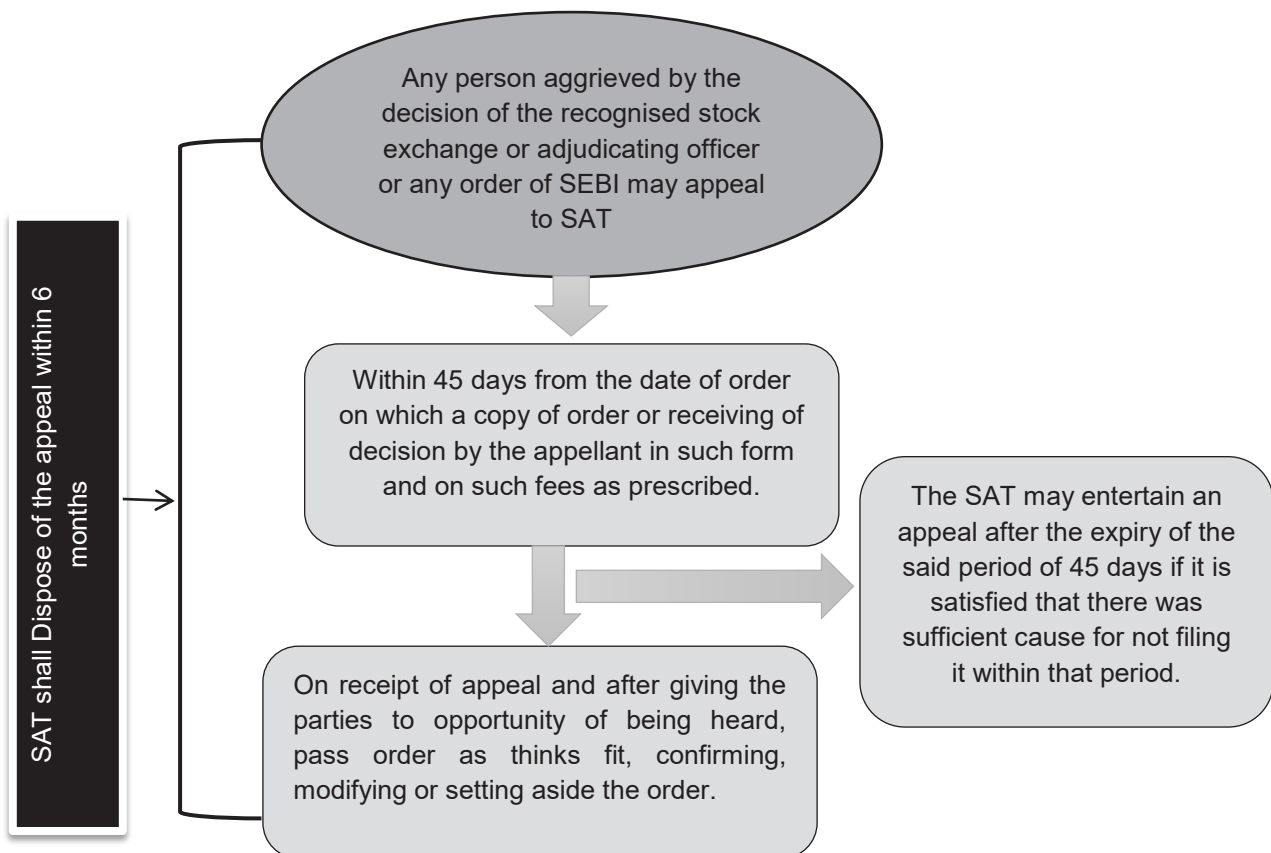
It has also been provided that the person attaining the age of sixty eight years cannot hold office as the presiding officer of Securities Appellate Tribunal. Also a person who has attained the age of sixty two years cannot hold office as member of Securities Appellate Tribunal.

### Orders Constituting Appellate Tribunal to be Final and not to invalidate its Proceedings

Section 15R makes it clear that no order of the Central Government appointing any person as the Presiding Officer or a member 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.

### Requirements for Appeal to the Tribunal

Section 15T and 15U deal with the appeal procedure and power of Securities Appellate Tribunals.



- 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.

- 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**

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 SAT**

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.

### **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 filling 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 SEBI

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

- 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
- 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
- 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:

- all the members shall, as from the date of supersession, vacate their offices as such;
- 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, be exercised and discharged by such person or persons as the Central Government may direct; and
- all property owned or controlled by SEBI shall, until SEBI is reconstituted, vest in the Central Government.

On the expiration of the period of supersession specified in the notification, the Central Government may reconstitute SEBI 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.

However, the Central Government may, at any time, before the expiration of the period of supersession, take

action. The Central Government shall cause a notification issued and a full report of any action taken under this section and the circumstances to such action to be laid before each House of Parliament at the earliest.

### **(c) 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.

Further, 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.

## **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 SEBI 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.

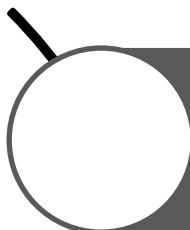
## **BAR OF JURISDICTION**

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 SEBI (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.

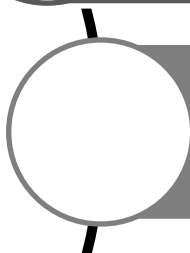
## PUBLIC SERVANTS

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.

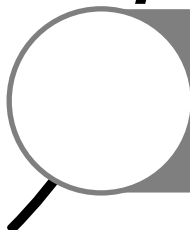
## OFFENCES AND PUNISHMENTS (Section 24)



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.



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.



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.

## COGNIZANCE OF OFFENCES BY COURTS

SI No.	Section	Particulars
1.	Section 26	Cognizance of Offences by Courts
2.	Section 26A	Establishment of Special Courts
3.	Section 26B	Offences triable by Special Courts
4.	Section 26C	Appeal and revision
5.	Section 26D	Application of Code to proceedings before Special Court



Section 26 (1) lays down that 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.



Section 26A (1) empowered the Central Government for providing speedy trial of offences under this Act, by notification, establish or designate as many Special Courts as may be necessary.



(2) A Special Court shall consist of a single judge who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working.



(3) A person shall not be qualified for appointment as a judge of a Special Court unless he is, immediately before such appointment, holding the office of a Sessions Judge or an Additional Sessions Judge, as the case may be.

#### Offences triable by Special Courts

- Section 26B stipulates that notwithstanding anything contained in the Code of Criminal Procedure, 1973, all offences under this Act, shall be taken cognizance of and triable by the Special Court established for the area in which the offence is committed or where there are more Special Courts than one for such area, by such one of them as may be specified in this behalf by the High Court concerned.

#### Appeal and revision

- Section 23 C provides for appeal and revision. The High Court may exercise, so far as may be applicable, all the powers conferred by Chapters XXIX and XXX of the Code of Criminal Procedure, 1973 on a High Court, as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court.

#### Application of Code to proceedings before Special Court

- Section 26D (1) provides that the provisions of the Code of Criminal Procedure, 1973 shall apply to the proceedings before a Special Court and for the purposes of the said provisions, the Special Court shall be deemed to be a Court of Session and the person conducting prosecution before a Special Court shall be deemed to be a Public Prosecutor within the meaning of clause (u) of section 2 of the Code of Criminal Procedure, 1973.

### Transitional provisions

Section 26E provides that any offence committed under this Act, which is triable by a Special Court shall, until a Special Court is established, be taken cognizance of and tried by a Court of Session exercising jurisdiction over the area, notwithstanding anything contained in the Code of Criminal Procedure, 1973.

However, this section shall not affect the powers of the High Court, under section 407 of the Code of Criminal Procedure, 1973 to transfer any case or class of cases taken cognizance by a Court of Session under this section.

### Offences by Companies

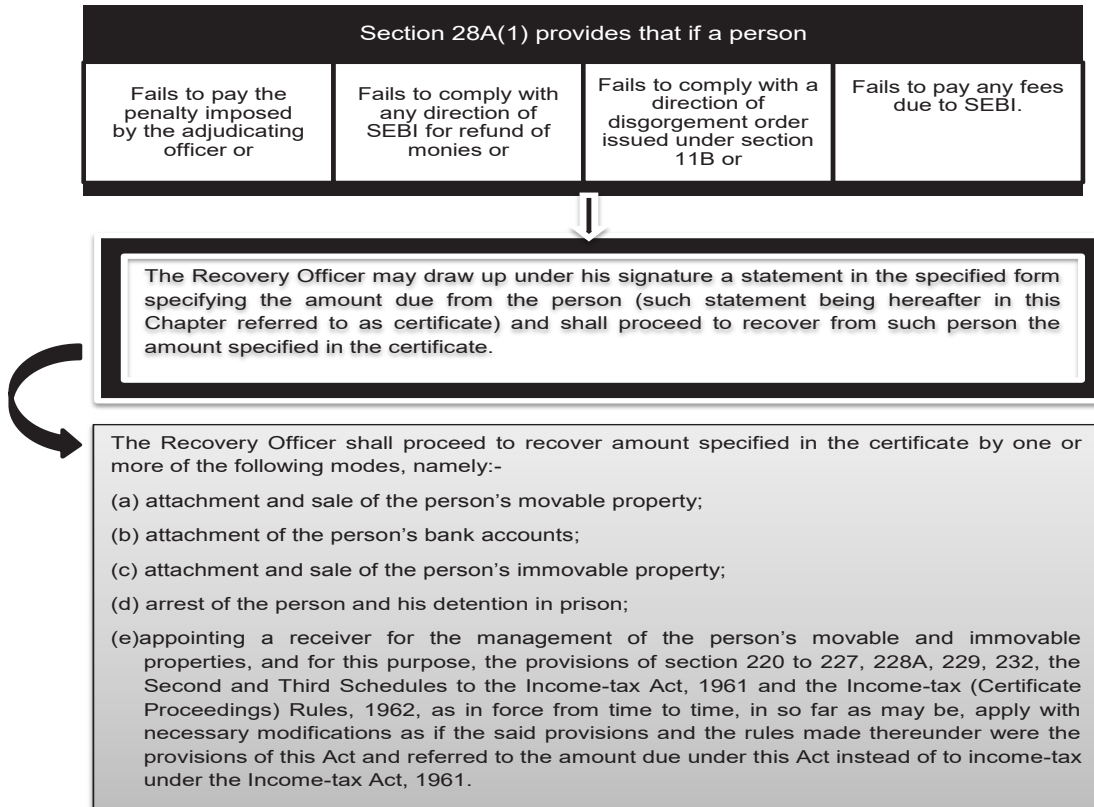
Section 27 on offences by company lays down that:

- (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;

However, this provision shall not 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) 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.

### RECOVERY OF AMOUNTS



**“Recovery Officer”** means any officer of SEBI who may be authorized, by general or special order in writing, to exercise the powers of a Recovery Officer.

Sub-section (2) empowered the Recovery Officer to seek the assistance of the local district administration while exercising the powers.

The recovery of amounts by a Recovery Officer, pursuant to noncompliance with any direction issued by SEBI under section 11B, shall have precedence over any other claim against such person.

**Explanation 1** - For the purpose of this sub-section, the person’s movable or immovable property or monies held in bank accounts shall include any property or monies held in bank accounts which has been transferred directly or indirectly on or after the date when the amount specified in certificate had become due, by the person to his spouse or minor child or son’s wife or son’s minor child, otherwise than for adequate consideration, and which is held by, or stands in the name of, any of the persons aforesaid; and so far as the movable or immovable property or monies held in bank accounts so transferred to his minor child or his son’s minor child is concerned, it shall, even after the date of attainment of majority by such minor child or son’s minor child, as the case may be, continue to be included in the person’s movable or immovable property or monies held in bank accounts for recovering any amount due from the person.

**Explanation 2** - Any reference under the provisions of the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962 to the assessee shall be construed as a reference to the person specified in the certificate.

**Explanation 3** - Any reference to appeal in Chapter XVIIID and the Second Schedule to the Income-tax Act, 1961, shall be construed as a reference to appeal before the Securities Appellate Tribunal under Section 15T of this Act.

## 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.

Under the SEBI Act, 1992, Securities Contracts (Regulation) Act, 1956 (SCRA) and the Depositories Act, 1996, SEBI pursues two streams of enforcement actions i.e. Administrative/Civil or Criminal. Administrative/civil actions include issuing directions such as remedial orders, cease and desist orders, suspension or cancellation of certificate of registration and imposition of monetary penalty under the respective statutes and action pursued or defended in a court of law/tribunal. Criminal action involves initiating prosecution proceedings against violators by filing complaint before a criminal court. Consent order is a remedial measure for settling civil proceedings initiated by SEBI.

SEBI vide circular ref no. EFD/ED/Cir-1/2007 dated April 20, 2007 laid down the framework for passing of consent orders and for considering requests for composition of offences under SEBI Act, SC(R) Act and Depositories Act. Again in the year 2012 SEBI with the purpose of providing more clarity on its scope and applicability, partially modified the same.

The President of India promulgated the Securities Laws (Amendment) Second Ordinance, 2013 on September 16, 2013 conferring explicit powers on SEBI to settle administrative and civil proceedings under section 15JB of the Securities and Exchange Board of India Act, 1992 (SEBI Act), section 23JA of the, Securities Contracts (Regulation) Act, 1956 and section 19-IA of the Depositories Act, 1996.

The said Ordinance provided that SEBI may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may determined by SEBI in accordance with the regulations made under SEBI Act. The said Ordinance further provided that the settlement proceedings shall be conducted in accordance with the procedure specified

in the regulations made under SEBI Act.

In the light of the above, SEBI framed SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014 and notified it vide Circular No. LAD-NRO/GN/2013-14/37/50 dated 09 January, 2014. The set of regulations have been notified with retrospective effect from 20 April 2007, the day when the existing consent settlement system was introduced by SEBI. These regulations will enable the persons who have defaulted on any SEBI laws & civil proceedings have been initiated against them, to settle the proceedings. These regulations do not provide for settling proceedings which are under criminal in nature.

These regulations provides for the involved entity to file settlement plea within 60 days of the show cause notice served to them by SEBI. The charges and related costs would not be considered upon the payment of settlement also in the cases in which the applicant has already been a party to two earlier settlements. The regulation mentions the minimum amount to be paid by entities, which will vary as per the charges against them.

### ROLE OF COMPANY SECRETARY

- Right to Legal Representation (Section 15V of the SEBI Act): Any person aggrieved (the appellant) may either appear in person or authorise one or more chartered accountants or company secretaries (PCS) or cost accountants or legal practitioners or any of its officers to present his or its case before the Securities Appellate Tribunal (SAT).
- The Securities and Exchange Board of India (SEBI) also recognises the Company Secretary as the Compliance Officer and authorises practising company secretaries to issue various certificates under its Regulations. Further, practising Company Secretaries are also authorised to certify compliance of conditions of corporate governance in case of listed companies.

### LESSON ROUND UP

- The SEBI Act, 1992, was inserted to protect the interests of the investors and to promote the development of, and to regulate the securities markets by such measures as it thinks fit.
- SEBI regulates the securities market and SAT acts as a watchdog to ensure justice.
- The SEBI Act, 1992 empowers an aggrieved person for 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.
- Section 15 Y of the SEBI Act provides that no civil court shall have jurisdiction to entertain a suit or proceeding in respect of any matter in which an adjudicating officer ('AO') is appointed under the Act or SAT is empowered by or under the 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 the Act.
- SEBI is empowered to issue directions under section 11B of the Act.
- SEBI is further empowered to conduct inspections of registered intermediaries.
- Besides inspection, SEBI is empowered to conduct investigations in case of breach of any regulation or in case of action detrimental to the interest of investors.

### GLOSSARY

#### Compounding of offences

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 charges.

<b>Injunction</b>	A court order by which an individual is required to perform, or is restrained from performing, a particular act.
<b>Ordinance</b>	An ordinance is an executive order issued by the President of India that holds the same force and effect on an Act passed by the Parliament.
<b>SAT</b>	Securities Appellate Tribunal is a quasi-judicial body established by Central Government by notification to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under SEBI Act or any other law for the time being in force.
<b>Tribunal</b>	Article 227 of the Constitution of India defines ‘tribunal’ as a person or a body other than a Court set up by the State for deciding rights of contending parties in accordance with rules framed for regulation having force of law.

## SELF TEST QUESTIONS

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

1. Discuss the various functions and powers of the SEBI.
2. Explain the role of SEBI in strengthening regulatory framework and fostering investor confidence.
3. Enumerate the various penalties which can be imposed under SEBI Act, 1992 for various failures, defaults, non-disclosure and other offences.
4. Explain the procedure for Appeal to the Securities Appellate Tribunal.
5. Discuss the various powers of the Central Government under SEBI Act, 1992.

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# Lesson 3

## Depositories Act, 1996

### LESSON OUTLINE

- Introduction
- Benefits of Depository System
- Depository System - An Overview
- Models of Depository
- Legal Linkage
- Depository Participant
- Registrar/Issuer
- Dematerialisation
- Rematerialisation
- Electronic Credit in New Issues
- Trading System
- Corporate Actions
- Legal Framework
- Depositories Act, 1996
- Power of SEBI
- Penalties and Adjudication
- Offences and Cognizance
- Membership Rights in respect of securities held by a Depository
- Evidentiary Value of the records of the Depository
- SEBI (Depositories and Participants) Regulations, 1996
- Audit under SEBI (Depositories And Participants) Regulations, 1996
- Internal Audit of operations of Depository Participants
- Concurrent Audit
- Role of Company Secretary
- LESSON ROUND UP
- GLOSSARY
- SELF-TEST QUESTIONS

### LEARNING OBJECTIVES

The inception of depository system in the Indian Capital market has been during the 90's. The depositories are an important intermediaries in the securities market that is scrip-less or moving towards such a state. The erstwhile settlement system on Indian stock exchanges involved movement of paper securities to the issuer for registration, with the change of ownership being evidenced by an endorsement on the security certificate. Theft, forgery, mutilation of certificates and other irregularities provided the issuer right to refuse the transfer of a security. Added costs and delays in settlement, restricted liquidity and made investor grievance redressal time consuming. To obviate these problems, the Depositories Act, 1996 was passed and subsequently the regulations were notified. Depositories are also treated as Infrastructure Institutions. Further, a company secretary in practice is authorised by SEBI to conduct internal/concurrent audit of depository participatory and also to conduct the reconciliation of share capital audit.

This lesson is designed to enable the student to understand the basic concept of depository, depository participants, its functions, rights and obligations of depositories, benefits of depositories, dematerialisation process, and the regulatory framework for depository in India, etc.

## INTRODUCTION

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

According to Section 2(e) of the Depositories Act, 1996 “Depository means a company formed and registered under the Companies Act, 2013 and which has been granted a certificate of registration under Section 12(1A) of the SEBI Act, 1992”.

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 (CDSL). 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, dematerialization, 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 pre-condition to the functioning of the depository. Depository and depository participant both are regulated by SEBI.

### Depository Functions

- Account opening
- Dematerialisation
- Rematerialisation
- Settlement
- Initial Public Offers (IPO's), corporate benefits
- Creation of encumbrance

### 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, while 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 the 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, while 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, mutilation of certificates, loss of certificates during movements through and from the registrars, thus exposing the investors to the cost of obtaining duplicate certificates, loss of 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 investor's 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. If securities are purchased in the physical environment, the investor has to send it to the company's Share Transfer Agent 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 their 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 investor's account, thereby ensuring faster disbursement and avoiding risk of loss of certificates in transit.

**Reduction in brokerage by many brokers for trading in dematerialized securities** – Brokers provide this benefit to investors as dealing in dematerialized securities reduces their back office cost of handling paper and also eliminates the risk of being the introducing broker.

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.

## 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 dematerialized 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 vs. payment.

In the Depository mode, corporate actions such as IPOs, rights, conversions, bonus, mergers/amalgamations,

subdivisions & consolidations are carried out without the movement of paper, 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 corporations of stock exchanges. This network facilitates holding of securities in the soft form and effects transfers by means of account transfers.

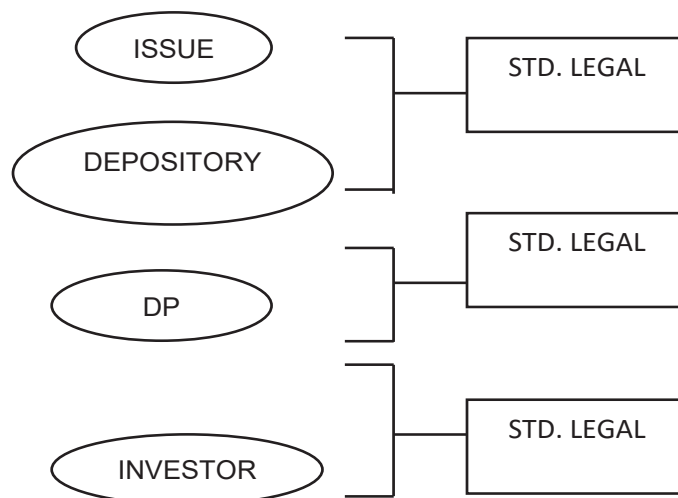
The following paragraphs discuss all about depositories, its concepts, models of depositories, depository functions, Legal linkage, depository participants, Registrars and issuers, dematerialisation, rematerialisation, electronic credit in new issues, trading system and corporate action.

### MODELS OF DEPOSITORY

**Immobilisation** – Where physical share certificates are kept in vaults with the depository for safe custody and 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.

### 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 intimates 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.

**Characteristics  
of a DP**

- Transmission requests/nomination
- Acts as an Agent of Depository
- Customer interface of Depository
- Functions like Securities Bank
- Account opening
- Facilitates dematerialisation/rematerialisation
- Instant transfer on pay-out
- Enables off market transfers
- Settles trades in electronic segment
- Pledge/enforcement of pledge etc.

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.

**REGISTRAR/ISSUER**

“Issuer” means any entity such as a corporate / state or central government organizations issuing securities which can be held by depository in electronic form.

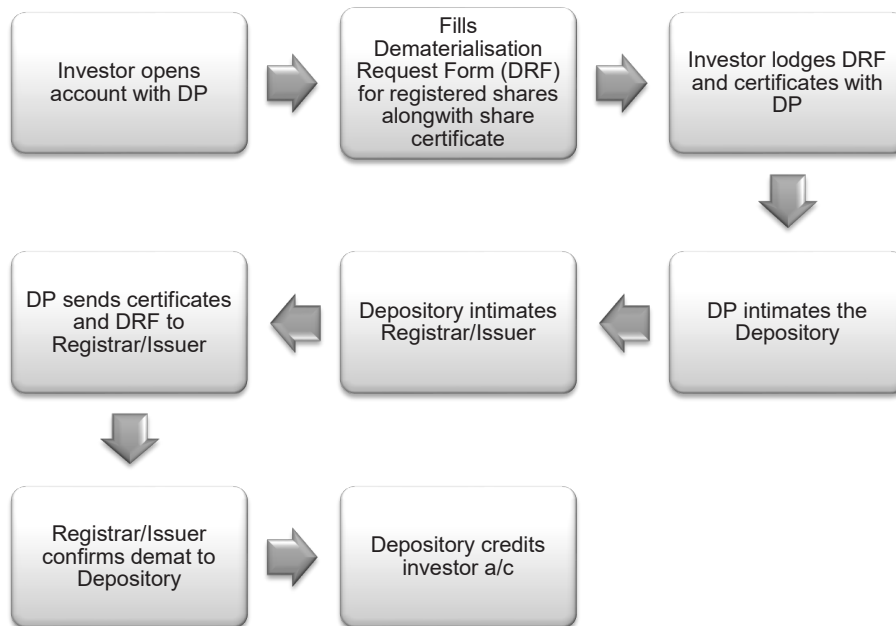
Only those securities, which are admitted into the depository system are available for dematerialisation to the holders of such securities or can be allotted in electronic record form by the issuer. Securities include shares, debentures, bonds, commercial paper (C.P.), certificate of deposits (C.D.), pass through certificates (PTCs), government securities and mutual fund units. Both listed and unlisted securities can be admitted into the depository system.

<b>Functions of Issuer</b>	Dematerialisation
	Confirmation of Beneficiary Holdings
	Corporate Actions – Rights, Bonus, etc.
	Reconciliation of Depository Holdings
	Rematerialisation

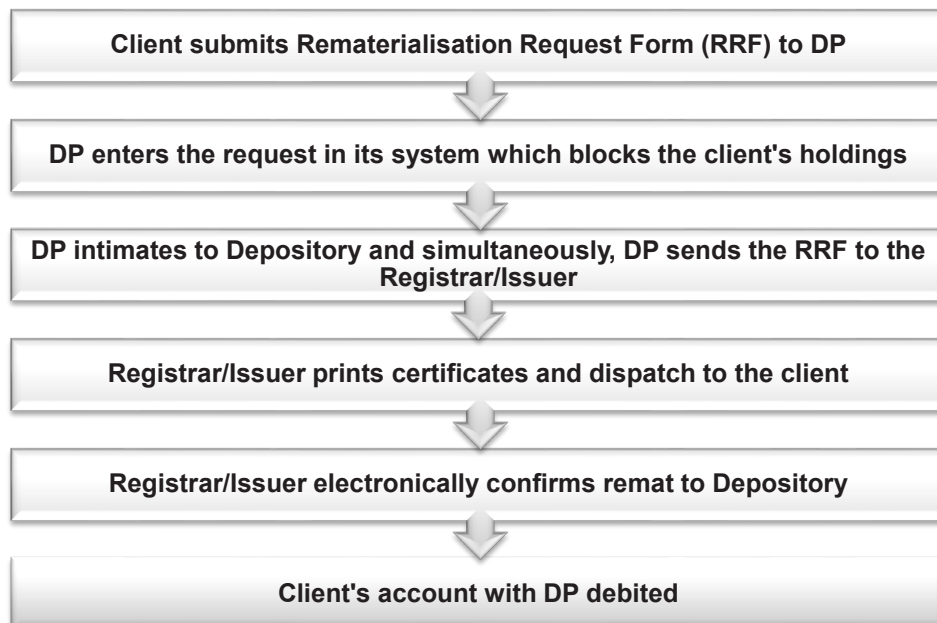
**DEMATERIALISATION**

Dematerialization 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 dematerialization of his share certificates through the Depository Participant so that the dematerialized holdings can be credited into that account. This is very similar to opening a Bank Account.

Dematerialization 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, as physical shares are to be sold through a separate session and are sold at a big discount to the market prices. 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. Similarly, in Public Issues/Right Issues, shares are issued only in demat form.

**PROCEDURE FOR DEMATERIALISATION****REMATERIALISATION**

Rematerialisation is the process of converting securities held in electronic form in a demat account back in physical certificate form. For the purpose of rematerialisation, the client has to submit the rematerialisation request to the DP with whom he has an account. A client can rematerialise his dematerialised holdings at any point of time. The securities sent for rematerialisation cannot be traded.

**PROCEDURE FOR REMATERIALISATION****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.

### 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, 2013
- The Indian Stamp Act, 1899
- Securities and Exchange Board of India Act, 1992
- Securities Contracts (Regulation) Act, 1956
- Benami Transaction (Prohibition) Act, 1988
- Income Tax Act, 1961
- Bankers' Books Evidence Act, 1891

The legal framework for depository system in the Depositories Act, 1996 provides for the establishment of multiple depositories. Anybody to be eligible for providing depository services must be formed and registered as a company under the Companies Act, 2013 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 the 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.

## DEPOSITORIES ACT, 1996

### Objectives

The depositories' legislation as per the Statement of Objects and Reasons appended to the Depositories Act, 1996 aims at providing :

- A legal basis for establishment of depositories to conduct the task of maintenance of ownership records and effecting 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, 2013.
- 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 opts for a depository based ownership record.

However, in case of fresh issue of securities all securities issued have to be in dematerialized 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.

### Is dematerialization of securities compulsory?

According to the Depositories Act, 1996, an investor has the option to hold securities either in physical or electronic form. Part of holding can be in physical form and part in demat form. However, SEBI has notified that settlement of market trades in listed securities should take place only in the demat mode.

**What type of instruments are available for demat at Depository?**

All types of equity/ debt instruments viz. equity shares, preference Shares, partly paid shares, bonds, debentures, commercial papers, certificates of deposit, government securities (G-SEC) etc. irrespective of whether these instruments are listed / unlisted / privately placed can be dematerialized with depository, if they have been admitted with the depository.

**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 89 and 186 of Companies Act, 2013 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 is subject 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, 2013.

**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 or any other encumbrance 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 fulfillment of such conditions and on payment of such fees as may be specified by the regulations, issue the certificate of securities to the beneficial owner or the transferee, as the case may be.

### 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 to 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.

### To Give Directions

Section 19 provides that SEBI after making or causing to be made an enquiry or inspection he is satisfied that it is necessary in the interest of investors or the securities market to prevent the affairs of any depository or participant being conducted in the manner detrimental to the interests of investors or the securities market.

May issue such directions, –

- (a) to any depository or participant or any person associated with the securities market; or
- (b) to any issuer, as may be appropriate in the interest of investors or the securities market.

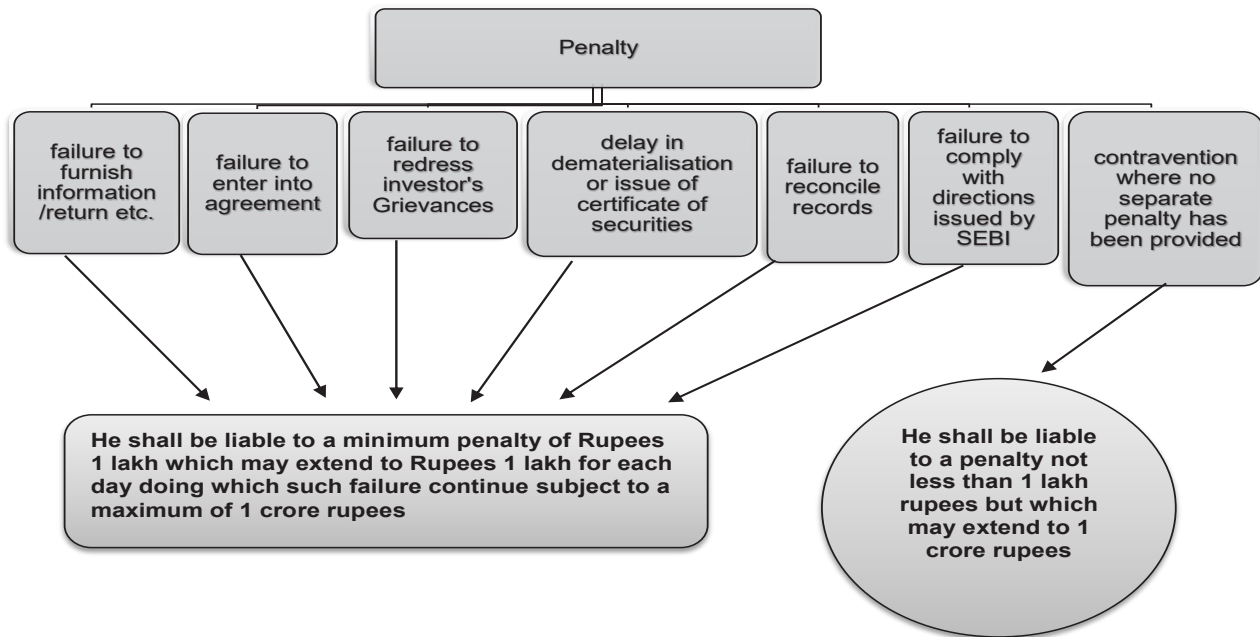
### PENALTIES AND ADJUDICATION

SI No.	Section	Particulars
1.	Section 19A	Failure to furnish information, return, etc.
2.	Section 19B	Failure to enter into an agreement
3.	Section 19C	Failure to redress investors' grievances
4.	Section 19D	Delay in dematerialisation or issue of certificate of securities
5.	Section 19E	Failure to reconcile records
6.	Section 19F	Failure to comply with directions issued by SEBI under section 19 of the Act
7.	Section 19G	Contravention where no separate penalty has been provided
8.	Section 19H	Power to adjudicate
9.	Section 19I	Factors to be taken into account by adjudicating officer



10.	Section 19-IA	Settlement of Administrative Civil Proceedings
11.	Section 19-IB	Recovery of amounts
12.	Section 19J	Crediting sums realised by way of penalties to Consolidated Fund of India

### Penalties



### Adjudication

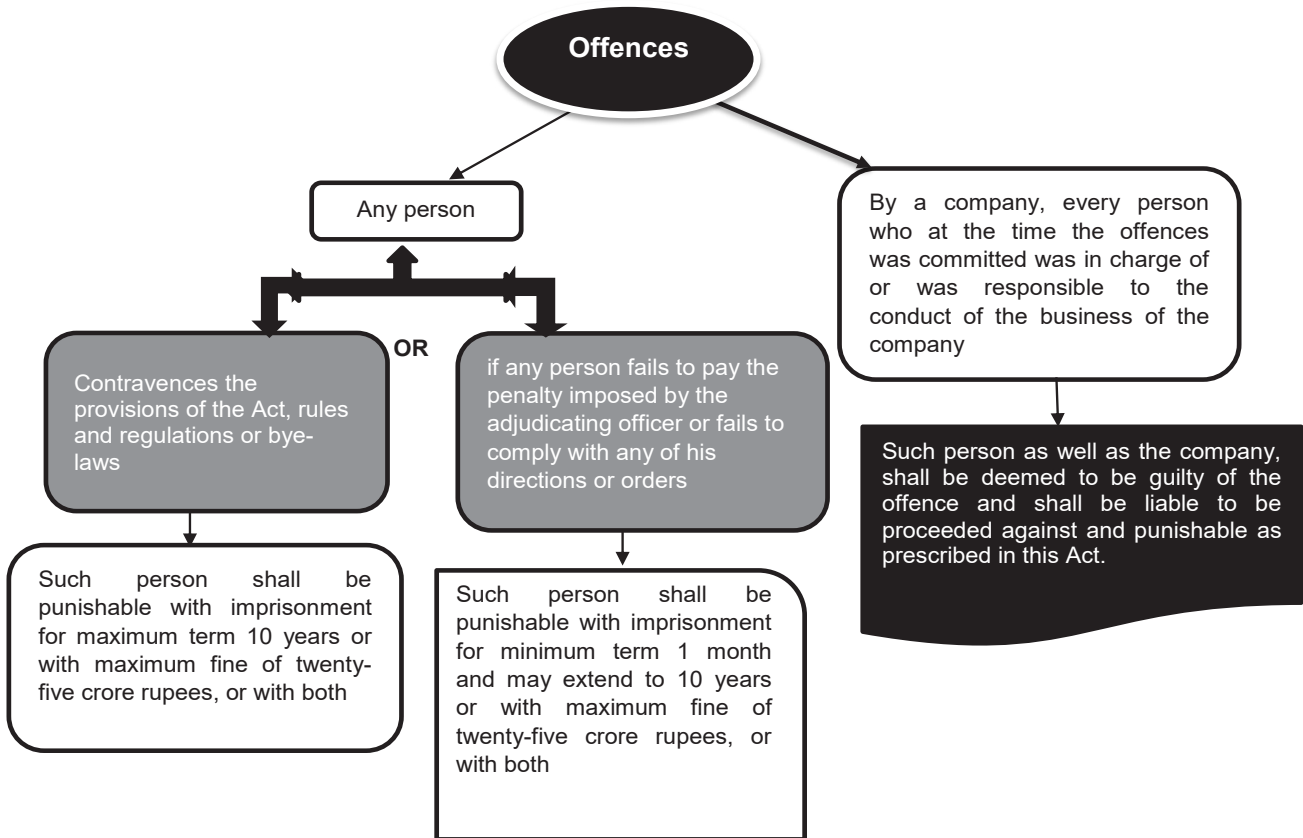
The adjudication procedure as mentioned under Section 19H to 19J of the Depositories Act, 1996 is same as the adjudication procedure prescribed under SEBI Act, 1992. Hence, student may refer the same.

### OFFENCES AND COGNIZANCE

Sl No.	Section	Particulars
1.	Section 20	Offences
2.	Section 21	Offences by Companies
3.	Section 22	Cognizance of Offences by Courts
4.	Section 22A	Composition of certain Offences
5.	Section 22B	Power to grant immunity
6.	Section 22C	Establishment of Special Courts
7.	Section 22D	Offences triable by Special Courts
8.	Section 22E	Appeal and revision
9.	Section 22F	Application of Code to proceedings before Special Court
10.	Section 22G	Transitional Provisions
11.	Section 23	Appeals
12.	Section 23A	Appeal to SAT
13.	Section 23B	Procedure and powers of Securities Appellate Tribunal
14.	Section 23C	Right to legal representation

15.	Section 23 D	Limitation
16.	Section 23E	Civil court not to have jurisdiction
17.	Section 23F	Appeal to Supreme Court

### Offences



### 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 SEBI or by any person.

### 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.

### Miscellaneous provisions

The Miscellaneous provisions from Section 22B to 23F as mentioned above in the table are same as the provisions as prescribed under SEBI Act, 1992. The Students may refer the same.

### 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.

### **SEBI (DEPOSITORIES AND PARTICIPANTS) REGULATIONS, 1996**

The Depositories Act, 1996 requires that the registration of the depository, depository participant and the custodian, is mandatory with the SEBI. 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.

### **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 practising 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.

### **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 (CDSL) 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:

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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 CDSL 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 CDSL from time to time. A copy of Internal Audit report shall be furnished to CDSL.”

### **Checklist of Internal Audit of Operations of Depository Participants:**

- Account opening
- Reporting to BOs
- Dematerialisation of Securities
- Rematerialisation of Securities
- Market Trades
- Off Market Trades
- Transmission
- Returns to Depository
- Grievance Redressal Mechanism
- Collateral Security
- Assignment of Business
- Freezing of Account
- Closure of Account
- Pledge and Hypothecation
- Invocation of Pledge/Hypothecation by Pledgee
- Lending and Borrowing of Securities
- Records to be Maintained by DPs
- Disclosure and Publication of Information
- Supervision by DP
- Code of Ethics for DPs
- Branch of Depository Participants

### **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.

## ROLE OF COMPANY SECRETARY

- **Right to Legal Representation** (Section 23C of the Act): In case of any decision of SEBI, **the aggrieved entity/ company** (the appellant) may either appear in person or authorise one or more chartered accountants or **company secretaries (PCS)** or cost accountants or legal practitioners or any of its officers **to present his or its case before the Securities Appellate Tribunal (SAT).**
- **Internal Audit of Depository Participants:** The 2 (two) Depository services providers in India, viz., National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Limited (CDSL) **have allowed Company Secretaries** in Whole-time Practice to **undertake internal audit** of the operations of Depository Participants (DPs). [Ref: NSDL Circular No. NSDL/POLICY/2008/0072 dated October 17, 2008 and CDSL Bye Law 16.3.1]
- **Reconciliation of Share Capital Audit:** Company Secretary is authorised to **issue quarterly certificate** with regard to reconciliation of the total issued capital, listed capital and capital held by

depositories in dematerialized form, details of changes in share capital during the quarter, and **in-principle approval obtained by the issuer** from all the stock exchanges where it is listed in respect of such further issued capital under SEBI (Depositories and Participants) Regulations, 1996. [**Regulation 55A of SEBI (Depositories and Participants) Regulations, 1996**]

- **Concurrent Audit of Depository Participants:** Practising Company Secretary is authorized to carry out **concurrent audit of Depository Participants** which covers audit of the process of demat account opening, control and verification of Delivery Instruction Slips (DIS).

### LESSON ROUND UP

- The legal framework for depository system 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.
- 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 Act, 1996 and 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 practising 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 Practising Company Secretaries to undertake internal audit of the operations of Depository Participants (DPs).
- 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.

### GLOSSARY

<b>Beneficial owner (BO)</b>	The true owner of a security or property, which may be registered in another name. Means a person whose name appears as such on the records of the depository.
<b>ISIN</b>	International Securities Identification Number (ISIN) is a code that uniquely identifies a specific security, which is allocated at the time of admitting the same in the depository system.
<b>Joint Account</b>	It means a bank or a demat account in the names of more than one person (maximum three in case of a demat account). All the account holders must give their signature to operate a demat account held jointly.
<b>Pledge</b>	Any person having a demat account can pledge securities against loan / credit facilities extended by a pledgee, who too has a demat account with a DP.

<b>RRN</b>	A system generated unique number when a remat request is set up.
<b>Transmission</b>	Transmission of securities denotes a process by which ownership of securities is transferred to a legal heir or to some other person by operation of law. In case of transmission transfer deed and stamp duty are not required.

## 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. Enumerate the enquiry, inspection and penalties under the Depositories Act, 1996.
3. Elucidate the procedure for dematerialisation of shares.
4. Write short note on:
  - (a) Fungibility
  - (b) Models of Depository
  - (c) Internal Audit of Depository Participants
  - (d) Concurrent Audit
  - (e) Rematerialisation

[illegible]





# Lesson 4

## An Overview of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

### LESSON OUTLINE

- Introduction
- Issue of Equity shares
- Eligibility Norms for Public Issue
- Types of Issue
- Meaning of draft offer document, letter of offer and Red herring Prospectus
- Fast Track Issues
- Promoters Contribution
- Underwriting
- Issue opening date
- Period of subscription
- Minimum number of share applications & Application Money
- Issue of advertisements
- Mandatory Collection Centres
- Minimum Subscription
- Restriction on Further Capital Issues
- Proportionate Allotment
- Basis of allotment
- Coordination with Intermediaries
- Minimum Offer to Public
- Reservation on Competitive Basis
- Allocation in Net Offer to Public
- Procedure for Issue of Securities
- Role of Company Secretary
- LESSON ROUND UP
- GLOSSARY
- SELF-TEST QUESTIONS

### LEARNING OBJECTIVES

India ushered from a merit based regime (Controller of Capital Act) to disclosure based regime under SEBI. Under CCI issue size and price were approved by CCI after examining the various parameters/ratios. The SEBI (Disclosure and Investor Protection) Guidelines, 2000 were introduced by SEBI which consist of serious of provisions.

Therefore, the DIP Guidelines needed to be strengthened and streamlined. The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 were introduced to address these needs and are more concise and systematic.

The student pursuing Company Secretaryship Course should have expert knowledge on the various aspects of issue of securities. This lesson will enable the student to know about various provisions of SEBI (ICDR) Regulations, 2009 like prospectus, eligibility criteria, promoter contribution, lock-in requirements etc.

## INTRODUCTION

Management of a public issue involves co-ordination of activities and co-operation 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.

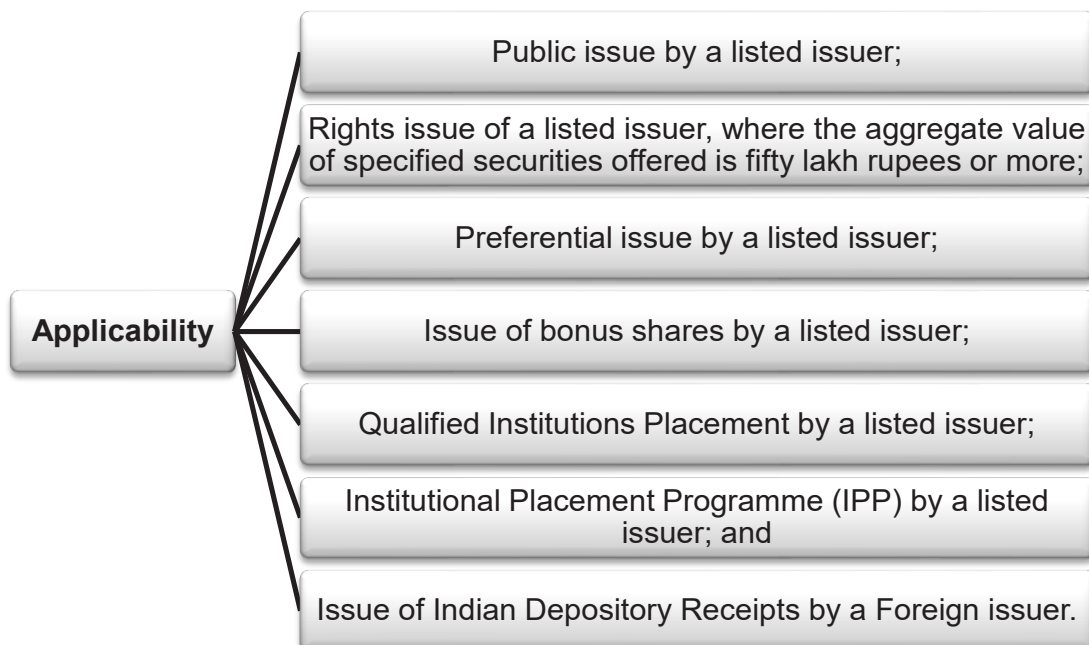
All activities beginning with the planning of capital issue till the opening of the subscription list are pre-issue activities while all activities subsequent to the opening of the subscription list may be called post issue activities. Since only the demat shares are being admitted for dealings on the stock exchanges, hence the securities can be issued only with the purpose of allotting the shares in Dematerialised Form.

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.

## ISSUE OF EQUITY SHARES

The important aspects of SEBI (ICDR) Regulations, 2009 with reference to issue of equity shares are as under:

### Applicability of the Regulations



## ELIGIBILITY NORMS FOR PUBLIC ISSUE

### Unlisted Company

An unlisted company can make an initial public offering (IPO) of equity shares or any other securities 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.

However, if more than 50% of the net tangible assets are held in monetary assets, the issuer has made firm commitments to utilise such excess monetary assets in its business or project. Further the limit of 50% on monetary assets shall not be applicable in case the public offer is made entirely through an offer for sale.

- (b) The company has a minimum average pre-tax operating profit of rupees fifteen crore, calculated on a restated and consolidated basis, during the three most profitable years out of the immediately preceding five 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;

#### **Alternative Eligibility Norms**

An issuer not satisfying the condition stipulated above may make an initial public offer if the issue is made through the book-building process and the issuer undertakes to allot, at least seventy five percent of the net offer to public, to qualified institutional buyers and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers.

#### **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 net worth 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.

### **TYPES OF ISSUE**

For raising capital from the public by the issue of shares, a public company has to comply with the provisions of the Companies Act, 2013 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.

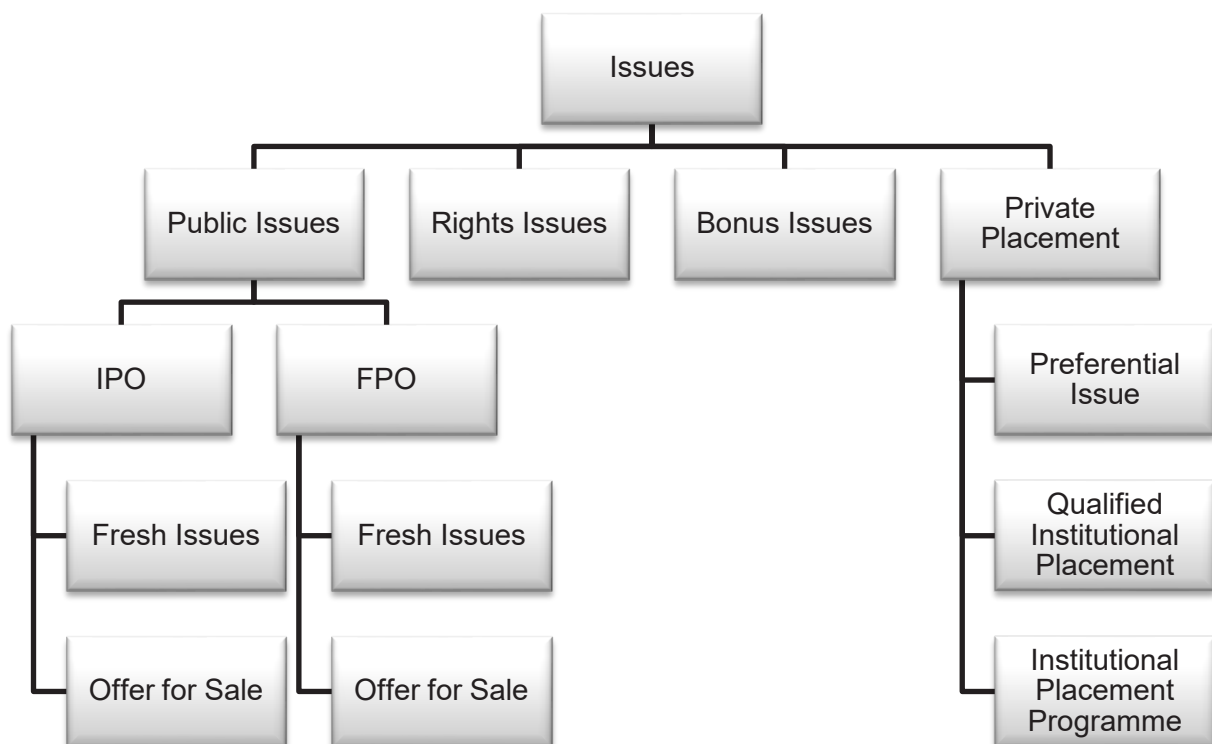
A company can raise funds from the primary market through different method:

- (a) **Public issue:** When an issue/offer of securities is made to public 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 their 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 in proportion to their paid up capital held 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 (200 in a financial year), and which is neither a rights issue nor a public issue, it is called a private placement. The same should be in compliance with section 42 of Companies Act, 2013.

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, 2013.
- (ii) **Qualified institutions placement (QIP)**: When a listed issuer issues equity shares or securities convertible into equity shares to Qualified Institutions Buyers (QIBs) only in terms of provisions of Chapter VIII of SEBI (ICDR) Regulations, it is called a QIP.
- (iii) **Institutional placement programme (IPP)**: When a listed issuer makes a further public offer of equity shares, or offer for sale of shares by promoter / promoter group of listed issuer in which, the offer allocation and allotment of such shares is made only to QIBs in terms of chapter VIIIA of SEBI (ICDR) Regulations, 2009 for the purpose of achieving minimum public shareholding it is called an IPP.



## **MEANING OF DRAFT OFFER DOCUMENT, LETTER OF OFFER AND RED HERRING PROSPECTUS**

### **Draft Offer Documents**

“Draft Offer document” means the offer document in draft stage. The draft offer documents are filed with SEBI, at least 30 days prior to the filing of the Offer Document with ROC/SEs. SEBI may specify changes/its observations, 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**

“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. As per Section 2(70) of Companies Act, 2013, Prospectus means any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

### **Red Herring Prospectus (RHP)**

“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, 2013. 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.

### **Issue of warrants along with public issue or right issue**

Warrant may be issued along with public issue or rights issue of convertible securities subject to the following :

- (a) the tenure of such warrant shall not exceed eighteen months from their date of allotment in the public/ rights issue;
- (b) not more than one warrant shall be attached to one specified security;
- (c) the price or conversion formula of the warrant shall be determined upfront and at least 25% of the consideration amount shall also be received upfront;
- (d) in case the warrant holder does not exercise the option to take equity shares against any of the warrants held by this, the consideration paid in respect of such warrant shall be forfeited by the issuer.

### **Debarment**

An issuer cannot 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 is 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 cannot make any public issue of securities, unless a draft offer document has been filed with SEBI through a Merchant Banker, at least 30 days prior to registering the prospectus, red herring prospectus or shelf 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, such changes or comply with observation shall be made by Issuer Company of the lead manager within 30 days from the date of receipt of the draft Prospectus by SEBI.

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 convertible securities are proposed to be listed and a soft copy of the offer document should also be furnished to SEBI. All filing with respect to SEBI is made through online platform.

### **Issue of Securities in Dematerialised Form**

A company cannot make public or rights issue or an offer for sale of securities, unless the company enters into an agreement with a depository for dematerialisation of securities already issued or proposed to be issued to the public or existing shareholders.

### **Security Deposit**

The issuer shall deposit, before the opening of subscription list, and keep deposited with the stock exchange(s), an amount calculated at the rate of one per cent of the amount of securities offered for subscription to the public.

The amount specified shall be deposited in the manner specified by SEBI and/or stock exchange(s). The amount shall be refundable or forfeitable in the manner specified by SEBI, subject to satisfactory resolution of Investor grievances and payment of fees to Intermediaries.

### **Partly Paid-up Shares**

These Regulations also require that all the existing partly paid-up shares must be made fully paid up or forfeited. A company cannot 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**

The fast-track route of fund raising is an alternative available for companies to access public funds by way of further capital offerings. Considering the need to enable well established and compliant listed companies to access Indian primary market in a time effective manner through follow-on public offerings and rights issues, SEBI decided to enable listed companies satisfying certain specified requirements to make Fast Track Issues (FTIs). Accordingly, such listed companies are 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.

### **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) The issuer should announce the floor price or price band at least 5 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.

The announcement and the relevant financial ratios shall be disclosed on the websites of those stock exchanges where the securities are proposed to be listed and shall also be pre-filled in the application forms available on the websites of the stock exchanges.

(4) The cap on the price band shall be less than or equal to one hundred and twenty percent 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 the provisions of the Companies Act, 2013 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 infrastructure sector.

(ii) The disclosure about the face value of equity shares (including the statement about the issue price being "X" 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 brought in within specified time 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 SEBI, 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

\* In case the post issue shareholding of the promoters is less than 20%, AIFs may contribute for the purpose of meeting the shortfall in minimum contribution as specified for promoters, subject to a maximum of 10 % 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

The requirements of minimum promoters' contribution shall not apply in case of:



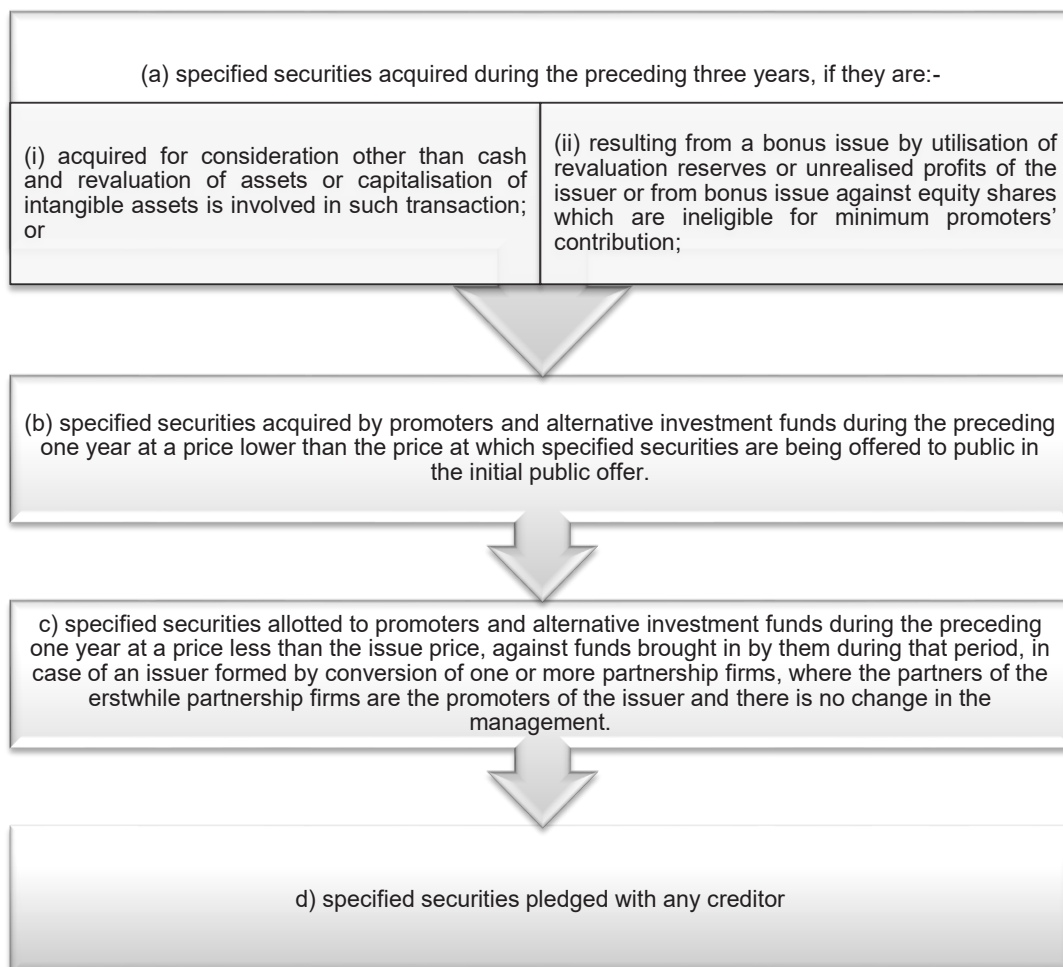
(a) An issuer which does not have any identifiable promoter;

(b) In case of a further public offer, where the equity shares of the issuer are not infrequently traded in a recognised stock exchange for a period of at least three years and the issuer has a track record of dividend payment for at least immediately preceding three years.

(c) Rights issues

#### **Securities ineligible for minimum promoters' contribution**

(1) For the computation of minimum promoters' contribution, the following specified securities shall not be eligible:



However, Clause (b) shall not apply:

- (i) if promoters /alternative investment funds, as applicable pay to the issuer, the difference between the price at which specified securities are offered in the initial public offer and the price at which the specified securities had been acquired;
- (ii) if such specified securities are acquired in terms of the scheme under sections 230-240 of the Companies Act, 2013, as approved by a tribunal, by promoters in lieu of business and invested capital that had been in existence for a period of more than one year prior to such approval;
- (iii) to an initial public offer by a government company, statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in infrastructure sector;

In clause (c), specified securities, allotted to promoters against capital existing in such firms for a period of more than one year on a continuous basis, shall be eligible.

(2) Specified securities referred above shall be eligible for the computation of promoters' contribution, if such securities are acquired pursuant to a scheme which has been approved under sections 230-240 of the Companies Act, 2013.

### **For Securities Held by Promoters**

In a public issue, the specified securities held by promoters shall be locked-in for the period stipulated hereunder:

- (a) The promoters contribution including contribution made by alternative investment fund is subject to lock-in-period of 3 years from the date of commencement of commercial production or date of allotment in the public issue whichever is later.
- (b) 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.
- (c) In case of issue of securities by a company listed on a stock exchange for at least 3 years and having a track record of dividend payment for at least 3 immediately preceding years promoter's contribution shall not be subject to lock-in-period.

### **Securities Held by Persons other than Promoters**

The entire pre-issue share capital, other than that locked-in as minimum promoters' contribution, shall be locked in for a period of one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later.

This is not applicable (i) 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 (ii) Equity shares held by a venture capital fund or alternative Investment fund of category I or a foreign venture capital investor and such equity shares shall be locked-in for a period of atleast one-year from the date of purchase by the venture capital or AIF or foreign venture capital investor.

### **Securities Lent to Stabilising Agent under Green Shoe Option**

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.

### Transferability of Share under Locked-In

Shares held by promoter(s) which are locked-in, can be transferred to and amongst promoter/promoter group or to a new promoter or persons in control of the company, subject to continuation of lock-in in the hands of transferees for the remaining period and compliance of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, as applicable.

The 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, 2011. 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.

### Pledge of locked-in specified securities

Specified securities held by promoters during locked-in period are allowed to be pledged with any scheduled commercial bank or public financial institution, subject to the following:

(a) if the specified securities are locked-in in terms as prescribed in the regulation, the loan has been granted by such bank or institution for the purpose of financing one or more of the objects of the issue and pledge of specified securities is one of the terms of sanction of the loan;

(b) if the specified securities are locked-in in terms as prescribed in the regulation and the pledge of specified securities is one of the terms of sanction of the 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, atleast 75 % 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) 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.
- (7) 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 SEBI.

### **Manner of Call**

If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within 12 months from the date of allotment in the issue and if any applicant fails to pay the call money within the said 12 months, the equity shares on which there are calls in arrear along with the subscription money already paid on such shares shall be forfeited.

However, it shall not be necessary to call the outstanding subscription money within 12 months, if the issuer has appointed a monitoring agency.

### **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, registrar to issue and share transfer agents, depository participants, stock brokers, 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 Section 26 of the Companies Act, 2013 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.

In case of shelf prospectus, the first issue can be opened within 3 months of issuance of observations by SEBI.

## PERIOD OF SUBSCRIPTION

A public issue must be kept open for atleast 3 working days but not more than 10 working days including the days for which the issue is kept open in case of revision in price band. In case the price band in a public issue made through the book building process is revised, the bidding (issue) period disclosed in the red herring prospectus should be extended for a minimum period of 3 working days. However, the total bidding period should not exceed 10 working days. Rights issue should be kept open for a minimum period of 15 days and for a maximum period of 30 days.

## MINIMUM NUMBER OF SHARE APPLICATIONS AND APPLICATION MONEY

The minimum application value shall be within the range of Rs.10,000 to Rs. 15,000. 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.

Assuming an issue is being made at a price of Rs.900 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 12 – 16 equity shares (in value terms between Rs.10,000- Rs.15,000), as explained hereunder:

Options	I	II	III	IV	V
Lot Size @ ₹ 900/- per share	12 shares	13 shares	14 shares	15 shares	16 shares
Application / Bid amount for 1 lots	10800	11700	12600	13500	14400
Application / Bid amount for 2 lots	21600	23400	25200	27000	28800
Application / Bid amount for 4 lots	43200	46800	50400	50400	57600
Application / Bid amount for 8 lots	86400	93600	100800	108000	115200
Application / Bid amount for 16 lots	172800	187200	–	–	–
Application / Bid amount for 18 lots	194400	–	–	–	–

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. The issue of advertisement has to comply with the restrictions imposed by SEBI ICDR Regulations.

### 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 30 of the Companies Act, 2013.

### Post-issue Advertisements

The post-issue 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, including ASBA number, value and percentage of successful allottees for all application including ASBA, date of completion of despatch of refund orders or instructions to Self Certified Syndicate Banks by the Registrar, 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 etc., 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.

### MANDATORY COLLECTION CENTRES

The Regulations require a minimum number of collection centres for an issue of capital to be at the four metropolitan centre 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 branches of Self Certified Syndicate Banks, as displayed on the websites of such banks and of SEBI, shall be deemed to be mandatory collection centres.

### MINIMUM SUBSCRIPTION

The minimum subscription to be received in an issue shall not be less than ninety percent of the offer through offer document. However, in the case of an initial public offer, the minimum subscription to be received shall be subject to allotment of minimum number of specified securities, as prescribed in sub-clause (b) of clause (2) of rule 19 of Securities Contracts (Regulation) Rules, 1957.

In the event of non-receipt of minimum subscription, all application moneys received shall be refunded to the applicants forthwith, but not later than –

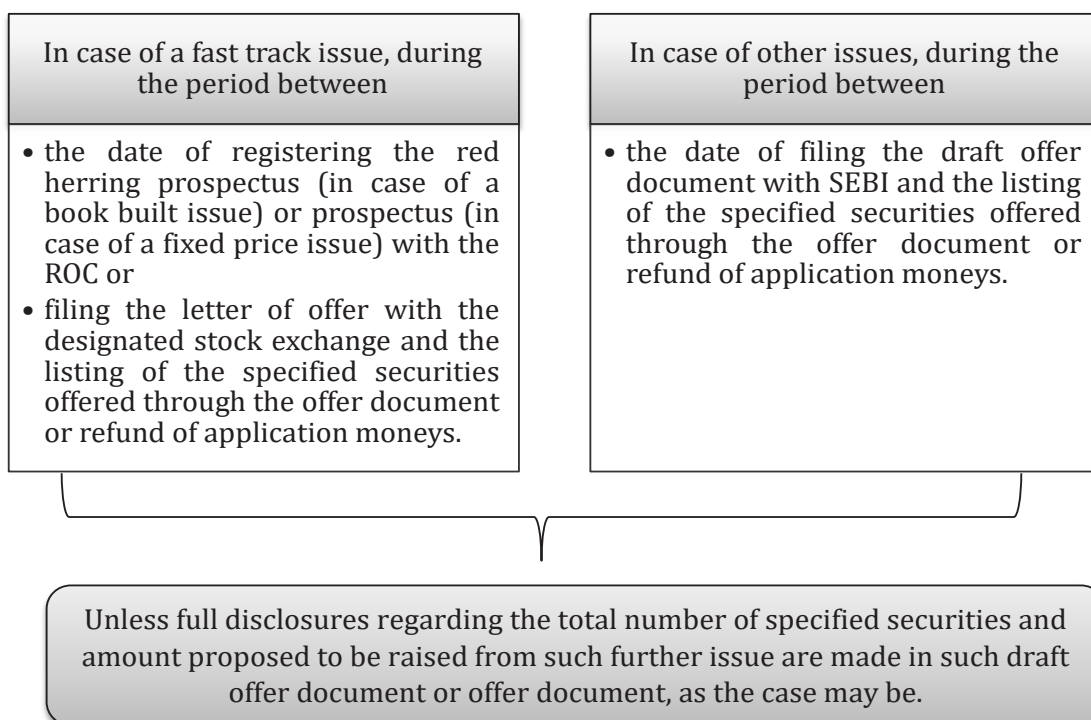
- (a) fifteen days of the closure of the issue, in case of a non-underwritten issue.
- (b) seventy days of the closure of the issue, in case of an underwritten issue where minimum subscription including devolvement obligations paid by the underwriters is not received within 60 days of the closure of issue.

**Note :** In case the issuing company fails to refund the entire subscription amount within stipulated time, then it is liable to pay the entire amount along with interest of 15% per annum for the period of delay.

The requirement of minimum subscription is not applicable to offer for sale.

### RESTRICTION ON FURTHER CAPITAL ISSUES

Issuer shall not make any further issue of specified securities in any manner whether by way of Public issue, Rights issue, Preferential issue, Qualified institutions placement, Issue of bonus shares or otherwise:-



## PROPORTIONATE ALLOTMENT

The allotment to applicants other than retail individual investor and 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.

However, the value of specified securities allotted to any person in pursuance of reservation, shall not exceeds two lakh rupees.

The allotment of specified securities to each retail individual investor shall not be less than the minimum bid lot, subject to availability of shares in retail individual investor category, and the remaining available shares, if any, shall be allotted on a proportionate basis.

## 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 this regulations.

The listed company should 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 devolvement on underwriters, the merchant banker is required to ensure that the notice for devolvement 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 devolvement 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.

### **MINIMUM OFFER TO PUBLIC**

The minimum net offer to the public shall be subject to the provision of clause (b) of sub-rule (2) of rule 19 of Securities Contracts (Regulations) Rules, 1957 as follows :

- (i) at least twenty five per cent of each class or kind of equity shares or debenture convertible into equity shares issued by the company, if the post issue capital of the company calculated at offer price is less than or equal to one thousand six hundred crore rupees;
- (ii) at least such percentage of each class or kind of equity shares or debentures convertible into equity shares issued by the company equivalent to the value of four hundred crore rupees, if the post issue capital of the company calculated at offer price is more than one thousand six hundred crore rupees but less than or equal to four thousand crore rupees;
- (iii) at least ten per cent of each class or kind of equity shares or debentures convertible into equity shares issued by the company, if the post issue capital of the company calculated at offer price is above four thousand crore rupees:

However, the company mentioned in clause (ii) or (iii), shall increase its public shareholding to at least twenty five per cent within a period of three years from the date of listing of the securities, in the manner specified by SEBI.

### **RESERVATION ON COMPETITIVE BASIS**

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.

According to SEBI (ICDR) Regulations, 2009, there are certain persons eligible for 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 post issue capital of the issuer;
- (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.

However, in the event of under-subscription in the employee reservation portion, the unsubscribed

In case of an issue made through the book building process as per regulation 26(1), then the allocation in the net offer to public category shall be as follows:

- not less than 35 % to retail individual investors;
- not less than 15 % to non-institutional investors;
- not more than 50% to qualified institutional buyers, 5 % of which shall be allocated to mutual fund

In case of an issue made through the book building process under regulation 26(2), the allocation in the net offer to public category shall be as follows:

- not more than 10% to retail individual investors;
- not more than 15% to non-institutional investors;
- not less than 75% to qualified institutional buyers, 5% of which shall be allocated to mutual fund

In an issue made other than through the book building process, allocation in the net offer to public category shall be made as follows:

- Minimum 50% to retail individual investors; and
- Remaining to:
  - (i) individual applicants other than RII and
  - (ii) other investors including corporate bodies or institutions, irrespective of the number of specified securities applied for;
- The unsubscribed portion in either of the categories specified above may be allocated to applicants in the other category.

portion may be allotted on a proportionate basis, for a value in excess of two lakhs rupees, subject to the total allotment to an employee not exceeding five lakhs 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.

## **ALLOCATION IN NET OFFER TO PUBLIC**

A person shall 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.

**Note :**

1. In case of an issue made through Book Building process under regulation 26(1) and 26(2), addition of 5% allocation available to mutual funds, Mutual Funds shall be eligible for allocation under the balance available for qualified institutional buyers.
2. The issuer may allocate up to 60% of the portion available for allocation to qualified institutional buyers to an anchor investor.
3. For 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, 2013 and SEBI (Merchant Bankers) 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.

In addition, 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 in fulfillment

of underwriting obligations to meet the minimum subscription requirement, shall not be entitled for the said interest. However, the issuer is obliged to refund within six working days from the date of closure of issue. (SEBI Circular)

### 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, 2013 and the rules made thereunder.

### 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 for the period of 3 years prior to the date of filing of the offer documents with ROC/Stock Exchange.

### Powers of SEBI

SEBI may either suo motu or on receipt of information or on completion or pendency of any inspection, inquiry or investigation, in the interests of investors or the securities market, issue such directions or orders as it deems fit including any or all of the following:

(a) directing the persons concerned not to access the securities market for a specified period.

(b) directing the person concerned to sell or divest the securities.

(a) directing the persons concerned not to access the securities market for a specified period.

### Disclaimer Clause of SEBI

SEBI notified the format of issue advertisement in Schedule XIII of SEBI (ICDR) Regulations. This provides 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.”

### 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 Contracts (Regulation) Rules, 1957 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 regulations 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 61, 62, 64), alteration in capital clause of the Memorandum of Association (Section 13), alteration of the articles of association (Section 14) etc. the approvals for the same should also be obtained at the General Meeting.

### **3. Appointment of managers to the issue**

The Company issuing shares is to appoint one or more Merchant Bankers to act as managers to the public issue.

### **4. 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, (h) Self Certified Syndicate Banks, etc.

### **5. Drafting of prospectus**

Next step is to draft a prospectus in accordance with Section 26 of the Companies Act, 2013 and an abridged prospectus as required under Section 33(1) of the Companies Act, 2013. The prospectus should contain the disclosures as required by SEBI Regulations under Schedule VIII.

### **6. 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.

### **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, regulations, 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 filed with SEBI for scrutiny. 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.

### **8. Approval of board of directors to prospectus and other documents**

After getting observations of SEBI in 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 40(1) of the Companies Act, 2013]. 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. For the purpose, the first step is to get adequate number of prospectuses and application forms printed. The provisions of Section 33 of the Companies Act, 2013 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.

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. The same shall be applicable if the promoter do not hold shares equivalent to minimum 20% of Post issue paid up capital.

### **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 40(3) of the Companies Act, 2013 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 PAS-3 of the Companies (Prospectus and Allotment of Securities) should be filed with the Registrar of Companies within 30 days of the date of allotment along with the fees as rules, 2014 specified in the Companies (Registration Offices and Fees) Rules, 2014.

### **19. Refund orders**

The company shall disclose the mode in which it shall made refunds to applicants in the prospectus and abridged prospectus.

## **ROLE OF COMPANY SECRETARY**

### **SEBI Circular**

Certification by practising Company Secretary in case of offer/allotment of securities to more than 49 and up to 200 investors

To issue a certificate regarding issuance of securities to more than 49 and up to 200 investors that the refund procedure as prescribed by SEBI has been duly complied with [SEBI Circular No. CFD/DIL3/CIR/P/2016/53 dated May 03, 2016]

### **Bombay Stock Exchange Limited**

#### **For listing of IPO**

A Certificate from a practising Company Secretary stating that:

- Allotment has been made as per the basis of allotment approved by the Designated Stock Exchange.
- The share certificates corresponding to equity Securities under lock in have been enfaced with non-transferability condition.
- In case of Employee reservation in the issue then "Allotment of shares from the employees' quota



has been made to permanent/regular employees of the company and of the promoter companies, as on the date of the opening of the public issue and who are entitled to such allotment. [Source: www.bseindia.com]

**For “In-principle approval” for issue of securities issued on a preferential basis under Regulation 28(1) of the SEBI Listing Regulations**

- A Certificate from a Practising Company Secretary confirming that:
  - a) None of the proposed allottee(s) has/ have sold any equity shares of the company during the six months period preceding the relevant date. Further, where the proposed allottee(s) is/ are promoter/ promoter group entity, then none of entities in the promoter and promoter group entities has/ have sold any equity share of the company during the six month period preceding the relevant date.
  - b) The pre-preferential shareholding of each of proposed allottee(s) has been locked in accordance with Regulation 78(6) SEBI (ICDR) Regulations, 2009. Further, there is no sale/ pledge of pre-preferential holding from Relevant Date till date of lock-in.
  - c) None of the proposed allottees belonging to promoter(s) or the promoter group who is ineligible for allotment in terms of Regulations 72(3) of SEBI (ICDR) Regulations, 2009.
  - d) The proposed issue is being made in accordance with the requirements of Chapter VII of SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009, Section 42 and 62 of the Companies Act 2013 and Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014.
  - e) The company will comply with all legal and statutory formalities and no statutory authority has restrained the company from issuing these proposed securities.
- A certificate from a practising Company Secretary confirming the relevant date for the purpose of said minimum issue price for the proposed preferential issue and that the minimum issue price is based on the pricing formula prescribed under Chapter VII of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. [Source: www.bseindia.com]

**For granting listing approvals, for the equity shares issued on a preferential**

- A Certificate from a practising Company Secretary with respect to the proposed preferential allotment certifying that:
  - a) The company has complied with all the provisions of Chapter VII of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, Companies Act, 2013 including Section 42 and Section 62 of the Companies Act 2013 and Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014. Further the company has also complied with all the legal and statutory formalities for allotment of aforesaid equity shares issued on a preferential basis.
  - b) Allotment of shares has been made only to such persons to whom offer / invitation was made.
  - c) No statutory/regulatory authorities has restrained the company for issuing equity shares to the company on preferential basis.
  - d) In the case of convertible instruments, the allottees have exercised the option to convert the instrument within a period of 18 months from the date of allotment of the instrument.
  - e) The pre-preferential shareholding of the allottees (mentioning the quantity) are under lock for the period starting from relevant date up to a period immediately prior to allotment.
  - f) At the time of allotment the pre-preferential shareholding (if any) of all the allottees were held in



dematerialized form only and no allotment has been made to any allottee whose pre-preferential shareholding was in physical form or was in the process of dematerialization.

- g) No allotment has been made to an allottee who did not have PAN at the time of allotment, unless the entity is exempt from PAN.
- h) None of the allottee has breached investment limit prescribed by any regulator. [Source: [www.bseindia.com](http://www.bseindia.com)]

#### **For Direct Listing for Companies which are listed with Stock Exchanges in Equity Segment**

- *Companies having Average Turnover more than Rs. 500 crores in previous Financial Year:*
  - An original certificate from a Practising Company Secretary regarding compliance with Corporate Governance requirements in accordance with Regulations 17-27 of the SEBI Listing Regulations.
  - If Regulations 17-27 of the Listing Regulations is not applicable to the company, a certificate from an independent professional e.g. practising Company Secretary has to be given at the time of applying for Listing, stating the reasons thereof. [Source: [www.bseindia.com](http://www.bseindia.com)].
- *Companies having Average Turnover less than Rs. 500 crores in previous Financial Year:*
  - An original certificate from a practising Company Secretary regarding compliance with Corporate Governance requirements in accordance with Regulations 17-27 of the SEBI Listing Regulations. [Source: [www.bseindia.com](http://www.bseindia.com)]

#### **Compliance Certificate by a practising Company Secretary for listing on BSE SME platform**

BSE vide its circular dated 26th November 2012 requires that Companies seeking listing on BSE SME Platform through IPO are required to comply with the quantitative eligibility norms as prescribed by BSE. Additionally, it will be desirable for the company to file a compliance certificate by a Practising Company Secretary as per the guidance note issued by the Institute of Company Secretaries of India as and when such a certification is made applicable by the SME Platform of BSE Ltd.

#### **National Stock Exchange of India Limited**

#### **Listing of further issue of securities issued pursuant to scheme of amalgamation/ merger/ scheme of arrangement etc.**

- A Certificate from practising Company Secretary regarding lock-in details (Mentioning the Lock-in date details). [Source: [www.nseindia.com](http://www.nseindia.com)]

#### **Listing of further issue of securities issued as Bonus**

- Certificate from practising Company Secretary to the effect that the SEBI (ICDR) Regulations, 2009 for bonus issue is duly complied with. [Source: [www.nseindia.com](http://www.nseindia.com)]

#### **Pre-preferential holding of the allottee/s**

- A Certificate from a practising Company Secretary confirming:
  - The entire pre-preferential holding of the allottee/s (mentioning the quantity) is locked-in for the period starting from relevant date up to a period immediately prior to the allotment.
  - The total equity shares are allotted pursuant to preferential allotment (the certificate should include the distinctive numbers of securities under lock-in) and the date from and upto a period of 1 Year/ 3 Years from the date of latest Trading Approval under which these shares are under lock-in. [source: [www.nseindia.com](http://www.nseindia.com)]

### Listing of shares/securities issued on Preferential/Private Placement basis in case of allotment under Section 62 (3) of Companies Act, 2013

- A confirmation signed by the Compliance Officer of the company duly counter confirmed by the Practising Company Secretary confirming that the said allotment has been made in accordance with the provisions of section 62(3) of the Companies Act, 2013. [Source: [www.nseindia.com](http://www.nseindia.com)]

#### LESSON ROUND UP

- Public Issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus.
- 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.
- Public Issue of shares are regulated by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.
- The promoters should contribute not less than 20% of post-issue capital, in case of a public issue by an unlisted company.
- 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.
- 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.

#### GLOSSARY

<b>Average market capitalisation of public shareholding</b>	It means 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 of Directors/ shareholders, as the case may be, divided by the number of trading days.
<b>Basis of allotment</b>	An allotment pattern of an issue among different categories of applicant.
<b>General Corporate Purpose</b>	It include such identified purposes for which no specific amount is allocated or any amount so specified towards General Corporate Purpose or any such purpose by whatever name called, in the draft offer document filed with SEBI.
<b>Offer for sale</b>	An offer of securities by existing shareholder(s) of a company to the public of subscription, through an offer document.
<b>Price Band</b>	The range within which the price of a security or the index of a currency is permitted to move within a given period.

## SELF TEST QUESTIONS

1. Discuss briefly provisions relating to reservation on competitive basis under SEBI (ICDR) Regulations, 2009.
2. What are the eligibility norms for public issue by an unlisted company?
3. A company cannot offer its shares at different sets of people in a particular public issue. Comment
4. Explain the various legal provisions to be complied with for further issue of capital.
5. Write short notes on –
  - (a) Minimum subscription
  - (b) Minimum promoters' contribution and lock-in-period
  - (c) Offer Document
  - (d) Red-herring Prospectus

[illegible]



# Lesson 5

## An Overview of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

### LESSON OUTLINE

- Introduction
- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
- Applicability
- Obligations of Listed Entities
- Compliances under SEBI Listing Regulations
- Corporate Governance under SEBI (LODR) Regulations, 2015
- In-Principle Approval of Recognised Stock Exchange(s)
- Role of Company Secretary
- LESSON ROUND UP
- GLOSSARY
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

Section 21 of Securities Contracts (Regulation) Act, 1956 ("SCRA") provides that "Where the 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". Pursuant to insertion of these provisions in SCRA in 1956, the Listing Agreement, although a contract, was made a statutory requirement, thereby making it mandatory for every listed entity in India to comply with the Listing Agreement. In India, SEBI has been regulating listed companies through the medium of listed agreement entered into between each listed company with the concerned stock exchange. Compliance with the listing conditions is mandatory by virtue of the governing law. SEBI has revamped its Listing Agreement that the companies need to enter into with the stock exchanges while listing its securities with the new SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

This lesson will give an overview of various time and event based compliances and various disclosure requirements prescribed under the listing Regulation.

## INTRODUCTION

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. Any company offering its shares to the public for subscription is required to be listed on the stock exchange and has to comply with the listing requirements prescribed by the Stock Exchange. A company seeking listing of their securities on the Stock Exchange is required to enter into a formal listing agreement with the Stock Exchange.

SEBI has prescribed and also specified all the quantitative and qualitative requirements to be continuously complied with by the issuer for continued listing. The Stock Exchange monitors such compliance and companies who do not comply with the provisions of the listing agreement may be suspended from trading on the Stock Exchange.

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 SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('Listing Regulations') and as applicable to public limited companies.

## SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

SEBI has notified SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('Listing Regulations') on September 2, 2015 which came into force w.e.f. December 1, 2015 with two objectives, firstly, to align clauses of the listing agreement with Companies Act, 2013 and secondly to consolidate the conditions under different securities listing agreements in one single regulation.

## APPLICABILITY

These regulations shall apply to the listed entity who has listed any of the following designated securities on recognised stock exchange(s):



## OBLIGATIONS OF LISTED ENTITIES

The obligations of listed entities have been classified under following categories -

Common obligations (Applicable for all listed entities)

Obligations of Listed entities which has listed its Specified Securities

Obligations of Listed entities which has listed its Non-Convertible Debt Securities or Non-Convertible Redeemable Preference Shares or both

Obligations of Listed entities which has listed its Specified Securities and either Non-Convertible Debt Securities or Non-Convertible Redeemable Preference Shares or both

Obligations of Listed entities which has listed its Indian depository receipts,

Obligations of Listed entities which has listed its securitised debt instruments,

Obligations of Listed entities which has listed its units issued by mutual funds

## COMPLIANCES UNDER SEBI LISTING REGULATIONS

The Listed entity shall comply with the following compliances under the Listing Regulations :-

- One Time Compliances
- Quarterly Compliances
- Half yearly Compliances
- Yearly Compliances
- Event based Compliances

### One-time Compliances

The following are the one time compliances:-

Regulation	Particulars
6(1)	A listed entity shall appoint a Company Secretary as the Compliance Officer
7(1)	The listed entity shall appoint a share transfer agent or the listed entity register with SEBI as Category II share transfer agent in case of share transfer facility in house.
9	The listed entity shall have a policy for preservation of documents, approved by its Board of Directors.

	<p>Constitution of Committees</p> <ul style="list-style-type: none"> <li>– Audit Committee (Regulation 18)</li> <li>– Nomination and Remuneration Committee (Regulation 19)</li> <li>– Stakeholders Relationship Committee (Regulation 20)</li> <li>– Risk Management Committee (Regulation 21)</li> <li>– Vigil Mechanism (Regulation 22)</li> </ul>
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### Quarterly Compliances

Regulation	Particulars	Time Limit
13(3)	The listed entity shall file with the recognised stock exchange, a statement giving the number of investor complaints pending at the beginning of the quarter, those received during the quarter, disposed of during the quarter and those remaining unresolved at the end of the quarter	within 21 days from end of quarter
27	The listed entity shall submit a quarterly compliance report on corporate governance in the format as specified by SEBI from time to time to the recognized stock exchange(s)	within 15 days from close of the quarter
31(1)(b)	The listed entity shall submit to the stock exchange(s) a statement showing holding of securities and shareholding pattern separately for each class of securities, in the format specified by SEBI from time to time	within 21 days from the end of each quarter
32(1)	The listed entity shall submit to the stock exchange a statement of deviation or variation	–
33(3)	The listed entity shall submit quarterly and year-to-date financial results to the stock exchange	within forty-five days of end of each quarter, other than the last quarter.

### Half Yearly Compliances

Regulation	Particulars	Time Limit
7(3)	The listed entity shall submit a compliance certificate to the exchange, duly signed by both the compliance officer of the listed entity and the authorised representative of the share transfer agent	Within one month of end of each half of the financial year.
40(9)	The listed entity shall ensure that the share transfer agent and/or the in-house share transfer facility, as the case may be, produces a certificate from a practising company secretary	within one month of the end of each half of the financial year



### Yearly Compliances

Regulation	Particulars	Time Limit
14	The listed entity shall pay all such fees or charges, as applicable, to the recognised stock exchange(s), in the manner specified by SEBI or the recognised stock Exchange (s).	within 30 days of the end of financial year
33(3)	The listed entity shall submit annual audited standalone financial results with audit report and Statement on Impact of Audit Qualifications applicable only for audit report with modified opinion to the stock exchange	within 60 days from the end of the financial year
34	The listed entity shall submit the annual report to the stock exchange	within twenty one working days of it being approved and adopted in the annual general meeting

### Event Based Compliances

Regulation	Particulars	Due date
7(5)	The listed entity shall intimate the appointment of Share Transfer Agent, to the stock exchange(s)	Within 7 days of Agreement with RTA
28(1)	The listed entity shall obtain In-principle approval from recognised stock exchange	Prior to issuance of Security
29(1)(a) read along with proviso to 29 (2)	Prior Intimations of Board Meeting for financial Result viz. quarterly, half yearly or annual, to the stock exchange(s)	At least 5 clear days in advance (excluding the date of the intimation and the date of the meeting)
29(1) (b), (c),(d), (e) & (f) read along with 29 (2)	Prior Intimations of Board Meeting for Buyback, Voluntary delisting , Fund raising by way of FPO, Rights Issue, ADR, GDR, QIP, FCCB, Preferential issue, debt issue or any other method, Declaration/ recommendation of dividend, issue of convertible securities carrying a right to subscribe to equity shares or the passing over of dividend, proposal for declaration of Bonus securities etc., to the stock exchange(s)	At least 2 working days in advance
29(3)	Prior Intimations of Board Meeting for alteration in nature of Securities, alteration in the date on which interest on debentures/bonds/redemption amount, etc. shall be payable to the stock exchange(s)	At least 11 clear working days in Advance
30(6)	Disclosure of Price Sensitive Information to the stock exchange(s)	Not later than twenty four hours as per Part A of Schedule III
31(1)(a)	The listed entity shall submit to the stock exchange(s) a statement showing holding of securities and shareholding pattern separately for each class of securities prior to listing of securities	One day prior to listing of Securities
31(1)(c)	The listed entity shall submit to the stock exchange(s) a statement showing holding of securities and shareholding pattern separately for each class of securities in case of Capital Restructuring	Within 10 days of any change in capital Structure exceeding 2% of the total paid-up share capital.

37(2)	The listed entity shall file draft Scheme of Arrangement to the stock exchange(s)	Prior approval before filing with Court
42(2)	The listed entity shall intimate the record date or date of closure of transfer books to all the stock exchange(s)	At least 7 clear working days in advance
42(3)	The listed entity shall give notice to stock exchange(s) of Record date for declaring dividend and/or cash bonus	At least 5 clear working days in advance
44(3)	The listed entity shall submit to the stock exchange details regarding voting results by Shareholders	Within 48 Hours of conclusion of its General Meeting
45(3)	The listed entity shall allowed to change its name	Prior approval from Stock Exchange(s)

### CORPORATE GOVERNANCE UNDER SEBI (LODR) REGULATIONS, 2015

The listed entities which has listed its specified securities on any recognised stock exchange(s) either on the main board or on SME Exchange or on institutional trading platform has to comply with certain corporate governance provisions which are specified in Regulations 17 to 27 & 34(3) of the Listing Regulations.

Sl. No.	Particulars	Listing Regulation
1.	Related Party	Clause 2(zb)
2.	Board Composition	17(1)
3.	Appointment of Woman Director	17(1)(a)
4.	Size of the Board	17(1)(a)
5.	Succession planning	17(4)
6.	Code of Conduct of Board of Directors & Senior Management	17(5)
7.	Prohibited Stock options for IDs	17(6)(d)
8.	Performance evaluation of IDs	17 (10)
9.	Constitution of Audit Committee	18
10.	Constitution of Nomination & Remuneration Committee	19
11.	Constitution of Stakeholders Relationship Committee	20
12.	Constitution of Risk management Committee	21
13.	Formulation of Vigil mechanism	22
14.	Related party transactions	23(1)
15.	Maximum number of directorship of IDs.	25(1)
16.	Maximum tenure of IDs	25(2)
17.	Separate meeting of IDs	25(3)
18.	Liability of IDs	25(5)
19.	Filing of Casual Vacancy of IDs	25(6)
20.	Familiarisation Programme for Independent Director	25(7)
21.	Disclosure of RPTs	27(2) (a)
22.	Disclosure of different Accounting standard	34 (3)
23.	Disclosure on Remuneration	34 (3)

### Exceptions

Regulation 15(2) of the Listing Regulations, the compliance with the corporate governance provisions as

specified in Regulations 17 to 27 and clauses (b) to (i) of Regulation 46(2) and para C, D and E of Schedule V shall not apply, in respect of following -

1. The listed entity having:-

- paid up equity share capital not exceeding rupees 10 crore and
- net worth not exceeding rupees 25 crore, as on the last day of the previous financial year.

(If the provisions of the regulations become applicable to a listed entity at a later date, such listed entity shall comply with the requirements those regulations within six months from the date on which the provisions became applicable to the listed entity.)

2. The listed entity which has listed its specified securities on the SME Exchange.

(For other listed entities which are not companies, but body corporate or are subject to regulations under other statutes, the provisions shall apply to the extent that it does not violate their respective statutes and guidelines or directives issued by the relevant authorities.)

Notwithstanding any provisions under Regulation 15(2) stated above, the provisions of Companies Act, 2013 shall continue to apply, wherever applicable.

### Board Committees under Listing Regulations



### VIGIL MECHANISM [REGULATION 22]

- The listed entity shall formulate a vigil mechanism for directors and employees to report genuine concerns.
- The vigil mechanism shall provide for adequate safeguards against victimization of director(s) or employee(s) or any other person who avail the mechanism.
- The vigil mechanism shall also provide for direct access to the chairperson of the audit committee in appropriate or exceptional cases.

## RELATED PARTY TRANSACTIONS [REGULATION 23]

### Related Party definitions under Different laws

#### *Under Listing Regulations, 2015*

Regulation 2(1) (zb) defines “related party” means a related party as defined under sub-section (76) of section 2 of the Companies Act, 2013 or under the applicable accounting standards.

#### *Under Companies Act, 2013*

According to section 2 (76) “related party”, with reference to a company, means —

- (i) a director or his relative;
  - (ii) a key managerial personnel or his relative;
  - (iii) a firm, in which a director, manager or his relative is a partner;
  - (iv) a private company in which a director or manager or his relative is a member or director;
  - (v) a public company in which a director and manager is a director and holds along with his relatives, more than two per cent of its paid-up share capital;
  - (vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;
  - (vii) any person on whose advice, directions or instructions a director or manager is accustomed to act;
- However, nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;
- (viii) Any body corporate which is –
    - (A) a holding, subsidiary or an associate company of such company;
    - (B) a subsidiary of a holding company to which it is also a subsidiary; or
    - (C) an investing company or the venturer of the company;”

*Explanation.* – For the purpose of this clause, “the investing company or the venturer of a company” means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.

- (ix) such other person as may be prescribed.

### Policy on materiality of related party transactions

The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions.

### When will a transaction with a related party be material?

A transaction with a related party shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds 10% of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

### Approval of Audit Committee

All related party transactions shall require prior approval of the audit committee.

Omnibus Approval: Audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity subject to the following conditions-

- (a) the audit committee shall lay down the criteria for granting the omnibus approval in line with the policy on related party transactions of the listed entity and such approval shall be applicable in respect of transactions which are repetitive in nature;
- (b) the audit committee shall satisfy itself regarding the need for such omnibus approval and that such approval is in the interest of the listed entity;
- (c) the omnibus approval shall specify:
  - (i) the name(s) of the related party, nature of transaction, period of transaction, maximum amount of transactions that shall be entered into,
  - (ii) the indicative base price / current contracted price and the formula for variation in the price if any; and
  - (iii) such other conditions as the audit committee may deem fit.

However, where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may grant omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.

- (d) the audit committee shall review, at least on a quarterly basis, the details of related party transactions entered into by the listed entity pursuant to each of the omnibus approvals given.
- (e) Such omnibus approvals shall be valid for a period not exceeding one year and shall require fresh approvals after the expiry of one year.

### **Approval of the shareholders**

All material related party transactions shall require approval of the shareholders through resolution and the related parties shall abstain from voting on such resolutions whether the entity is a related party to the particular transaction or not.

### **Exceptions**

The approval of Audit committee and shareholders shall not be required in the following cases:

- (a) transactions entered into between two government companies;
- (b) transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

*Government Company(ies) means Government Company as defined in sub-section (45) of section 2 of the Companies Act, 2013.*

### **Other provisions**

- The provisions of this regulation shall be applicable to all prospective transactions.
- For the purpose of this regulation, all entities falling under the definition of related parties shall abstain from voting irrespective of whether the entity is a party to the particular transaction or not.
- All existing material related party contracts or arrangements entered into prior to the date of notification of these regulations and which may continue beyond such date shall be placed for approval of the shareholders in the first General Meeting subsequent to notification of these regulations.

### **IN-PRINCIPLE APPROVAL OF RECOGNIZED STOCK EXCHANGE(S) [REGULATION 28]**

The listed entity, before issuing securities, shall obtain an 'in-principle' approval from recognised stock exchange(s) in the following manner:

- (a) where the securities are listed only on recognised stock exchange(s) having nationwide trading terminals, from all such stock exchange(s);
- (b) where the securities are not listed on any recognised stock exchange having nationwide trading terminals, from all the stock exchange(s) in which the securities of the issuer are proposed to be listed;
- (c) Where the securities are listed on recognised stock exchange(s) having nationwide trading terminals as well as on the recognised stock exchange(s) not having nationwide trading terminals, from all recognised stock exchange(s) having nationwide trading terminals.

The requirement of obtaining in-principle approval from recognised stock exchange(s), shall not be applicable for securities issued pursuant to the scheme of arrangement for which the listed entity has already obtained No-Objection Letter from recognised stock exchange(s) in accordance with regulation 37.

### **ROLE OF COMPANY SECRETARY**

A listed entity shall appoint a Qualified Company Secretary as the Compliance Officer.

The compliance officer of the listed entity shall be responsible for –

- ensuring conformity with the regulatory provisions applicable to the listed entity in letter and spirit.
- co-ordination with and reporting to SEBI, recognised stock exchange(s) and depositories with respect to compliance with rules, regulations and other directives of these authorities in manner as specified from time to time.
- ensuring that the correct procedures have been followed that would result in the correctness, authenticity and comprehensiveness of the information, statements and reports filed by the listed entity under these regulations.
- monitoring email address of grievance redressal division as designated by the listed entity for the purpose of registering complaints by investors.

In addition to the above responsibilities, the following are the recognition to Company Secretary under SEBI Listing Regulations, 2015 :

### **SEBI (LODR) Regulations, 2015**

#### **Certificate regarding Transfer of Securities**

- Certification to the effect that all transfers have been completed within the stipulated time. [Regulation 40(9)]

#### **Certificate Regarding Compliance of Conditions of Corporate Governance under SEBI Listing Regulations**

- SEBI listing regulations authorizes Practising Company Secretary to issue certificate regarding compliance of conditions of Corporate Governance. [Schedule V, clause E]

#### **Certificate Regarding Maintenance of 100% Asset Cover**

- To issue half yearly certificate regarding maintenance of 100% security cover in respect of listed non-convertible debt securities. [Regulation 56(1)] (d)]

### **Bombay Stock Exchange Limited**

#### **For revocation of suspension in trading of equity shares**

- A Compliance certificate obtained from the practising Company Secretary on compliance w.r.t. Regulations 17-27 of the SEBI Listing Regulations. [Source: [www.bseindia.com](http://www.bseindia.com)]

#### **Promoter to be reclassified as public shareholder [Regulation 31A (6) SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015]**

- Where an entity becomes professionally managed and does not have any identifiable promoter the existing promoters may be reclassified as public shareholders and in such a case the pre and post shareholding pattern pursuant to proposed reclassification should be certified by a practising Company Secretary [source: [www.nseindia.com](http://www.nseindia.com)]

#### **Grant of approval under Regulation 37 of the SEBI Listing Regulations, 2015 (Demerger -Resulting Company Seeking Listing at Exchange, other companies, reduction of Capital under Section 66 of Companies Act, 2013, re-commencement of trading of listed company post scheme of arrangement / capital reduction)**

- A Certificate from practising Company Secretary for Networth of the Company pre and post Scheme under Sections 101, 391 and 394 of the Companies Act, 1956. [Source: [www.nseindia.com](http://www.nseindia.com)]

#### **Grant of In-principle approval (Preferential Issue) for listing under Regulation 28(1) of the SEBI Listing Regulations, 2015**

- A Certificate from practising Company Secretary for the following confirmations:
  - The entire pre-preferential holding of the allottee(s) and that the same is in dematerialized form.
  - The Pricing of the issue along with the detailed working of the same. [Source: [www.nseindia.com](http://www.nseindia.com)]

### **LESSON ROUND UP**

- SEBI has notified SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('Listing Regulations') on September 2, 2015 after the consultation process. The Listing Regulations came into force w.e.f. December 1, 2015.
- A listed entity shall appoint a Qualified Company Secretary as a Compliance Officer.
- The Listed entity shall comply with the following compliances under Listing Regulations:-
  - One Time Compliances
  - Quarterly Compliances
  - Half yearly Compliances
  - Yearly Compliances
  - Event based Compliances
- The listed entities which has listed its specified securities on any recognised stock exchange(s) either on the main board or on SME Exchange or on institutional trading platform has to comply with certain corporate governance provisions which are specified in Regulations 17 to 27 of the Listing Regulations.
- The Board of directors shall have an optimum combination of executive and non-executive directors with at least one woman director and at least 50% of the board of directors shall comprise of non-executive directors.



- The Board Committees are required to be constituted under Listing Regulations:
  - Audit Committee
  - Nomination and Remuneration committee
  - Stakeholders Relationship Committee
  - Risk Management Committee
- The listed entity shall formulate a vigil mechanism for directors and employees to report genuine concerns.
- The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions.
- All material related party transactions shall require approval of the shareholders through resolution and the related parties shall abstain from voting on such resolutions whether the entity is a related party to the particular transaction or not.

### GLOSSARY

<b>Financial year</b>	It means the period of twelve months commencing on the first day of April every year. However, a company may at its option have a financial year commencing on a date other than the first day of April.
<b>Firm Allotment</b>	Allotment on a firm basis in public issues by an issuing company made to Indian and multilateral development financial institutions, Indian mutual funds, foreign portfolio investors including non-resident Indians and overseas corporate bodies and permanent/regular employees of the issuer company.
<b>Interim Dividend</b>	A dividend payment made during the course of a company's financial year. Interim dividend, unlike the final dividend does not have to be agreed in a general meeting.
<b>Investing Company/Venture of a Company</b>	It means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.
<b>Record Date</b>	A 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.

### SELF TEST QUESTIONS

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

1. Briefly explain the applicability of SEBI (LODR) Regulations, 2015?
2. Elucidate the obligations of Listed Entities under SEBI (LODR) Regulations, 2015.
3. State the conditions for which Omnibus approval of Audit Committee is required under SEBI (LODR) Regulations, 2015.
4. Explain the Event based compliances under SEBI (LODR) Regulations, 2015.
5. Discuss about the various committees which are required to be mandatorily constituted under the Listing Regulations.



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# Lesson 6

## An Overview of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

### LESSON OUTLINE

- Introduction
- Background
- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
- Important Definitions
- Applicability
- Trigger point for making an open offer by an acquirer
- Open Offer
- Conditional Offer
- Public Announcement
- Submission of Draft Letter of Offer
- Dispatch of Letter of Offer
- Opening of the Offer
- Completion of Requirements
- Restriction on Acquisition
- Provision of Escrow
- Mode of Payment
- Withdrawal of Open Offer
- Obligations of the Target Company
- Obligations of the Acquirer
- Disclosures
- Exemptions
- LESSON ROUND UP
- GLOSSARY
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

A lot has changed in the corporate world since 1997, the year in which the (SAST) Regulations, 1997 was enacted. In line with the ever changing global scenario this old takeover code was replaced with new SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ('SAST Regulations'). The main purpose for the takeover code is to prevent hostile takeovers and at the same time, provide some more opportunities of exit to Shareholders when there is change in control. The SEBI takeover code will also balance the conflicting objectives and interests of various stakeholders in the context of substantial acquisition of shares in, and takeovers of, listed companies and also regulate and provide for fair and effective competition among acquirers desirous of taking over the same target company.

This lesson provides an overview of the takeover code and after going through this lesson, students will be able to understand the various procedural aspects which an acquirer and target company with respect to takeover.

## INTRODUCTION

The SEBI Takeover code prescribes a systematic framework for acquisition of stake in listed companies. By these laws the regulatory system ensures that the interests of the shareholders of listed companies are not compromised in case of an acquisition or takeover. It also protect the interests of minority shareholders, which is also a fundamental attribute of corporate governance principle.

The takeover code ensures that public shareholders of a listed company are treated fairly and equitably in relation to a substantial acquisition in, or takeover of, a listed company thereby maintaining stability in the securities market. The objective of the takeover regulations is to ensure that the public shareholders of a company are mandatorily offered an exit opportunity from the company at the best possible terms in case of a substantial acquisition in, or change in control of, a listed company.

## BACKGROUND

The earliest attempts at regulating takeovers in India can be traced back to the 1990s with the incorporation of Clause 40 in the erstwhile Listing Agreement. While, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994 which were notified in November 1994 made way for regulation of hostile takeovers and competitive offers for the first time. In 1995, SEBI appoints a committee under the chairmanship of Justice P. N. Bhagwati to review the Takeover Regulation, 1994 and based on the recommendations of the committee. The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 were notified in 1997, pursuant to repeal of the 1994 Regulations.

Owing to several factors such as the growth of Mergers & Acquisitions activity in India as the preferred mode of restructuring, the increasing sophistication of takeover market, the decade long regulatory experience and various judicial pronouncements, it was felt necessary to review the Takeover Regulations 1997. Accordingly, SEBI formed a Takeover Regulations Advisory Committee (TRAC) in September 2009 under the Chairmanship of (Late) Shri. C. Achuthan, Former Presiding Officer, Securities Appellate Tribunal (SAT) for this purpose. After extensive public consultation on the report submitted by TRAC, SEBI came out with the SAST Regulations 2011 which were notified on September 23, 2011. The Takeover Regulations, 1997 stand repealed from October 22, 2011, i.e. the date on which SAST Regulations, 2011 come into force.

SAST aims at protecting interest of the investors in securities of a listed company providing amongst others, an opportunity for the public shareholders to exit where there is a substantial acquisition of shares or voting rights or control over a listed company, consolidation of holdings by existing shareholders and related disclosures and penalties for non-compliance etc. SAST requires an acquirer to make an offer to shareholders of the target company on acquiring shares exceeding stipulated thresholds. It also contains provisions relating to open offer size and price, time bound process for making an open offer, exemption from making an open offer, etc.

## SEBI (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVERS) REGULATIONS, 2011

1.	Chapter I	Definitions - Regulations 1 and 2
2.	Chapter II	Substantial acquisition of Shares, Voting Rights or Control, Threshold limit for open offer, Exemptions – Regulations 3 to 11
3.	Chapter III	Open offer process- Regulations 12 to 23
4.	Chapter IV	Obligations of Target Company, Acquirer, Manager – Regulations 24 to 27
5.	Chapter V	Disclosures of Shareholding and Control – Regulations 28 to 31
6.	Chapter VI	Powers of SEBI - Regulations 31 to 35

## IMPORTANT DEFINITIONS

To understand the concept of the Takeover Code, it would be pertinent to first go through some of the definitions:

### **Acquirer**

“Acquirer” means any person who, directly or indirectly, acquires or agrees to acquire whether by himself, or through, or with persons acting in concert with him, shares or voting rights in, or control over a target company.

### **Acquisition**

“Acquisition” means, directly or indirectly, acquiring or agreeing to acquire shares or voting rights in, or control over, a target company.

### **Control**

“Control” includes the right to appoint majority of the directors 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 shareholders agreements or voting agreements or in any other manner.

However, a director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position.

### **Enterprise value**

Enterprise value means the value calculated as market capitalization of a company plus debt, minority interest and preferred shares, minus total cash and cash equivalents.

Enterprise Value= Market capitalization+ Debt+ Minority Interest and Preferred Shares- Total Cash and Cash Equivalents

### **Frequently traded shares**

Frequently traded shares means shares of a target company, in which the traded turnover on any stock exchange during the twelve calendar months preceding the calendar month in which the public announcement is made, is at least ten percent of the total number of shares of such class of the target company.

However, where the share capital of a particular class of shares of the target company is not identical throughout such period, the weighted average number of total shares of such class of the target company shall represent the total number of shares.

### **Offer period**

“Offer period” means the period between the date of entering into an agreement, formal or informal, to acquire shares, voting rights in, or control over a target company requiring a public announcement, or the date of the public announcement, as the case may be, and the date on which the payment of consideration to shareholders who have accepted the open offer is made, or the date on which open offer is withdrawn, as the case may be.

### **Persons Acting in Concert**

“Persons acting in concert” means, –

- (1) persons who, with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly co-operate for acquisition of shares or voting rights in, or exercise of control over the target company.
- (2) Without prejudice to the generality of the foregoing, the persons falling within the following categories

shall be deemed to be persons acting in concert with other persons within the same category, unless the contrary is established, –

- (i) a company, its holding company, subsidiary company and any company under the same management or control;
- (ii) a company, its directors, and any person entrusted with the management of the company;
- (iii) directors of companies referred to in item (i) and (ii) of this sub-clause and associates of such directors and members of the promoter group;
- (iv) immediate relatives;
- (v) a mutual fund, its sponsor, trustees, trustee company, and asset management company;
- (vi) a collective investment scheme and its collective investment management company, trustees and trustee company;
- (vii) a venture capital fund and its sponsor, trustees, trustee company and asset management company;
- (viii) an alternate investment fund and its sponsor, trustees, trustee company and manager;
- (ix) a merchant banker and its client, who is an acquirer;
- (x) a portfolio manager and its client, who is an acquirer;
- (xi) banks, financial advisors and stock brokers of the acquirer, or of any company which is a holding company or subsidiary of the acquirer, and where the acquirer is an individual, of the immediate relative of such individual.

However, this shall not apply to a bank whose sole role is that of providing normal commercial banking services or activities in relation to an open offer under these regulations;

- (xii) an investment company or fund and any person who has an interest in such investment company or fund as a shareholder or unitholder having not less than 10 per cent of the paid-up capital of the investment company or unit capital of the fund, and any other investment company or fund in which such person or his associate holds not less than 10 per cent of the paid-up capital of that investment company or unit capital of that fund.

However, this shall not be applicable to holding of units of mutual funds registered with SEBI.

### ***Target company***

Target Company means a company and includes a body corporate or corporation established under a Central legislation, State legislation or Provincial legislation for the time being in force, whose shares are listed on a stock exchange.

### ***Tendering period***

Tendering period means the period within which shareholders may tender their shares in acceptance of an open offer to acquire shares made under these regulations.

### ***Volume weighted average market price***

Volume weighted average market price means the product of the number of equity shares traded on a stock exchange and the price of each equity share divided by the total number of equity shares traded on the stock exchange.

Number of shares traded on the Stock Exchange on a particular day: X, Market Price: Y

$$\text{Volume Weighted Average Market Price} = \frac{X1*Y1+X2*Y2+X3*Y3\dots\dots\dots}{X1+X2+X3\dots\dots\dots}$$

### **Weighted average number of total shares**

Weighted average number of total shares means the number of shares at the beginning of a period, adjusted for shares cancelled, bought back or issued during the aforesaid period, multiplied by a time-weighting factor.

### **Volume weighted average price**

Volume weighted average price means the product of the number of equity shares bought and price of each such equity share divided by the total number of equity shares bought.

Number of shares bought on a particular day: A, Market Price: B

$$\text{Volume weighted Average Price} = \frac{A1*B1+A2*B2+A3*B3\dots\dots\dots}{A1+A2+A3\dots\dots\dots}$$

## **APPLICABILITY**

These regulations shall apply to direct and indirect acquisition of shares or voting rights, in or control over Target Company. However, these regulations shall not apply to direct and indirect acquisition of shares or voting rights in, or control over a company listed without making a public issue in the Institutional trading platform of a recognized stock exchange.

## **TRIGGER POINT FOR MAKING AN OPEN OFFER BY AN ACQUIRER**

### **25% Shares or Voting Rights**

An acquirer, along with Persons acting in concert( PAC) , if any, who intends to acquire shares which along with his existing shareholding would entitle him to exercise 25% or more voting rights, can acquire such additional shares only after making a Public Announcement (PA) to acquire minimum twenty six percent shares of the Target Company from the shareholders through an Open Offer.

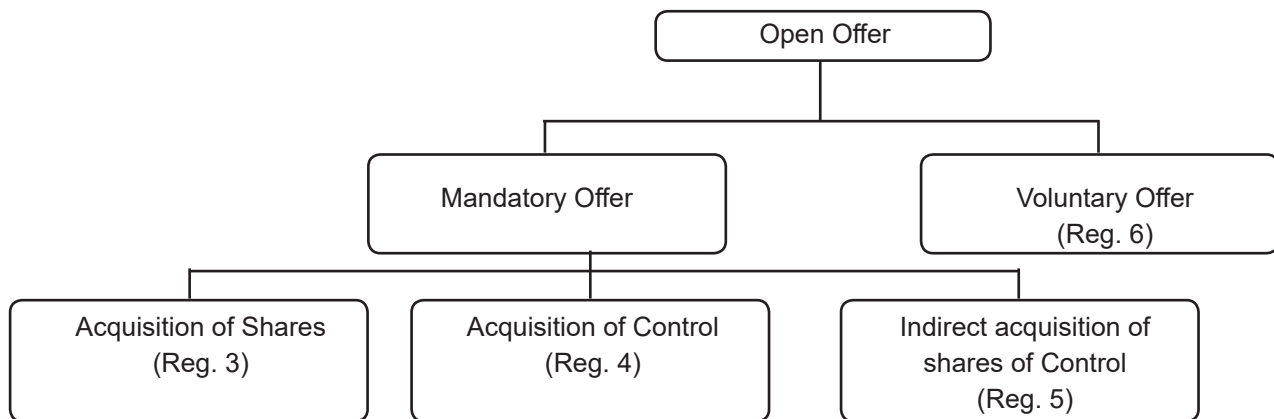
### **Creeping Acquisition Limit**

An acquirer who holds 25% or more but less than maximum permissible non-public shareholding of the Target Company, can acquire such additional shares as would entitle him to exercise more than 5% of the voting rights in any financial year ending March 31 only after making a Public Announcement to acquire minimum twenty six percent shares of Target Company from the shareholders through an Open Offer.

Name	Per Holding	Creeping Acquisition	Post Holding	Applicability of SEBI Takeover Regulation, 2011
A	23%	3%	26%	Open Offer Obligations
B	7%	2%	9%	—

## **OPEN OFFER**

SEBI Takeover Regulations, 2011 provides certain trigger events wherein the Acquirer is required to give Open Offer to the shareholders of the Target Company to provide them exit opportunity.



### I. Mandatory Open Offer

SEBI Takeover Regulations, 2011 provides a threshold for mandatory Open Offer. The regulations provide that whenever an acquirer acquires the shares in excess of the threshold as prescribed under regulation 3 and 4 of SEBI Takeover Regulations, 2011, then the acquirer is required to make a public announcement of offer to the shareholders of the Target Company.

Regulation 3 of the SEBI Takeover Regulations, 2011 provides the Acquirer to give an open offer to the shareholders of Target Company on the acquisition of shares or voting rights entitling the Acquirer along with the persons acting in concert with him to exercise 25% or more voting rights in the Target Company.

Further any Acquirer who holds shares between 25%-75%, together with PACs can acquire further 5% shares as creeping acquisition without giving an Open Offer to the shareholders of the Target Company upto a maximum of 75%. The quantum of acquisition of additional voting rights shall be calculated after considering the following:

#### (a) No Netting off allowed:

For the purpose of determining the quantum of acquisition of additional voting rights, the gross acquisitions without considering the disposal of shares or dilution of voting rights owing to fresh issue of shares by the target company shall be taken into account.

#### (b) Incremental voting rights in case of fresh issue

In the case of acquisition of shares by way of issue of new shares by the target company, the difference between the pre-allotment and the post-allotment percentage voting rights shall be regarded as the quantum of additional acquisition. **[Regulation 3(2)]**

#### ***What is the basis of computation of the creeping acquisitions limit under Regulation 3(2) of Takeover Regulations 2011?***

For computing acquisitions limits for creeping acquisition specified under regulation 3(2), gross acquisitions/purchases shall be taken into account thereby ignoring any intermittent fall in shareholding or voting rights whether owing to disposal of shares or dilution of voting rights on account of fresh issue of shares by the target company.

The Individual Acquirer Shareholding shall also be considered for determining the Open Offer Trigger Points apart from consolidated shareholding of Acquirer and Persons Acting in Concert. **[Regulation 3(3)]**

This shall not apply to acquisition of shares or voting rights of a company by the promoters or shareholders in control, in terms of the provisions of VI-A of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. **[Regulation 3(4)]**



Regulation 4 of the SEBI Takeover Regulations, 2011 specifies that if any acquirer including person acting in concert acquires control over the Target Company irrespective of the fact whether there has been any acquisition of shares or not, then he has to give public announcement to acquire shares from shareholders of the Target Company. **[Regulation 4]**

### **Delisting Offer**

Regulation 5A deals with delisting in case of certain cases arising out of open offer which is discussed below:

1. In the event the acquirer makes a public announcement of an open offer for acquiring shares of a target company, he may delist the company in accordance with provisions of the SEBI (Delisting of Equity Shares) Regulations, 2009 but the acquirer shall have declared upfront his intention to so delist at the time of making the detailed public statement.
2. Where an offer made is not successful-
  - (i) On account of non-receipt of prior approval of shareholders in terms of regulation 8(1)(b) of SEBI (Delisting of Equity Shares) Regulations, 2009; or
  - (ii) In terms of regulation 17 of SEBI (Delisting of Equity Shares) Regulations, 2009; or
  - (iii) On account of the acquirer rejecting the discovered price determined by the book building process in terms of regulation 16(1) of SEBI (Delisting of Equity Shares) Regulations, 2009,

The acquirer shall make an announcement within 2 working days in respect of such failure in all the newspapers in which the detailed public statement was made and shall comply with all applicable provisions of these regulations.

3. In the event of the failure of the delisting offer the acquirer, through the manager to the open offer, shall within five working days from the date of the announcement file with SEBI, a draft of the letter of offer and shall comply with all other applicable provisions of these regulations.

However, the offer price shall stand enhanced by an amount equal to a sum determined at the rate of ten per cent per annum for the period between the scheduled date of payment of consideration to the shareholders and the actual date of payment of consideration to the shareholders.

*Note:* Scheduled date shall be the date on which the payment of consideration ought to have been made to the shareholders in terms of the timelines in these regulations.

4. Where a competing offer is made -
  - (a) the acquirer shall not be entitled to delist the company;
  - (b) the acquirer shall not be liable to pay interest to the shareholders on account of delay due to competing offer;
  - (c) the acquirer shall comply with all the applicable provisions of these regulations and make an announcement in this regard, within two working days from the date of public announcement made, in all the newspapers in which the detailed public statement was made.
5. Shareholders who have tendered shares in acceptance of the offer, shall be entitled to withdraw such shares tendered, within 10 working days from the date of the announcement.
6. Shareholders who have not tendered their shares in acceptance of the offer shall be entitled to tender their shares in acceptance of the offer made under these regulations.

## II. Voluntary Open Offer

Voluntary Open Offer means the Open Offer given by the Acquirer voluntarily without triggering the mandatory Open Offer obligations as envisaged under the regulations. Voluntary Offers are an important means for substantial shareholders to consolidate their stake and therefore recognized the need to introduce a specific framework for such Open Offers.

Regulation 6 of the Takeover Regulations provides the threshold and conditions for making the Voluntary Open Offer which are detailed below:

- **Eligibility-Prior holding of atleast 25% shares**

To be eligible for making a Voluntary Open Offer, the regulations mandates the prior holding of atleast 25% stake in the Target Company by the Acquirer along with the PACs.

- **Shareholding of the Acquirer and PACs post completion of Open Offer**

Post completion of the Open Offer, the shareholding of the Acquirer along with PACs shall not exceed the maximum permissible non-public shareholding.

- **Acquisition of shares prior to the Voluntary Open Offer**

The Acquirer shall become ineligible to make a Voluntary Open Offer if during the preceding 52 weeks, the Acquirer or PACs with him has acquired shares of the Target Company without attracting the obligation to make a Public Announcement of an Open Offer. This condition is given because the Voluntary Open Offer is permitted as an exception to the general rule on the offer size, thus the ability to voluntarily make an Open Offer should not be available if in the proximate past, any of such persons have made acquisitions within the creeping acquisition limits permitted under the Regulations.

- **Prohibition on the acquisition of shares during the Offer Period**

SEBI Takeover Regulations, 2011 prohibits the acquirer who has made a Voluntary Open Offer from further acquiring the shares during the Offer Period otherwise than under the Open Offer.

- **Restriction of the acquisition of shares post completion of Voluntary Open Offer**

An acquirer and PACs who have made a Voluntary Open Offer shall not be entitled to further acquire shares for a period of 6 months after completion of the Open Offer except pursuant:

- (a) To another Voluntary Open Offer.
- (b) To Competing Open Offer to the Open Offer made by any other person for acquiring shares of the Target Company.

- **Offer size**

The Voluntary Open Offer shall be made for the acquisition of at least ten per cent (10%) of the voting rights in the Target Company and shall not exceed such number of shares as would result in the post-acquisition holding of the acquirer and PACs with him exceeding the maximum permissible non-public shareholding applicable to such Target Company.

According to Regulation 6A, any person who is a wilful defaulter shall not make a public announcement of an open offer for acquiring shares or enter into any transaction that would attract the obligation to make a public announcement of an open offer for acquiring shares.

This regulation shall not prohibit the wilful defaulter from making a competing offer in accordance with these regulations upon any other person making an open offer for acquiring shares of the target company.

## CONDITIONAL OFFER

An offer in which the acquirer has stipulated a minimum level of acceptance is known as a conditional offer.

Minimum level of acceptance implies minimum number of shares which the acquirer desires under the said conditional offer. If the number of shares validly tendered in the conditional offer, are less than the minimum level of acceptance stipulated by the acquirer, then the acquirer is not bound to accept any shares under the offer. In a conditional offer, if the minimum level of acceptance is not reached, the acquirer shall not acquire any shares in the target company under the open offer or the Share Purchase Agreement which has triggered the open offer.

## PUBLIC ANNOUNCEMENT

SEBI (SAST) Regulation, 2011 provides that whenever acquirer acquires the shares or voting rights of the Target Company in excess of the limits prescribed under these Regulations, Acquirer is required to give a Public Announcement of an Open Offer to the shareholder of the Target Company. During the process of making the Public Announcement of an Open Offer, the Acquirer is required to give Public Announcement and publish Detailed Public Statement. The regulations have prescribed the separate timeline for Public Announcement as well as for Detailed Public Statement.

I. Public Announcement

II. Detailed Public Statement

### ***Timing of Pubic Announcement***

The Public Announcement shall be sent to all the stock exchanges on which the shares of the target company are listed. Further, a copy of the same shall also be sent to SEBI and to the target company at its registered office within one working day of the date of the public announcement. The time within which the Public Announcement is required to be made to the Stock Exchanges under different circumstances is tabulated below:

Applicable Regulation	Particulars	Time of making Public Announcement to Stock Exchange
13(1)	Agreement to Acquirer Shares or Voting Rights or Control Over The Target Company.	On the same day of entering into agreement to acquire share, voting rights or control over the Target Company.
13(2)(a)	Market Purchase of shares.	Prior to the placement of purchase order with the stock broker.
13(2)(b)	Acquisition pursuant to conversion of Convertible Securities without a fixed date of conversion or upon conversion of depository receipts for the underlying shares.	On the same day when the option to convert such securities into shares is exercised.
13(2)(c)	Acquiring shares or voting rights or control pursuant to conversion of Convertible Securities with a fixed date of conversion.	On the second working day preceding the scheduled date of conversion of such securities into shares.
13(2)(d)	In case of disinvestment.	On the date of execution of agreement for acquisition of shares or voting rights or control over the Target Company.

13(2)(e)	In case of Indirect Acquisition where the parameters mentioned in Regulation 5(2) are not met	Within four working days of the following dates, whichever is earlier:  a. When the primary acquisition is contracted; and  b. Date on which the intention or decision to make the primary' acquisition is announced in the public domain.
13(2) (f)	In case of Indirect Acquisition where the parameters mentioned in Regulation 5(2) are met	On the same day of the following dates, whichever is earlier:  a. When the primary acquisition is contracted; and  b. Date on which the intention or decision to make the primary' acquisition is announced in the public domain.
13(2)(g)	Acquisition of shares, voting rights or control over the Target Company pursuant to Preferential Issue	On the date on which the Board of directors of the target company authorises such preferential issue
13(2)(h)	Increase in voting rights pursuant to a buy-back not qualifying for exemption under Regulation 10	Not later than 90th day from the date of closure of buy-back offer by the target company.
13(2)(i)	Acquisition of shares, voting rights or control over the Target Company where the such acquisition is beyond the control of acquirer	Not later than two working days from the date of receipt of such intimation.
13(2A)	Acquisition of shares, voting rights in or control over the Target Company through a combination :  (i) all agreement and any one or more modes of acquisition referred to in regulation 13(2), or  (ii) any one or more modes of acquisition referred in clause (a) to (i) of regulation 13(2) or	On the date of first acquisition, provided the acquirer in the public announcement the details of proposed subsequent acquisition.
13(3)	Voluntary Offer	On the same day when the Acquirer decides to make Voluntary Offer

#### **Timing of Detailed Public Statement**

In terms of Regulation 13(4) of SEBI (SAST) Regulations, 2011, a Detailed Public Statement shall be published by the acquirer through the Manager to the Open Offer within maximum 5 working days from the date of Public Announcement.

However, in case of Indirect Acquisition where none of condition specified in Regulation 5(2) are satisfied, the Detailed Public Statement shall be published not later than five working days of the completion of the primary acquisition of shares or voting rights in or control over the company or entity holding shares or voting rights in, or control over the target company.

**Publication of Public Announcement and Detailed Public Statement**

Regulation 14 of SEBI (SAST) Regulation, 2011 provides the requirements relating to publication of Public Announcement and Detailed Public Statement which are tabulated below:

Regulation	Particulars	Time	To whom
14(1)	Public Announcement	On the same day	All the stock exchanges on which the shares of the target company are listed. The stock exchanges shall forthwith disseminate such information to the public.
14(2)	Public Announcement	One working day of the date of the public announcement	The acquirer shall sent copy of Public announcement to SEBI and to the target company at its registered office.
14(3)	Detailed Public Statement	5 working days from the date of Public Announcement.	Publication in the following newspaper: (a) One Hindi national language daily with wide circulation (b) One English national language daily with wide circulation (c) One regional national language daily with wide circulation language at a place where registered office of the company is situated; and (d) One regional language daily with wide circulation at the place of the stock exchange where the maximum volume of trading in the shares of the target company is recorded during the sixty trading days preceding the date of the public announcement.
14(4)	Detailed Public Statement		A copy of Detailed Public Statement shall be sent to followings: (a) SEBI; (b) All the stock exchanges in which the shares of the target company are listed; and (c) The target company at its registered office.

After the publication of Detailed Public Statement, the acquirer is further required to file with SEBI a Draft of Letter of Offer within five working days from the date of Detailed Public Statement containing such information as may be specified along with non-refundable fees as prescribed by way of banker's cheque or demand draft payable in Mumbai in favour of SEBI.

**Offer price**

Offer price is the price at which the acquirer announces to acquire shares from the public shareholders under the open offer. The offer price shall not be less than the price as calculated under regulation 8 of the SAST Regulations, 2011 for frequently or infrequently traded shares.

If the target company's shares are frequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

Highest negotiated price per share under the share purchase agreement ("SPA") triggering the offer;

- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement ("PA"),
- Highest price paid for any acquisition by the acquirer during 26 weeks immediately preceding the PA;

- Volume weighted average market price for sixty trading days preceding the PA.

If the target company's shares are infrequently traded then the open offer price for acquisition of shares under the minimum open offer shall be highest of the following:

- Highest negotiated price per share under the share purchase agreement ("SPA") triggering the offer;
- Volume weighted average price of shares acquired by the acquirer during 52 weeks preceding the public announcement ("PA");
- Highest price paid or payable for any acquisition by the acquirer during 26 weeks immediately preceding the PA;
- The price determined by the acquirer and the manager to the open offer after taking into account valuation parameters including book value, comparable trading multiples, and such other parameters that are customary for valuation of shares of such companies.

It may be noted that the SEBI may at the expense of the acquirer, require valuation of shares by an independent merchant banker other than the manager to the offer or any independent chartered accountant in practice having a minimum experience of 10 years.

The shares of the target company will be deemed to be frequently traded if the traded turnover on any stock exchange during the 12 calendar months preceding the calendar month, in which the PA is made, is at least 10% of the total number of shares of the target company. If the said turnover is less than 10%, it will be deemed to be infrequently traded.

#### **SUBMISSION OF DRAFT LETTER OF OFFER**

The Acquirer shall submit a draft letter of offer to SEBI within 5 working days from the date of detailed public announcement along with a non-refundable fee as applicable. **[Regulation 16(1)]**

Simultaneously, a copy of the draft letter of offer shall be send to the Target Company at its registered office and to all the Stock Exchanges where the shares of the Company are listed. **[Regulation 18(1)]**

#### **DISPATCH OF LETTER OF OFFER**

The Acquirer shall ensure that the letter of offer is dispatched to the shareholders whose names appear on the register of members of the Target Company as of the identified date, and to the custodian of shares underlying depository receipts, if any, of the Company, within maximum 7 working days from the date of receipt of communication of comments from SEBI or where no comments are offered by SEBI, within 7 working days from the expiry 15 working days from the date of receipt of draft letter of offer by SEBI.

However, it is provided that where a shareholder holding less than 5% of the voting rights of the Target Company is resident outside India and local laws or regulations of such jurisdiction may expose the acquirer or the target company to material risk of civil, regulatory or criminal liabilities in the event, then the letter of offer in its final form were to be sent without material amendments or modifications into such jurisdiction, then the acquirer may refrain from dispatch of the letter of offer into such jurisdiction. **[Regulation 18(2)]**

#### **OPENING OF THE OFFER**

The tendering period shall start within maximum 12 working days from date of receipt of comments from SEBI and shall remain open for 10 working days. **[Regulation 18(8)]**

#### **COMPLETION OF REQUIREMENTS**

Within 10 working days from the last date of the tendering period, the acquirer shall complete all requirements

as prescribed under these regulations and other applicable law relating to the Open Offer including payment of consideration to the shareholders who have accepted the open offer. **[Regulation 18(10)]**

### RESTRICTION ON ACQUISITION

If the acquirer or persons acting in concert with him acquires shares of the target company during the period of 26 weeks after the tendering period at a price higher than the offer price, then the acquirer shall pay the difference between the highest acquisition price and the offer price, to all the shareholders whose shares were accepted in the open offer, within 60 days from the date of such acquisition. However, such provisions shall not be applicable if the acquisition is made through another open offer, Delisting of shares or open market purchase in the ordinary course on the stock exchange. **[Regulation 8(10)]**

### PROVISION OF ESCROW

Not later than two working days prior to the date of the detailed public statement of the open offer for acquiring shares, the acquirer shall create an escrow account towards security for performance of his obligations under these regulations, and deposit in escrow account such aggregate amount as per the following scale:

S. No.	Consideration payable under the Open Offer	Escrow Amount
(a)	On the first five hundred crore rupees	An amount equal to twenty-five per cent of the consideration
(b)	On the balance consideration	An additional amount equal to ten per cent of the balance consideration

However, where an open offer is made conditional upon minimum level of acceptance, hundred percent of the consideration payable in respect of minimum level of acceptance or fifty per cent of the consideration payable under the open offer, whichever is higher, shall be deposited in cash in the escrow account.

The escrow account may be in the form of, –

- (a) cash deposited with any scheduled commercial bank;
- (b) bank guarantee issued in favour of the manager to the open offer by any scheduled commercial bank; or
- (c) deposit of frequently traded and freely transferable equity shares or other freely transferable securities with appropriate margin.

### Release of amount from Escrow Account

Applicable Regulation	Details	
17(4)	Bank Guarantee or Deposit of Security	Deposit at least 1% of the total consideration payable in cash with schedule commercial bank as part of Escrow Account.
17(5)	Cash deposit	Empower the manager to the open offer to instruct the bank to issue a bankers cheque or demand draft or to make payment of the amounts lying to the credit of the escrow account.



17(6)	Bank Guarantee	The bank guarantee shall be in the favor of manager to the offer and shall be kept valid throughout the offer period and additional 30 days after the payment to the shareholders who have tendered their shares have been made.
17(7)	Securities	Manager to the Open Offer shall be empowered to realize the value of escrow account by way of sale or otherwise. Further in case of any shortfall in the amount in the escrow account such shortfall shall be made good by the Manager.

The amount lying in escrow account can be released in the following cases only:

1. In case of withdrawal of offer, the entire amount can be released only after certification by the merchant banker.
2. The amount deposited in escrow account is transferred to special bank account opened with the bankers to an issue. However, the amount so transferred shall not exceed 90% of the cash deposit.
3. The balance 10% is released to the acquirer on the expiry of thirty days from the completion of all obligations under the offer.
4. The entire amount to the acquirer on the expiry of thirty days from the completion of all obligations under the offer where the open offer is for exchange of shares or other secured instruments.
5. In the event of forfeiture of amount, the entire amount is distributed in the following manner:
  - One third of the amount to Target Company;
  - One third of the escrow account to the Investor Protection and Education Fund established under SEBI (Investor Protection and Education Fund) Regulations, 2009;
  - Residual one third is to be distributed to the shareholders who have tendered their shares in the offer.

## MODE OF PAYMENT

The offer price may be paid, –

- (a) in cash;
- (b) by issue, exchange or transfer of listed shares in the equity share capital of the acquirer or of any person acting in concert;
- (c) by issue, exchange or transfer of listed secured debt instruments issued by the acquirer or any person acting in concert with a rating not inferior to investment grade as rated by a credit rating agency registered with SEBI;
- (d) by issue, exchange or transfer of convertible debt securities entitling the holder thereof to acquire listed shares in the equity share capital of the acquirer or of any person acting in concert; or
- (e) a combination of the mode of payment of consideration stated in clause (a), clause (b), clause (c) and clause (d).

Where any shares have been acquired or agreed to be acquired by the acquirer and persons acting in concert with him during the fifty-two weeks immediately preceding the date of public announcement constitute more than ten per cent of the voting rights in the target company and has been paid for in cash, the open offer shall



entail an option to the shareholders to require payment of the offer price in cash, and a shareholder who has not exercised an option in his acceptance shall be deemed to have opted for receiving the offer price in cash.

In case of revision in offer price the mode of payment of consideration may be altered subject to the condition that the component of the offer price to be paid in cash prior to such revision is not reduced.

### **WITHDRAWAL OF OPEN OFFER**

1. An open offer for acquiring shares once made shall not be withdrawn except under any of the following circumstances, –

- (a) statutory approvals required for the open offer or for effecting the acquisitions attracting the obligation to make an open offer under these regulations having been finally refused, subject to such requirements for approval having been specifically disclosed in the detailed public statement and the letter of offer;
- (b) the acquirer, being a natural person, has died;
- (c) any condition stipulated in the agreement for acquisition attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, then it should be disclosed in the detailed public statement and the letter of offer; or
- (d) such circumstances as in the opinion of the SEBI, merit withdrawal.

SEBI shall pass a reasoned order permitting withdrawal and such order shall be listed by SEBI on its official website. However, an acquirer shall not withdraw an open offer pursuant to a public announcement made under clause (g) of sub-regulation (2) of regulation 13, even if the proposed acquisition through the preferential issue is not successful.

2. In the event of withdrawal of the open offer, the acquirer shall through the manager to the open offer, within two working days, –

- (a) make an announcement in the same newspapers in which the public announcement of the open offer was published, providing the grounds and reasons for withdrawal of the open offer; and
- (b) simultaneously with the announcement, inform in writing to,—
  - (i) SEBI;
  - (ii) all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public; and
  - (iii) the target company at its registered office.

### **OBLIGATIONS OF THE TARGET COMPANY**

Upon a public announcement of an open offer for acquiring shares of a target company being made, the board of directors of such target company shall ensure that during the offer period, the business of the target company is conducted in the ordinary course consistent with past practice.

During the offer period, unless the approval of shareholders of the target company by way of a special resolution by postal ballot is obtained, the board of directors of either the target company or any of its subsidiaries shall not, –

- (a) alienate any material assets whether by way of sale, lease, encumbrance or otherwise or enter into any agreement therefore outside the ordinary course of business;
- (b) effect any material borrowings outside the ordinary course of business;
- (c) issue or allot any authorised but unissued securities entitling the holder to voting rights.

However, the target company or its subsidiaries may, –

- (i) issue or allot shares upon conversion of convertible securities issued prior to the public announcement of the open offer, in accordance with pre-determined terms of such conversion;
- (ii) issue or allot shares pursuant to any public issue in respect of which the red herring prospectus has been filed with the Registrar of Companies prior to the public announcement of the open offer; or
- (iii) issue or allot shares pursuant to any rights issue in respect of which the record date has been announced prior to the public announcement of the open offer;
- (d) implement any buy-back of shares or effect any other change to the capital structure of the target company;
- (e) enter into, amend or terminate any material contracts to which the target company or any of its subsidiaries is a party, outside the ordinary course of business, whether such contract is with a related party, within the meaning of the term under applicable accounting principles, or with any other person; and
- (f) accelerate any contingent vesting of a right of any person to whom the target company or any of its subsidiaries may have an obligation, whether such obligation is to acquire shares of the target company by way of employee stock options or otherwise.

(3) In any general meeting of a subsidiary of the target company in respect of the matters referred to in sub-regulation (2), the target company and its subsidiaries, if any, shall vote in a manner consistent with the special resolution passed by the shareholders of the target company.

(4) The target company shall be prohibited from fixing any record date for a corporate action on or after the third working day prior to the commencement of the tendering period and until the expiry of the tendering period.

(5) The target company shall furnish to the acquirer within two working days from the identified date, a list of shareholders as per the register of members of the target company containing names, addresses, shareholding and folio number, in electronic form, wherever available, and a list of persons whose applications, if any, for registration of transfer of shares are pending with the target company:

However, the acquirer shall reimburse reasonable costs payable by the target company to external agencies in order to furnish such information.

(6) Upon receipt of the detailed public statement, the board of directors of the target company shall constitute a committee of independent directors to provide reasoned recommendations on such open offer, and the target company shall publish such recommendations.

However, such committee shall be entitled to seek external professional advice at the expense of the target company.

(7) The committee of independent directors shall provide its written reasoned recommendations on the open offer to the shareholders of the target company and such recommendations shall be published in such form as may be specified, at least two working days before the commencement of the tendering period, in the same newspapers where the public announcement of the open offer was published, and simultaneously, a copy of the same shall be sent to, –

- (i) SEBI;
- (ii) all the stock exchanges; and
- (iii) to the manager to the open offer, and where there are competing offers, to the manager to the open offer for every competing offer.

(8) The board of directors of the target company shall facilitate the acquirer in verification of shares tendered in acceptance of the open offer.

(9) The board of directors of the target company shall make available to all acquirers making competing offers, any information and co-operation provided to any acquirer who has made a competing offer.

(10) Upon fulfilment by the acquirer, of the conditions required under these regulations, the board of directors of the target company shall without any delay register the transfer of shares acquired by the acquirer in physical form, whether under the agreement or from open market purchases, or pursuant to the open offer.

### **OBLIGATIONS OF THE ACQUIRER**

(1) Prior to making the public announcement of an open offer for acquiring shares under these regulations, the acquirer shall ensure that firm financial arrangements have been made for fulfilling the payment obligations under the open offer and that the acquirer is able to implement the open offer, subject to any statutory approvals for the open offer that may be necessary.

(2) In the event the acquirer has not declared an intention in the detailed public statement and the letter of offer to alienate any material assets of the target company or of any of its subsidiaries whether by way of sale, lease, encumbrance or otherwise outside the ordinary course of business, the acquirer, where he has acquired control over the target company, shall be debarred from causing such alienation for a period of two years after the offer period.

However, in the event the target company or any of its subsidiaries is required to so alienate assets despite the intention to alienate not having been expressed by the acquirer, such alienation shall require a special resolution passed by shareholders of the target company, by way of a postal ballot and the notice for such postal ballot shall inter alia contain reasons as to why such alienation is necessary.

(3) The acquirer shall ensure that the contents of the public announcement, the detailed public statement, the letter of offer and the post-offer advertisement are true, fair and adequate in all material aspects and not misleading in any material particular, and are based on reliable sources, and state the source wherever necessary.

(4) The acquirer and persons acting in concert with him shall not sell shares of the target company held by them, during the offer period.

(5) The acquirer and persons acting in concert with him shall be jointly and severally responsible for fulfilment of applicable obligations under these regulations.

### **DISCLOSURES**

In SEBI Takeover Regulations, 2011, the obligation to give the disclosures on the acquisition of certain limits is only on the acquirer and not on the Target Company. Further as against the Open Offer obligations where the individual shareholding is also to be considered, the disclosure shall be of the aggregated shareholding and voting rights of the acquirer or promoter of the target company or every person acting in concert with him.

Clause 29(2) even if such change in shareholding or voting rights result in shareholding falling below 5%, if there is change in such holding from last disclosure made.

#### **EVENT BASED DISCLOSURES**

<b>Regulation</b>	<b>Made</b>	<b>Trigger</b>	<b>Time Period</b>	<b>Made to</b>
Regulation 29(1)	Acquirer	Acquirer + Persons acting in concert (PAC) acquiring 5% or more shares of the target company	2 working days of the receipt of intimation of allotment of shares, or the acquisition of shares or voting rights	SE where the shares are listed and the target company

Regulation 29(2)	Acquirer	The number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below five per cent and such change exceed 2% of total shareholding or voting rights in the target company by the Acquirer + PAC holding 5% or more shares, of the target company or voting rights.		
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Note :

- Shares taken by way of encumbrance shall be treated as an “acquisition”.
- Share given upon release of encumbrance shall be treated as a “disposal”
- The requirement as listed above shall not apply to a Scheduled Commercial bank or public financial institution as pledge in connection with a pledge of shares for securing indebtedness in the ordinary course of business.

#### CONTINUAL DISCLOSURES

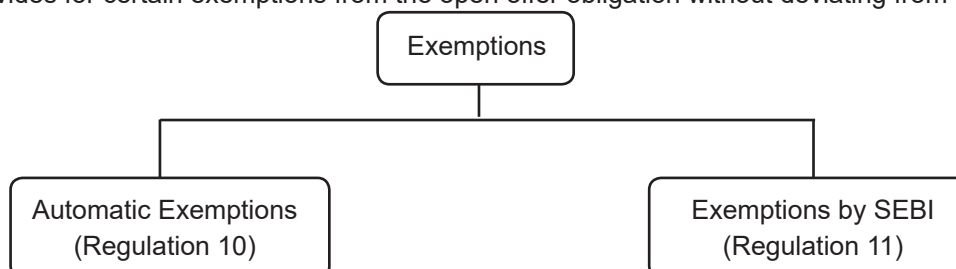
Regulation	Trigger	Time Period	Made to
Regulation 30(1)	Any Person + PAC holding more than 25% shares or voting rights in the target to disclose their aggregate shareholding and voting rights	Within 7 working days from the financial year ending 31st March every year	SE where the shares are listed and target company

#### DISCLOSURES OF PLEDGED/ENCUMBERED SHARES

Regulation	Made	Trigger	Time Period	Made to
Regulation 31(1)	Promoter	Promoter + PAC pledging or creating encumbrance on the shares of the target company	Within 7 working days from the creation, invocation or release of pledge	Stock exchange where the shares are listed and target company
Regulation 31(2)	Acquirer	Invocation or release of the pledge or encumbrance on the shares of the target company	—	—

#### EXEMPTIONS

While the fundamental objective of the Takeover Code is investor protection, the Takeover Code like the 1997 Code also provides for certain exemptions from the open offer obligation without deviating from its objective.



### **Regulation 10 - Automatic Exemptions**

Regulation 10 of the SEBI Takeover Regulations, 2011 provides for automatic exemptions from the applicability of making Open Offer to the shareholders of the Target Company in respect of certain acquisitions subject to the compliance of certain conditions specified therein.

Further, Regulation 11 of SEBI Takeover Regulations, 2011 provides the provisions whereby the acquirer can apply to SEBI for availing the exemption from the Open Offer obligations and the Target Company can apply for relaxation from strict compliance with any procedural requirement relating to Open Offer as provided under Chapter III and IV of these regulations.

Some of the important exemptions provided therein regulation 10 along with their conditions for exemption is detailed below:

The following acquisitions shall be exempt from the obligation to make an open offer under regulation 3 and regulation 4 :

- (1) (a) acquisition pursuant to inter se transfer of shares amongst qualifying persons, being, –
  - (i) immediate relatives;
  - (ii) persons named as promoters in the shareholding pattern filed by the target company in terms of the listing agreement or these regulations for not less than three years prior to the proposed acquisition;
  - (iii) a company, its subsidiaries, its holding company, other subsidiaries of such – holding company, persons holding not less than fifty per cent of the equity shares of such company, other companies in which such persons hold not less than fifty per cent of the equity shares, and their subsidiaries subject to control over such qualifying persons being exclusively held by the same persons;
  - (iv) persons acting in concert for not less than three years prior to the proposed acquisition, and disclosed as such pursuant to filings under the listing agreement;
  - (v) shareholders of a target company who have been persons acting in concert for a period of not less than three years prior to the proposed acquisition and are disclosed as such pursuant to filings under the listing agreement, and any company in which the entire equity share capital is owned by such shareholders in the same proportion as their holdings in the target company without any differential entitlement to exercise voting rights in such company;

However, for purposes of availing of the exemption under this clause, –

- (i) If the shares of the target company are frequently traded, the acquisition price per share shall not be higher by more than twenty-five per cent of the volume-weighted average market price for a period of sixty trading days preceding the date of issuance of notice for the proposed inter se transfer, as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, and if the shares of the target company are infrequently traded, the acquisition price shall not be higher by more than twenty-five percent of the price determined; and
  - (ii) the transferor and the transferee shall have complied with applicable disclosure requirements set out in these regulations.
- (b) acquisition in the ordinary course of business by, –
  - (i) an underwriter registered with SEBI by way of allotment pursuant to an underwriting agreement in terms of the SEBI (ICDR) Regulations, 2009;

- (ii) a stock broker registered with SEBI on behalf of his client in exercise of lien over the shares purchased on behalf of the client under the bye-laws of the stock exchange where such stock broker is a member;
  - (iii) a merchant banker registered with SEBI or a nominated investor in the process of market making or subscription to the unsubscribed portion of issue in terms of Chapter XB of SEBI (ICDR) Regulations, 2009;
  - (iv) any person acquiring shares pursuant to a scheme of safety net in terms of SEBI (ICDR) Regulations, 2009;
  - (v) a merchant banker registered with SEBI acting as a stabilising agent or by the promoter or pre-issue shareholder in terms of SEBI (ICDR) Regulations, 2009;
  - (vi) by a registered market-maker of a stock exchange in respect of shares for which he is the market maker during the course of market making;
  - (vii) a Scheduled Commercial Bank, acting as an escrow agent; and
  - (viii) invocation of pledge by Scheduled Commercial Banks or Public Financial Institutions as a pledgee.
- (c) acquisitions at subsequent stages, by an acquirer who has made a public announcement of an open offer for acquiring shares pursuant to an agreement of disinvestment, as contemplated in such agreement:

However, (i) both the acquirer and the seller are the same at all the stages of acquisition; and (ii) full disclosures of all the subsequent stages of acquisition, if any, have been made in the public announcement of the open offer and in the letter of offer.

- (d) acquisition pursuant to a scheme, –
- (i) made under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 or any statutory modification or re-enactment thereto;
  - (ii) of arrangement involving the target company as a transferor company or as a transferee company, or reconstruction of the target company, including amalgamation, merger or demerger, pursuant to an order of a court or a tribunal or a competent authority under any law or regulation, Indian or foreign; or
  - (iii) of arrangement not directly involving the target company as a transferor company or as a transferee company, or reconstruction not involving the target company's undertaking, including amalgamation, merger or demerger, pursuant to an order of a court or a tribunal or a competent authority under any law or regulation, Indian or foreign, subject to, –
    - A. the component of cash and cash equivalents in the consideration paid being less than twenty-five per cent of the consideration paid under the scheme; and
    - B. where after implementation of the scheme of arrangement, persons directly or indirectly holding at least thirty-three per cent of the voting rights in the combined entity are the same as the persons who held the entire voting rights before the implementation of the scheme.
- (da) acquisition pursuant to a resolution plan approved under section 31 of the Insolvency and Bankruptcy Code, 2016.
- (e) acquisition pursuant to the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

- (f) acquisition pursuant to the provisions of SEBI (Delisting of Equity Shares) Regulations, 2009;
- (g) acquisition by way of transmission, succession or inheritance;
- (h) acquisition of voting rights or preference shares carrying voting rights arising out of the operation of subsection (2) of section 47 of the Companies Act, 2013.
- (i) Acquisition of shares by the lenders pursuant to conversion of their debt as part of a debt restructuring scheme implemented in accordance with the guidelines specified by RBI.

However, the conditions specified under sub-regulation (5) of regulation 70 of the SEBI (ICDR) Regulations, 2009 are complied with.

- (ia) Acquisition of shares by the person(s), by way of allotment by the target company or purchase from the lenders at the time of lenders selling their shareholding or enforcing change in ownership in favour of such person(s), pursuant to a debt restructuring scheme implemented in accordance with the guidelines specified by RBI.

However, in respect of acquisition by persons by way of allotment by the target company, the conditions specified under regulation 70(6) of the SEBI (ICDR) Regulations, 2009 are complied with.

Further that in respect of acquisition by way of purchase of shares from the lenders, the acquisition shall be exempted subject to the compliance with the following conditions:

- (a) the guidelines for determining the purchase price have been specified by the RBI and that the purchase price has been determined in accordance with such guidelines;
- (b) the purchase price shall be certified by two independent qualified valuers, and “Valuer” shall be a person who is registered under section 247 of the Companies Act, 2013 and the relevant Rules framed thereunder.

However, till such date on which section 247 of the Companies Act, 2013 and the relevant Rules come into force, valuer shall mean an independent merchant banker registered with SEBI or an independent chartered accountant in practice having a minimum experience of ten years;

- (c) specified securities shall be locked-in for a period of at least three years from the date of purchase;
- (d) the lock-in of equity shares acquired pursuant to conversion of convertible securities purchased from the lenders shall be reduced to the extent the convertible securities have already been locked in;
- (e) a special resolution has been passed by shareholders before the purchase;
- (f) the issuer shall, in addition to the disclosures required under the Companies Act, 2013 or any other applicable law, disclose the following information pertaining to the proposed acquirer(s) in the explanatory statement to the notice for the general meeting proposed for passing special resolution:
  - 1. the identity including of the natural persons who are the ultimate beneficial owners of the shares proposed to be purchased and/ or who ultimately control the proposed acquirer(s);
  - 2. the business model;
  - 3. a statement on growth of business over the period of time;



4. summary of audited financials of previous three financial years;
5. track record in turning around companies, if any;
6. the proposed roadmap for effecting turnaround of the issuer.

(g) Applicable provisions of the Companies Act, 2013 are complied with.

- (j) increase in voting rights arising out of the operation of sub-section (1) of section 106 of the Companies Act, 2013 or pursuant to a forfeiture of shares by the target company, undertaken in compliance with the provisions of the Companies Act, 2013 and its articles of association.

(2) The acquisition of shares of a target company, not involving a change of control over such target company, pursuant to a scheme of corporate debt restructuring in terms of the Corporate Debt Restructuring Scheme notified by the Reserve Bank of India vide Circular No. B.P.BC 15/21.04, 114/2001 dated August 23, 2001, or any modification or re-notification thereto provided such scheme has been authorised by shareholders by way of a special resolution passed by postal ballot, shall be exempted from the obligation to make an open offer.

(3) An increase in voting rights in a target company of any shareholder beyond the limit attracting an obligation to make an open offer under sub-regulation (1) of regulation 3, pursuant to buy-back of shares by the target company shall be exempt from the obligation to make an open offer provided such shareholder reduces his shareholding such that his voting rights fall to below the threshold referred to in regulation 3(1) within ninety days from the date of the closure of the said buy back offer.

(4) The following acquisitions shall be exempt from the obligation to make an open offer –

- (a) acquisition of shares by any shareholder of a target company, upto his entitlement, pursuant to a rights issue;
- (b) acquisition of shares by any shareholder of a target company, beyond his entitlement, pursuant to a rights issue, subject to fulfilment of the following conditions, –
  - (i) the acquirer has not renounced any of his entitlements in such rights issue; and
  - (ii) the price at which the rights issue is made is not higher than the ex-rights price of the shares of the target company, being the sum of, –
    - (A) the volume weighted average market price of the shares of the target company during a period of sixty ending on the day prior to the date of determination of the rights issue price, multiplied by the number of shares outstanding prior to the rights issue, divided by the total number of shares outstanding after allotment under the rights issue. However, such volume weighted average market price shall be determined on the basis of trading on the stock exchange where the maximum volume of trading in the shares of such target company is recorded during such period; and
    - (B) the price at which the shares are offered in the rights issue, multiplied by the number of shares so offered in the rights issue divided by the total number of shares outstanding after allotment under the rights issue.
- (c) increase in voting rights in a target company of any shareholder pursuant to buy-back of shares. However:
  - (i) such shareholder has not voted in favour of the resolution authorising the buy-back of securities under section 68 of the Companies Act, 2013;
  - (ii) in the case of a shareholder resolution, voting is by way of postal ballot;
  - (iii) where a resolution of shareholders is not required for the buy-back, such shareholder, in his



capacity as a director, or any other interested director has not voted in favour of the resolution of the board of directors of the target company authorising the buy-back of securities under section 68 of the Companies Act, 2013; and

(iv) the increase in voting rights does not result in an acquisition of control by such shareholder over the target company. However, where the aforesaid conditions are not met, in the event such shareholder reduces his shareholding such that his voting rights fall below the level at which the obligation to make an open offer would be attracted under sub-regulation (2) of regulation 3, within ninety days from the date of closure of the buy-back offer by the target company, the shareholder shall be exempt from the obligation to make an open offer;

(d) acquisition of shares in a target company by any person in exchange for shares of another target company tendered pursuant to an open offer for acquiring shares under these regulations;

(e) acquisition of shares in a target company from state-level financial institutions or their subsidiaries or companies promoted by them, by promoters of the target company pursuant to an agreement between such transferors and such promoter;

(f) acquisition of shares in a target company from a venture capital fund or foreign venture capital investor registered with SEBI, by promoters of the target company pursuant to an agreement between such venture capital fund or category I Alternative Investment Fund or foreign venture capital investor and such promoters.

(5) In respect of acquisitions under clause (a) of sub-regulation (1), and clauses (e) and (f) of sub-regulation (4), the acquirer shall intimate the stock exchanges where the shares of the target company are listed, the details of the proposed acquisition in such form as may be specified, at least four working days prior to the proposed acquisition, and the stock exchange shall forthwith disseminate such information to the public.

(6) In respect of any acquisition made pursuant to exemption provided for in this regulation, the acquirer shall file a report with the stock exchanges where the shares of the target company are listed, in such form as may be specified not later than four working days from the acquisition, and the stock exchange shall forthwith disseminate such information to the public.

(7) In respect of any acquisition of or increase in voting rights pursuant to exemption provided for in clause (a) of sub-regulation (1), sub-clause (iii) of clause (d) of sub-regulation (1), clause (h) of sub-regulation (1), sub-regulation (2), sub-regulation (3) and clause (c) of sub-regulation (4), clauses (a), (b) and (f) of sub-regulation (4), the acquirer shall, within twenty-one working days of the date of acquisition, submit a report in such form as may be specified along with supporting documents to SEBI giving all details in respect of acquisitions, along with a non-refundable fee of rupees one lakh fifty thousand by way of direct credit in the bank account through NEFT/ RTGS/IMPS or any other mode allowed by RBI or by way of a banker's cheque or demand draft payable in Mumbai in favour of SEBI.

### **Regulation 11 – Exemption by SEBI**

Regulation 11 provides that on an application being made by the acquirer in writing giving the details of the proposed acquisition and grounds on which the exemption is sought along with duly sworn affidavit, SEBI may grant exemption to the acquirer from the Open Offer obligations subject to the compliance with such conditions as it deems fits. For instance, in case where the exemptions is sought from the Open Offer obligations which has been triggered pursuant to the issue of shares by way preferential allotment, SEBI may require that the approval of shareholders should be obtained by way of postal ballot. Further, along with the application, the acquirer is also required to pay a non-refundable fee of Rs.5,00,000, by way of direct credit in the bank account through NEFT/RTGS/IMPS or any other mode allowed by or by way of banker's cheque or demand draft in payable in favour of Mumbai.

However, it is to be noted that the Acquirer is not exempted from making other compliances related to the disclosure requirements as provided under regulation 29, 30 and 31 of the SEBI Takeover Regulations, 2011.

#### COMPLIANCES UNDER SAST

Regulation	Particulars of Compliances	Time frame within which it shall be complied
<b>PUBLIC ANNOUNCEMENT</b>		
13(1)	Agreement to acquire shares or voting rights or control over the Target Company	On the same day of entering into agreement to acquire share, voting rights or control over the Target Company.
13(2)(a)	Market Purchase of shares	Prior to the placement of purchase order with the stock broker.
13(2)(b)	Acquisition pursuant to conversion of Convertible Securities without a fixed date of conversion or upon conversion of depository receipts for the underlying shares	On the same day when the option to convert such securities into shares is exercised.
13(2)(c)	Acquiring shares or voting rights or control pursuant to conversion of Convertible Securities with a fixed date of conversion	On the second working day preceding the scheduled date of conversion of such securities into shares.
13(2)(d)	In case of disinvestment	On the date of execution of agreement for acquisition of shares or voting rights or control over the Target Company.
13(2)(e)	In case of Indirect Acquisition where the parameters mentioned in Regulation 5(2) are not met	Within four working days of the following dates, whichever is earlier:  a. When the primary acquisition is contracted; and  b. Date on which the intention or decision to make the primary acquisition is announced in the public domain
13(2)(f)	In case of Indirect Acquisition where the parameters mentioned in Regulation 5(2) are met	On the same day of the following dates, whichever is earlier:  a. When the primary acquisition is contracted; and  b. Date on which the intention or decision to make the primary acquisition is announced in the public domain.
13(2)(g)	Acquisition of shares, voting rights or control over the Target Company pursuant to Preferential Issue	On the date when the board of directors of the target company authorizes such preferential issue
13(2)(h)	Increase in voting rights pursuant to a buy-back not qualifying for exemption under Regulation 10	Not later than 90th day from the date of closure of the buy-back offer by the target company.
13(2)(i)	Acquisition of shares, voting rights or control over the Target Company where the such acquisition is beyond the control of acquirer	Not later than two working days from the date of receipt of such intimation.

13(3)	Voluntary Offer	On the same day when the Acquirer decides to make Voluntary Offer
14(1)	Public Announcement shall be sent to all the stock exchanges and same information disseminate to public	On the same day
14(2)	Public Announcement shall also sent to Board of Directors and Target Company at its Registered Office	One working day of the date of the public announcement
14(3)	Detailed Public Statement pursuant to the public announcement shall be published in all Editions of any one of English Newspaper, any one Hindi Newspaper and any one Regional Language newspaper. Where registered office of company and any one Regional Language Newspaper at place of stock exchange where highest volume traded in preceding 60 days.	Within 5 working days from the date of Public Announcement
14(4)	Such detailed public statement in the newspapers, a copy of the same shall be sent a) SEBI; b) All the stock exchanges on which the shares of the target company are listed c) the target company at its registered office	Immediately
16	Submission of Letter of Offer to SEBI with non-refundable fees	within 5 working days from the date of detailed public announcement
17	Opening of Escrow Account	Not later than two working days prior to the date of the detailed public statement of the open offer for acquiring shares
18(1)	The acquirer shall send a copy of the draft letter of offer to the target company at its registered office address and to all stock exchanges where the shares of the target company are listed.	Immediately
18(2)	The letter of offer shall be dispatched to the shareholders whose names appear on the register of members of the target company as of the identified date	not later than seven working days from the receipt of comments from SEBI or where no comments are offered by SEBI, within seven working days from the expiry of the period stipulated in regulation 16(4)
18(3)	The acquirer shall send the letter of offer to the custodian of shares underlying depository receipts, if any, of the target company.	Immediately
18(8)	Opening of the offer	not later than 12 working days from date of receipt of comments from SEBI and shall remain open for 10 working days

18(10)	Completion of requirements relating to the Open Offer tendering period	Within 10 working days from the last date of the tendering period
<b>EVENT BASED DISCLOSURES</b>		
	<b>Disclosure of Acquisition and Disposal</b>	
29(1)	When an Acquirer together with PAC acquires 5% or more in aggregate of the shares or voting rights of the target company (together with the existing shares or voting rights held by them) shall disclose to Stock Exchange & Target Company	Within 2 working days of the receipt of intimation of allotment of shares or acquisition of shares or voting rights
29(2)	When an Acquirer together with PAC holding 5% or more in a target company shall disclose every acquisition or disposal of shares representing 2% or more of the shares or voting rights.	Within 2 working days of the receipt of intimation of allotment of shares or disposal or acquisition of shares or voting rights
<b>ANNUAL DISCLOSURES</b>		
	<b>Continual disclosures</b>	
30(1)	Acquirer with PAC holding 25% or more shares or voting rights to Stock Exchange and Target Company	Within seven working days from the end of each financial year i.e., <b>31 March</b>
30(2)	Promoter with PAC shall disclose their aggregate shareholding to the stock Exchange and Target	Within seven working days from the end of each financial year i.e., <b>31 March</b>
	<b>Disclosure of Encumbered Shares</b>	
31(1)	A Promoter shall disclose details of shares in such target company encumbered by him or by PAC's with him	Within 7 working days from the creation or invocation or release of encumbrance as the case may be
31(2)	A Promoter shall disclose details of invocation of such encumbrance or release of such encumbrance of shares	Within 7 working days from the creation or invocation or release of encumbrance as the case may be

### LESSON ROUND UP

- SAST aims at protecting interest of the investors in securities of a listed company providing amongst others, an opportunity for the public shareholders to exit where there is a substantial acquisition of shares or voting rights or control over a listed company, consolidation of holdings by existing shareholders and related disclosures and penalties for non-compliance etc.
- The Takeover Regulations, 1997 stand repealed from October 22, 2011, i.e. the date on which SAST Regulations, 2011 come into force.
- SEBI Takeover Regulations, 2011 provides certain trigger events wherein the Acquirer is required to give Open Offer to the shareholders of the Target Company to provide them exit opportunity.
- Regulation 6 of the Takeover Regulations provides the threshold and conditions for making the Voluntary Open Offer.

- An offer in which the acquirer has stipulated a minimum level of acceptance is known as a conditional offer.
- Regulation 10 & 11 provides for automatic exemptions and exemptions by SEBI.
- The public announcement shall be sent to all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public.
- In SEBI Takeover Regulations, 2011, the obligation to give the disclosures on the acquisition of certain limits is only on the acquirer and not on the Target Company.

## GLOSSARY

<b>Competitive Bid</b>	An offer made by a person other than the acquirer who has made the first public announcement.
<b>Control of management</b>	The right to appoint directly or indirectly or by virtue of agreements or in any other manner majority of directors on the Board of the target company or to control management or policy decisions affecting the target company.
<b>Corporate restructuring</b>	Involves making radical changes in the composition of the businesses in the company's portfolio.
<b>Disinvestment</b>	Disinvestment means the direct or indirect sale by the Central Government or any State Government or by a government company, as the case may be, of shares or voting rights in, or control over, a target company, which is a public sector undertaking;
<b>Encumbrance</b>	It shall include a pledge, lien or any such transaction, by whatever name called.
<b>Public Announcement</b>	A public announcement is an announcement made in the newspapers by the acquirer primarily disclosing his intention to acquire shares of the target company from existing shareholders by means of an open offer.
<b>Takeover</b>	Takeover is a corporate device whereby one company acquires control over another company, usually by purchasing all or majority of its shares.
<b>Weighted average number of total shares</b>	Weighted average number of total shares means the number of shares at the beginning of a period, adjusted for shares cancelled, bought back or issued during the aforesaid period, multiplied by a time-weighting factor.

## SELF TEST QUESTIONS

(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.)

1. What is the meaning of Person acting in concert under SEBI (SAST) 2011 Regulations?
2. What are the conditions for making Voluntary open offer?
3. What are the provisions relating to Public announcement under the Takeover regulations?
4. Discuss about the continuous disclosure required to be made under these regulations.
5. Briefly explain the conditions on which SEBI can grant exemption to an acquirer.
6. What do you mean by creeping acquisition?
7. Briefly explain the provisions relating to Escrow Account.



# Lesson 7

## SEBI (Buy-Back of Securities) Regulations 1998

### LESSON OUTLINE

- Introduction
- Objectives of Buy-back
- Applicability
- Important Definitions
- Authorisation in the Articles
- Methods of buy back
- Board resolution
- Special resolution
- Explanatory statement
- Disclosures under Schedule II Part A
- Buy-back from existing security-holders through tender offer
- Odd-lot Buy-back
- Buy-back from Open Market
- Obligations of the Company
- Obligations of merchant banker
- Buy-back vis-a-vis compliance under SEBI (SAST) Regulations, 2011
- LESSON ROUND UP
- GLOSSARY
- SELF-TEST QUESTIONS

### LEARNING OBJECTIVES

There are generally two ways a company can return cash to its shareholders – declaration of dividend or through a buyback of shares. A buyback represents a more flexible way of returning surplus cash to its shareholders as it is governed by a process laid down by law, it is carried out through the stock exchange mechanism and is more tax efficient as it does not involve the company to make payment of dividend distribution tax and it has the benefits of long term capital gains. 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. Under the Companies Act, 2013 buyback is governed by sections 68, 69 and 70 and listed companies are governed by the SEBI (Buy-Back of Securities) Regulations, 1998.

Being a company secretary of a company it is very important to know about the various procedural requirements of Buy-back by a Company. Because a company secretary can only then be able to make the directors understand the real effects of buy back when deciding to return cash to shareholders or to pursue other investment options. A buyback's impact on share price comes from changes in a company's capital structure and, more critically, from the signals a buyback sends. Investors are generally relieved to learn that companies don't intend to do something wasteful such as make an unwise acquisition or a poor capital expenditure with the excess cash.

So this lesson will give an insight into various methods of buy back available, prohibitions, objectives and process of buy back etc.

## INTRODUCTION

The corporates adopts various tools, viz., mergers, amalgamations and takeovers for restructuring the business. 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.

Similarly, buy-back of securities is a corporate financial strategy which involves repurchase of its outstanding shares by a company. Companies generally buyback shares in order to reorganise its capital structure, return cash to shareholders and enhance overall shareholders' value. Buyback leads to reduction in outstanding number of equity shares, which may lead to improvement in earnings per equity share and enhance return on net worth and create long term value for continuing shareholders.

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.

## 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.

- 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 efficient.

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.

## APPLICABILITY

The SEBI (Buy-back of Securities) Regulations, 1998 as amended from time to time apply to buy-back of shares or other specified securities of a company listed on a stock exchange.

A company listed on a stock exchange shall not buy-back its shares or other specified securities so as to delist its shares or other specified securities from the stock exchange.

## IMPORTANT DEFINITIONS

**“Associate”** includes a person, who directly or indirectly by himself or in combination with relatives, exercise control over the company or, whose employee, officer or director is also a director, officer or employee of another 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 security-holders or voting agreements or in any other manner.

**“Small shareholder”** means a shareholder of a listed company, who holds shares or other specified securities whose market value, on the basis of closing price of shares or other specified securities, on the recognized stock exchange in which highest trading volume in respect of such security, as on record date is not more than two lakh rupee;

**“Securities”** ‘means ‘securities’ as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956;

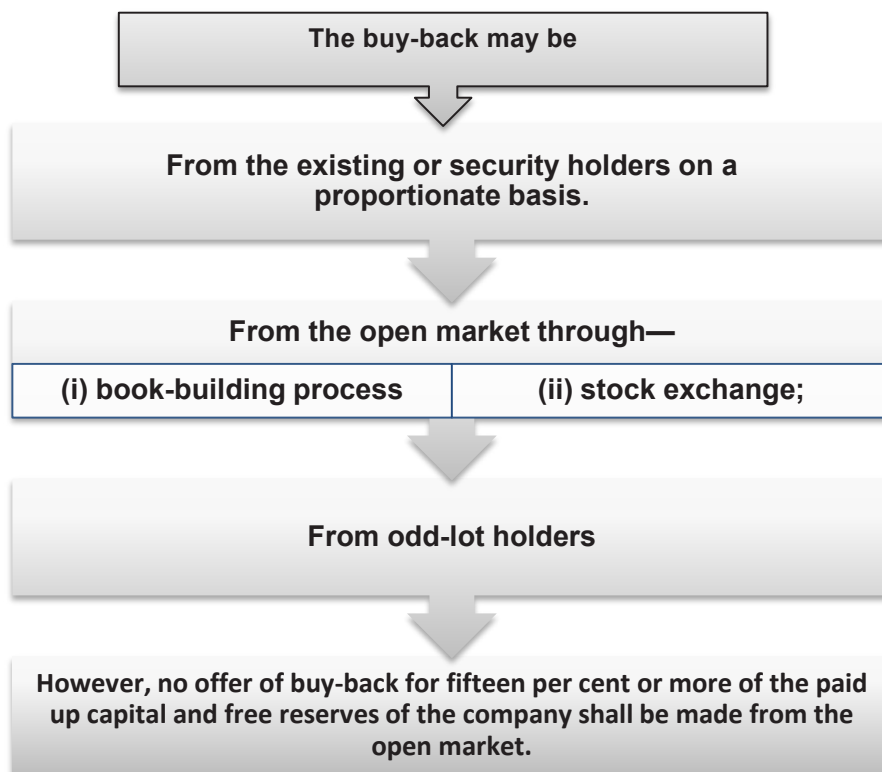
**“Tender offer”** means an offer by a company to buy-back its shares or other specified securities through a letter of offer from the holders of the shares or other specified securities of the company.

### AUTHORISATION IN THE ARTICLES

The articles of association of the company should authorise the buyback of securities. In case, such a provision is not available, it would be necessary to alter the articles of association to authorise buyback.

Buy-back can be made with the approval of the Board of directors at a meeting and/or by a special resolution passed by shareholders in a general meeting, depending on the quantum of buy back. In case of a listed company, approval of shareholders shall be obtained only by postal ballot.

### METHODS OF BUY-BACK



A company shall not buy-back its shares or other specified securities from any person through negotiated deals, whether on or of the stock exchange or through spot transactions or through any private arrangement.

Any person or an insider shall not deal in securities of the company on the basis of unpublished information relating to buy-back of shares or other specified securities of the company.

A company shall not make any offer of buy-back within a period of one year reckoned from the date of closure of the preceding offer of buy-back, if any.

**Can a company buy back its shares or any specified securities through negotiated deal on or of the stock exchange?**

**No, Regulation 4(2) does not permit buy back through negotiated deals (of and on stock exchange) or private arrangement or spot transactions.**

## BOARD RESOLUTION

A company, authorized by a resolution passed by the Board of Directors at its meeting to buy back its shares or other specified securities under first proviso to clause (b) of sub-section (2) of section 68 of the Companies Act, 2013 shall file a copy of the resolution, with SEBI and the stock exchanges, where the shares or other specified securities of the company are listed, within two working days of the date of the passing of the resolution.

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 68 (2)(b)]. 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 179(3)(b)]. Such a resolution should not be passed by circulation or at a meeting of a committee of the Board.

## SPECIAL RESOLUTION

For the purposes of passing a special resolution the explanatory statement to be annexed to the notice for the general meeting shall contain disclosures as specified in Schedule II Part A to the Regulations. A copy of the above resolution shall be filed with SEBI and the stock exchanges where the shares or other specified securities of the company are listed, within seven days from the date of passing of the resolution.

## EXPLANATORY STATEMENT

The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating –

- (a) a full and complete disclosure of all material facts;
- (b) the necessity for the buy-back;
- (c) the class of shares or securities intended to be purchased under the buy-back;
- (d) the amount to be invested under the buy-back; and
- (e) the time-limit for completion of buy-back.

## DISCLOSURES UNDER SCHEDULE II PART A

An explanatory statement containing full and complete disclosure of all the material facts and the following

disclosures prescribed in Schedule II Part A of the Regulations should be annexed to the notice where the buy-back is pursuant to shareholders' approval:

- (i) Date of the Board meeting at which the proposal for buy back was approved by the Board of Directors of the company;
- (ii) Necessity for the buy back;
- (iii) Maximum amount required under the buy back and its percentage of the total paid up capital and free reserves;
- (iv) Maximum price at which the shares or other specified securities are proposed be bought back and the basis of arriving at the buyback price;
- (v) Maximum number of securities that the company proposes to buy back;
- (vi) Method to be adopted for buy-back as referred under these regulations;
- (vii) (a) the aggregate shareholding of the promoter and of the directors of the promoters, 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 of Directors;  
  
(b) aggregate number of shares or other specified securities purchased or sold by persons including persons mentioned in (a) above from a period of six months preceding the date of the Board Meeting at which the buyback 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 shares or other specified securities for buy-back indicating the number of shares or other 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 institutions or banks;
- (x) A confirmation that the Board of Directors has made a full enquiry into the affairs and prospects of the company and that they have formed the opinion:
  - (a) that immediately following the date on which the General Meeting or the meeting of the Board of Directors 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 their 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 their view 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) informing 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 Companies Act, 2013 (including prospective and contingent liabilities);
- (xi) A report addressed to the Board of Directors 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 of Directors have formed the opinion as specified in clause (x) on reasonable grounds and that the company will not, having regard to its state of affairs, will not be rendered insolvent within a period of one year from that date.

### **BUY-BACK FROM EXISTING SECURITY-HOLDERS THROUGH TENDER OFFER**

A company may buy back its securities from its existing security-holders on a proportionate basis in accordance with the provisions of the Regulations. It may be noted that fifteen percent of the number of securities which the company proposes to buy back or number of securities entitled as per their shareholding, whichever is higher, shall be reserved for small shareholders.

### **Additional Disclosures**

In addition to disclosure required under Schedule II Part A, the following disclosures are required to be made to the explanatory statement:

- (a) the maximum price at which the buy-back of shares or other specified securities shall be made and whether the Board of Directors of the company are being authorised at the general meeting to determine subsequently the specific price at which the buy-back may be made at the appropriate time;
- (b) if the promoter intends to offer their shares or other specified securities,
  - (i) the quantum of shares or other specified securities proposed to be tendered, and
  - (ii) the details of their transactions and their holdings for the last six months prior to the passing of the special resolution for buy-back including information of number of shares or other specified securities acquired, the price and the date of acquisition.

### **Public announcement and Filing of offer documents**

The company which has been authorised by a special resolution or a resolution passed by the Board of Directors at its meeting shall make a public announcement within two working days from the date of resolution 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 and shall contain all the material information as specified in Schedule II, Part A.

A copy of the public announcement along with the soft copy, shall also be submitted to SEBI simultaneously through a merchant banker.

The company shall within five working days of the public announcement file with SEBI a draft-letter of offer, along with soft copy containing disclosures as specified in Schedule III through a merchant banker who is not associated with the company.

SEBI may give its comments on the draft letter of offer not later than seven working days of the receipt of the draft letter of offer. In the event SEBI has sought clarifications or additional information from the merchant banker to the buyback offer, the period of issuance of comments shall be extended to the seventh working day from the date of receipt of satisfactory reply to the clarification or additional information sought.

In the event, SEBI specifies any changes, the merchant banker to the buyback offer and the company shall carryout such changes in the letter of offer before it is dispatched to the shareholders.

The company shall file along with the draft letter of offer, a declaration of solvency in the prescribed form and in a manner prescribed in the Companies Act, 2013.

**Offer Procedure**

- (1) A company making a buy-back offer shall announce a record date for the purpose of determining the entitlement and the names of the security holders, who are eligible to participate in the proposed buy-back offer.
- (2) The letter of offer along with the tender form shall be dispatched to the security holders who are eligible to participate in the buy-back offer, not later than five working days from the receipt of communication of comments from SEBI.
- (3) The date of the opening of the offer shall be not later than five working days from the date of dispatch of letter of offer.
- (3A) The acquirer or promoter shall facilitate tendering of shares by the shareholders and settlement of the same, through the stock exchange mechanism as specified by SEBI.
- (4) The offer for buy back shall remain open for a period of ten working days.
- (5) The company shall accept shares or other specified securities from the security holders on the basis of their entitlement as on record date.
- (6) The shares proposed to be bought back shall be divided into two categories;
  - (a) reserved category for small shareholders and
  - (b) the general category for other shareholders, and the entitlement of a shareholder in each category shall be calculated accordingly.
- (7) After accepting the shares or other specified securities tendered on the basis of entitlement, shares or other specified securities left to be bought back, if any in one category shall first be accepted, in proportion to the shares or other specified securities tendered over and above their entitlement in the offer by security holders in that category and thereafter from security holders who have tendered over and above their entitlement in other category.

**Escrow account**

1. The company should as and by way of security for performance of its obligations under the Regulations, on or before the opening of the offer, deposit in an escrow account the sum as specified under these regulation.
2. The escrow amount is payable in the following manner:
  - (i) if the consideration payable does not exceed Rs 100 crores – 25 per cent of the consideration payable;
  - (ii) if the consideration payable exceeds Rs 100 crores – 25 per cent upto Rs 100 crores and 10 per cent thereafter;
3. The escrow account referred to above shall consist of:
  - (a) cash deposited with a scheduled commercial bank, or
  - (b) bank guarantee in favour of the merchant banker, or
  - (c) deposit of acceptable securities with appropriate margin, with the merchant banker, or
  - (d) a combination of (a), (b) and (c) above;
4. Where the escrow account consists of deposit with a scheduled commercial bank, the company while opening the account, 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, as provided in the Regulations;

5. Where the escrow account consists of bank guarantee, such bank guarantee shall be in favour of the merchant banker and valid until thirty days after the closure of the offer;
6. Where the escrow account consists of securities, the company should empower the merchant banker to realise the value of such escrow account by sale or otherwise. If there is any deficit on realisation of the value of the securities, the merchant banker shall be liable to make good any such deficit;
7. In case the escrow account consists of bank guarantee or approved securities, these shall not be returned by the merchant banker till the completion of all obligations under the Regulations;
8. Where the escrow account consists of bank guarantee or deposit of approved securities, the company is also required to deposit with the bank in cash, a sum of at least one per cent of the total consideration payable, as and by way of security for fulfilment of the obligations under these Regulations by the company;
9. On payment of consideration to all the security-holders who have accepted the offer and after completion of all the formalities of buy-back, the amount, guarantee and securities in the escrow, if any, should be released to the company;
10. SEBI, in the interest of the security-holders, may, in case of non-fulfilment of obligations under the Regulations by the company forfeit the escrow account either in full or in part;
11. The amount so forfeited may be distributed pro rata amongst the security-holders who accepted the offer and the balance, if any, shall be utilised for investor protection.

#### **Payment to the Security holders**

1. The company shall immediately after the date of closure of the offer, open a special account with a SEBI registered banker to an issue and deposit therein, such sum as would, together with the amount lying in the escrow account make up the entire sum due and payable as consideration for the buy-back and for this purpose, may transfer the funds from the escrow account.
2. The company shall complete the verifications of offers received and make payment of consideration to those security holders whose offer has been accepted or return the shares or other specified securities to the security holders within seven working days of the closure of the offer.

#### **Extinguishing of bought-back securities**

The company shall extinguish and physically destroy the security certificates so bought back in the presence of a Registrar to issue or the Merchant Banker and the Statutory Auditor within fifteen days of the date of acceptance of the shares or other specified securities. The company shall also ensure that all the securities bought-back are extinguished within seven days of the last date of completion of buy-back.

The shares or other specified securities offered for buy-back if already dematerialised shall be extinguished and destroyed in the manner specified under SEBI (Depositories and Participants) Regulations, 1996, and the bye-laws framed thereunder.

The company shall, furnish a certificate to SEBI certifying compliance as specified above and duly certified and verified by -

- (i) the registrar and whenever there is no registrar by the merchant banker;
- (ii) two directors of the company one of whom shall be a managing director where there is one;

- (iii) the statutory auditor of the company,

The certificate shall be furnished to SEBI on a monthly basis by the seventh day of the month succeeding the month in which the securities certificates are extinguished and destroyed.

The company shall furnish, the particulars of the security certificates extinguished and destroyed, to the stock exchanges where the shares 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. The company shall also maintain a record of security certificates which have been cancelled and destroyed as prescribed in the Companies Act.

### **ODD-LOT BUY-BACK**

The provisions pertaining to buy-back through tender offer as specified in this Lesson shall be applicable *mutatis mutandis* to buy-back of odd-lot shares or other specified securities.

### **BUY-BACK FROM OPEN MARKET**

Regulation 14 of the Regulations lays down that a buy-back of shares or other specified securities from the open market may be in any one of the following methods:

- (i) Through stock exchange.
- (ii) Book-building process.

The company shall ensure that atleast 50% of the amount earmarked for buy back, as specified in resolutions (Board/special resolution) is utilized for buying back shares and other specified securities.

#### **Buy-back through the stock exchange**

A company should buy-back its specified securities through the stock exchange as provided hereunder:

- The special resolution/ board resolution, should specify the maximum price at which the buy-back will be made;
- The buy-back of securities should not be from the promoters or persons in control of the company;
- The company should appoint a merchant banker and make a public announcement within seven days from the date of passing the resolution;
- The public announcement shall be made within 7 working days from the date of passing special resolution;
- Simultaneously with the issue of such public announcement, the company shall file a copy of the public announcement with SEBI.
- The company shall submit the information regarding the shares or other specified securities bought back, to the stock exchange on a daily basis in such form as may be specified by SEBI and the stock exchange shall upload the same on its official website immediately;
- The company shall upload the information regarding the shares or other specified securities bought back on its website on a daily basis;
- The buy-back offer shall open not later than seven working days from the date of public announcement and shall close within six months from the date of opening of the offer;
- The buy-back should be made only on stock exchanges having Nationwide Trading Terminal facility and only through the order matching mechanism except 'all or none' order matching system;



- The company shall submit information regarding the shares or other specified securities bought back, to the stock exchange on daily basis in such form as may be specified by SEBI;
- The identity of the company as a purchaser would appear on the electronic screen when the order is placed.
- The company shall upload the information regarding the shares or other specified securities bought back, on its website on daily basis.

### **Buy-back of physical shares or other specified securities**

A company shall buy-back its shares or other specified securities in physical form through open market method as provided hereunder:

- a separate window shall be created by the stock exchange, which shall remain open during the buy-back period, for buy-back of shares or other specified securities in physical form.
- the company shall buy-back shares or other specified securities from eligible shareholders holding physical shares through the separate windows, only after verification of the identity proof and address proof by the broker.
- the price at which the shares or other specified securities are bought back shall be the volume weighted average price of the shares or other specified securities bought-back, other than in the physical form, during the calendar week in which such shares or other specified securities were received by the broker.

However, the price of shares or other specified securities tendered during the first calendar week of the buy-back shall be the volume weighted average market price of the shares or other specified securities of the company during the preceding calendar week.

*Explanation:* In case no shares or other specified securities were bought back in the normal market during calendar week, the preceding week when the company has last bought back the shares or other specified securities may be considered.

### **Escrow account**

- (1) The Company shall, before opening of the offer, create an escrow account.
- (2) Where part of the escrow account is in the form of a bank guarantee, the company shall deposit with a scheduled commercial bank, in cash, a sum of at least 2.5 per cent of the total amount earmarked for buyback as specified in the resolutions as and by way of security for fulfillment of the obligations by the company.
- (3) The escrow amount may be released for making payment to the shareholders subject to atleast 2.5% of the amount earmarked for buy-back as specified in the resolutions remaining in the escrow account at all points of time.
- (4) On fulfilling the obligation, the amount and the guarantee remaining in the escrow account, if any, shall be released to the company.
- (5) In the event of non-compliance, except in cases where,-
  - volume weighted average market price (VWAMP) of the shares or other specified securities of the company during the buy-back period was higher than the buy-back price as certified by the Merchant banker based on the inputs provided by the Stock Exchanges.
  - inadequate sell orders despite the buy orders placed by the company as certified by the Merchant banker based on the inputs provided by the Stock Exchanges.



- (c) such circumstances which were beyond the control of the company and in the opinion of SEBI merit consideration, SEBI may direct the merchant banker to forfeit the escrow account, subject to a maximum of 2.5 per cent of the amount earmarked for buy-back as specified in the resolutions.

(6) In the event of forfeiture for non-fulfillment of obligations as specified under these regulations, the amount forfeited shall be deposited in the Investor Protection and Education Fund of SEBI.

### Extinguishment of certificates

Subject to the provisions of sub-regulation (2) and sub regulation (3), the provisions of regulation 12 pertaining to extinguishment of certificates shall be applicable *mutatis mutandis*.

The company shall complete the verification of acceptances within fifteen days of the payout.

The company shall extinguish and physically destroy the security certificates so bought back during the month in the presence of a Merchant Banker and the Statutory Auditor, on or before the fifteenth day of the succeeding month:

However, the company shall ensure that all the securities bought-back are extinguished within seven days of the last date of completion of buyback.

### Buy-back through book-building

A company can buy-back its securities through the book-building process as provided hereunder:

1. (a) The special resolution, should specify the maximum price at which the buy-back will be made.
- (b) The company should appoint a merchant banker.
- (c) A public announcement shall be made at least seven days prior to the commencement of the buy-back.
- (d) Subject to the provisions of Sub-clauses (i) and (ii), the provisions of Regulation 10 regarding escrow account are applicable:
  - (i) The deposit in the escrow account should be made before the date of the public announcement.
  - (ii) The amount to be deposited in the escrow account should be determined with reference to the maximum price as specified in the public announcement containing detailed methodology of the book-building process, manner of acceptance, format of acceptance to be sent by the security-holders pursuant to public announcement and details of bidding centres.
- (e) A copy of the public announcement must be filed with SEBI within two days of the announcement along with the fees as specified. The Public announcement shall also contain the detailed methodology of the book building process, the manner of acceptance, the format of acceptance to be sent by the security holders pursuant to the public announcement and the details of bidding centres.
- (f) The book-building process should be made through an electronically linked transparent facility.
- (g) The number of bidding centres should not be less than thirty and there should be at least one electronically linked computer terminal at all the bidding centres.
- (h) The offer for buy-back should be kept open to the security-holders for a period of not less than fifteen days and not exceeding thirty days.
- (i) The merchant banker and the company should determine the buy-back price based on the acceptances received and the final buy-back price, which should be the highest price accepted should be paid to all holders whose securities have been accepted for the buy-back.

- (2) The provisions of sub-regulation (2) of regulation 11, pertaining to verification of acceptances and the provisions of regulation 11 pertaining to opening of special account and payment of consideration shall be applicable *mutatis mutandis*.

### Extinguishment of certificates

The provisions of regulation 12 pertaining to extinguishment of certificates shall be applicable *mutatis mutandis*.

## OBLIGATIONS OF THE COMPANY

The company shall ensure that:

- (a) the letter of offer, the public announcement of the offer or any other advertisement, circular, brochure, publicity material contains true, factual and material information and does not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such documents;
- (b) the company shall not issue any specified securities including by way of bonus till the date of closure of the offer is made under these Regulations;
- (c) the company shall pay consideration only by cash;
- (d) the company shall not withdraw the offer to buy-back after the draft letter of offer is filed with the SEBI or public announcement of the offer to buy-back is made;
- (e) the promoter or the person shall not deal in the specified securities of the company in the stock exchange or off market, including inter-se transfer of shares among the promoters during the period "from the date of passing the resolution till the closing of the offer.
- (f) the company shall not raise further capital for a period of one year from the closure of buy-back offer, except in discharge of its subsisting obligations.

No public announcement of buy-back shall be made during the pendency of any scheme of amalgamation or compromise or arrangement pursuant to the provisions of the Companies Act, 2013.

The company should nominate a compliance officer and investors service centre for compliance with the buy-back regulations and to redress the grievances of the investors.

The particulars of the said security certificates extinguished and destroyed should be furnished by the company to the stock exchanges where the securities of the company are listed, within seven days of extinguishment and destruction of the certificates.

The company should not buy-back the locked-in securities and non-transferable securities till the pendency of the lock-in or till the securities become transferable.

The company should issue, within two days of the completion of buy-back, a public advertisement in a national daily, *inter alia*, disclosing the following:

- (i) number of securities bought;
- (ii) price at which the securities were bought;
- (iii) total amount invested in the buy-back;
- (iv) details of the security-holders from whom securities exceeding one per cent of the total securities were bought-back; and

- (v) the consequent changes in the capital structure and the shareholding pattern after and before the buy-back.

## **OBLIGATIONS OF THE MERCHANT BANKER**

The merchant banker should ensure that:

- (a) the company is able to implement the offer;
- (b) the provision relating to escrow account has been made;
- (c) firm arrangements for monies for payment to fulfill the obligations under the offer are in place;
- (d) the public announcement of buy-back is made and the letter of offer has been filed in terms of the Regulations;
- (e) the merchant banker should furnish to SEBI, a due diligence certificate which should accompany the draft letter of offer;
- (f) the merchant banker should ensure that the contents of the public announcement of offer as well as the letter of offer are true, fair and adequate and quoting the source wherever necessary.
- (g) the merchant banker should ensure compliance of Section 68 and Section 70 of the Companies Act, 2013 and any other applicable laws or rules in this regard;
- (h) upon fulfillment of all obligations by the company under the Regulations, the merchant banker should inform the bank with whom the escrow or special amount has been deposited to release the balance amount to the company and send a final report to SEBI in the specified form, within 15 days from the date of closure of the buy-back offer.

## **BUYBACK VIS-A-VIS COMPLIANCE UNDER SEBI (SAST) REGULATIONS, 2011**

In case the acquirer's initial shareholding was more than 25% and the increase in shareholding due to buyback is beyond the permissible creeping acquisition limit of 5% per financial year, the acquirer can get an exemption from making an open offer, subject to the following:

- Such acquirer does not vote in favour of the resolution authorising the buy-back of securities under section 68 of the Companies Act, 2013;
- In the case of a shareholder's resolution, voting is by way of a postal ballot;
- The increase in voting rights does not result in an acquisition of control by such an acquirer over the target company. In case the above conditions are not fulfilled, the acquirer may, within 90 days from the date of increase, dilute his stake so that his voting rights fall below the threshold which requires an open offer.

### 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.
- 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.

### GLOSSARY

<b>Bid</b>	An offer of a price to buy as in an auction. Business on the Stock Exchange is done through bids. Bid also refers to the price one is willing to pay for a security.
<b>Earnings per share (EPS)</b>	It is the portion of a company's profit allocated to each outstanding share of common stock and it serves as an indicator of a company's profitability.
<b>Odd Lot</b>	Anything less than the standard unit of trading
<b>Open Market</b>	Purchase or sale of government securities by the monetary authorities (RBI in India) to increase or decrease the domestic money supply.
<b>Stakeholder</b>	Any individual or group who has an interest in a firm; in addition to shareholders and bondholders, includes labor, consumers, suppliers, the local community and so on.

### 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 process?
3. Elucidate the various objectives of buy-back of shares?
4. What are the different methods of buy-back of shares?
5. Explain the obligation of a company under SEBI (Buy-back of Securities) Regulations, 1998?

[illegible]



# Lesson 8

## SEBI (Delisting of Equity Shares) Regulations, 2009

### LESSON OUTLINE

- Introduction
- Background
- Framework of SEBI (Delisting of Equity Shares) Regulations, 2009
- Agencies involved in delisting process and their Role
- Applicability
- Non-Applicability
- Voluntary Delisting
- Compulsory Delisting
- Role of Company Secretary in delisting
- LESSON ROUND UP
- GLOSSARY
- SELF-TEST QUESTIONS

### LEARNING OBJECTIVES

SEBI has constituted various Committees on delisting of shares, e.g., Chandratre Committee, Pratip Kar Committee, etc., to *inter alia* examine and review the condition for delisting of securities of companies listed on recognised stock exchange. SEBI has earlier notified delisting guidelines, 2003. In the year 2009 notified the SEBI (Delisting of Equity Shares) Regulations, 2009 superseding its earlier guideline. These regulations provide for a simple procedure for delisting by small companies exempting them from certain specific requirements.

A student should be well acquainted the various provisions of delisting, why delisting happens and the various requirements to be complied with. Keeping this in view, this lesson will explain the various types of delisting, the various modes of voluntary delisting, consequences of delisting, etc.

## INTRODUCTION

Delisting denotes removal of the listing of the securities of a listed company from the Stock Exchange. Delisting differs from suspension or withdrawal of admission to dealings of listed securities, which is for a limited period.

‘Suspension’ of trading in securities means that no trade can take place in the securities of the company suspended for a temporary period. Suspension is not done at the instance of company but it is action taken by the Stock Exchanges against the company, generally for non-compliance of listing conditions as stipulated under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations). Once, the company makes good the compliance of the listing conditions under LODR Regulations, stock exchange withdraw suspension and permits trading. Stock exchanges may impose fines or freeze promoter/promoter group holding of designated securities, as may be applicable in coordination with depositories at the instances of non-compliance with LODR Regulations.

On the other hand, ‘delisting’ of securities means removal of the name of the company from the stock exchange and no trade can take place in the securities of the company delisted. Delisting of securities can be done either by company voluntarily or by the stock exchange, compulsorily. Generally stock exchange, in order to impose severe punishment on companies compulsorily delists securities of any company, as a last resort. Compulsory delisting affects reputation of company and to the extent of liquidity in trading those shares.

Delisting of securities may be of two types, namely, voluntary delisting and compulsory delisting. In the case of voluntary delisting, a listed company seeks of its own volition for the delisting of its securities; while in case of compulsory delisting, the Stock Exchange itself delists the securities of such Company.

## BACKGROUND

In its continuous endeavour, SEBI in the year 2002 constituted a committee on delisting of shares to *inter alia* examine and review the conditions for delisting of securities of companies listed on recognized stock exchanges and suggest norms and procedures in connection therewith. The Report of the Committee was considered and accepted by SEBI. Pursuant to the same, SEBI issued the SEBI (Delisting of Securities) Guidelines, 2003.

The said Guidelines, although to a great extent, covered the issues involved in Delisting of Securities. Various representations and views, from intermediaries, stock exchanges, shareholders’ associations, chambers of commerce, etc., were given to the Regulators on the operational issues and procedural complications in the guidelines.

SEBI circulated Concept Paper on the proposed SEBI (Delisting of Securities) Regulations, 2006, asking for public comments on the proposed Regulations. SEBI received various comments, opinions and suggestions on the subject and finally, by its publication dated 10th June 2009 in the Official Gazette, SEBI notified the SEBI (Delisting of Equity Shares) Regulations, 2009.

## FRAMEWORK OF SEBI (DELISTING OF EQUITY SHARES) REGULATIONS, 2009

These regulations contain 8 chapters and three schedules dealing with the following:

1.	Chapter I	Preliminary - Regulations 1 and 2
2.	Chapter II	Delisting of Equity Shares - Regulations 3 and 4
3.	Chapter III	Voluntary Delisting - Regulations 5 to 8
4.	Chapter IV	Exit Opportunity - Regulations 9 to 21



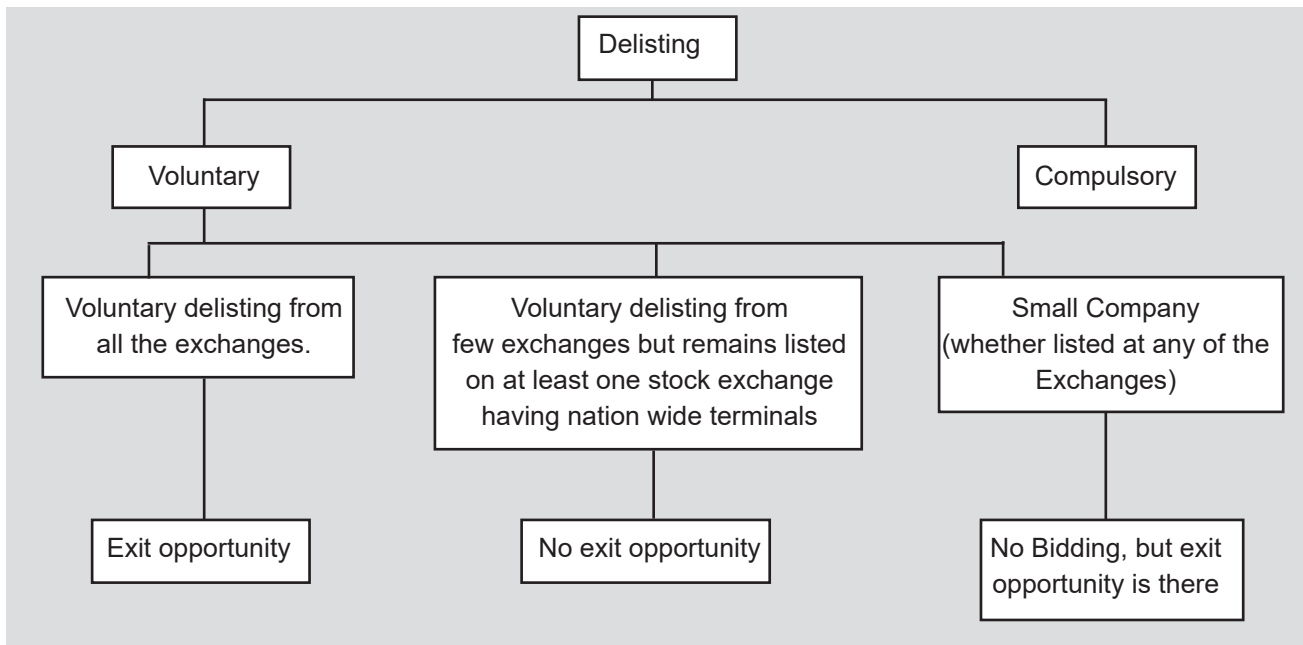
5.	Chapter V	Compulsory Delisting - Regulations 22 to 24
6.	Chapter VI	Powers of the SEBI - Regulations 25, 25A and 26
7.	Chapter VII	Special provisions for small companies and delisting by operation of law-Regulations 27 and 28
8.	Chapter VIII	Miscellaneous - Regulations 29 to 31
9.	Schedule I	Contents of the Public Announcement
10.	Schedule II	The Book building process
11.	Schedule III	Criteria for Compulsory Delisting

### AGENCIES INVOLVED IN DELISTING PROCESS AND THEIR ROLE

Agencies	Functions
Merchant banker	<ul style="list-style-type: none"> <li>• Determines exit price.</li> <li>• Makes public announcements.</li> <li>• Determines bidding centres.</li> <li>• Appoints trading members.</li> <li>• Determines and announces final trading price.</li> <li>• Overseas settlement process.</li> </ul>
Professionals involved	<ul style="list-style-type: none"> <li>• Intimates stock exchange.</li> <li>• Gets special resolution approved and filed at ROC.</li> <li>• Determines exit price.</li> <li>• Finalizes schedule of delisting.</li> <li>• Overseas book building process.</li> <li>• Opens escrow account.</li> <li>• Prepare public announcement.</li> <li>• Determines and announces final trading price.</li> <li>• Overseas settlement process.</li> </ul>

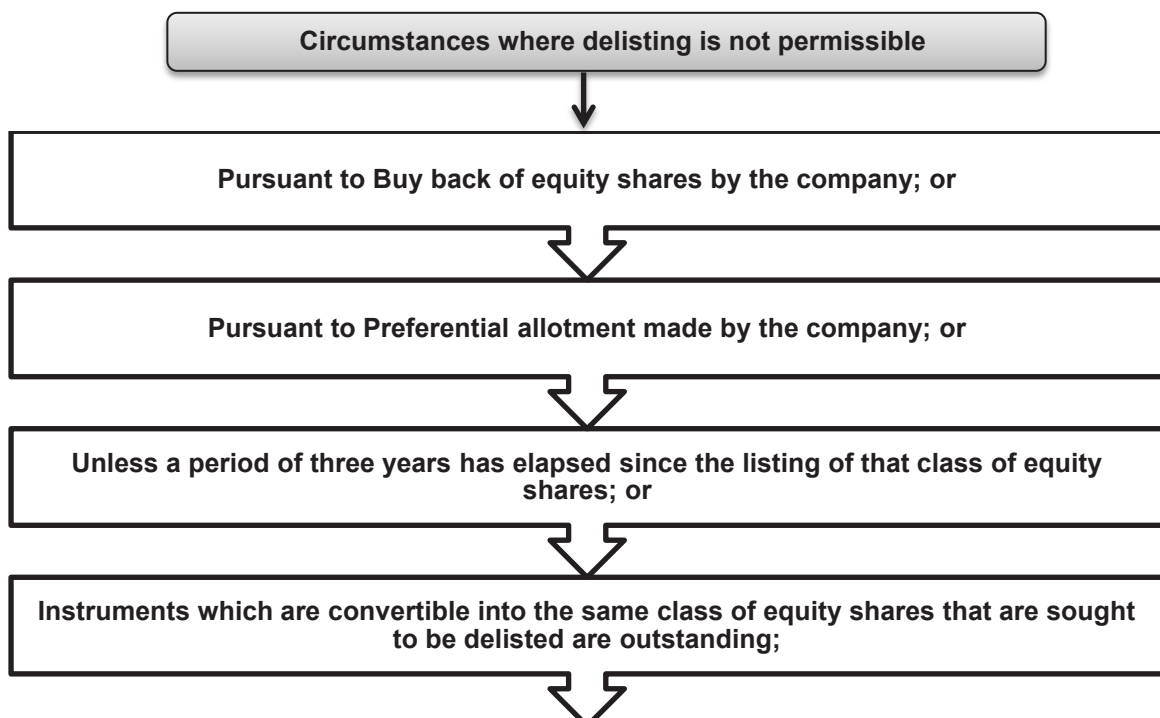
### APPLICABILITY

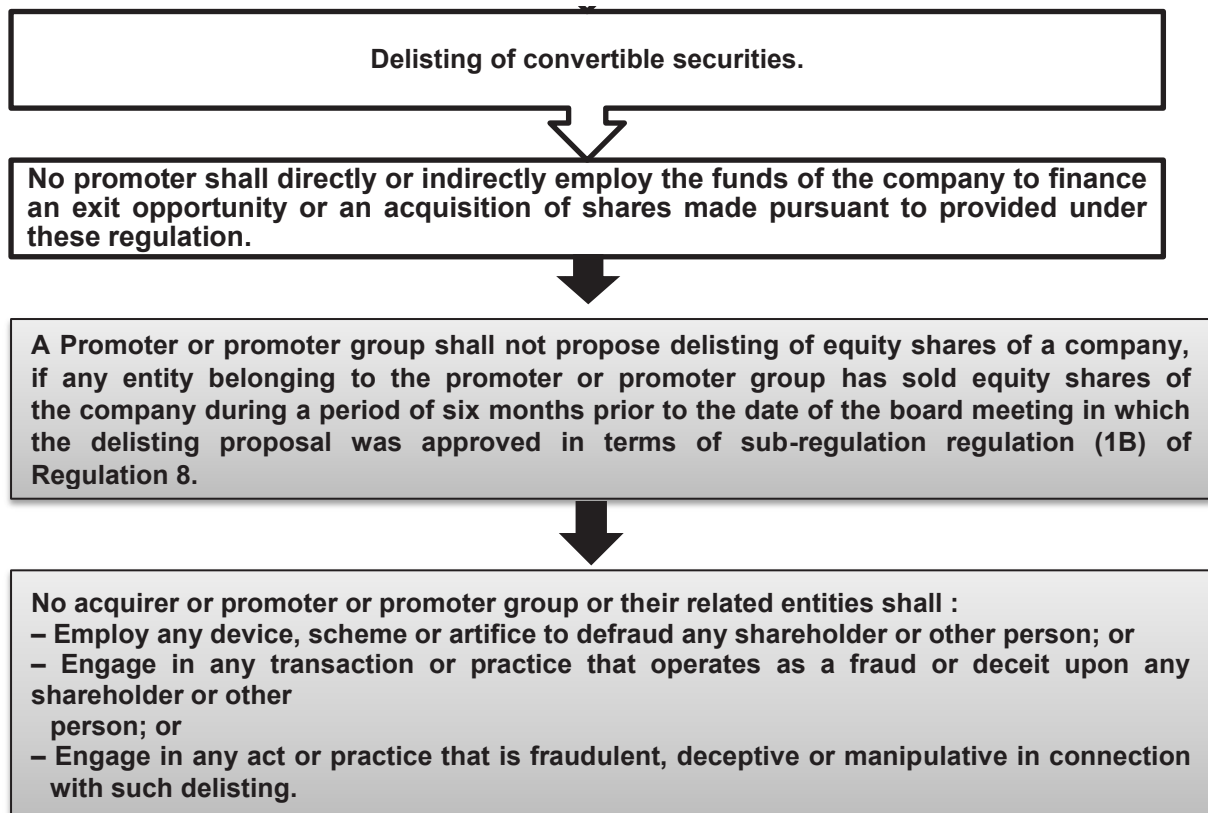
These regulations shall be applicable to delisting of equity shares of a company from all or any of the recognised stock exchanges where such shares are listed.



### NON-APPLICABILITY

These regulations shall not be applicable to securities listed without making a public issue, on the institutional trading platform of a recognised stock exchange and 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 262 of the Companies Act, 2013, 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. These regulations are also not applicable to delisting of listed debentures.





## VOLUNTARY DELISTING

In voluntary delisting, a listed company decides on its own to permanently remove its securities from a stock exchange.

Chapter III of SEBI (Delisting of Shares) Regulations 2009 gives an option to the listed company to either get itself delisted from all the recognised stock exchanges where it is listed or only from some of the few stock exchanges and continue to be listed on the exchange(s) having nation wide terminals.

The difference between two options is that of giving 'exit opportunity' to the shareholders. This is described as under:

**Option I**

• **No 'exit opportunity' required to be given** : In this option, if after the proposed delisting from any one or more recognised stock exchanges, the equity shares still remain listed on any recognised stock exchange which has nation-wide trading terminals, no exit opportunity needs to be given to the public shareholders. The procedure for such delisting of shares can be through a board resolution, public notice and application to the concerned exchange.

**Option II**

• **'Exit opportunity' must be given** : This option requires that if after the proposed delisting, the equity shares do 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, through reverse book building.

***Recognised stock exchange having nation wide trading terminals***

It 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.

**Different modes of Voluntary Delisting**

1. Voluntary delisting from all the stock exchanges
2. Voluntary delisting from few stock exchanges subject to listing at atleast one stock exchange having nation wide terminals
3. Voluntary delisting for Small Companies

**1. Procedure for voluntary delisting from all the stock exchanges**

If after the proposed delisting, the equity shares would not remain listed on any recognised stock exchange having nationwide trading terminals, exit opportunity shall be given to all the public shareholders holding the equity shares sought to be delisted. [(Regulation 6 (b))]

**Convene a Board Meeting [Regulation 8 (1) (a)]**

The proposed delisting shall be approved by a resolution of the board of directors of the company in its meeting.

**Intimation of Board Meeting to Stock Exchange [Regulation 29 (1) (c) of SEBI Listing Regulations]**

The decision of the board meeting that the Board of directors has proposed to Delist the company from the exchanges be sent to the exchanges.

**Special Resolution Through postal Ballot [Regulation 8 (1) (b)]**

The prior approval of shareholders of the company is taken by special resolution to be passed through postal ballot, disclosing all material facts in the explanatory statement sent to the shareholders in relation to such resolution.

**Note – 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.**

#### **Application for In Principal Approval to Concerned Stock Exchange [Regulation 8(1) (c)]**

The company makes an application to the concerned recognized stock exchange for in-principle approval of the proposed delisting in the form specified by the recognized stock exchange. The application shall be accompanied by an audit report as required under regulation 55A of the Securities and Exchange Board of India (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.

#### **In principal Approval by the Exchange [Regulation 8 (3)]**

The recognized stock exchange shall dispose off the Application of the in-Principal approval complete in all respects within a period not exceeding five working days from the date of receipt of such application.

#### **While considering an application seeking in-principle approval for delisting, the recognised stock exchange satisfy itself on the following grounds – [Regulation 8(4)]**

- a. compliance with clause (b) of sub-regulation (1);
- 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.

#### **Appointment of Merchant Banker [Regulation 10 (4)]**

The acquirer or promoter shall appoint a merchant banker registered with SEBI and such other intermediaries as are considered necessary. It should not be associated to the promoter or acquirer.

#### **Determination of Offer Price (Regulation 15)**

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. The floor price shall be determined in terms regulation 8 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, as may be applicable.

#### **Opening of Escrow account [Regulation 11]**

The acquirer or promoter 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. 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.

Where the escrow account consists of deposit with a scheduled commercial bank, the promoter shall, while opening the account, empower the merchant banker to instruct the bank to issue banker's cheques or demand drafts for the amount lying to the credit of the escrow account, for the purposes mentioned in these regulations, and the amount in such deposit, if any, remaining after full payment of consideration for equity shares tendered

in the offer and those tendered under sub-regulation (1) of regulation 21 shall be released to the promoter. Where the escrow account consists of a bank guarantee, such bank guarantee shall be valid till payments are made in respect of all shares tendered under sub-regulation (1) of regulation 21.

### **Public Announcement [Regulation 10]**

The acquirer or promoters of the company within one working day from the date of receipt of in-principle approval for delisting from the recognized stock exchange, make a public announcement 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 recognized stock exchange is located.

The public announcement contain the material information including the information specified in Schedule I –

1. The floor price and the offer price and how they were arrived at.
2. The dates of opening and closing of the offer.
3. The name of the exchange from which the equity shares are sought to be delisted.
4. The manner in which the offer can be accepted by the shareholders.
5. Disclosure regarding the minimum acceptance condition for success of the offer.
6. The names of the merchant banker and other intermediaries together with the helpline number for the shareholders.
7. The specified date fixed as per sub-regulation (3) of regulation 10.
8. The object of the proposed delisting.
9. The proposed time table from opening of the offer till the payment of consideration or return of equity shares.
10. Details of the escrow account and the amount deposited therein.
11. Listing details and stock market data:
  - (a) high, low and average market prices of the equity shares of the company during the preceding three years;
  - (b) monthly high and low prices for the six months preceding the date of the public announcement; and,
  - (c) the volume of equity shares traded in each month during the six months preceding the date of public announcement.
12. Present capital structure and shareholding pattern.
13. The likely post-delisting shareholding pattern.
14. The aggregate shareholding of the promoter together with persons acting in concert and of the directors of the promoter where the promoter is a company and of persons who are in control of the company.
15. A statement, certified to be true by the board of directors of the company, disclosing material deviation, if any, in utilisation of proceeds of issues of securities made during the five years immediately preceding the date of public announcement, from the stated object of the issue.
16. A statement by the board of directors of the company confirming that all material information which is required to be disclosed under the provisions of continuous listing requirement have been disclosed to the stock exchanges.
17. A statement by the board of directors of the company certifying that:-

- a) the company is in compliance with the applicable provisions of securities laws;
  - b) the acquirer or promoter or promoter group or their related entities have not carried out any transaction during the aforesaid period to facilitate the success of the delisting offer;
  - c) the delisting is in the interest of the shareholders.
18. Name of compliance officer of the company.
19. It should be signed and dated by the promoter. Where the promoter is a company, the public announcement shall 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 [Regulation 10 (3)]**

A date not later than thirty working days from the date of the public announcement, to be determined on which the names of shareholders to whom the letter of offer shall be sent is determined.

**Dispatch of Letter of offer [Regulation 12]**

The acquirer or promoter shall dispatch the letter of offer to the public shareholders of equity shares, not later than two working days from the date of the public announcement. The letter of offer shall contain all the disclosures made in 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.

**Duration of the Bidding period [Regulation 13]**

The date of opening of the offer shall not be later than seven working days from the date of the public announcement and shall remain open for a period of five working days during which the public shareholders may tender their bids.

The acquirer or promoter shall facilitate tendering of shares by the shareholders and settlement of the same, through the stock exchange mechanism.

**Final Price (SCHEDULE II)** The final offer price shall be determined as the price at which shares accepted through eligible bids.

**If the Final Price is accepted.****Minimum number of equity shares to be acquired [Regulation 17]**

An offer made shall be deemed to be successful only if, –

- (a) the post offer promoter shareholding (along with the persons acting in concert with the promoter) taken together with the shares accepted through eligible bids at the final price determined as per Schedule II, reaches ninety percent 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; and
- (b) at least twenty five percent of the public shareholders holding shares in the demat mode as on date of the board meeting had participated in the Book Building Process.

However, this requirement shall not be applicable to cases where the acquirer and the merchant banker demonstrate to the stock exchanges that they have delivered the letter of offer to all the public shareholders either through registered post or speed post or courier or hand delivery with proof of

delivery or through email as a text or as an attachment to email or as a notification providing electronic link or Uniform Resource Locator including a read receipt.

**Explanation.** – In case the delisting offer has been made in terms of regulation 5A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, the threshold limit of ninety per cent for successful delisting offer shall be calculated taking into account the post offer shareholding of the acquirer taken together with the existing shareholding, shares to be acquired which attracted the obligation to make an open offer and shares accepted through eligible bids at the final price determined as per Schedule II.

#### **Public Announcement after closure of offer [Regulation 18]**

Within five working days of closure of the offer, the promoter/acquirer and the merchant banker shall make a public announcement 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 recognized stock exchanges are located regarding the success of the offer in terms of regulation 17 alongwith the final price accepted by the acquirer.

#### **Payment of consideration [Regulation 20]**

The promoter shall immediately on ascertaining success of the offer, open a special account with a SEBI registered banker to an issue and transfer thereto, the entire amount due and payable as consideration in respect of equity shares tendered in the offer, from the escrow account. 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.

#### **Final Application to Stock Exchange [Regulation 8 (5)]**

A final application for delisting be made to the concerned recognised stock exchange accompanied with such proof of having given the exit opportunity in accordance with the provisions of Chapter IV, as the recognised stock exchange may require.

#### **Delisting Order**

The recognized stock exchange shall dispose off the Application of the delisting complete in all respects and pass the delisting order.

#### **Right of remaining shareholders to tender equity shares [Regulation 21]**

Remaining public shareholder holding such equity shares may tender their 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. The payment of consideration for shares accepted shall be made out of the balance amount lying in the escrow account.

#### **Release of amount in the escrow account**

The amount in the escrow account or the bank guarantee be released to the promoter after all payments are made in respect of shares tendered under sub-regulation (1).

#### **If the Final Price is not accepted**

#### **Returning of the Equity Shares tendered [Regulation 16 (2)]**

Where the acquirer or promoter decides not to accept the offer price so determined, the acquirer or promoter



shall not acquire any equity shares tendered pursuant to the offer and the equity shares deposited or pledged by a shareholder pursuant to paragraphs 7 or 9 of Schedule II shall be returned or released to him within ten working days of closure of the bidding period;

### **Failure of Offer [Regulation 19]**

(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;

However, the acquirer shall not be required to return the shares if the offer is made pursuant to regulation 5A of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

- (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.

## **2. Procedure for Voluntary delisting from few stock exchanges subject to listing at least one stock exchange having nationwide terminals**

If after the proposed delisting from any one or more recognised stock exchanges, 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. (Section 6 (a))

### ➞ Convene a Board Meeting [Regulation 7 (1) (a)]

The proposed delisting shall be approved by a resolution of the board of directors of the company in its meeting.

### ➞ Outcome of Board Meeting to Stock Exchange [Regulation 29 of SEBI Listing Regulations]

The decision of the board meeting that the Board of directors has proposed to Delist the company from the exchanges be sent to the exchanges.

### ➞ Public notice [Regulation 7 (1) (b)]

The company to 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 recognized stock exchanges are located.

### ➞ Details shall mention in Public notice [Regulation 7 (2)]

- (a) The names of the recognized stock exchanges from where the equity shares of the company are intended to be delisted.
- (b) The reasons for such delisting.
- (c) The fact of continuation of listing of equity shares on recognized stock exchange having nationwide trading terminals.

### ➞ Application to the concerned recognized stock exchange. [Regulation 7 (1)(c) ]

The company shall make an application to the concerned recognized stock exchange for delisting its equity shares.

### ➞ Delisting order by the Exchange. [Regulation 7 (3)]

The recognized stock exchange shall dispose off the Application of the delisting complete in all respects within a period not exceeding thirty working days from the date of receipt of such application.

➡ Disclosure in the Annual report. [Regulation 7 (1)(d)]

In the first Annual report which will be prepared after the delisting, include the names of the recognised stock exchanges from where the company got voluntary delisted during that year and the reason of the delisting there from.

### 3. Voluntary Delisting by Small Companies

#### Small Company means

- a) A company has a paid up capital not exceeding ten crore rupees and net worth not exceeding twenty five crore rupees as on the last date of preceding financial year;
- b) The number of equity shares of the company traded on each such recognised stock exchange during the twelve calendar months immediately preceding the date of board meeting is less than ten per cent of the total number of shares of such company.

However, where the share capital of a particular class of shares of the company is not identical throughout such period, the weighted average of the shares of such class shall represent the total number of shares of such class of shares of the company; and

- c) the company has not been suspended by any of the recognised stock exchanges having nationwide trading terminals for any non-compliance in the preceding one year;

#### Convene a Board Meeting [Regulation 8 (1) (a)]

The proposed delisting shall be approved by a resolution of the board of directors of the company in its meeting.

#### Appointment of Merchant Banker [Regulation 27 (3)(b)]

The promoter appoint a merchant banker registered with SEBI.

#### Outcome of Board Meeting to Stock Exchange (Schedule III of SEBI (LODR), Regulations, 2015)

The decision of the board meeting that the Board of directors has proposed to Delist the company from the exchanges be sent to the exchanges within 30 minutes of the closure of the meeting.

#### Special Resolution Through postal Ballot (Regulation 8 (1) (b))

The prior approval of shareholders of the company be taken by special resolution to be passed through postal ballot, disclosing all material facts in the explanatory statement sent to the shareholders in relation to such resolution.

#### **Points to Remember:-**

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.

#### Determination of Exit Price [Regulation 27 (3)(b)]

The exit price offered to the public shareholders shall not be less than the floor price determined in terms of sub-regulation (2) of regulation 15 of these regulations read with clause (e) of sub-regulation (2) of regulation 8

of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

**Application for In Principal Approval to Concerned Stock Exchange [Regulation 8(1)(c)]**

The company makes an application to the concerned recognized stock exchange for in-principle approval of the proposed delisting in the form specified by the recognized stock exchange. The application shall be accompanied by an audit report as required under regulation 55A of the Securities and Exchange Board of India (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.

**In principal Approval by the Exchange [Regulation 8 (3)]**

The recognized stock exchange shall dispose off the Application of the In Principal approval complete in all respects within a period not exceeding five working days from the date of receipt of such application.

While considering an application seeking in-principle approval for delisting, the recognised stock exchange satisfy itself on the following grounds – [Regulation 8(4)]

- a. compliance with clause (b) of sub-regulation (1);
- 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.

**Public notice [Regulation 7(1)(b)]**

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 recognized stock exchanges are located.

**Letter to all public Shareholders [Regulation 27 (3)(c)]**

The promoters shall write individually to all the public shareholders containing the following particulars:

- i. Intention of delisting the shares.
- ii. Exit price and justification of the exit price.
- iii. Seeking the consent of the shareholders for delisting proposal.

**Consent of the Public Shareholders [Regulation 27 (3)(d)]**

Atleast 90% of the public shareholders shall give their positive consent in writing for the delisting of the shares and the shareholders shall have the option to surrender their shares at the exit price determined or to remain the shareholders even if the shares get delisted.

**Receiving consent from the Shareholders [Regulation 27(3)(e)]**

The process of inviting the positive consent and finalisation of the proposal for delisting of shares to be made within 75 working days of dispatching the Letter to all the shareholder .

**Payment to shareholders [Regulation 27 (3)(f)]**

The promoters shall make the payment in cash to the public shareholders who have tendered their shares within 15 working days from the date of expiry of 75 working days as mentioned above.

**Final Application to Stock Exchange [Regulation 8 (5)]**

A final application for delisting be made to the concerned recognised stock exchange accompanied with such proof of having given the exit opportunity in accordance with the above said provisions.

**Delisting Order**

The recognized stock exchange shall dispose off the Application of the delisting complete in all respects and pass the delisting order.

*Can the promoter of a small company, as defined under regulation 27 of Delisting Regulations, be considered to have complied with the condition under regulation 27(3)(d) if the public shareholders holding at least ninety percent of the public shareholding give their positive consent in writing to the proposal for delisting?*

Yes, the promoter of a small company would be considered to have complied with the condition under regulation 27(3) (d) if the public shareholders, irrespective of their numbers, holding ninety percent or more of the public shareholding give their positive consent in writing to the proposal for delisting. (Please refer to SAT Order dated November 04, 2011 in the matter of V. T. Somasundaram and M/s. Trichy Distilleries & Chemicals Limited vs. Madras Stock Exchange and SEBI.)

**COMPULSORY DELISTING**

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

A recognized 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 .

**Constitution of Panel [Regulation 22 (2)]**

The decision regarding compulsory delisting shall be taken by a panel to be constituted by the recognized stock exchange consisting of -

- a. Two directors of the recognized 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 recognized stock exchange.

**Public notice before delisting order [Regulation 22 (3)]**

Before making a delisting order the recognized 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 recognized stock exchange is located and shall also display such notice on its trading systems and website.

**Time period of making representation [Regulation 22 (3)]**

Time period of not less than fifteen working days from the notice, be given to any person who may be aggrieved by the proposed delisting within which he can made representations to the recognized stock exchange which has issued a notice for the delisting.

**Delisting Order by the Recognised Stock Exchange [Regulation 22 (4)]**

The recognized stock exchange passes an order under sub-regulation (1) after considering the representations, if any, made by the company and any aggrieved person in response to the notice and after considering the following points:-

1. 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.
2. The status of compliance of the company with the office of the concerned Registrar of Companies.

**Public notice after Delisting Order [Regulation 22 (6)]**

Where the recognized stock exchange passes the delisting 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 recognized stock exchange is located.
- (b) Inform all other stock exchanges where the equity shares of the company are listed, about such delisting and the surrounding circumstances.

***Disclosures to be made in the notice –***

- Facts of such delisting,
- The name and address of the company,
- The fair value of the equity shares determined under sub-regulation (1) of regulation 23 and
- The names and addresses of the promoters of the company who would be liable under sub-regulation (3) of regulation 23.

**Exit Price Determination by an Independent Valuer (Regulation 23 (1))**

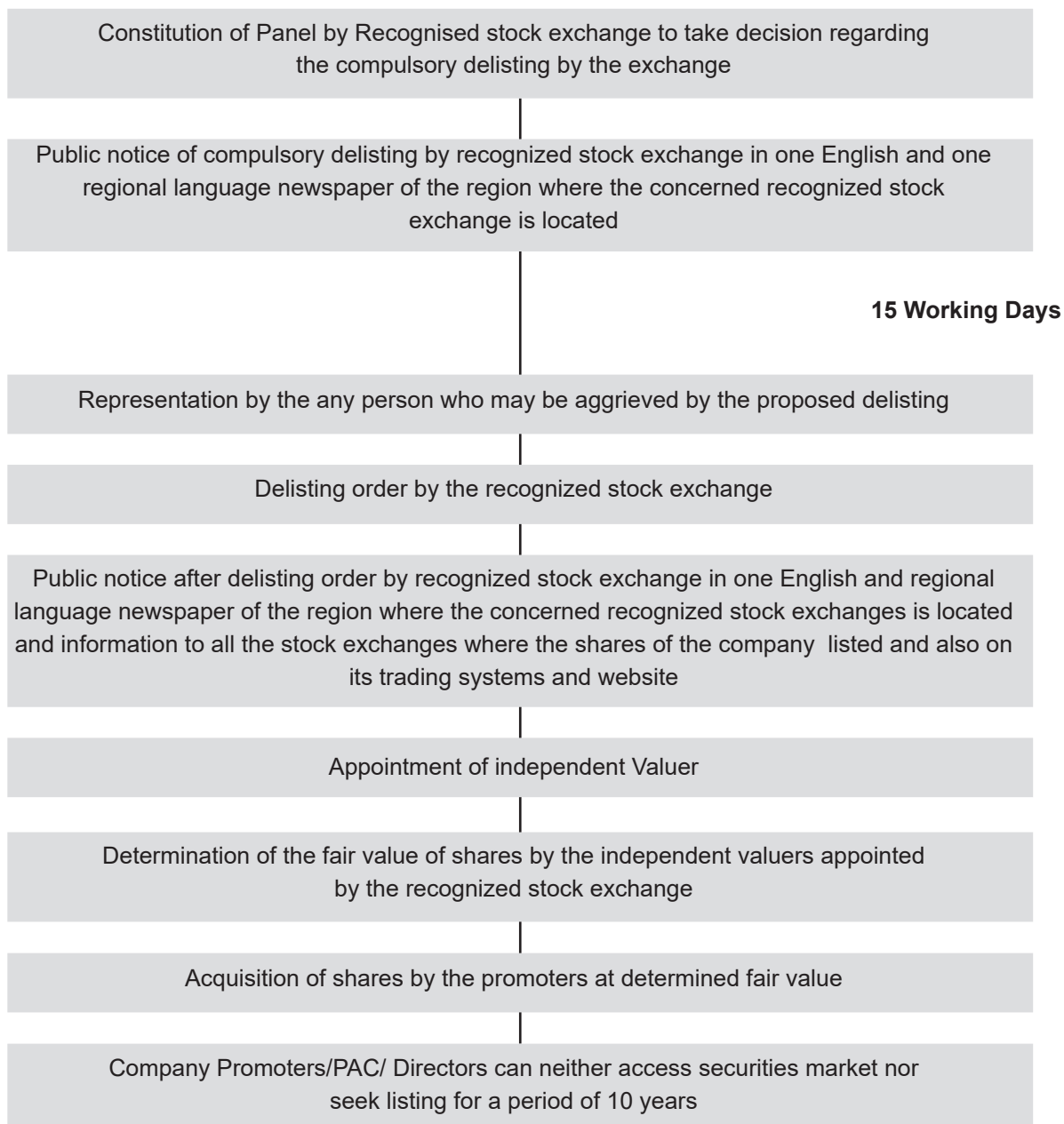
- The recognized stock exchange shall form a panel of expert valuers from whom the valuer or valuers shall be appointed.
- The promoter of the delisted company shall acquire equity shares from the public shareholders by paying them the value determined by the valuer, subject to their option of retaining their shares.

**Important points:-**

1. No open offer is required to be given by the Delisted Company in the case of compulsory delisting made by a recognized stock exchange.
2. 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 Powers to the recognized stock Exchanges (SCHEDULE III)

1. The recognised stock exchange can 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.
2. The recognised stock exchange can also file a petition for winding up the company under section 271 of the Companies Act, 2013 or make a request to the Registrar of Companies to strike off the name of the company from the register under section 248 of the said Act.



**Compulsory Delisting – Time-line**

<b>Compulsory Delisting</b>	<b>Time-line in Working Days</b>
1. CONSTITUTION OF PANEL [Reg. 22(2)] The recognised stock exchange(s) shall constitute the panel to take the decision regarding the compulsory delisting of the Company.	—
2. PUBLIC NOTICE BEFORE MAKING THE DELISTING ORDER [Reg. 22(3)] The recognised stock exchange (s) shall give the public notice for the compulsory delisting of the company in one English, one Hindi national daily and one Regional language news paper where the concerned stock exchange is located and also on its trading system & website.	X
3. REPRESENTATIONS [Reg. 22(4)] Any person aggrieved by such public notice may give representation within maximum 15 working days from the date of the public notice.	X + 15
4. DELISTING ORDER [Reg. 22(3)] The recognised stock exchange(s) may pass the delisting order after giving the reasonable opportunity of being heard to the concerned person.	X + 30
5. PUBLIC NOTICE AFTER DELISTING ORDER [Reg. 22(6)] The recognized stock exchange(s) shall publish the delisting order in one English, one Hindi national daily newspaper and one Regional language newspaper where the concerned stock exchange is located.	X + 31
6. INTIMATION TO OTHER EXCHANGE(S) [Reg. 22(6)] The recognized stock exchange(s) shall intimate other exchange(s) where the company is listed about the delisting order.	X + 31
7. APPOINTMENT OF INDEPENDENT VALUER [Reg. 23(1)] The recognised stock exchange(s) shall appoint the independent valuer(s) from the panel of expert valuers.	X + 30
8. DETERMINATION OF FAIR VALUE [Reg. 23(1)] The independent valuer(s) shall determine the fair value of the delisted equity shares at which the shares may be tendered by the public shareholders.	X + 30
9. ACQUISITION OF SHARES [Reg. 23(3)] The promoters shall acquire the shares at the fair value from the public shareholders.	—
10. CONSEQUENCE OF COMPULSORY DELISTING (Reg. 24) The company / promoters / person acting in concert/ directors cannot access securities market or seek listing for a period of 10 years.	—

**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.**



## ROLE OF COMPANY SECRETARY IN DELISTING

The SEBI has widened the area of responsibilities of a Company Secretary by mandating a listed company to appoint Company Secretary to act as compliance officer under SEBI Listing Regulations.

Being a compliance officer it is the responsibility of a Company Secretary to look after and ensure timely compliances of various SEBI regulations. In case of non-compliance with the listing regulation a stock exchange may delist the securities of a company.

Apart from this, a Company Secretary has to appoint and co-ordinate with various intermediaries, regulators, etc. and advise the Board of Directors, the various requirements of Delisting.

## LESSON ROUND UP

- Delisting of securities means permanent removal of securities of a listed company from a stock exchange. As a consequence of delisting, the securities of that company would no longer be traded at that stock exchange.
- Delisting can be voluntary or compulsory.
- SEBI has notified the SEBI (Delisting of Equity Shares) Regulations, 2009 by its publication dated 10th June, 2009.
- The delisting regulations are applicable to delisting of equity shares of a company from all or any of the recognised stock exchanges where such shares are listed.
- There are certain circumstances as prescribed by SEBI where delisting is not permissible.
- Chapter III of delisting regulations gives an option to the listed company to either get itself delisted from all the recognised stock exchanges where it is listed or only from some of the few stock exchange(s) having nation wide terminals.
- In voluntary delisting, a company decides its own to permanently remove its securities from stock exchange.
- A recognised stock exchange may by order delist any equity shares of a company on any grounds prescribed under the rules made under section 21 of SCRA, 1956.
- When 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.

## GLOSSARY

<b>Bid</b>	An offer of a price to buy it as an auction. Business on the stock exchange is done through bids. Bid also refers to the price one is willing to pay.
<b>Delisting Exchange</b>	The exchange from which securities of a company are proposed to be delisted.
<b>Offer Price</b>	Price at which units in trust can be bought it often includes an entry fee. It also refers to the price at which securities are offered to the public.
<b>Public Shareholders</b>	It means the holders of equity shares, other than the following: (a) promoters; (b) holders of depository receipts issued overseas against equity shares held with a custodian and such custodian.
<b>Working Days</b>	It means the working days of the SEBI.



## SELF TEST QUESTIONS

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

1. Discuss the eligibility criteria for voluntary delisting of shares.
2. What are the rights of security holders in case of compulsory delisting of securities?
3. Can cash component of the escrow account in the delisting offer process be maintained in an interest bearing account?
4. Explain the circumstances where delisting is not permissible under SEBI (Delisting of Equity Shares) Regulations, 2009.
5. How does one tender one's shares for delisting in the tender offer method?

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# Lesson 9

## SEBI (Share Based Employee Benefits) Regulations, 2014 – An Overview

### LESSON OUTLINE

- Background
- Companies Act, 2013
- SEBI (Share Based Employee Benefits) Regulations, 2014
- Schemes – Implementation & Process
- Administration of Specific Schemes
- Directions by SEBI & Action in case of Default
- SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015 for ESOP/ESPS
- Role of Company Secretary
- LESSON ROUND UP
- GLOSSARY
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

Taking into account the wider perspective of employee benefit scheme in India as well as Overseas and with the intent to align the provisions of the extant regulations with the Companies Act, 2013, SEBI has notified SEBI (Share Based Employee Benefits) Regulations, 2014.

This lesson will enable the students to learn the various provisions of SEBI (Share Based Employee Benefits) Regulations, 2014 in respect of various types of Schemes, its applicability, Scheme implementation and process, Administration of Specific Scheme and direction of SEBI etc.

## BACKGROUND

SEBI has (i) issued SEBI (ESOS & ESPS) Guidelines, 1999 (“ESOS Guidelines”) to enable listed companies to reward their employees through stock option schemes and stock purchase schemes and (ii) notified SEBI (Issue of Sweat Equity) Regulations, 2002 (“Sweat Equity Regulations”) to regulate issuance of sweat equity shares by listed companies in accordance with Section 79A of the Companies Act, 1956.

Under the ESOS Guidelines, an ESOS/ESPS Trust can only distribute options/shares to its employees issued by the company. However, ESOS Guidelines, till recently, were silent regarding acquisition of shares from secondary market. It came to the notice of SEBI that some listed companies were framing their own employees benefit schemes wherein Trusts were set up to deal in their own securities in the secondary market, which was not envisaged within the purview of the ESOS Guidelines.

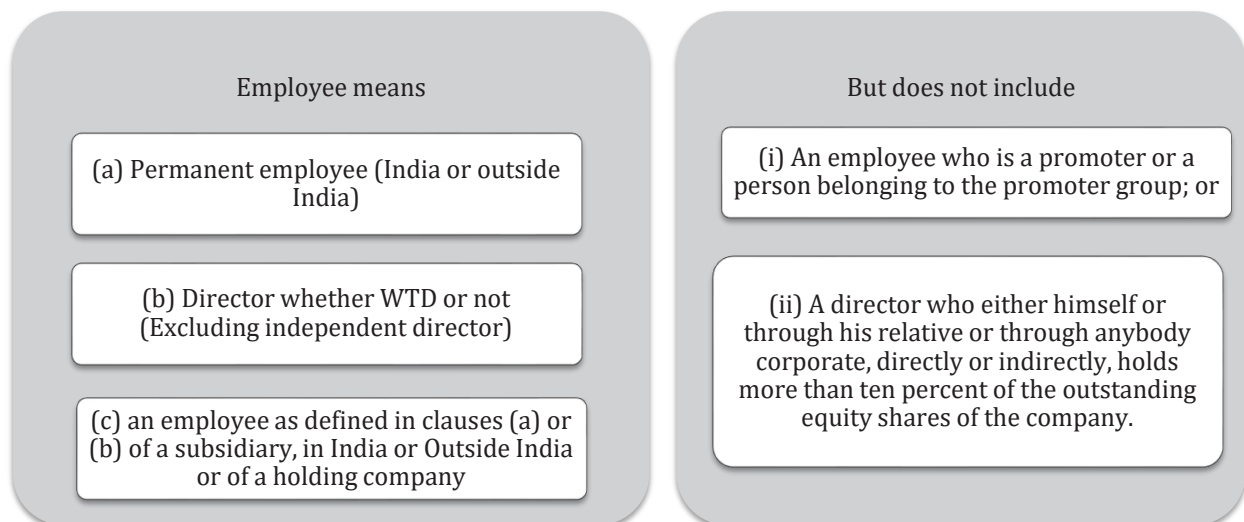
Therefore, to regulate the listed companies from framing any employee benefit scheme involving acquisition of own securities from the secondary market, it was felt that secondary market acquisitions by Trusts being an internationally accepted practice should be considered subject to necessary safeguards to prevent misuse. It was also recognized that there are many kinds of employee benefit schemes involving own securities which being outside the purview of extant ESOS Guidelines are unregulated.

Accordingly, taking into account the wider perspective of employee benefit scheme in India as well as overseas and with the intent to align the provisions of the extant regulations with the Companies Act, 2013 SEBI notified the SEBI (Share Based Employee Benefits) Regulations, 2014

## COMPANIES ACT, 2013

As per Section 62(1) (b) of Companies Act 2013, a Company can offer shares through employee stock option to their employees through special resolution subject to the conditions specified under Rule 12 of Companies (Share Capital and Debentures) Rules 2014.

For the purposes of clause (b) of sub-section (1) of section 62 and this rule “Employee” means –



However, in case of Startup Company, as defined in notification number GSR 180(E) dated 17th February, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India the conditions mentioned in table point (i) and (ii) shall not apply upto five years from the date of its incorporation or registration.

***In terms of the provisions of the SEBI (Share Based Employee Benefits) Regulations, 2014 and the Companies Act, 2013, independent directors are not entitled to ESOPs. However, prior to commencement of these provisions, independent directors were eligible to receive ESOPs. In light of this, if an independent director has been granted ESOPs before commencement of the said provisions and such options remains to be exercised, can he/she still exercise such ESOPs?***

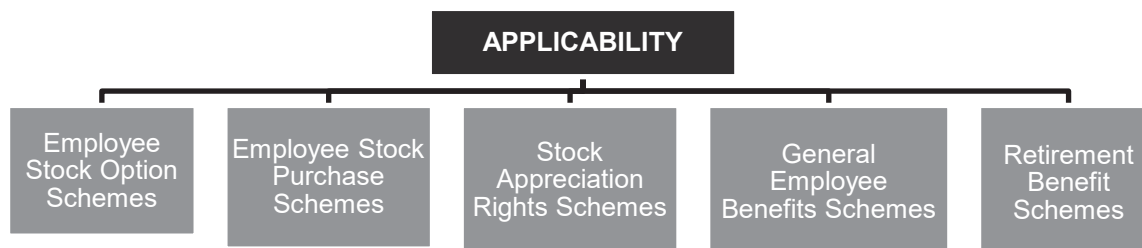
Yes, the restriction on grant of ESOPs to independent director applies only on fresh grants of ESOPs after commencement of the aforesaid provisions. Any grant already made prior to commencement of these provision shall remain valid, i.e., an independent director can exercise such ESOPs subject to fulfillment of terms and conditions of the ESOPs schemes framed by the Companies in terms of the relevant regulations.

## SEBI (SHARE BASED EMPLOYEE BENEFITS) REGULATIONS, 2014

The SEBI (Share Based Employee Benefits) Regulations, provides for regulation of all schemes by companies for the benefit of their employees involving dealing in shares, directly or indirectly, with a view to facilitate smooth operation of such schemes while preventing any possible manipulation and matters connected therewith or incidental thereto.

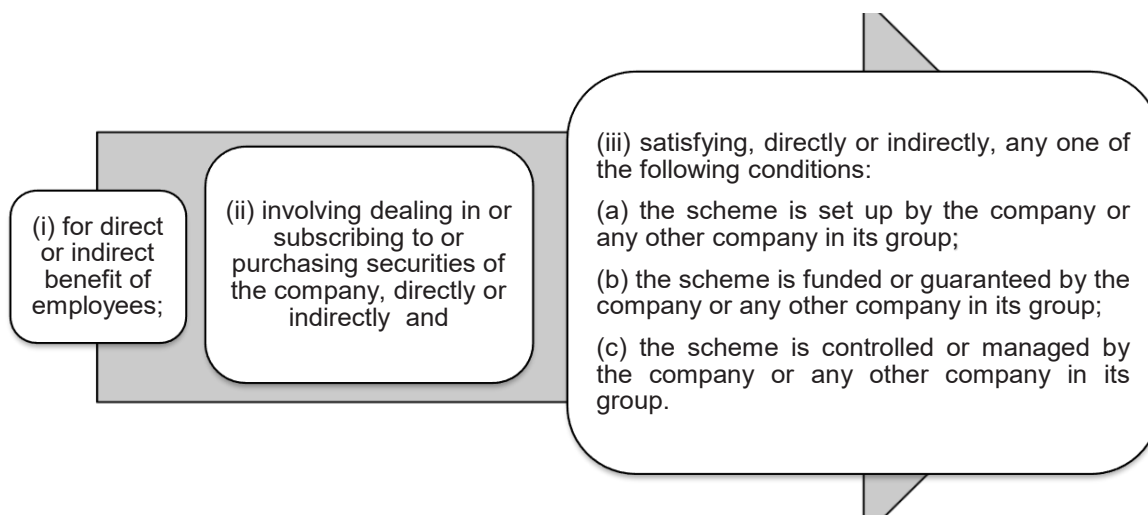
SEBI (Share Based Employee Benefits) Regulations, 2014 comprises of four chapters. Chapter I deal mainly with the preliminary and definition used in regulation. Chapter II provides for implementation and process of scheme. Chapter III deals with administration of specific schemes. Chapter IV deals with miscellaneous provisions.

### APPLICABILITY



### COMPANIES COVERED

The provisions of these regulations shall apply to any company whose shares are listed on a recognised stock exchange in India, and has a scheme:



### NON- APPLICABILITY

- Shares issued to employees in compliance with the provisions pertaining to preferential allotment as specified in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.
- The provisions pertaining to preferential allotment as specified in SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 shall not be applicable in case of a company issuing new shares in pursuance and compliance of these regulations.

### IMPORTANT DEFINITIONS

**“Appreciation”** means the difference between the market price of the share of a company on the date of exercise of stock appreciation right (SAR) or vesting of SAR, as the case may be, and the SAR price.

**“Employee Stock Option Scheme”** means a scheme under which a company grants employee stock option directly or through a trust.

**“Employee Stock Purchase Scheme”** means a scheme under which a company offers shares to employees, as part of public issue or otherwise, or through a trust where the trust may undertake secondary acquisition for the purposes of the scheme.

**“General Employee Benefits Scheme”** means any scheme of a company framed in accordance with these regulations, dealing in shares of the company or the shares of its listed holding company, for the purpose of employee welfare including healthcare benefits, hospital care or benefits, or benefits in the event of sickness, accident, disability, death or scholarship funds, or such other benefit as specified by such company.

**“Relevant Date”** means,-

- (i) in the case of grant, the date of the meeting of the compensation committee on which the grant is made; or
- (ii) in the case of exercise, the date on which the notice of exercise is given to the company or to the trust by the employee;

**“Retirement Benefit Scheme”** means a scheme of a company, framed in accordance with these regulations, dealing in shares of the company or the shares of its listed holding company, for providing retirement benefits to the employees subject to compliance with existing rules and regulations as applicable under laws relevant to retirement benefits in India.

**“Stock Appreciation Right”** means a right given to a SAR grantee entitling him to receive appreciation for a specified number of shares of the company where the settlement of such appreciation may be made by way of cash payment or shares of the company.

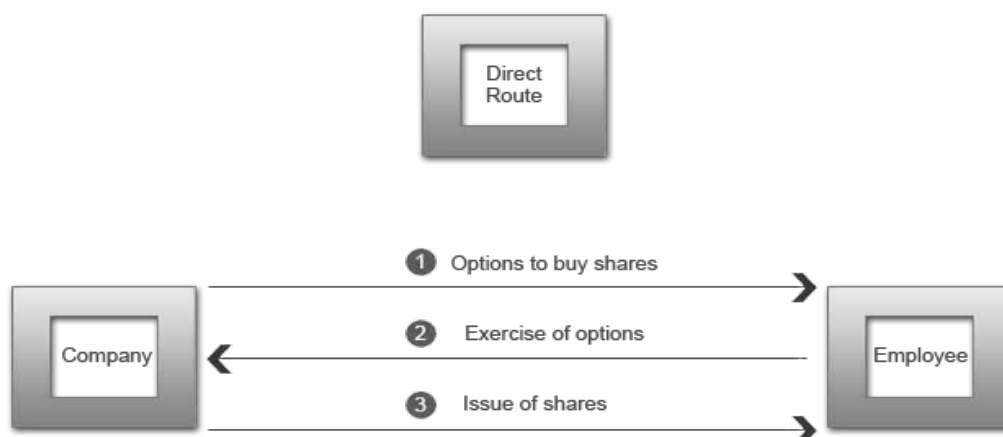
*Explanation* – An SAR settled by way of shares of the company shall be referred to as equity settled SAR.

**“Stock Appreciation Right Scheme”** means a scheme under which a company grants SAR to employees.

### SCHEMES - IMPLEMENTATION AND PROCESS

A company may implement schemes either :-

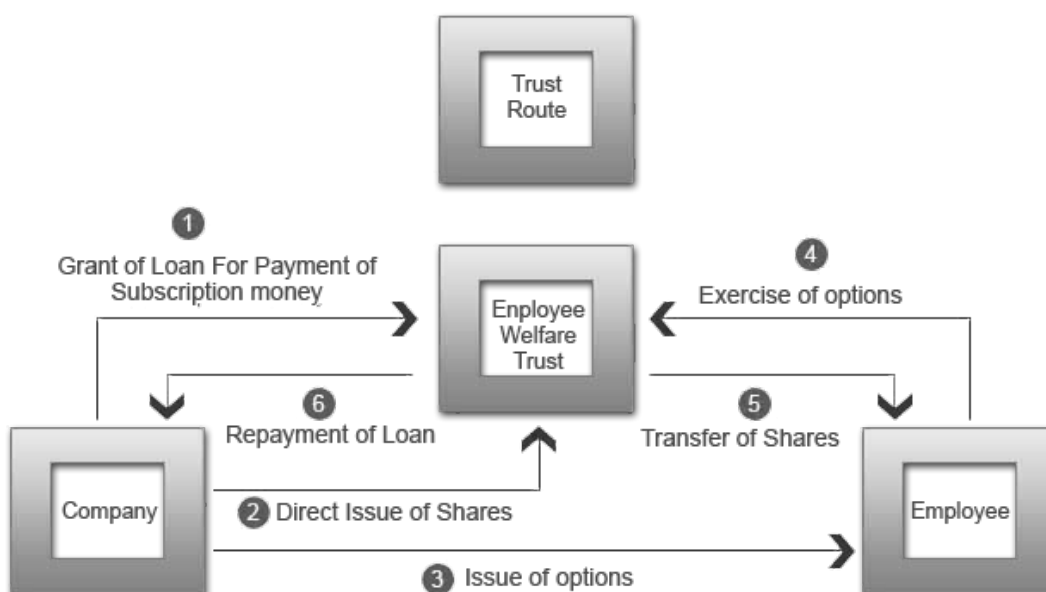
- a) directly or
- b) by setting up an irrevocable trust(s).



#### Direct Route for ESOP's

- ① Company forms an Compensation committee and define the eligibility criteria of ESOPs
- ② Issue fresh shares for ESOPs.
- ③ After vesting period employees can exercise the option.
- ④ On exercise of an option Company issue the shares to the employees.

#### Trust Route



#### Trust Route for ESOP's

- ① Company forms an Employee Welfare Trust.
- ② Company grants Loan to the trust for subscribing shares.
- ③ Company issues fresh shares to the Trust and options to the Employees.
- ④ Employees exercises the options.
- ⑤ Trust Transfers the Shares to the employee upon receipt of exercise price.
- ⑥ Trust repays the loan to the Company.

## IMPLEMENTATION OF SCHEMES THROUGH TRUST

1. If a company has implemented the scheme through a trust and the same has to be decided upfront at the time of taking approval of the shareholders for setting up the schemes.

However, if the scheme involves secondary acquisition or gift or both, then it is mandatory for the company to implement such scheme(s) through a trust(s).

2. A company may implement several schemes as permitted under these regulations through a single trust.

However, such single trust shall keep and maintain-

- proper books of account,
- records and documents,

for each such 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 each scheme.

3. SEBI may specify the minimum provisions to be included in the trust deed under which the trust is formed, and such trust deed and any modifications thereto shall be mandatorily filed with the stock exchange in India where the shares of the company are listed.

4. A person shall not be appointed as a trustee, if he-

- (i) is a director, key managerial personnel or promoter of the company or its holding, subsidiary or associate company or any relative of such director, key managerial personnel or promoter; or
- (ii) beneficially holds ten percent or more of the paid-up share capital of the company;

However, where individuals or 'one person companies' as defined under the Companies Act, 2013 are appointed as trustees, there shall be a minimum of two such trustees, and in case a corporate entity is appointed as a trustee, then it may be the sole trustee.

5. The trustees of a trust, which is governed under these regulations, shall not vote in respect of the shares held by such trust, so as to avoid any misuse arising out of exercising such voting rights.
6. The trustee should ensure that appropriate approval from the shareholders has been obtained by the company in order to enable the trust to implement the scheme(s) and undertake secondary acquisition for the purposes of the scheme(s).
7. The trust shall not deal in derivatives, and shall undertake only delivery based transactions for the purposes of secondary acquisition as permitted by these regulations.
8. The company may lend monies to the trust on appropriate terms and conditions to acquire the shares either through new issue or secondary acquisition, for the purposes of implementation of the scheme(s).
9. For the purposes of disclosures to the stock exchange, the shareholding of the trust shall be shown as 'non-promoter and non-public' shareholding.

*Explanation:* Shares held by the trust shall not form part of the public shareholding which needs to be maintained at a minimum of twenty five percent as prescribed under Securities Contracts (Regulations) Rules, 1957

10. Secondary acquisition in a financial year by the trust shall not exceed two percent of the paid up equity capital as at the end of the previous financial year.
11. The total number of shares under secondary acquisition held by the trust shall at no time exceed the



below mentioned prescribed limits as a percentage of the paid up equity capital as at the end of the financial year immediately prior to the year in which the shareholder approval is obtained for such secondary acquisition:

Sl. No.	Particulars	Limit
A	For the schemes enumerated in Part A, Part B or Part C of Chapter III of these regulations	5%
B	For the schemes enumerated in Part D, or Part E of Chapter III of these regulations	2%
C	For all the schemes in aggregate	5%

12. The un-appropriated inventory of shares which are not backed by grants, acquired through secondary acquisition by the trust under Part A, Part B or Part C of these regulations, shall be appropriated within a reasonable period which shall not extend beyond the end of the subsequent financial year.

However, if such trust(s) existing as on the date of notification of these regulations are not able to appropriate the un-appropriated inventory within one year of such notification, the same shall be disclosed to the stock exchange(s) at the end of such period and then the same shall be sold on the recognized stock exchange(s) where shares of the company are listed, within a period of five years from the date of notification of these regulations.

***Keeping in view point No. 12, for the purpose of clarifying the inventory as un-appropriated, whether the appropriation made to scheme can be considered as compliance?***

Appropriation towards ESPS/ESOP/SAR General Employee Benefit Scheme/Retirement Benefit Scheme by October 27, 2015 would be considered as compliance with proviso to regulation 3(12). The company may appropriate towards individual employees or sell in the market during next four years so that no un-appropriated inventory remains thereafter.

13. The trust shall be required to hold the shares acquired through secondary acquisition for a minimum period of six months except where they are required to be transferred in the circumstances enumerated in this regulation, whether off market or on the platform of stock exchange.

***Shares have been acquired by the trust from secondary market and held for the minimum period of six months in terms of regulation 3(13) of SEBI (SBEB) Regulations, 2014 pursuant to which the same are transferred to employees under ESPS. Whether the requirement of Lock-in, in terms of regulation 22(2) of these regulations, shall be applicable to shares received by employees?***

No, lock-in shall not be applicable to the shares received by employees.

14. The trust shall be permitted to undertake off-market transfer of shares only under the following circumstances:
- transfer to the employees pursuant to scheme(s);
  - when participating in open offer under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, or when participating in buy-back, delisting or any other exit offered by the company generally to its shareholders.
15. The trust shall not become a mechanism for trading in shares and hence shall not sell the shares in secondary market except under the following circumstances:

- a) cashless exercise of options under the scheme as prescribed in these regulations;
  - b) on vesting or exercise, as the case may be, of SAR under the scheme as prescribed in these regulations;
  - c) in case of emergency for implementing the schemes covered under Part D and Part E of Chapter III of these regulations, and for this purpose -
    - (i) the trustee shall record the reasons for such sale; and
    - (ii) money so realised on sale of shares shall be utilised within a definite time period as stipulated under the scheme or trust deed.
  - d) participation in buy-back or open offers or delisting offers or any other exit offered by the company generally to its shareholders, if required;
  - e) for repaying the loan, if the un-appropriated inventory of shares held by the trust is not appropriated within the timeline as provided above.
  - f) winding up of the scheme(s); and
  - g) based on approval granted by SEBI to an applicant, for the reasons recorded in writing in respect of the schemes covered in these regulations, upon payment of a non-refundable fee of rupees one lakh along with the application by way of a banker's cheque or demand draft payable at Mumbai in favour of SEBI.
16. The trust shall be required to make disclosures and comply with the other requirements applicable to insiders or promoters under the SEBI (Prohibition of Insider Trading) Regulations, 2015 or any modification or re-enactment thereto.

### ELIGIBILITY CRITERIA

An employee shall be eligible to participate in the schemes of the company as determined by the compensation committee.

*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 or 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 the grants by the company under its scheme(s) can be accepted by the said employee in his capacity as director of the company;
- b. that grant if made to the director, shall not be renounced in favour of the nominating institution; and
- c. the conditions subject to which fees, commissions, other incentives, etc. can be accepted by the director from the company.

(ii) The institution nominating its employee as a director of a company shall file a copy of the contract or agreement with the said company, which shall, in turn file the copy with all the stock exchanges on which its shares are listed.

(iii) The director so appointed shall furnish a copy of the contract or agreement at the first board meeting of the company attended by him after his nomination.

## COMPENSATION COMMITTEE

- A company shall constitute a compensation committee for administration and superintendence of the schemes.

However, the company may designate such of its other committees as compensation committee if they fulfil the criteria as prescribed in these regulations. Further that where the scheme is being implemented through a trust the compensation committee shall delegate the administration of such scheme(s) to the trust.

- The compensation committee shall be a committee of such members of the board of directors of the company as provided under section 178 of the Companies Act, 2013, as amended or modified from time to time.
- The compensation committee shall, inter alia, formulate the detailed terms and conditions of the schemes which shall include the provisions as specified by SEBI in this regard.
- The compensation committee shall frame suitable policies and procedures to ensure that there is no violation of securities laws, as amended from time to time, including SEBI (Prohibition of Insider Trading) Regulations, 2015 and SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 2003 by the trust, the company and its employees, as applicable.

## SHAREHOLDERS APPROVAL

- A Scheme shall not be offered to employees of a company unless the shareholders of the company approve it by passing a special resolution in the general meeting.
- The explanatory statement to the notice and the resolution proposed to be passed by shareholders for the schemes shall include the information as specified by SEBI in this regard.
- Approval of shareholders by way of separate resolution in the general meeting shall be obtained by the company in case of:

- a) Secondary acquisition for implementation of the schemes.

***Such approval shall mention the percentage of secondary acquisition (subject to limits specified under these regulations) that could be undertaken;***

- b) Secondary acquisition by the trust in case the share capital expands due to capital expansion undertaken by the company including preferential allotment of shares or qualified institutions placement, to maintain the five percent cap as prescribed in these regulations of such increased capital of the company;
- c) Grant of option, SAR, shares or other benefits, as the case may be, to employees of subsidiary or holding company;
- d) Grant of option, SAR, shares or benefits, as the case may be, to identified employees, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option, SAR, shares or incentive, as the case may be.

## VARIATION OF TERMS OF THE SCHEMES

- The company shall not vary the terms of the schemes in any manner, which may be detrimental to the interests of the employees.

However, the company shall be entitled to vary the terms of the schemes to meet any regulatory requirements.

- The company may by special resolution in a general meeting vary the terms of the schemes offered pursuant to an earlier resolution of the general body but not yet exercised by the employee provided such variation is not prejudicial to the interests of the employees.
- The provisions of shareholders' approval shall apply to such variation of terms as they apply to the original grant of option, SAR, shares or other benefits, as the case may be.
- The notice for passing special resolution for variation of terms of the schemes shall disclose full details of the variation, the rationale therefore, and the details of the employees who are beneficiaries of such variation.
- A company may reprice the options, SAR or shares, as the case may be which are not exercised, whether or not they have been vested if the schemes were rendered unattractive due to fall in the price of the shares in the stock market.

However, the company ensures that such repricing shall not be detrimental to the interest of the employees and approval of the shareholders in general meeting has been obtained for such repricing.

### **WINDING UP OF THE SCHEMES**

In case of winding up of the schemes being implemented by a company through trust, the excess monies or shares remaining with the trust after meeting all the obligations, if any, shall be utilised for repayment of loan or by way of distribution to employees as recommended by the compensation committee.

### **NON-TRANSFERABILITY**

- Option, SAR or any other benefit granted to an employee under the regulations shall not be transferable to any person.
- No person other than the employee to whom the option, SAR or other benefit is granted shall be entitled to the benefit arising out of such option, SAR, benefit etc.

However, in case of ESOS or SAR, under cashless 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 applicable law or regulations.

- The option, SAR, or any other benefit granted to the employee shall not be pledged, hypothecated, mortgaged or otherwise alienated in any other manner.
- In the event of death of the employee while in employment, all the options, SAR or any other benefit granted to him under a scheme till such date shall vest in the legal heirs or nominees of the deceased employee.
- In case the employee suffers a permanent incapacity while in employment, all the options, SAR or any other benefit granted to him under a scheme as on the date of permanent incapacitation, shall vest in him on that day.
- In the event of resignation or termination of the employee, all the options, SAR, or any other benefit which are granted and yet not vested as on that day shall expire.

However, an employee shall, subject to the terms and conditions formulated by the compensation committee, be entitled to retain all the vested options, SAR, or any other benefit covered by these regulations.

- In the event that an employee who has been granted benefits under a scheme is transferred or deputed to an associate company prior to vesting or exercise, the vesting and exercise as per the terms of grant shall continue in case of such transferred or deputed employee even after the transfer or deputation.

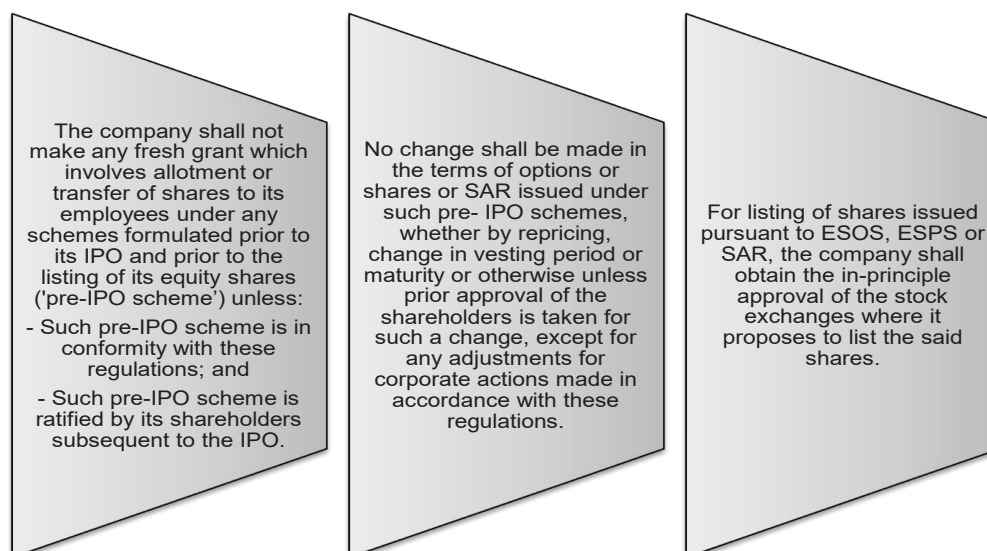
**LISTING**

In case new issue of shares is made under any scheme, shares so issued shall be listed immediately in any recognised stock exchange.

In case of the existing shares are listed, subject to the following conditions :-		
Scheme is in compliance with these regulations	A statement specified by SEBI in this regard, is filed and the company has obtained an in-principle approval from the stock exchanges	As and when an exercise is made, the company notifies the concerned stock exchange as per the statement as specified by SEBI in this regard

**SCHEMES IMPLEMENTED BY UNLISTED COMPANIES**

The shares arising after the initial public offering ("IPO") of an unlisted company, out of options or SAR granted under any scheme prior to its IPO to the employees shall be listed immediately upon exercise in all the recognised stock exchanges where the shares of the company are listed subject to compliance with SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

**COMPLIANCES AND CONDITIONS**

However, the ratification under clause (ii) may be done at any time prior to grant of new options or shares or SAR under such pre-IPO scheme.

**CERTIFICATE FROM AUDITORS**

In case of company which has passed a resolution for the schemes under these regulations, the board of directors shall at each annual general meeting place before the shareholders a certificate from the auditors of

the company that the scheme(s) has been implemented in accordance with these regulations and in accordance with the resolution of the company in the general meeting.

## **DISCLOSURES**

In addition to the information that a company is required to disclose, in relation to employee benefits under the Companies Act, 2013, the board of directors of such a company shall also disclose the details of the scheme(s) being implemented, as specified by SEBI in this regard.

## **ACCOUNTING POLICIES**

Any company implementing any of the share based schemes shall follow the requirements of the 'Guidance Note on Accounting for employee share-based Payments' (Guidance Note) or Accounting Standards as may be prescribed by the Institute of Chartered Accountants of India (ICAI) from time to time, including the disclosure requirements prescribed therein.

Where the existing Guidance Note or Accounting Standard do not prescribe accounting treatment or disclosure requirements for any of the schemes covered under these regulations, then the company shall comply with the relevant Accounting Standard as may be prescribed by the ICAI from time to time.

## **ADMINISTRATION OF SPECIFIC SCHEMES**

### **Employee Stock Option Scheme (ESOS)**

#### **Administration and Implementation**

The ESOS shall contain the details of the manner in which the scheme will be implemented and operated. ESOS shall not be offered unless the disclosures, as specified by SEBI in this regard, are made by the company to the prospective option grantees.

#### **Pricing**

The company granting option to its employees pursuant to ESOS will have the freedom to determine the exercise price subject to conforming to the accounting policies as specified in these regulation.

#### **Vesting Period**

There shall be a minimum vesting period of one year in case of ESOS. However, in case where options are granted by a company under an ESOS in lieu of options held by a person under an ESOS in another company which has merged or amalgamated with that company, the period during which the options granted by the transfer or company were held by him shall be adjusted against the minimum vesting period required under this sub-regulation.

The company may specify the lock-in period for the shares issued pursuant to exercise of option.

#### **Rights of the option holder**

The employee shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to him, till shares are issued upon exercise of option.

#### **Consequence of failure to exercise option**

The amount payable by the employee, if any, at the time of grant of option, -

- a) may be forfeited by the company if the option is not exercised by the employee within the exercise period; or

- b) may be refunded to the employee if the options are not vested due to non-fulfilment of conditions relating to vesting of option as per the ESOS.

## Employee Stock Purchase Scheme (ESPS)

### Administration and Implementation

The ESPS scheme shall contain the details of the manner in which the scheme will be implemented and operated.

### Pricing and Lock-In

The company may determine the price of shares to be issued under an ESPS, provided they conform to the provisions of accounting policies under these regulation. Shares issued under an ESPS shall be locked-in for a minimum period of one year from the date of allotment.

However, in case where shares are allotted by a company under an ESPS in lieu of shares acquired by the same person under an ESPS in another company which has merged or amalgamated with the first mentioned company, the lock-in period already undergone in respect of shares of the transferor company shall be adjusted against the lock-in period.

If ESPS 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 pursuant to ESPS shall not be subject to lock-in.

***Regulation 22(2) of the SEBI (SBEB) Regulations, 2014 prescribes lock-in of shares issued under ESPS for a minimum period of one year from the date of allotment. Whether the said lock-in is applicable to the Trust, if an ESPS scheme is implemented through Trust Route?***

No, the Lock-in requirement is applicable at the level of employee and not at the level of trust. Lock-in in terms of regulation 22(2) shall be applicable from the day shares are received by the employees.

## Stock Appreciation Rights Scheme (SARS)

### Administration and Implementation

The SAR scheme shall contain the details of the manner in which the scheme will be implemented and operated. The company shall have the freedom to implement cash settled or equity settled SAR scheme. However, in case of equity settled SAR scheme, if the settlement results in fractional shares, then the consideration for fractional shares should be settled in cash.

SAR shall not be offered unless the disclosures, as specified by SEBI in this regard, are made by the company to the prospective SAR grantees.

### Vesting

There shall be a minimum vesting period of one year in case of SAR scheme. However, in a case where SAR is granted by a company under a SAR scheme in lieu of SAR held by the same person under a SAR scheme in another company which has merged or amalgamated with the first mentioned company, the period during which the SAR granted by the transferor company were held by the employee shall be adjusted against the minimum vesting period.

### Rights of the SAR Holder

The employee shall not have right to receive dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of SAR granted to him.



## General Employee Benefits Scheme (GEBS)

### Administration and Implementation

GEBS shall contain the details of the scheme and the manner in which the scheme shall be implemented and operated. At no point in time, the shares of the company or shares of its listed holding company shall exceed ten percent of the book value or market value or fair value of the total assets of the scheme, whichever is lower, as appearing in its latest balance sheet for the purposes of GEBS.

## Retirement Benefit Scheme (RBS)

### Administration and Implementation

Retirement benefit scheme may be implemented by a company provided it is in compliance with these regulations, and provisions of any other law in force in relation to retirement benefits. The retirement benefit scheme shall contain the details of the benefits under the scheme and the manner in which the scheme shall be implemented and operated.

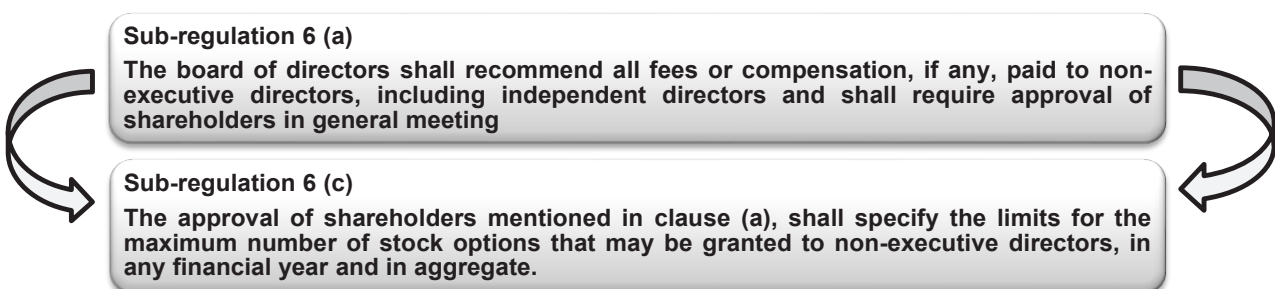
At no point in time, the shares of the company or shares of its listed holding company shall exceed ten per cent of the book value or market value or fair value of the total assets of the scheme, whichever is lower, as appearing in its latest balance sheet for the purposes of RBS.

## DIRECTIONS BY SEBI AND ACTION IN CASE OF DEFAULT

SEBI may issue any direction or order or undertake any measure in the interests of the investors or the securities market, and deal with any contravention of these regulations, in exercise of its powers under SEBI Act, 1992, the Securities Contracts (Regulation) Act, 1956 or the Companies Act, 2013 and any statutory modification or re-enactment thereto.

## SEBI (LISTING OBLIGATIONS & DISCLOSURE REQUIREMENTS) REGULATIONS, 2015 FOR ESOP/ESPS

### Regulation 17: Board of Directors



### Regulation 30: Disclosure of events or information read with Para B of Part A of Schedule III

- (1) Every listed entity shall make disclosures of any events or information which, in the opinion of the board of directors of the listed company, is material.
- (3) The listed entity shall make disclosure of events specified in Para B of Part A of Schedule III, based on application of the guidelines for materiality, as specified in sub-regulation (4).
- (4) (i) The listed entity shall consider the following criteria for determination of materiality of events/ information:



- (a) the omission of an event or information, which is likely to result in discontinuity or alteration of event or information already available publicly; or
- (b) the omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date;
- (c) case where the criteria specified in sub-clauses (a) and (b) are not applicable, an event/information may be treated as being material if in the opinion of the board of directors of listed entity, the event / information is considered material.

(ii) The listed entity shall frame a policy for determination of materiality, based on criteria specified in this sub-regulation, duly approved by its board of directors, which shall be disclosed on its website.

- (6) The listed entity shall first disclose to stock exchange(s) of all events, as specified in Part A of Schedule III, or information as soon as reasonably possible and not later than twenty four hours from the occurrence of event or information:

Provided that in case the disclosure is made after twenty four hours of occurrence of the event or information, the listed entity shall, along with such disclosures provide explanation for delay:

- (8) The listed entity shall disclose on its website all such events or information which has been disclosed to stock exchange(s), and such disclosures shall be hosted on the website of the listed entity for a minimum period of five years and thereafter as per the archival policy of the listed entity, as disclosed on its website.

#### **SCHEDULE III PART A: DISCLOSURES OF EVENTS OR INFORMATION: SPECIFIED SECURITIES**

B. Events which shall be disclosed upon application of the guidelines for materiality referred under sub-regulation (4) of regulation (30):

Options to purchase securities including any ESOP/ESPS Scheme.

#### **SEBI circular dated September 09, 2015**

Details which a listed entity need to disclose for events on which the listed entity may apply materiality in terms of Para B of Part A of Schedule III of Listing Regulations.

**Item No. 10.** Options to purchase securities (including any Share Based Employee Benefit (SBEB) Scheme) at the time of instituting the scheme and vesting or exercise of options:

- a) brief details of options granted;
- b) whether the scheme is in terms of SEBI (SBEB) Regulations, 2014 (if applicable);
- c) total number of shares covered by these options;
- d) pricing formula;
- e) options vested;
- f) time within which option may be exercised;
- g) options exercised;
- h) money realized by exercise of options;
- i) the total number of shares arising as a result of exercise of option;
- j) options lapsed;

- k) variation of terms of options;
- l) brief details of significant terms;
- m) subsequent changes or cancellation or exercise of such options;
- n) diluted earnings per share pursuant to issue of equity shares on exercise of options.

### Procedure for issuing ESOP by a Listed Company

- Hold a Board Meeting to consider and approve ESOP and formation of Compensation Committee;
- Compensation committee shall plan draft the scheme of ESOP;
- Hold Board meeting to adopt the final scheme, appoint the Merchant banker and approve the notice of the General meeting for shareholders approval;
- Hold General Meeting for approval of shareholders;
- Make an application to the stock exchange for obtaining in-principal approval of the stock exchange;
- Issue of letter of grant of option to the eligible employees along with the letter of acceptance of option;
- On receipt of letter of acceptance of option along with upfront payment (if any), from the employee issue the option certificates;
- After expiry of vesting period, not less than one year the options shall vest in the employee. At that time, the Company shall issue a letter of vesting along with the letter of exercise of options;
- Receipt to letter of exercise from the employee;
- Hold a Board Meeting at the suitable Interval during the exercise period for allotment of shares on options exercised by the optioness;
- Dispatch of letter of allotment along with the share certificates or credit the shares so allotted with the Depositories;
- Make an application to the Stock exchange for listing of the Shares so allotted; and
- Receipt of Listing of the shares from the Stock exchange.

***Does the contra trade restriction (for a period not less than six months) under clause 10 of Schedule B of the SEBI (Prohibition of Insider Trading) Regulation, 2015 also apply to the exercise of ESOPs and the sale of shares so acquired?***

Exercise of ESOPs shall not be considered to be “trading” except for the purposes of Chapter III of the Regulations. However, other provisions of the Regulations shall apply to the sale of shares so acquired.

For Example:

- (i) If a designated person has sold/ purchased shares, he can subscribe and exercise ESOPs at any time after such sale/purchase, without attracting contra trade restrictions.
- (ii) Where a designated person acquires shares under an ESOP and subsequently sells/pledges those shares, such sale shall not be considered as contra trade, with respect to exercise of ESOPs.
- (iii) Where a designated person purchases some shares (say on August 01, 2015), acquires shares later under an ESOP (say on September 01, 2015) and subsequently sells/pledges (say on October 01, 2015) shares so acquired under ESOP. The sale will not be a contra trade but will be subject other provisions of the Regulations, however, he will not be able to sell the shares purchased on August 01, 2015 during the period of six months from August 01, 2015.

- (iv) Where a designated person sells shares (say on August 01, 2015), acquires shares later under an ESOP (say on September 01, 2015) the acquisition under ESOP shall not be a contra trade. Further, he can sell/pledge shares so acquired at any time thereafter without attracting contra trade restrictions. He, however, will not be able to purchase further shares during the period of six months from August 01, 2015 when he had sold shares.

## ROLE OF COMPANY SECRETARY

For listing of equity shares issued pursuant to exercise of options granted under ESPS/ESOS/SARS/GEBS/RBS basis- Post issue

- A Certificate from Company Secretary for receipt of money.
- A quarterly certificate from the practising Company Secretary specifically certifying that the company has received the application/allotment monies from the applicants of these shares. [Source: [www.bseindia.com](http://www.bseindia.com)]

## LESSON ROUND-UP

- As per Section 62(1) (b) of Companies Act 2013, A Company can offer shares through employee stock option to their employees through special resolution subject to the conditions specified under Rule 12 of Companies (Share Capital and Debentures) Rules 2014.
- Issue of Employee Stock option by a listed entity is regulated by SEBI (Share Based Employee Benefits) Regulations, 2014.
- SEBI has, on 28th October 2014 notified SEBI (Share Based Employee Benefits) Regulations, for regulation of all schemes by companies for the benefit of their employees involving dealing in shares, directly or indirectly, with a view to facilitate smooth operation of such schemes while preventing any possible manipulation and matters connected therewith or incidental thereto.
- A company may implement schemes either :-
  - directly or
  - by setting up an irrevocable trust(s).
- An employee shall be eligible to participate in the schemes of the company as determined by the compensation committee.
- In case of winding up of the schemes being implemented by a company through trust, the excess monies or shares remaining with the trust after meeting all the obligations, if any, shall be utilised for repayment of loan or by way of distribution to employees as recommended by the compensation committee.

## GLOSSARY

<b>Grant</b>	It means issue of option to employees under the scheme.
<b>Option grantee</b>	It means an employee having a right but not an obligation to exercise an option in pursuance of ESOS.
<b>Secondary Market</b>	The market for previously issued securities or financial instruments.
<b>Trustee</b>	Legal Custodian who looks after all the monies invested in a unit trust or mutual fund.
<b>Vesting</b>	The process by which the employee is given the right to apply for shares of the company against the option granted to him in pursuance of ESOS.

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

- [illegible]

# Lesson 10

## SEBI (Issue of Sweat Equity) Regulations, 2002 – An Overview

### LESSON OUTLINE

- Introduction
- Companies Act, 2013
- SEBI (Issue of Sweat Equity) Regulations, 2002
- Sweat equity shares may be issued to employee and directors
- Special Resolution
- Issue of Sweat Equity Shares to Promoters
- Pricing of Sweat Equity Shares
- Valuation of Intellectual Property
- Accounting Treatment
- Placing of Auditors before Annual General Meeting
- Ceiling on Managerial Remuneration
- Lock-in
- Listing
- Applicability of Takeover
- LESSON ROUND UP
- GLOSSARY
- SELF-TEST QUESTIONS

### LEARNING OBJECTIVES

Factors to the success of any company is its ability to attract top talent while retaining those already working within the company. One of the ways in which companies attract and retain key employees is by rewarding them with equity shares. Traditionally, these types of equity shares are called Sweat Equity Shares which is administered by SEBI (Issue of Sweat Equity) Regulations, 2002 in case of listed company and Companies Act, 2013 in case of unlisted company respectively.

In this lesson, the students will be able to understand the various provisions of SEBI (Issue of Sweat Equity) Regulations, 2002, its applicability, non-applicability, issuance of Sweat equity shares to employee & directors, Special Resolution, Pricing, Valuation, Ceiling on Managerial Remuneration, Lock-in, Listing etc.

## INTRODUCTION

Sweat equity shares refers to equity shares given to the company's employees on favourable terms, in recognition of their work. Sweat equity shares is one of the modes of making share based payments to employees of the company. The issue of sweat equity shares allows the company to retain the employees by rewarding them for their services. Sweat equity shares rewards the beneficiaries by giving them incentives in lieu of their contribution towards the development of the company. Further, Sweat equity shares enables greater employee stake and interest in the growth of an organization as it encourages the employees to contribute more towards the company in which they feel they have a stake.

Section 2 (88) of the Companies Act, 2013 defines "sweat equity shares" which means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Company issue shares at a discount or for consideration other than cash to selected employees and directors as per norms approved by the Board of Directors or any committee, like compensation committee, formed for this purpose. This is 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.

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.

## COMPANIES ACT, 2013

According to Section 54 of the Companies Act, 2013 a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled:

- (a) The issue is authorized 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) 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 and if they are not listed the sweat equity shares are to be issued in accordance with the rule 8 of Companies (Share Capital and Debenture) Rules, 2014.

Where the equity shares of the company are listed on a recognized stock exchange, sweat equity shares should be issued in accordance with regulations made by the Securities and Exchange Board of India in this regard.

### ***Whether Issue of sweat equity shares can be in the form of preferential Issue?***

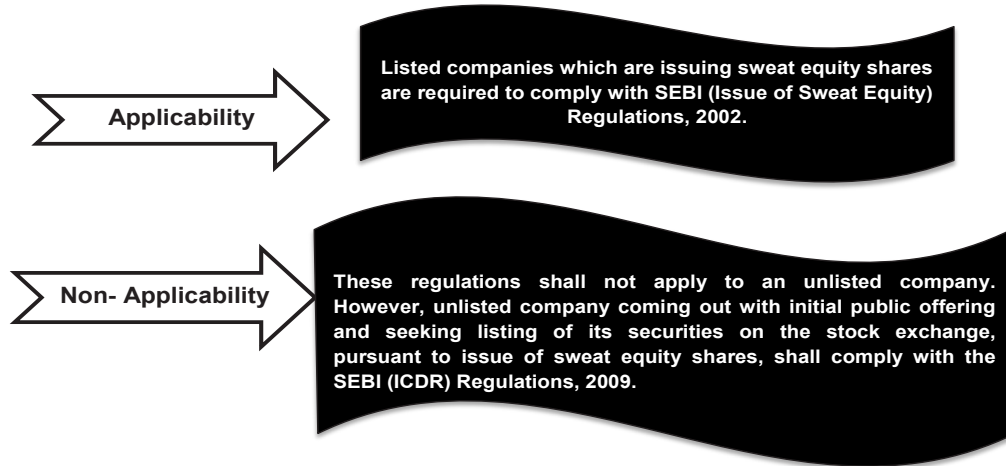
Issue of Sweat Equity Shares is not a 'preferential issue' as per regulation 2(1)(z) of SEBI (ICDR) Regulations, 2009 which gives the meaning of a preferential issue excludes an issue of sweat equity shares there from, which means issue of sweat equity shares is not a preferential issue within the meaning of preferential issue.

Further Rule 8 (13) of The Companies (Share Capital and Debentures) Rules, 2014, clearly excludes issue of sweat equity shares from the definition of preferential offer.

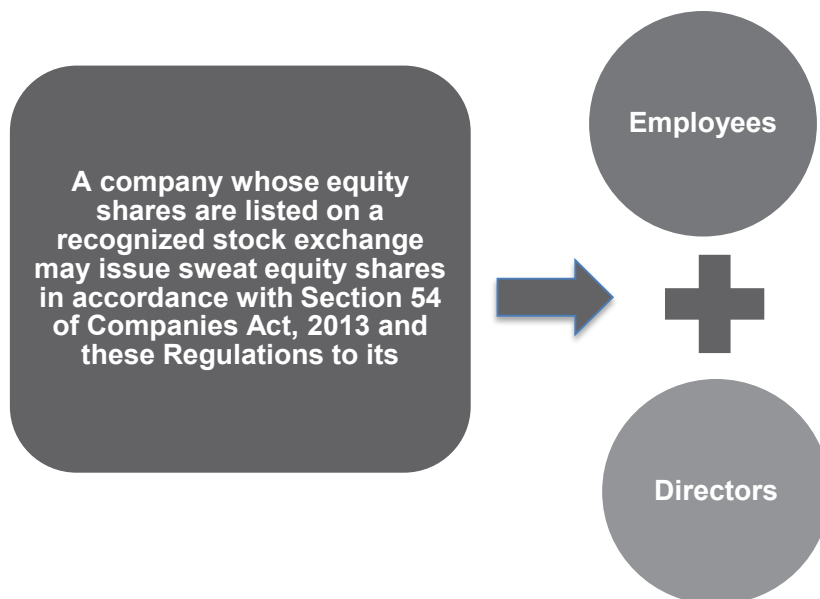
## SEBI (ISSUE OF SWEAT EQUITY) REGULATIONS, 2002

SEBI (Issue of Sweat Equity) Regulations, 2002 has been notified on 24th September, 2002 in order to streamline

the process of issue of sweat equity shares. These regulations are divided into Four Chapters and a Schedule. Chapter I deals with Preliminary & Important Definitions, Chapter II deals with Issue of Sweat Equity by a Listed Company, Chapter III deals General Obligations of the company and Chapter IV deal with Penalties and Procedure.



### SWEAT EQUITY SHARES MAY BE ISSUED TO EMPLOYEE AND DIRECTORS



### SPECIAL RESOLUTION

For the purposes of passing a special resolution under clause (a) of sub section (1) of Section 54 of the Companies Act, 2013, the Board of Directors at the time of sending notice to the shareholders shall send additional information for approving the issuance of sweat equity shall, *inter alia*, contain the following information:

- The total number of shares to be issued as sweat equity.
- The current market price of the shares of the company.
- The value of the intellectual property rights or technical know how or other value addition to be received from the employee or director along with the valuation report / basis of valuation.
- The names of the employees or directors or promoters to whom the sweat equity shares shall be issued and their relationship with the company.

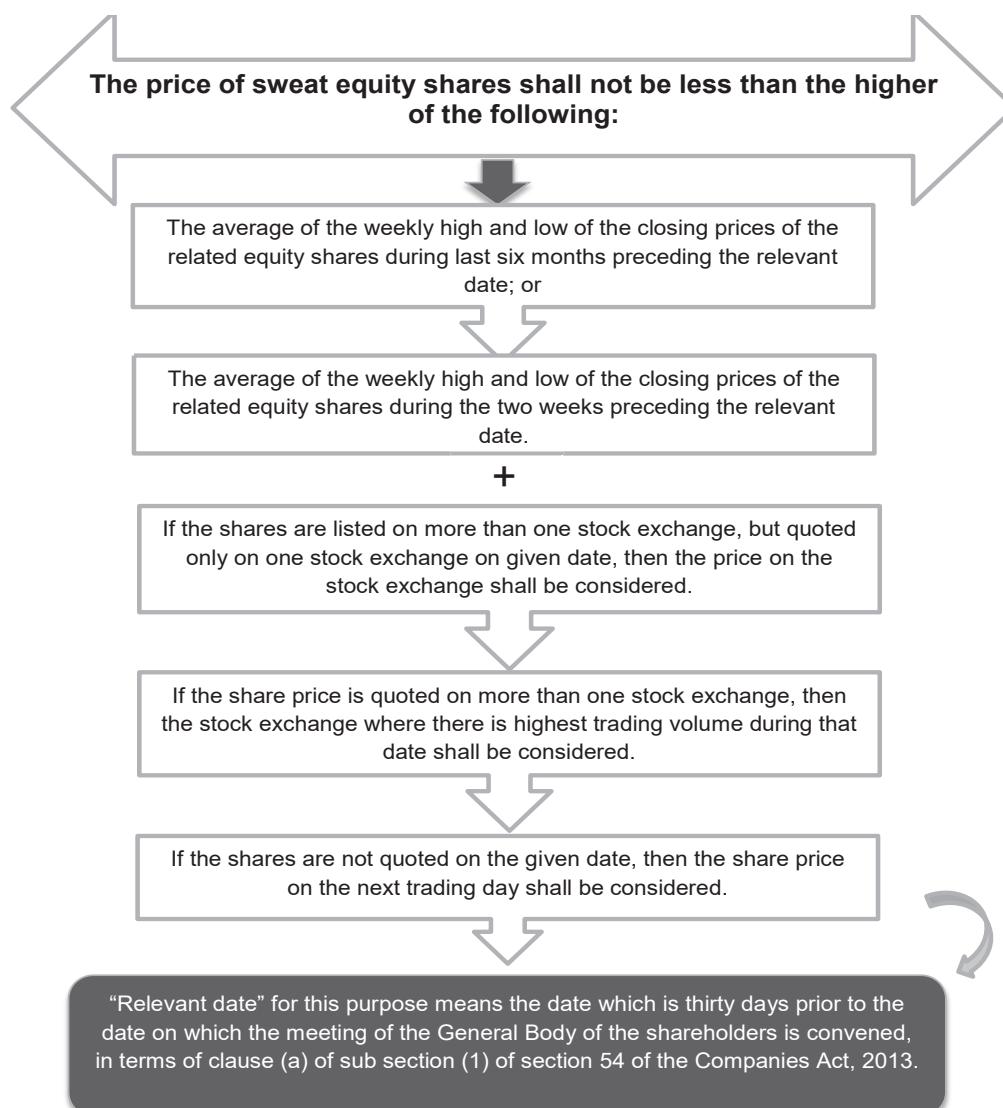
- e) The consideration to be paid for the sweat equity.
- f) The price at which the sweat equity shares shall be issued.
- g) Ceiling on managerial remuneration, if any, which will be affected by issuance of such sweat equity.
- h) A statement to the effect that the company shall conform to the accounting policies as specified by SEBI.
- i) Diluted Earning Per Share pursuant to the issue of securities to be calculated in accordance with International Accounting Standards / standards specified by the Institute of Chartered Accountants of India.

### ISSUE OF SWEAT EQUITY SHARES TO PROMOTERS

In case of Issue of sweat equity shares to promoters, the same shall also be approved by simple majority of the shareholders in General Meeting.

Further, the promoters to whom such Sweat Equity Shares are proposed to be issued shall not participate in such resolution and separate resolution shall be passed for each transaction of issue of Sweat Equity. Such resolution shall be valid for a period of not more than twelve months from the date of passing of the resolution. For the purposes of passing the resolution, the explanatory statement shall contain the disclosures as specified in the Schedule.

### PRICING OF SWEAT EQUITY SHARES





## VALUATION OF INTELLECTUAL PROPERTY

- The valuation of the intellectual property rights or of the know how provided or other value addition mentioned in Explanation II of sub-rule (1) of Rule (8) of Companies (Share Capital and Debentures) Rules, 2014 shall be carried out by a merchant banker.
- The merchant banker may consult such experts and valuers, as he may deem fit having regard to the nature of the industry and the nature of the property or other value addition.
- The merchant banker shall obtain a certificate from an independent Chartered Accountant that the valuation of the intellectual property or other value addition is in accordance with the relevant accounting standards.

## ACCOUNTING TREATMENT

Where the sweat equity shares are issued for a non-cash consideration, such non cash consideration shall be treated in the following manner in the books of account of the company:-

1. where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the relevant accounting standards; or
2. where the above clause is not applicable, it shall be expensed as provided in the relevant accounting standards.

## PLACING OF AUDITORS BEFORE ANNUAL GENERAL MEETING

In the General meeting subsequent to the issue of sweat equity, the Board of Directors shall place before the shareholders, a certificate from the auditors of the company that the issue of sweat equity shares has been made in accordance with the Regulations and in accordance with the resolution passed by the company authorizing the issue of such Sweat Equity Shares.

## CEILING ON MANAGERIAL REMUNERATION

The amount of Sweat Equity shares issued shall be treated as part of managerial remuneration for the purpose of sections 197 of the Companies Act, 2013, if the following conditions are fulfilled:

- (i) the Sweat Equity shares are issued to any director or manager; and
- (ii) they are issued for non-cash consideration, which does not take the form of an asset which can be carried to the balance sheet of the company in accordance with the relevant accounting standards.

## LOCK-IN

The Sweat Equity shares shall be locked in for a period of three years from the date of allotment. SEBI (ICDR) Regulations, 2009 on public issue in terms of lock-in and computation of promoters' contribution shall apply if a company makes a public issue after it has issued sweat equity.

## LISTING

The Sweat Equity issued by a listed company shall be eligible for listing only if such issues are in accordance with these regulations.

## APPLICABILITY OF TAKEOVER

Any acquisition of Sweat Equity Shares shall be subject to the provision of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

## LESSON ROUND UP

- Section 2 (88) of the Companies Act, 2013 defines “sweat equity shares” which means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.
- Where the equity shares of the company are listed on a recognized stock exchange, sweat equity shares should be issued in accordance with regulations made by the Securities and Exchange Board of India in this regard.
- These regulations shall not apply to an unlisted company. However, unlisted company coming out with initial public offering and seeking listing of its securities on the stock exchange, pursuant to issue of sweat equity shares, shall comply with the SEBI (ICDR) Regulations, 2009.
- In case of Issue of sweat equity shares to promoters, the same shall also be approved by simple majority of the shareholders in General Meeting.
- The Sweat Equity shares shall be locked in for a period of three years from the date of allotment.
- The Sweat Equity issued by a listed company shall be eligible for listing only if such issues are in accordance with these regulations.

## GLOSSARY

<b>Accounting Standard</b>	Accounting Standards are codified or written statements of accounting rules and guidelines for preparation and presentation of financial statements. They are policy documents issued by an expert accounting body or by the Government or other regulatory body.
<b>Diluted Earning Per Shares</b>	EPS is which accrues to the shareholder of the company. Dilution is a reduction in EPS or an increase in loss per share resulting from the assumption, that convertible instruments are converted, that options or warrants are exercised or the ordinary shares are issued.
<b>Intellectual Property</b>	It is a category of property that includes intangible creations of the human intellect, and primarily encompasses copyrights, patents, and trademarks. It also includes other types of rights, such as trade secrets, publicity rights, moral rights, and rights against unfair competition.
<b>Special Resolution</b>	A special resolution is a resolution of a company's shareholders which requires at least 75% of the votes cast by the shareholders in favour of it in order to pass.
<b>Valuer</b>	It means a Chartered Accountant or a merchant banker appointed to determine the value of the intellectual property rights or other value addition.

## SELF TEST QUESTIONS

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

1. What are applicability and non-applicability of the SEBI (Issue of Sweat Equity) Regulations, 2002?
2. Explain the requirements for issue of Sweat Equity shares to promoters.
3. Elucidate the Pricing provisions of Sweat Equity Shares.

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# Lesson 11

## SEBI (Prohibition of Insider Trading) Regulations, 2015

### LESSON OUTLINE

- Introduction
- SEBI (Prohibition of Insider Trading) Regulations, 2015
- Communication or Procurement of UPSI
- Trading when in possession of UPSI
- Trading Plans
- Disclosure of trading by insiders
- Disclosure of interest by certain persons
- Codes of Fair Disclosure and Conduct
- Penalty Provisions for violations of the Regulations
- Appeal to Securities Appellate Tribunal
- Role of Company Secretary as Compliance Officer
- LESSON ROUND UP
- GLOSSARY
- SELF-TEST QUESTIONS

### LEARNING OBJECTIVES

In simple terms 'insider trading' is buying or selling a security, in breach of a fiduciary duty or other relationship of trust, and confidence, while in possession of material, non-public information about the security. Therefore, preventing such transactions is an important obligation for any capital market regulatory system, because insider trading undermines investor confidence in the fairness and integrity of the securities markets.

A Company Secretary, being a professional, and most importantly being a compliance officer plays a pivotal role in a company to prevent Insider Trading by establishment of policies and procedures in this regard. This lesson will enable the students to have the basic understanding of the Insider trading regulations in India, the disclosures required to be made under these regulations by the company, employee, directors, promoters, etc. the duty of compliance officer, Model Code of Conduct, Code of Corporate Disclosure Practices, the Penal provisions for Insider Trading by SEBI.

## INTRODUCTION

The practice of Insider Trading came into existence ever since the very concept of trading of securities of a company became prevalent among the investors worldwide and has now become a formidable challenge for investors all over the world.

The United State of America was the first country to formally enact a legislation to regulate insider trading. Over the years, most of the jurisdictions around the world have recognized the requirement to restrict insider trading in one form or other and accordingly put in place legal restrictions to this effect.

India was not late in recognizing the detrimental impact of insider trading. The history of Insider Trading in India relates back to the 1940's with the formulation of government committees such as the Thomas Committee under the chairmanship of Mr. P.J.Thomas to evaluate restrictions that can be imposed on short swing profit of 1948, which evaluated *inter alia*, the regulations in the US on short swing profits under Section 16 of the Securities Exchange Act, 1934. Thereafter in India provisions relating to Insider Trading were incorporated in the Companies Act, 1956 under Sections 307 and 308, which required shareholding disclosures by the directors and managers of a company. Due to inadequate provisions of enforcement in the companies Act, 1956, the Sachar Committee in 1979, the Patel Committee in 1986 and the Abid Hussain Committee in 1989 proposed recommendations for a separate statute regulating Insider Trading.

The Patel committee in 1986 in India defined Insider Trading as:

“Insider trading generally means trading in the shares of a company by the persons who are in the management of the company or are close to them on the basis of undisclosed price sensitive information regarding the working of the company, which they possess but which is not available to others.”

The concept of Insider Trading in India started fermenting in the 80's and 90's and came to be known and observed extensively in the Indian Securities market. As mentioned earlier due to inadequate provisions in the Companies Act, 1956 and rapidly advancing Indian Securities market needed a more comprehensive legislation to regulate the practice of Insider Trading, thus resulting in the formulation of the SEBI (Insider Trading) Regulations in the year 1992, which were amended in the year 2002 after the discrepancies observed in the 1992 regulations in the cases like *Hindustan Levers Ltd. vs. SEBI*, *Rakesh Agarwal vs. SEBI*, etc. to remove the lacunae existing in the Regulations of 1992. The amendment in 2002 came to be known as the SEBI (Prohibition of Insider Trading) Regulations, 1992.

Further, the PIT Regulations, 1992 had their challenges in their drafting, interpretation and reach. Besides, the felt need to ensure a clear regulatory policy that is not only easily comprehensible but is also comprehensive led to this Committee being set up under the chairmanship of Justice N. K. Sodhi, Former Chief Justice of the High Courts of Kerala and Karnataka and a Former Presiding Officer of the Securities Appellate Tribunal. The High Level Committee reviewed the SEBI (Prohibition of Insider Trading) Regulations, 1992 submitted its report to SEBI on December 7, 2013.

The Committee made a range of recommendations to the legal framework for prohibition of insider trading in India and has focused on making this area of regulation more predictable, precise and clear by suggesting a combination of principles-based regulations and rules that are backed by principles. The Committee had also suggested that each regulatory provision might be backed by a note on legislative intent.

SEBI issued and notified the SEBI (Prohibition of Insider Trading) Regulations, 2015 on 15th January, 2015 based on recommendations of Sodhi committee and became effective from **15th May, 2015, by repealing SEBI (Prohibition of Insider Trading) Regulations 1992.**

These regulations strengthen the legal and enforcement framework, align Indian regime with international practices, provide clarity with respect to the definitions and concepts, and facilitate legitimate business transactions.

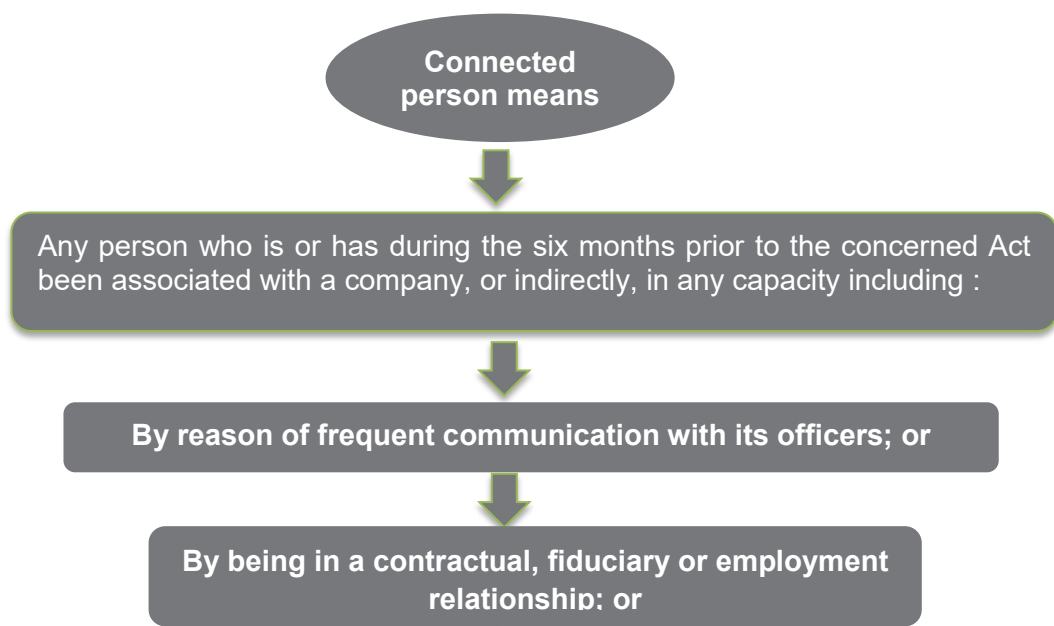
The definition of price sensitive information has also been included. No person including any director or KMP of a company shall enter into insider trading except any communication required in the ordinary course of business or profession or employment or under any law.

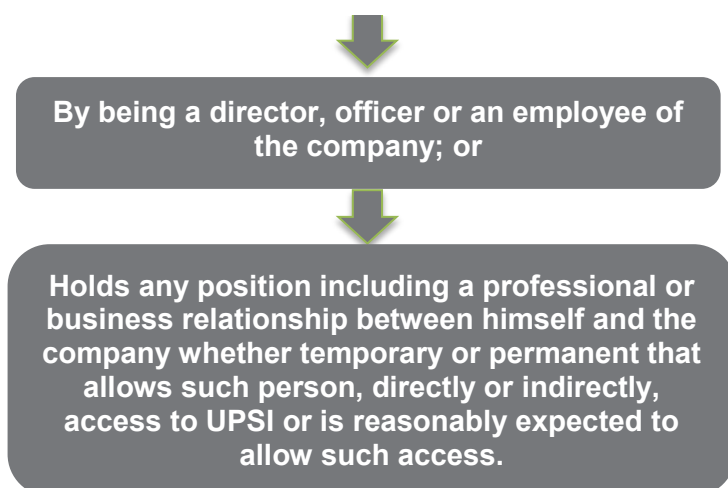
## SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015	
Five Chapters	Two Schedules
<b>Chapter I</b>	Definitions
<b>Chapter II</b>	Restrictions on communication and trading in securities by insiders
<b>Chapter III</b>	Disclosures of trading by insiders.
<b>Chapter IV</b>	Codes of fair disclosure and conduct to be followed by listed companies and other entities, disclosure requirements
<b>Chapter V</b>	Miscellaneous matters like sanction for violation, power to remove difficulties, repeal and savings

### Definitions

#### Connected person





### Person deemed to be connected person

“Person is deemed to be a connected person”, if such person –

- (a) an immediate relative of connected persons; or
- (b) a holding company or associate company or subsidiary company; or
- (c) an intermediary as specified in section 12 of the SEBI Act or an employee or director thereof; or
- (d) an investment company, trustee company, asset management company or an employee or director thereof; or
- (e) an official of a stock exchange or of clearing house or corporation; or
- (f) a member of board of trustees of a mutual fund or a member of the board of directors of the asset management company of a mutual fund or is an employee thereof; or
- (g) a member of the board of directors or an employee, of a public financial institution as defined in section 2 (72) of the Companies Act, 2013; or
- (h) an official or an employee of a self-regulatory organization recognised or authorized by SEBI; or
- (i) a banker of the company; or
- (j) a concern, firm, trust, Hindu undivided family, company or association of persons wherein a director of a company or his immediate relative or banker of the company, has more than ten percent of the holding or interest;

**If a spouse is financially independent and does not consult an insider while taking trading decisions is that spouse exempted from the definition of ‘immediate relative’?**

A spouse is presumed to be an ‘immediate relative’, unless rebutted so.

### Insider

“Insider” means any person who is:

- i) a connected person; or
- ii) in possession of or having access to unpublished price sensitive information.



## Trading

“Trading” means and includes subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, deal in any securities, and “trade” shall be construed accordingly.

## Unpublished price sensitive information

“Unpublished price sensitive information” means any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following—

- (i) Financial results;
- (ii) Dividends;
- (iii) Change in capital structure;
- (iv) Mergers, de-mergers, acquisitions, delisting, disposals and expansion of business and such other transactions;
- (v) Changes in key managerial personnel; and
- (vi) Material events in accordance with the listing agreement.

## Compliance officer

Compliance Officer means:

- any senior officer, designated so and reporting to the board of directors or head of the organization in case board is not there,
- who is financially literate and is capable of appreciating requirements for legal and regulatory compliance under these regulations and
- who shall be responsible for compliance of policies, procedures, maintenance of records, monitoring adherence to the rules for the preservation of unpublished price sensitive information,
- monitoring of trades and the implementation of the codes specified in these regulations under the overall supervision of the board of directors of the listed company or the head of an organization, as the case may be.

## COMMUNICATION OR PROCUREMENT OF UNPUBLISHED PRICE SENSITIVE INFORMATION

Regulation 3 provides that any person shall not :

- communicate, provide, or allow access to any unpublished price sensitive information or
- procure from or cause the communication by any insider of unpublished price sensitive information, relating to a company or securities listed or proposed to be listed or proposed to be listed except in furtherance of legitimate purposes, performance of duties or discharge of legal obligations.

However, above provisions shall not be applicable to any unpublished price sensitive information which may be communicated, provided, allowed access to or procured, in connection with a transaction that would:—

- entail an obligation to make an open offer under the takeover regulations or
- not attract the obligation to make an open offer under the takeover regulations
- Where the board of directors of the company is of informed opinion that the proposed transaction is in the best interests of the company and

- the information that constitute unpublished price sensitive information is disseminated to be made generally available at least 2 trading days prior to the proposed transaction being effected in such form as the board of directors may determine.

The board of directors shall require the parties to execute agreements to contract confidentiality and non-disclosure obligations and such parties shall keep information so received confidential, except for the purpose specified above and shall not otherwise trade in securities of the company when in possession of unpublished price sensitive information.

### **TRADING WHEN IN POSSESSION OF UNPUBLISHED PRICE SENSITIVE INFORMATION (UPSI)**

Regulation 4 prescribes that an insider shall not trade in securities, which are listed or proposed to be listed on stock exchange when in possession of unpublished price sensitive information. However there are certain exemptions:

#### **When there is an off-market transfer between promoters**

- Who are aware of price sensitive information without being in breach of regulation 3 and
- Both parties had made a conscious and informed trade decision; or

#### **In the case of non-individual insiders**

- The individuals who were in possession of such unpublished price sensitive information were different from the individuals taking trading decisions and
- Such decision-making individuals were not in possession of such unpublished price sensitive information when they took the decision to trade; and
- Appropriate and adequate arrangements were in place to ensure that these regulations are not violated and no unpublished price sensitive information was communicated by the individuals
- Possessing the information to the individuals taking trading decisions and there is no evidence of such arrangements having been breached;

**The trades were pursuant to a trading plan set up in accordance these regulations.**

**Note :** In the case of connected persons, the onus of establishing, that they were not in possession of unpublished price sensitive information, shall be on such connected persons and in other cases, the onus would be on SEBI. SEBI may specify such standards and requirements, from time to time, as it may deem necessary for the purpose of these regulations.

#### ***Whether creation of a pledge or invocation of pledge is allowed when trading window is closed?***

Yes, however, the pledgor or pledgee may demonstrate that the creation of the pledge or invocation of pledge was bonafide and prove this innocence under proviso to sub-regulation (1) of regulation 4.

## TRADING PLANS

Regulation 5 states that an insider would be required to submit trading plan in advance to the compliance officer for his approval. The compliance officer is also empowered to take additional undertakings from the insiders for approval of the trading plan. Such trading plan on approval will also be disclosed to the stock Exchanges, where the securities of the company are listed.

The trading plan shall comply with requirements as follows:

- It shall be submitted for a minimum period of 12 months.
- No overlapping of plan with the existing plan submitted by Insider
- It shall set out either the value of trades to be effected or the number of securities to be traded along with:
  - the nature of the trade and
  - the intervals at, or
  - dates on which such trades shall be effected.
- Trading can only commence only after 6 months from public disclosure of plan. No trading between 20th day prior to closure of financial period and 2nd trading day after disclosure of financial results.
- Compliance officer to approve the plan.
- The trading plan once approved shall be irrevocable and the insider shall mandatorily have to implement the plan, without being entitled to either deviate from it or to execute any trade in the securities outside the scope of the trading plan.

(Except in few case like where insider is in possession of price sensitive information at the time of formulation of the plan and such information has not become generally available at the time of the commencement of implementation)

- Upon approval of the trading plan, the compliance officer shall notify the plan to the stock exchanges on which the securities are listed.

### ***Whether contra trade is allowed within the duration of the trading plan?***

Any trading plan opted by a person under trading plan can be done only to the extent and in the manner disclosed in the plan, save and except for pledging of securities.

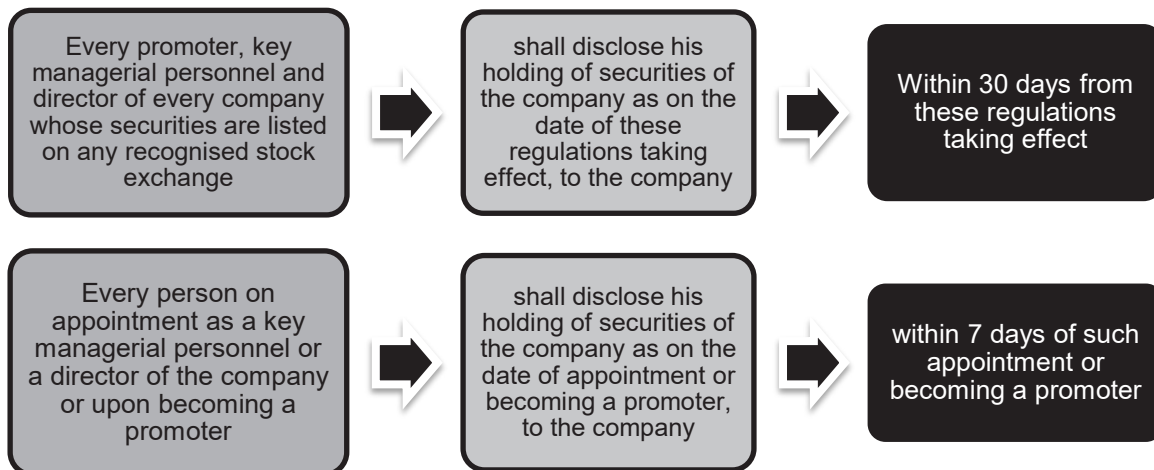
## DISCLOSURES OF TRADING BY INSIDERS

Regulation 6 deals with general provisions of disclosures :

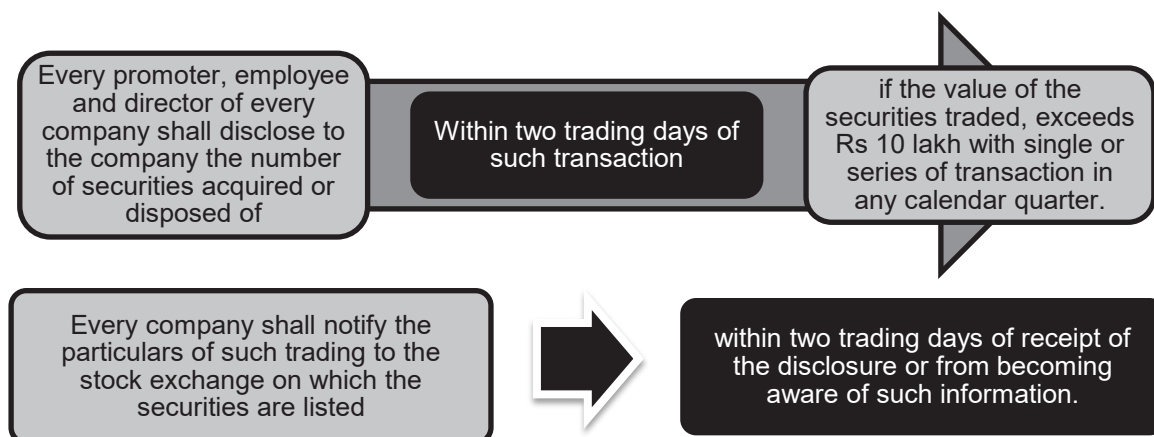
- The disclosures made by person shall also include those relating to trading by such person's immediate relatives, and by any other person for whom such person takes trading decisions.
- The disclosures of trading in securities shall also include trading in derivatives of securities if permitted under law.
- Such disclosure shall be preserved for 5 years.

## DISCLOSURES OF INTEREST BY CERTAIN PERSONS

### Initial Disclosures



### Continual Disclosures



Any company whose securities are listed on stock exchange may, at its discretion require any other connected person or class of connected persons to make disclosures of holdings and the company may determine trading in securities of the company in such form and at such frequency as may be determined by the company in order to monitor compliance with these regulations.

## CODES OF FAIR DISCLOSURE AND CONDUCT

### A. CODE OF FAIR DISCLOSURE

The board of directors of the company shall formulate and publish on its official website, a code of practices and procedures for fair disclosure of unpublished price sensitive information.

Every such code of practices and procedures for fair disclosure of unpublished price sensitive information and every amendment thereto shall be promptly intimated to the stock exchanges where the securities are listed.

#### Principles and Procedures of Fair Disclosure

Schedule A of these regulations lays down the following principles of fair disclosure for purposes of Code of Practices and Procedures for Fair Disclosure of Unpublished Price Sensitive Information:-

1. Prompt public disclosure of unpublished price sensitive information that would impact price discovery no sooner than credible and concrete information comes into being in order to make such information generally available.
2. Uniform and universal dissemination of unpublished price sensitive information to avoid selective disclosure.
3. Designation of a senior officer as a chief investor relations officer to deal with dissemination of information and disclosure of unpublished price sensitive information.
4. Prompt dissemination of unpublished price sensitive information that gets disclosed selectively, inadvertently or otherwise to make such information generally available.
5. Appropriate and fair response to queries on news reports and requests for verification of market rumours by regulatory authorities.
6. Ensuring that information shared with analysts and research personnel is not unpublished price sensitive information.
7. Developing best practices to make transcripts or records of proceedings of meetings with analysts and other investor relations conferences on the official website to ensure official confirmation and documentation of disclosures made.
8. Handling of all unpublished price sensitive information on a need-to-know basis.

***Whether Chief Investor Relations Officer (CIRO) will also be responsible along with compliance officer for not disseminating information or non-disclosure of UPSI?***

Regulation 2(c) clearly provides the functions and responsibilities of the compliance officer. Specific responsibilities to deal with dissemination of information and disclosure of UPSI are given to CIRO under clause 30 of Schedule A. It is company's discretion to designate two separate persons as CIRO and compliance officer, respectively for fulfilling specified responsibilities in cases where CIRO and compliance officer have been designated for overlapping functions, they shall be jointly and severally responsible.

## **B. CODE OF CONDUCT**

The board of directors of listed company and market intermediary or every other person who is required to handle unpublished price sensitive information in the course of business operations.

Shall formulate a code of conduct to regulate, monitor and report trading by its employees and other connected persons towards achieving compliance.

Adopt the minimum standards set out in Schedule B to these regulations.

Every listed company, market intermediary and other persons formulating a code of conduct shall identify and designate a compliance officer to administer the code of conduct and other requirements under these regulations.

### Minimum Standards for Code of Conduct

Schedule B of these regulations lays down the following minimum standards for Code of Conduct to regulate, monitor and report trading by insiders :-

1. The compliance officer shall report to the board of directors and in particular, shall provide reports to the Chairman of the Audit Committee, if any, or to the Chairman of the board of directors at such frequency as may be stipulated by the board of directors.
2. All information shall be handled within the organisation on a need-to-know basis and no unpublished price sensitive information shall be communicated to any person except in furtherance of the insider's legitimate purposes, performance of duties or discharge of his legal obligations.
3. The code of conduct shall contain norms for appropriate Chinese Walls procedures, and processes for permitting any designated person to "cross the wall".
4. Employees and connected persons designated on the basis of their functional role ("designated persons") in the organisation shall be governed by an internal code of conduct governing dealing in securities.
5. The board of directors shall in consultation with the compliance officer specify the designated persons to be covered by such code on the basis of their role and function in the organisation. Due regard shall be had to the access that such role and function would provide to unpublished price sensitive information in addition to seniority and professional designation.
6. Designated persons may execute trades subject to compliance with these regulations. Towards this end, a notional trading window shall be used as an instrument of monitoring trading by the designated persons.
7. The trading window shall be closed when the compliance officer determines that a designated person or class of designated persons can reasonably be expected to have possession of unpublished price sensitive information. Such closure shall be imposed in relation to such securities to which such unpublished price sensitive information relates.
8. Designated persons and their immediate relatives shall not trade in securities when the trading window is closed.
9. The timing for re-opening of the trading window shall be determined by the compliance officer taking into account various factors including the unpublished price sensitive information in question becoming generally available and being capable of assimilation by the market, which in any event shall not be earlier than forty-eight hours after the information becomes generally available.
10. The trading window shall also be applicable to any person having contractual or fiduciary relation with the company, such as auditors, accountancy firms, law firms, analysts, consultants etc., assisting, or advising the company.
11. When the trading window is open, trading by designated persons shall be subject to pre-clearance by the compliance officer, if the value of the proposed trades is above such thresholds as the board of directors may stipulate. No designated person shall apply for pre-clearance of any proposed trade if such designated person is in possession of unpublished price sensitive information even if the trading window is not closed.
12. The compliance officer shall confidentially maintain a list of such securities as a "restricted list" which shall be used as the basis for approving or rejecting applications for pre-clearance of trades.
13. Prior to approving any trades, the compliance officer shall be entitled to seek declarations to the effect that the applicant for pre-clearance is not in possession of any unpublished price sensitive information.

14. He shall also have regard to whether any such declaration is reasonably capable of being rendered inaccurate.
15. The code of conduct shall specify any reasonable timeframe, which in any event shall not be more than seven trading days, within which trades that have been pre-cleared have to be executed by the designated person, failing which fresh pre-clearance would be needed for the trades to be executed.
16. The code of conduct shall specify the period, which in any event shall not be less than six months, within which a designated person who is permitted to trade shall not execute a contra trade. The compliance officer may be empowered to grant relaxation from strict application of such restriction for reasons to be recorded in writing provided that such relaxation does not violate these regulations. Should a contra trade be executed, inadvertently or otherwise, in violation of such a restriction, the profits from such trade shall be liable to be disgorged for remittance to SEBI for credit to the Investor Protection and Education Fund administered by SEBI under the Act.
17. The code of conduct shall stipulate such formats as the board of directors deems necessary for making applications for pre-clearance, reporting of trades executed, reporting of decisions not to trade after securing pre-clearance, recording of reasons for such decisions and for reporting level of holdings in securities at such intervals as may be determined as being necessary to monitor compliance with these regulations.
18. The code of conduct shall stipulate the sanctions and disciplinary actions, including wage freeze, suspension etc. that may be imposed, by the persons required to formulate a code of conduct for the contravention of the code of conduct.
19. The code of conduct shall specify that in case it is observed by the persons required to formulate a code of conduct, that there has been a violation of these regulations, they shall inform SEBI promptly.

***Whether separate code of conduct can be adopted for listed company and each of intermediaries in a group?***

In case of group, separate code may be adopted for listed company and each of intermediaries as applicable to the concerned entity.

**PENALTY PROVISIONS FOR VIOLATIONS OF THE REGULATIONS**

If any person violates provisions of these regulations, he shall be liable for appropriate action under Sections 11, 11 B, 11D, Chapter VIA and Section 24 of the SEBI Act.

Regulation 11 & 14 of the Insider regulations empowers the SEBI to issue following directions to the violators without prejudice to its right to initiate criminal prosecution under section 24 or any action under Chapter VIA of the SEBI Act, to protect the interests of investor and in the interests of the securities market and for due compliance with the provisions of the Act, regulation made there under issue any or all of the following order, namely:

- (a) directing the insider or such person as mentioned in clause (i) of sub-section (2) of section 11 of the Act not to deal in securities in any particular manner;
- (b) prohibiting the insider or such person as mentioned in clause (i) of sub-section (2) of section 11 of the Act from disposing of any of the securities acquired in violation of these regulations;
- (c) restraining the insider to communicate or counsel any person to deal in securities;
- (d) declaring the transaction(s) in securities as null and void;



- (e) directing the person who acquired the securities in violation of these regulations to deliver the securities back to the seller:

However, in case the buyer is not in a position to deliver such securities, the market price prevailing at the time of issuing of such directions or at the time of transactions whichever is higher, shall be paid to the seller;

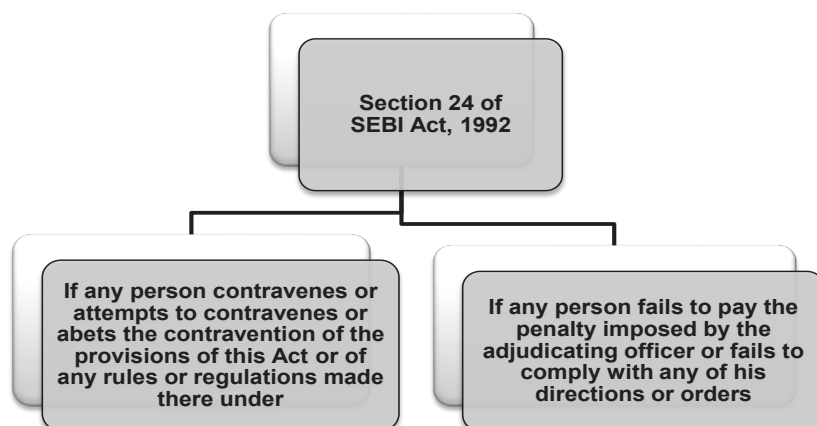
- (f) directing the person who has dealt in securities in violation of these regulations to transfer an amount or proceeds equivalent to the cost price or market price of securities, whichever is higher to the investor protection fund of a recognised stock exchange.

### Penalty for insider trading under section 15G of SEBI Act, 1992

**If any insider who, –**

- 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
- 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
- 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**



### APPEAL TO SECURITIES APPELLATE TRIBUNAL

Violation of the provisions of these regulations attract huge monetary penalty and may lead to criminal prosecution. However those aggrieved by an order of SEBI, may prefer an appeal to the Securities Appellate Tribunal within a period of forty-five days of the order.



## ROLE OF COMPANY SECRETARY AS COMPLIANCE OFFICER

The obligations cast upon the Company Secretary in relation to insider trading regulations can be summarized as under. The Company Secretary shall:

1. Ensure compliance with SEBI (Prohibition of insider Trading) Regulations, 2015 including maintenance of various documents.
2. Frame a code of fair disclosure and conduct in line with the model code specified in the Schedule A of the regulations and get the same approved by the board of directors of the company.
3. Frame “minimum standards for Code of Conduct” to regulate, monitor and report trading by insiders as enumerated in the Schedule B of the regulations.
4. Receive initial disclosure from every Promoter, KMP and director or every person on appointment as KMP or director or becoming a Promoter shall disclose its shareholding in the prescribed form within :
  - 30 days from these regulations taking effect or
  - 7 days of such appointment or becoming a promoter
5. Receive from every Promoter, employee and director, continual disclosures of the number of securities acquired or disposed of and changes therein, even if the value of the securities traded, exceeds Rs. 10 lakh with single or series of transaction in any calendar quarter in prescribed form within two trading days of :
  - receipt of the disclosure or
  - from becoming aware of such information
6. Ensure that no trading shall between 20th day prior to closure of financial period and 2nd trading day after disclosure of financial results.
7. Approve the trading plan and after the approval of the trading plan, as compliance officer shall notify the plan to the stock exchanges on which the securities are listed.
8. Maintain records, as a Compliance Officer, of all the declarations given by the directors/designated employees/partners in the appropriate form for a minimum period of three years.
9. Take additional undertakings, as a compliance officer, from the insiders for approval of the trading plan. Such trading plan on approval will also be disclosed to the Stock Exchanges, where the securities of the company are listed.
10. Maintain confidentially list of such securities as a “restricted list” which shall be used as the basis for approving or rejecting applications for pre-clearance of trades.
11. Monitor of trades and the implementation of the code of conduct under the overall supervision of the Board of Directors of the listed company.
12. Frame and then to monitor adherence to the rules for the preservation of “Price sensitive information”.
13. Suggest any improvements required in the policies, procedures, etc. to ensure effective implementation of the code.
14. Assist in addressing any clarifications regarding the SEBI (Prohibition of Insider Trading) Regulations, 2015 and the company’s code of conduct.
15. Maintain a list of all information termed as ‘price sensitive information’.
16. Maintain a record of names of files containing confidential information deemed to be price sensitive information and persons in charge of the same.

17. Ensure that files containing confidential information are kept secured.
18. Keep records of periods specified as 'close period' and the 'Trading window'.
19. Ensure that the trading restrictions are strictly observed and all directors/officers/designated employees conduct all their dealings in the securities of the company only in a valid trading window and do not deal in the company's securities during the period when the trading window is closed.
20. Receive and maintain records of periodic and annual statement of holdings from directors/officers/designated employees and their dependent family members.
21. Ensure that the "Trading Window" is closed at the time of :
  - a) Declaration of financial results(quarterly, half-yearly and annual)
  - b) Declaration of dividends("interim and final)
  - c) Issue of securities by way of public/right/bonus etc.,
  - d) Any Major expansion plans or execution of new projects.
  - e) Amalgamation, mergers, takeovers and buy-back
  - f) Disposal of whole or substantially whole of the undertaking
  - g) Any change in policies, plans or operations of the company
22. Place before the Chief Executive Officer/Partner or a committee notified by the organization/firm, as a Compliance Officer, on a monthly basis all the details of the dealing in the securities by designated employees/directors/partners of the organization/firm.

### LESSON ROUND UP

- To curb insider trading SEBI formulated SEBI (Prohibition of Insider Trading) Regulations, 2015 and which prescribes code of fair disclosure and conduct to be followed by listed companies and entities connected with them.
- The Insider Trading Regulations comprises of five chapter and two schedules encompassing the various regulations relating to Insider Trading.
- Insider means and includes deemed to be a connected person. The definition of deemed to be a connected person is very elaborate.
- The regulations not only seeks to curb dealing in securities, they also seek to curb communicating or counseling about securities by the insiders.
- The regulations provide for initial as well as continual disclosures by members of the company by the directors/ employees/ designated employees/promoter/promoter group at regular interval.

### GLOSSARY

<b>Book Closure</b>	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.
<b>Chinese Walls</b>	Artificial barriers to the flow of information set up in large firms to prevent the movement of sensitive information between departments.
<b>Contra Trade</b>	Contra trading involves buying and selling the same shares without paying for them.

<b>Interim Dividend</b>	A dividend payment made during the course of a company's financial year. Interim dividend, unlike the final dividend, does not have to be agreed in a general meeting.
<b>Punitive</b>	It implies involving or inflicting punishment.

## SELF TEST QUESTIONS

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

1. What do you mean by insider trading? Enumerate the penalties which can be imposed under the SEBI Act, 1992 for insider trading?
2. What are the restrictions on communication or procurement of unpublished price sensitive information?
3. State the circumstances and conditions subject to which insider trading is permitted under the SEBI (Prohibition of Insider Trading) Regulations, 2015.
4. Explain the disclosure requirements by certain persons under the SEBI (Prohibition of Insider Trading) Regulations, 2015.
5. Discuss the provisions relating to 'Codes of fair disclosure and conduct' as per the SEBI (Prohibition of Insider Trading) Regulations, 2015.

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# Lesson 12

## Mutual Funds

### LESSON OUTLINE

- Introduction
- Structure of a Mutual Fund
- Overview of Mutual Fund Industry in India
- Schemes according to Investment Objective
- Advantages of Mutual Funds
- Risks involved in Mutual Funds
- Key Players in Mutual Fund
- Expense Ratio
- Holding Period Return
- Evaluating Performance of Mutual Fund
- SEBI (Mutual Fund) Regulations, 1996
- SEBI (Listing Obligations & Disclosure Requirements), Regulations 2015
- LESSON ROUND UP
- GLOSSARY
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

Different investment avenues are available to investors, one of them being Mutual Fund. Mutual fund is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with objectives as disclosed in offer document.

Mutual funds offer good investment opportunities to the investors. Like all investments, they also carry certain risks. The investors should compare the risks and expected yields after adjustment of tax on various instruments while taking investment decisions.

SEBI formulates policies and regulates the mutual funds to protect the interest of the investors. SEBI notified regulations for the mutual funds in 1993. Thereafter, mutual funds sponsored by private sector entities were allowed to enter the capital market. The regulations were fully revised in 1996 and have been amended thereafter from time to time.

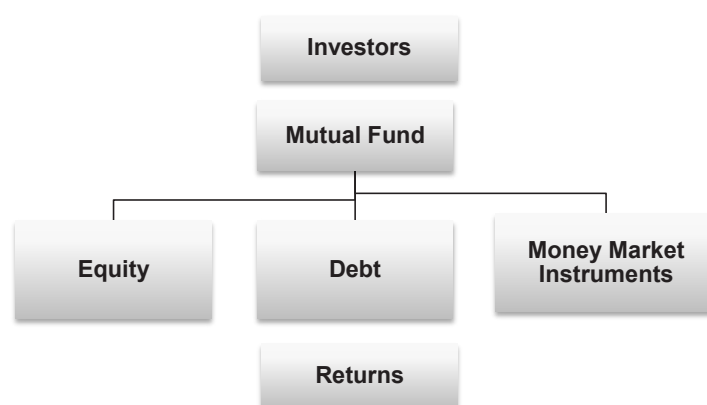
Keeping the above in view this lesson is designed to enable the students to understand the trend of mutual funds in India over a period of time. Various schemes of mutual funds, advantages and risk involved in Mutual Fund and SEBI law governing mutual fund pertaining the mutual fund operating in India etc.

## 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. 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 before it can collect funds from the public.

### What is a mutual fund?

- A trust that raises money through sale of units
- Gives investors exposure to different segments of markets
- Investors get access to professional management
- Plays an active role in building wealth and generating income for investors
- A key participant in the capital market
- Source for corporates to raise money



List of all stakeholders in Indian mutual fund industry is as follows:

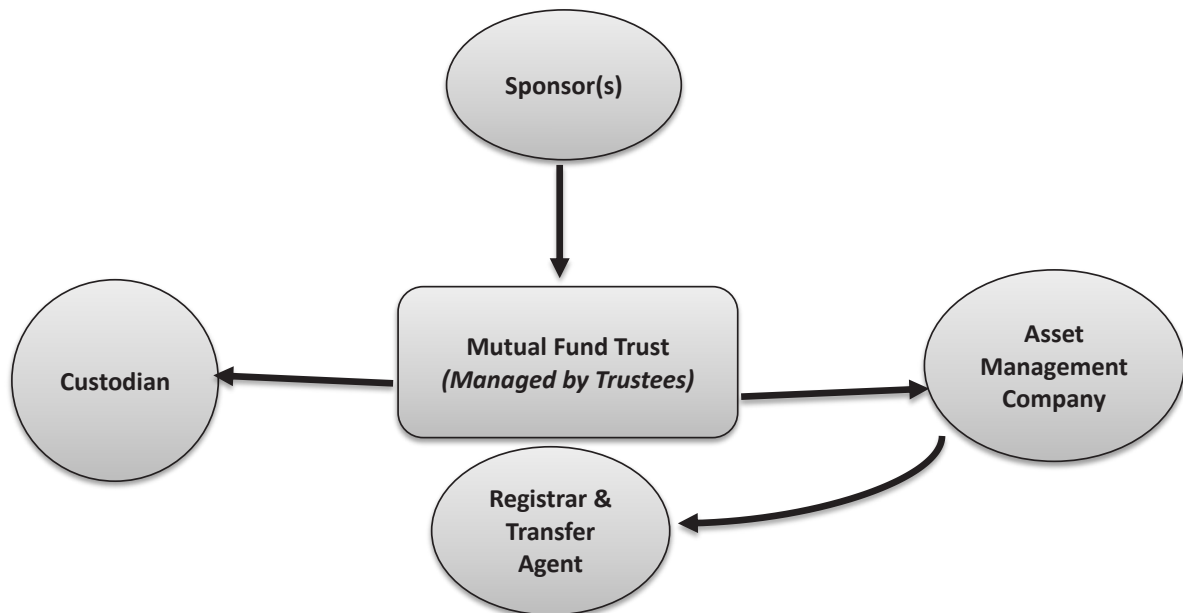
- RBI
- SEBI
- AMFI
- Ministry of Finance
- SROs (in general)
- Income Tax Regulations
- Investors' Associations

## STRUCTURE OF A MUTUAL FUND

A mutual fund is set up in the form of a trust, which has sponsor, trustees, asset management company ("AMC") and a custodian. The trust is established by a sponsor or more than one sponsor who is like a promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unit-holders. The AMC, approved by SEBI, manages the funds by making investments in various types of securities. The custodian,

who is registered with SEBI, holds the securities of various schemes of the fund in its custody. The trustees are vested with the general power of superintendence and direction over AMC. They monitor the performance and compliance of SEBI Regulations by the mutual fund.

#### Mutual Fund Structure



#### Mutual Fund Structure - Example

Description	Entity
Mutual Fund Trust	IDBI Mutual Fund
Sponsor	IDBI Bank Limited
Trustee	IDBI MF Trustee Company Limited
Asset Management Company	IDBI Asset Management Limited
Registrar	Karvy Computershare Private Limited
Custodian	Stock Holding Corporation of India Limited The Bank of Nova Scotia

### OVERVIEW OF MUTUAL FUNDS INDUSTRY IN INDIA

- Started with the introduction of Unit Trust of India (UTI) – in 1963
- Public sector companies started setting up mutual funds, beginning with SBI Mutual Fund in 1987. This was followed by Canbank Mutual Fund, Punjab National Bank Mutual Fund, Bank of Baroda Mutual Fund, etc.
- Private sector mutual funds started in 1993; Franklin Templeton (erstwhile Kothari Pioneer) was the first of its kind
- Today, there are 44 mutual funds in India.

### Types of Mutual Fund Houses in India – By Ownership

Type	No. of Mutual Fund Houses
Bank Sponsored	7
Indian – Public Sector	2
Indian – Private Sector	19
Indian – Foreign Joint Ventures	11
Foreign	5
Total	44

### Regulator & Industry Body

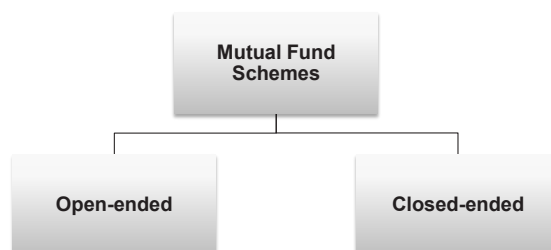
#### Regulator: Securities and Exchange Board of India (SEBI)

- Regulates mutual funds, custodians and registrars & transfer agents
- The applicable guidelines for mutual funds are set out in SEBI (Mutual Funds) Regulations, 1996; updated periodically

#### Industry Body: Association of Mutual Funds in India (AMFI)

- All 44 AMCs are members of AMFI
- Recommends and promotes best business practices and code of conduct
- Disseminates information and carries out studies/research on mutual fund industry

### Types of Mutual Funds



#### Open Ended

- Can be purchased on any transaction day
  - Can be redeemed on any transaction day
- (Except when units are locked-in in the case of ELSS funds)
- High liquidity

#### Close Ended

- Can be purchased only during NFO
  - Can be redeemed only at maturity
- Low on liquidity

### Types of Mutual Fund Plans





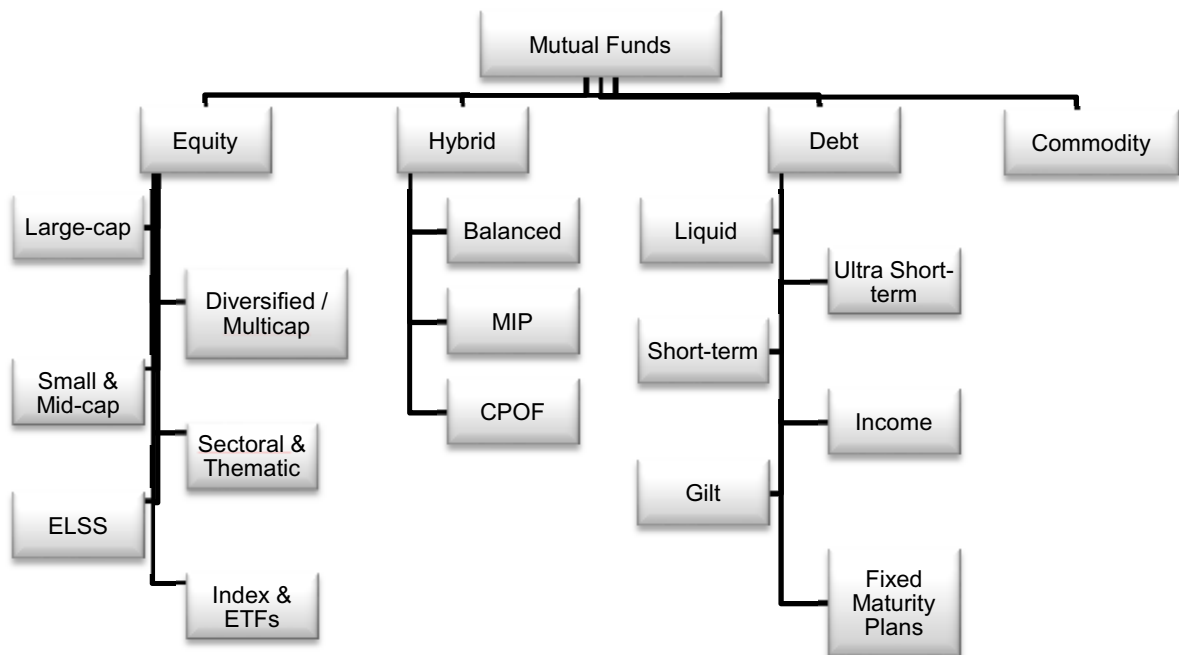
### Regular Plans

- Sold through a distributor
- Higher Expense Ratio  
(Due to commissions paid to distributor)
- Potentially lower returns to the investor  
(Due to higher expenses)

### Direct Plans

- Sold directly by the AMC
- Lower Expense Ratio  
(No commission paid to distributor)
- Potentially higher returns  
(Due to lower expenses)

### Categories of Mutual Funds



### 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, corporate debentures, Government securities and money market instruments, etc.
- (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.
- (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 fall.
- (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 introduced in 1993. 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.
- (p) **Infrastructure Debt Fund:** They invest primarily in the debt securities or securitized debt investment of infrastructure companies.

## 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.

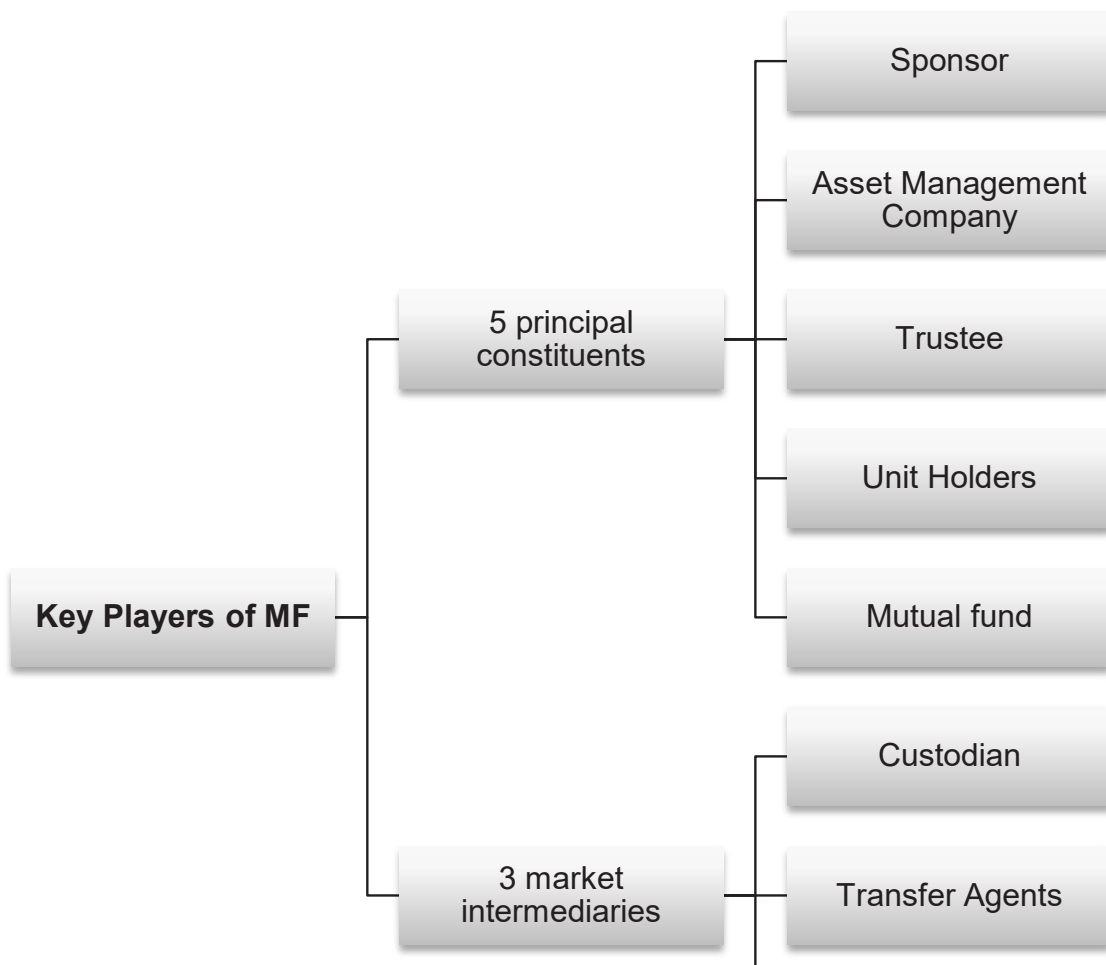
## RISKS INVOLVED IN MUTUAL FUNDS

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.
3. Necessity to effect high turnover through liquidation of portfolio resulting in large payments of brokerage and commission.
4. Poor planning of investment 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.
8. Under performance in comparison to peers.

## KEY PLAYERS IN MUTUAL FUND

A mutual fund is a professionally-managed investment scheme, usually run by an asset management company that brings together a group of people and invests their money in stocks, bonds and other securities. It is formed by trust body.



There are five principal constituents and three market intermediaries in the formation and functioning of mutual fund:

### Five principal constituents

- *Sponsor*

A sponsor is an **influential investor** who creates demand for a security because of their positive outlook on it. The sponsor brings in capital and creates a mutual fund trust and sets up the AMC. The sponsor makes an application for registration of the mutual fund and contributes at least 40% of the **net worth** of the AMC.

- *Asset Management Company*

An asset management company (AMC) is a company that invests its **clients' pooled funds** into securities that match declared **financial objectives**. Asset management companies provide investors with more **diversification** and **investing options** than they would have themselves. AMCs manage mutual funds, hedge funds and pension plans, these companies earn income by charging **service fees** or commissions to their clients.

- *Trustee*

A trustee is a person or firm that holds and administers property or assets for the benefit of a **third party**. A trustee may be appointed for a wide variety of purposes, such as in case of bankruptcy, for a charity, for a trust fund or for certain types of retirement plans or pensions.

- *Unit Holders*

A unitholder is an investor who owns the **units issued by** a trust, like a real estate investment trust or a master limited partnership (MLP). The securities issued by trusts/MF are called **units**, and investors in units are called unitholders. The unit in turn reflect share of the investor in the Net Assets of the fund.

- *Mutual fund*

A mutual fund established under the Indian Trust Act to raise money through, the **sale of units** to the public for investing in the **capital market**. The funds thus collected as per the directions of asset management company for invested. The mutual fund has to be **SEBI** registered.

### Three market intermediaries are:

- *Custodian*

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

Every custodian should have adequate facilities, sufficient capital and financial strength to manage the custodial services. The SEBI (Custodian of Securities) Regulations, 1996 prescribe the roles and responsibilities of the custodians.

According to the SEBI the roles and responsibilities of the custodians are to Administrate and protect the assets of the clients; Open a separate custody account and deposit account in the name of each client; Record assets; and Conduct registration of securities.

- *Transfer Agents*

A transfer agent is a person who has been granted a Certificate of Registration to conduct the business of transfer agent under SEBI Regulations Act 1993. Transfer agents' services include **issue** and **redemption** of mutual fund units, preparation of transfer documents and maintenance of updated investment records. They also record transfer of units between investors where depository does not function. They also facilitate investors to get customized reports.

- *Depository*

A depositor facilitates the smooth **flow of trading** and ensure the investor's about their investment in securities.

## Mutual Fund Terminology

### A. Offer Document

- AMC raises money in new schemes through New Fund Offer (NFO)
- Offer document contains key details about the NFO – open and close dates, scheme objective, nature of the scheme, etc.
- Filed with SEBI

### Two parts:

1. **Scheme Information Document (SID)** - A document that contains the details of the scheme. SID has to be updated every year

**Key Contents:**

- Scheme name on the cover page, along with scheme structure (open / closed-ended) and expected scheme nature (equity / debt / balanced / liquid / ETF)
- Highlights of the scheme
- Risk factors
  - o Standard
  - o Scheme specific
- Due diligence certificate issued by the AMC
- Fees and expenses
- Rights of unit holders
- Penalties, litigations, etc.

2. **Statement of Additional Information** - A document that contains statutory information about the fund house offering the scheme. SAI has to be updated the end of every quarter

**Key Contents:**

- Information about sponsor, mutual fund, trustees, custodian and registrar & transfer agents
- Condensed financial information for schemes launched in the last three financial years
- Information on how to apply
- Rights of unit holders
- Details of the fund managers
- Tax, legal and other general information

**B. Key Information Memorandum (KIM)**

- Essentially a summary of SID & SAI
- As per SEBI regulations, every application form should be accompanied by the KIM
- The KIM has to be updated at least once a year

**Contents**

- Name of the AMC, Mutual Fund Trust, Trustee, Fund Manager(s) and Scheme details
- Open and close dates of the issue
- Issue price of the scheme
- Plans and options available in the scheme
- Risk profile of the scheme
- Benchmark
- Dividend policy
- Performance of the scheme and benchmark over last 1, 3, 5 years and since inception
- Loads and expenses
- Contact information and registrars

### C. Fact Sheets

Usually provided on a monthly basis by AMC's

#### Contains the following:

- NAV and AUM
- Expense ratio, exit loads, average maturity, YTM, modified duration
- Benchmark & Fund manager details
- Past performance
- Scheme's allocation & portfolios
- Style box
- Other scheme attributes – like risk category, minimum investment amount, scheme objective, etc.

### D. Net Asset Value (NAV)

#### What is NAV?

- The value of one unit of a mutual fund scheme on a given date
- It has to be declared by fund houses on every business day – on AMC website and AMFI website
- It has to be published on 2 national newspapers

#### How is it calculated?

$$\text{Net Asset Value} = \frac{\text{Net Asset of the Scheme}}{\text{Number of units outstanding}}$$

Net Asset of the Scheme = Market value of investments + Receivables + other accrued income + other assets –  
Accrued Expenses – Other Payables – Other Liabilities

#### Net Asset Value (NAV) – Cut-off Timeline

Type of Transaction	Before/ After	Cut-off Time	Applicable NAV
Equity-oriented & Debt funds (except liquid funds)			
Purchase & Switch-in (value < Rs.2 lakhs)	3 pm	Before	Same day NAV
		After	Next business day NAV
Purchase & Switch-in (value > Rs.2 lakhs)	3 pm	Before After	NAV of the business day on which funds are available for utilization
Redemption & Switch-out	3 pm	Before	Same day NAV
		After	Next business day NAV
Liquid Funds			
Purchase & Switch-in	2 pm	Before	Previous day NAV if funds are realized
		After	NAV of the day previous to the funds realized
Redemption & Switch-out	3 pm	Before	NAV of the day immediately preceding the next business day
		After	NAV of the day preceding the second business day from submission

## **E. Assets under Management (AUM)**

### **What is AUM?**

It is the total market value of the assets managed by a mutual fund scheme as on a particular date

### **Periodic AUM Available**

- Month-end
- Quarterly average

## **F. Know Your Client (KYC)**

### **What is KYC?**

- A one-time process made mandatory to invest in mutual funds
- Key details required: PAN, Address proof, contact details, occupation and income details

### **Where can it be done?**

- CDSL Ventures Limited KRA
- CAMS KRA
- Karvy KRA
- NDML KRA (wholly owned subsidiary of NSDL)
- DOTEX KRA (wholly owned subsidiary of NSE)

## **G. Foreign Account Tax Compliance Act (FATCA)**

### **What is FATCA?**

- Requires that all financial institutions (including Indian mutual funds) need to report financial transactions of US persons and entities in which US persons hold a substantial ownership.
- Enacted to prevent tax evasion through foreign investments.
- Key details required: Country of birth, Country of citizenship, country of tax residence, TIN from such country.
- Currently made mandatory for all investors (existing and new) in Indian mutual funds.
- For non-individual investors, Ultimate Beneficial Ownership (UBO) details have to be provided.

## **H. Modes of Holding**

- Single
- Either or Survivor
  - o Signature of any of the applicants is sufficient for making transactions
- Joint
  - o Signature of all the applicants is required for making transactions

## **I. Nomination**

- Up to 3 nominees can be registered for a folio
- Units get transferred to the nominees (in the proportion specified) in case of the investor's demise
- Nomination can be updated as and when required by the investor



- A minor can also be nominated, provided the guardian is specified
- If nomination is not registered, in case of death of the investor, the legal heir has to produce documents such as Will, Legal Heir Certificate, No-Objection Certificate from other legal heirs, etc.

## EXPENSE RATIO

- The fees charged by the scheme to manage investors' money

### What does it contain?

- Fees paid to service providers like trustees, Registrar & Transfer Agents, Custodian, Auditor, etc.
- Asset management expenses
- Commissions paid to distributors
- Other selling expenses including advertising expenses
- Expenses on investor communication, account statements, dividend / redemption cheques / warrants
- Listing fees and Depository fees
- Service tax

Under SEBI (Mutual Funds) Regulations, 1996, Mutual Funds are permitted to incur / charge certain operating expenses for managing a mutual fund scheme – such as sales & marketing / advertising expenses, administrative expenses, transaction costs, investment management fees, registrar fees, custodian fees, audit fees – as a percentage of the fund's daily net assets.

This is commonly referred to as 'Expense Ratio'. In short, Expense ratio is the cost of running and managing a mutual fund which is charged to the scheme. All expenses incurred by a Mutual Fund, AMC will have to be managed within the limits specified under Regulation 52 of SEBI Mutual Fund Regulations.

For actively managed equity schemes, the total expense ratio (TER) allowed under the regulations is 2.5 % for the first ₹100 crore of average weekly net assets; 2.25 % for the next ₹300 crore, 2 % for the subsequent ₹300 crore and 1.75 % for the balance AUM. For debt schemes, the expense ratio permitted is 0.25 % lower than that allowed for equity funds. Information on expense ratio applicable to a MF scheme is mentioned in the Scheme Information Document. For example, an expense ratio of 1% per annum means that each year 1% of a scheme's total assets will be used to cover the expenses managing and operating a scheme.

In addition, mutual funds have been allowed to charge up to 30 bps more, if 30% or more of new inflows come from locations "Beyond the Top-15 (B15) cities, to widen the penetration of the mutual funds in tier - 2 and tier - 3 cities.

The expense ratio is calculated as a percentage of the Scheme's average Net Asset Value (NAV). The daily NAV of a mutual fund is disclosed after deducting the expenses. Thus, the TER has a direct bearing on a scheme's NAV – the lower the expense ratio of a scheme, the higher the NAV.

However, while expense ratio is important, it should be borne in mind that it is not the only criterion while selecting mutual fund scheme. A scheme with a consistently decent track record, but a higher expense ratio may be better than the one which lower expense ratio, but gives poor returns.

## HOLDING PERIOD RETURN

Holding period return is the total return received from holding an asset or portfolio of assets over a period of time, generally expressed as a percentage. Holding period return is calculated on the basis of total returns from the asset or portfolio – i.e. income plus changes in value. It is particularly useful for comparing returns between investments held for different periods of time.

*Calculation of HPR*

$$\text{HPR} = \frac{(\text{Income} + (\text{end of period value} - \text{original value}))}{\text{Original Value}} \times 100$$

**EVALUATING PERFORMANCE OF MUTUAL FUND**

While looking at a mutual fund scheme's performance, one must not be led by the scheme's return in isolation. A scheme may have generated 10% annualised return in the last couple of years. But then, even the market indices would have gone up in similar way during the same period. Under-performance in a falling market, i.e. when the NAV of the scheme falls more than its benchmark (or the market), is the time when one must review his/her investment.

One must compare the scheme's return as against its benchmark return. It is better to be rid of investment in a scheme that consistently under-performs as compared to its benchmark over a period of time, from one's portfolio. It is important to identify under-performers over the longer time horizon (as also out-performers).

In addition, one may also consider evaluating the 'category average returns' as well. Even if a scheme has outperformed its benchmark by a decent margin, there could be better performers in the peer group. The category average returns will reveal how good (or bad) is one's investment is against its peers which help in deciding whether it is time shift the investment to better performers.

One may be holding a too little or too much-diversified portfolio. Even the expense ratio of some of the schemes that one could be holding may be high compared to others within the same category.

**SEBI (MUTUAL FUND) REGULATIONS, 1996**

SEBI (Mutual Fund) Regulations, 1996 has been notified on 9th December, 1996 with objective to improve the working and regulation of the mutual fund industry, so that mutual funds could provide a better performance and service to all categories of investors and offer a range of innovative products in a competitive manner to match investor needs and preferences across various investor segments. SEBI (Mutual Funds) Regulations, 1996 deals with 10 Chapters and 12 schedules.

The key provisions of the SEBI Regulations, 1996 include:

- All the schemes to be launched by the AMC needs to be approved by the Board of Trustees and copies of offer documents of such schemes are to be filed with SEBI.
- The offer documents shall contain adequate disclosures to enable the investors to make informed decisions.
- The listing of close-ended schemes is mandatory and they should be listed on a recognised stock exchange within six months from the closure of subscription. However, the listing is not mandatory in case:
  - a) if the scheme provides for monthly income or caters to senior citizens, women, children and physically handicapped;
  - b) if the scheme discloses details of repurchase in the offer document; or
  - c) if the scheme opens for repurchase within six months of closure of subscription.
  - d) if the scheme is a capital protection oriented scheme.
- Units of a close-ended scheme can be opened for sale or redemption at a predetermined fixed interval if the minimum and maximum amount of sale, redemption and periodicity is disclosed in the offer document.

- Units of a close-ended scheme can be converted into an open-ended scheme with the consent of a majority of the unit-holders and disclosure is made in the offer document about the option and period of conversion.
- Units of close-ended scheme may be rolled over by passing a resolution by a majority of the shareholders.
- No scheme other than equity-linked saving scheme can be opened for subscription for more than 15 days. Further, the minimum subscription and the extent of over subscription that is intended to be retained should be specified in the offer document. In the case of over-subscription, all applicants applying up to 5,000 units must be given full allotment subject to over subscription.
- The AMC is required to refund the application money if minimum subscription is not received, and also the excess over subscription within five working days of closure of subscription.
- A close-ended scheme shall be wound up on redemption date, unless it is rolled over, or if 75% of the unit-holders of a scheme pass a resolution for winding up of the scheme; if the trustees on the happening of any event require the scheme to be wound up; or if SEBI, so directs in the interest of investors.

In addition, the SEBI took various measures and issued guidelines to facilitate operations of mutual funds. As part of these measures, mutual funds were allowed to invest in foreign debt securities in the countries with full convertible currencies and with highest foreign currency credit rating by accredited credit rating agencies.

They were also allowed to invest in government securities where the countries are AAA rated. Moreover, guidelines were issued for valuation of unlisted equity shares in order to bring about uniformity in the calculation of NAVs of mutual fund schemes.

In order to allow mutual funds to invest in both gold and gold related instruments, the SEBI amended its regulation in 2006. The amended regulation, Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulation, 2006 permits introduction of Gold Exchange Traded Fund (GETF) Schemes by mutual fund. The new mutual fund scheme can invest primarily in gold and gold related instruments, subject to certain investment restrictions.

### **SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015**

The provisions of chapter IX of SEBI (LODR) Regulations, 2015 is apply to the asset management company managing the mutual fund scheme whose units are listed on the recognised stock exchange(s).

Notwithstanding anything contained in this chapter, the provisions of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 and directions issued thereunder shall apply on the listed entity and to the schemes whose units are listed on the recognised stock exchange(s).

### **Submission of Documents**

The listed entity shall intimate to the recognised stock exchange(s), the information relating to daily Net Asset Value, monthly portfolio, half yearly portfolio of those schemes whose units are listed on the recognised stock exchange(s) in the format as specified under SEBI (Mutual Funds) Regulations, 1996 and directions issued there under.

The listed entity shall intimate to the recognised stock exchange(s) in the manner specified by the recognized stock exchange(s) of:

- (a) movement in unit capital of those schemes whose units are listed on the recognised stock exchange(s);
- (b) rating of the scheme whose units are listed on the recognised stock exchange(s) and any changes in the rating thereof (wherever applicable);

- (c) imposition of penalties and material litigations against the listed entity and Mutual Fund; and
- (d) any prohibitory orders restraining the listed entity from transferring units registered in the name of the unit holders.

### Dissemination on the website of stock exchange(s)

The listed entity shall submit such information and documents, which are required to be disseminated on the listed entity's website in terms of SEBI (Mutual Funds) Regulations, 1996 and directions issued thereunder, to the recognized stock exchange for dissemination.

### LESSON ROUNDUP

- Mutual fund is a trust that collects money from a number of investors who share a common investment objective and invests the same in equities, bonds, money market instruments and/or other securities.
- Mutual funds are regulated by SEBI (Mutual Fund) Regulations, 1996.
- Mutual Fund schemes could be 'open ended' or close-ended' and actively managed or passively managed.
- There are five principal constituents and three market intermediaries in the formation and functioning of mutual fund.
- The NAVs of all Mutual Fund schemes are declared at the end of the trading day after markets are closed, in accordance with SEBI Mutual Fund Regulations.
- Holding period return is calculated on the basis of total returns from the asset or portfolio – i.e. income plus changes in value.
- SEBI (LODR) Regulations, 2015 is applicable to the AMC managing the mutual fund scheme whose units are listed on the recognised stock exchange.

### GLOSSARY

<b>Annual Return</b>	The change in percentage in the Net Asset Value (NAV) of a fund over one year based on the assumption that distributions such as dividend payment and bonuses have been reinvested.
<b>Diversification</b>	The process of investing across different asset classes (equity, debt, property, etc.) and across different investments within each asset class (for instance, investing across equity shares of various companies in case of equity) to reduce risk.
<b>Investment objective</b>	Every mutual fund scheme has an investment objective according to which the fund manager has to make investments for the scheme. For example, in case of an equity fund, the investment objective may be to invest in large cap companies across a range of sectors in order to give investors capital appreciation.
<b>Maturity</b>	Some investments such as close-ended funds have a maturity date, which is the date on which the investor is paid back his principal amount as well as all income due to him on that investment.
<b>Repurchase/ Redemption</b>	When a mutual fund investor wants to exit from his mutual fund investment, he can sell back the units to the mutual fund and receive cash. The mutual fund 'repurchases' his units and the investor is said to 'redeem' his units.

## SELF-TEST QUESTIONS

1. Elucidate the key players of Mutual funds in the formation and functioning of mutual fund.
2. What do you mean by Net Asset Value? How to calculate NAV?
3. Distinguish between Open ended Mutual Funds and Close ended Mutual funds.
4. Write short notes on the followings:
  - a) Asset Management Company
  - b) Holding Period Return
  - c) Expense Ratio

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# Lesson 13

## Collective Investment Schemes

### LESSON OUTLINE

- Introduction
- SEBI (Collective Investment Schemes) Regulations, 1999 – An Overview
- Restriction on Business Activities
- Obligations of Collective Investment Management Company (CIMC)
- Penal Provisions
- Role of Company Secretary
- LESSON ROUND UP
- GLOSSARY
- SELF-TEST QUESTIONS

### LEARNING OBJECTIVES

The increasing complexity of the financial markets witnessed unravelled financial schemes that defrauded investors by promising exorbitantly high returns on their principal investment. It was in response to these Ponzi Schemes that the SEBI formulated regulations encompassing Collective Investment Schemes (CIS) that specifically characterised a unique manner of financial manipulations.

Considering difficulties in enforcement of the Securities Laws (Amendment) Act, 2014 amends the SEBI Act, 1992 as well as introduces consequential changes in the Securities Contracts Regulation Act, 1956 and the Depositories Act, 1996. Section 11AA of the principal Act was amended to include a new proviso which gave SEBI the power to regulate all pooling of funds under any scheme or arrangement in excess of 100 crores not regulated by any other law, thus slipping into the net of a CIS.

This lesson will briefly explain the student what CIS is, and how they are regulated and penal provisions for violations etc.

## INTRODUCTION

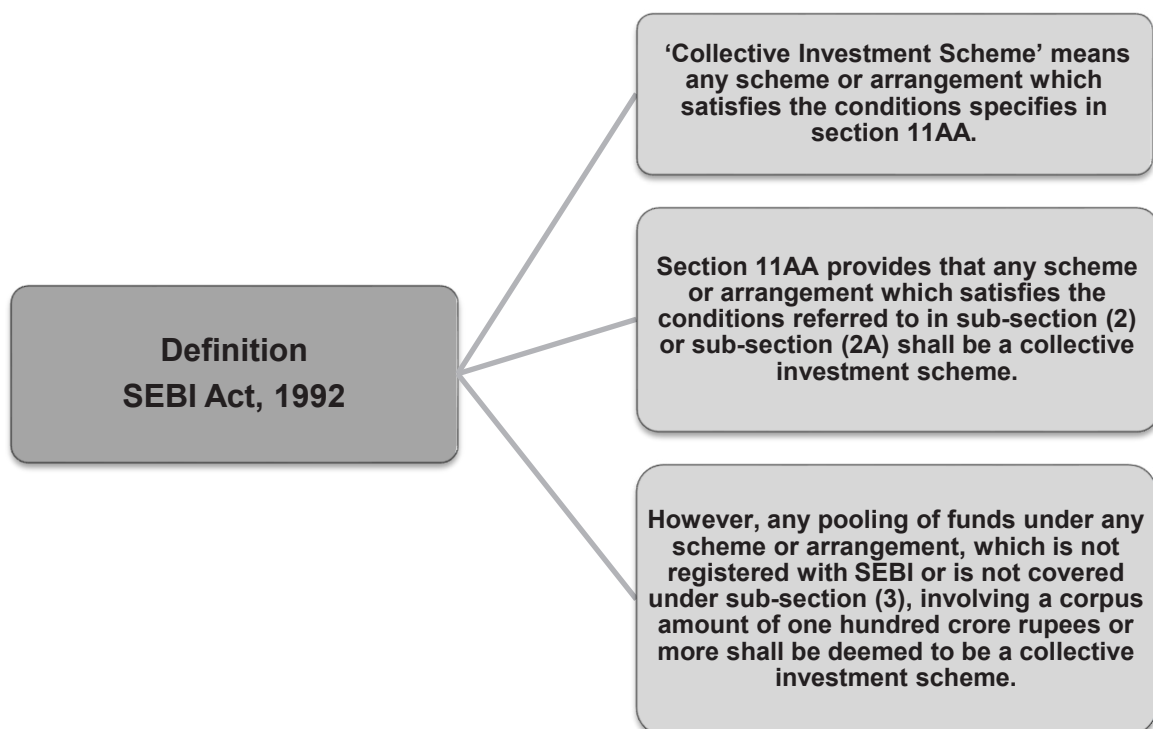
A collective investment scheme is a scheme that comprises a pool of assets that is managed by a collective investment scheme manager and is governed by the Collective Investment Schemes Regulations given by SEBI.

The word 'unit' refers to the portion or part of the CIS portfolio that is owned by the investor. The 'trust' is the financial instrument that is created in order to manage the investment. The trust enables financial experts to invest the money on behalf of the CIS investor.

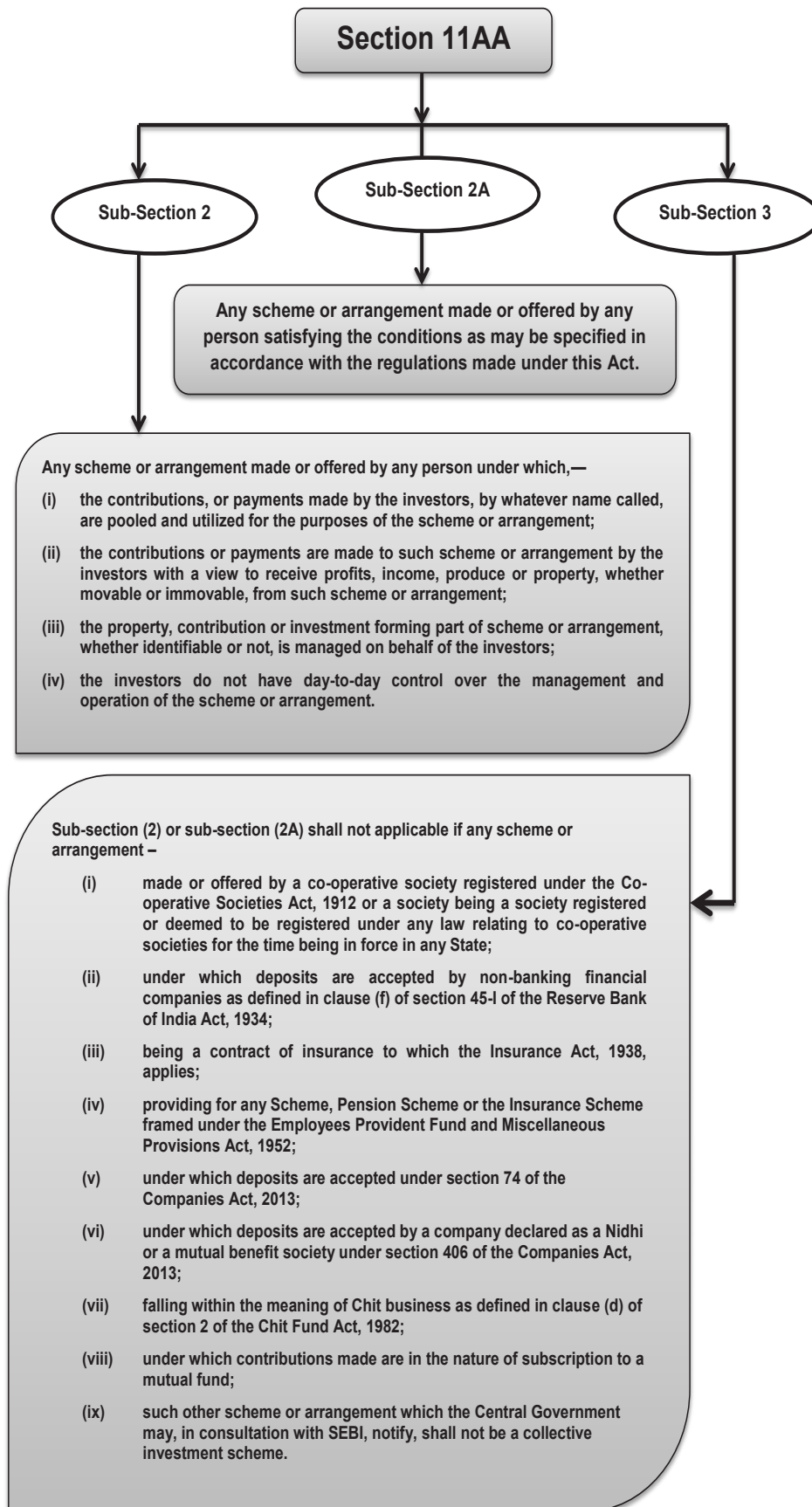
With a CIS, the money or funds from a group of investors are pooled or collected together to form a CIS portfolio.

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 SC(R) Act, 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 International Organisation of Securities Commission (IOSCO) in its Report on Investment Management of the Technical Committee defined a Collective Investment Scheme (CIS) as an open ended collective investment scheme that issues redeemable units and invests primarily in transferable securities or money market instruments.







### SEBI (COLLECTIVE INVESTMENT SCHEMES) REGULATIONS, 1999 – AN OVERVIEW

SEBI (Collective Investment Schemes) Regulations, 1999 defines Collective Investment Management Company to mean a company incorporated under the Companies Act, 2013 and registered with SEBI under these regulations, whose object is to organize, operate and manage a collective investment.

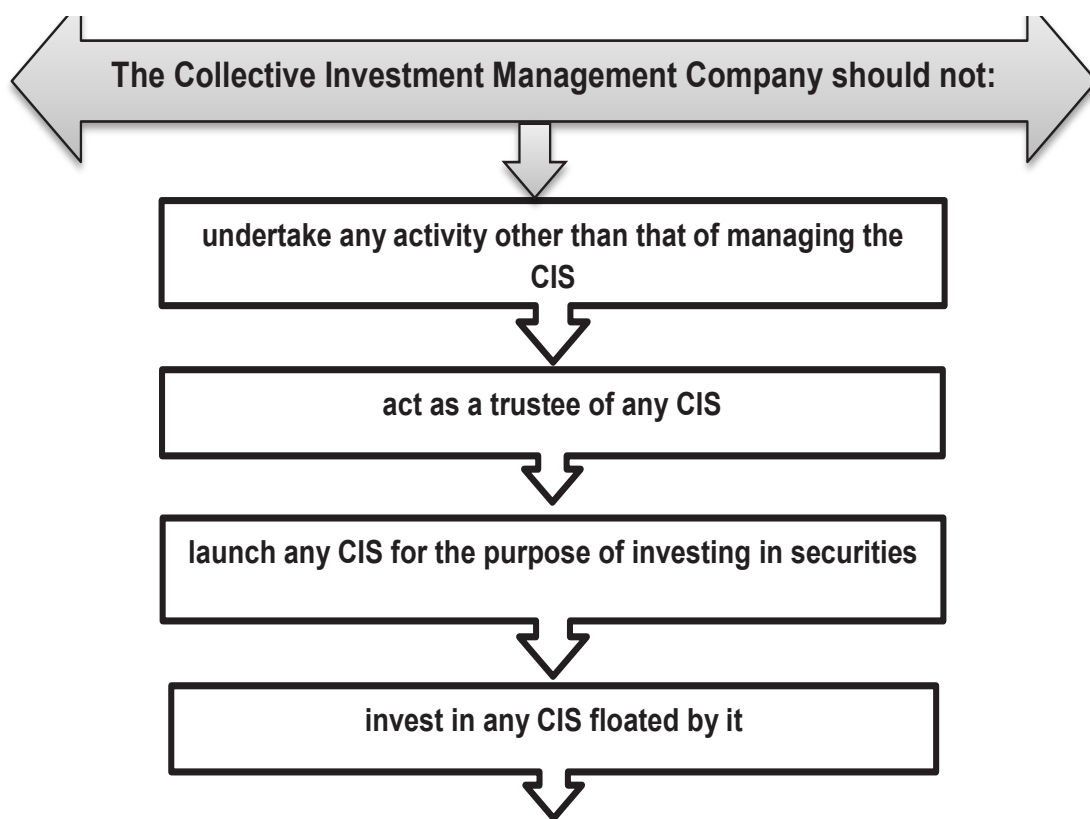
No person other than a Collective Investment Management Company which has obtained a certificate under the regulations should carry on or sponsor or launch a collective investment scheme.

“Close ended collective investment scheme” means any collective investment scheme launched by a collective investment management company. In which the maturity period of the collective investment scheme is specified and there is no provision for repurchase before the expiry of the collective investment scheme.

“Collective investment scheme property” includes:

- (i) subscription of money or money’s worth (including bank deposits) to the collective investment scheme;
- (ii) property acquired, directly or indirectly, with, or with the proceeds of, subscription of money retired to in item (i); or
- (iii) income arising, directly or indirectly from, subscription money or property retired to in item (i) or (ii).

### RESTRICTIONS ON BUSINESS ACTIVITIES



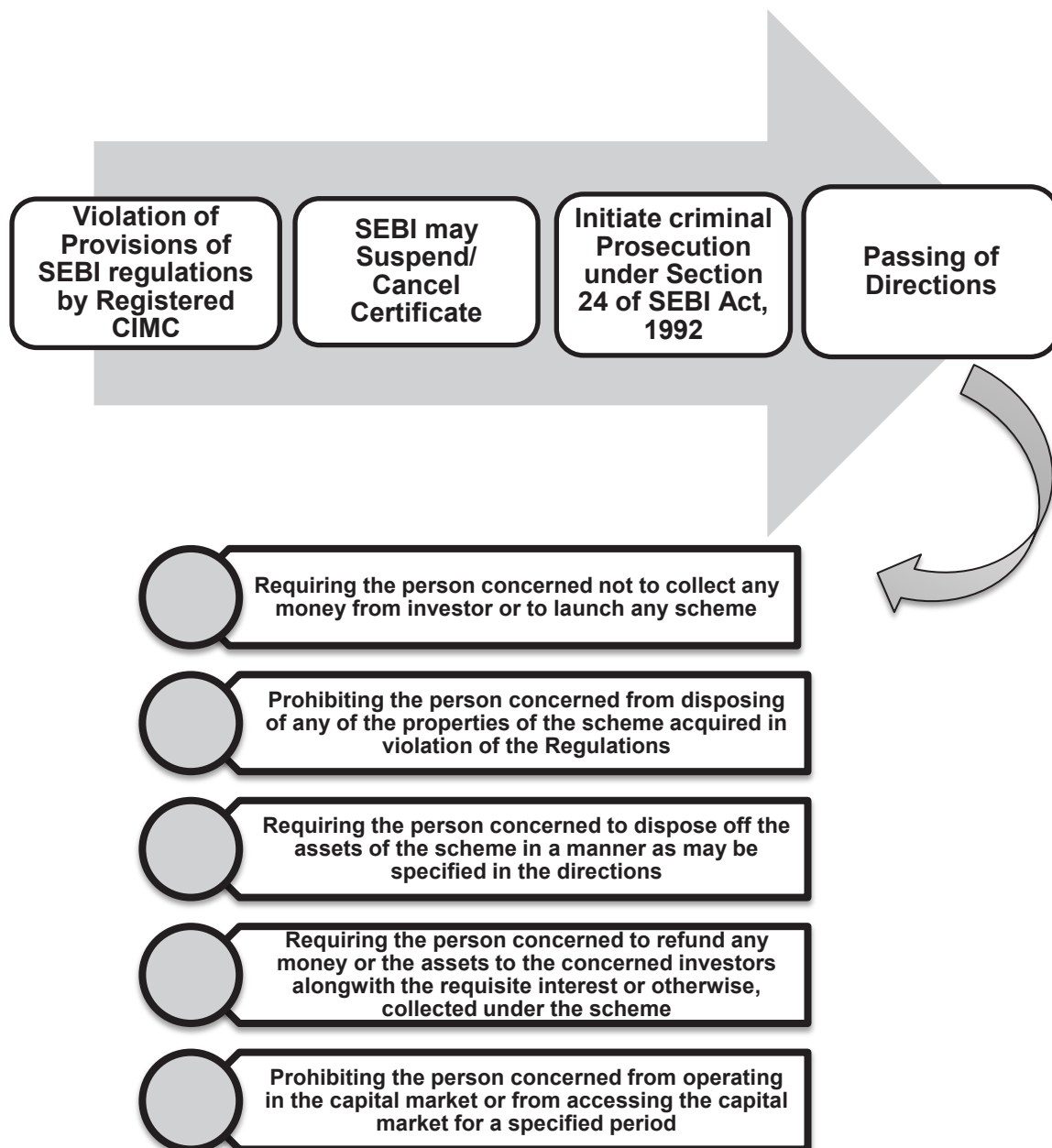
However, it has been provided that a CIMC may invest in its own CIS, if it makes a disclosure of its intention to invest in the offer document of the CIS, and does not charge any fees on its investment in that CIS.

**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 these regulations, the 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 contrary 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.
- (iv) be incompetent to enter into any transaction with or through its associates, or their relatives relating to the scheme. However, in case the CIMC enters into any transactions relating to the scheme with any of its associates, a report to that effect shall immediately be sent to the trustee and to SEBI.
- (v) appoint registrar and share transfer agents and should also abide by their respective Code of Conducts as specified in the Third Schedule;
- (vi) give receipts for all monies received and report of the receipts and payments to SEBI, on monthly basis;
- (vii) hold a meeting of Board of Directors to consider the affairs of scheme, at least 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;
- (viii) obtain adequate insurance against the properties of the schemes 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 Scheme i.e. as the end of March, June, September and December.

## PENAL PROVISIONS



## ROLE OF COMPANY SECRETARY

The Company Secretary shall ensure that the money mobilization carried out by the company will not trigger the parameters of CIS Regulations.

## LESSON ROUND UP

- A collective investment scheme is a trust based scheme that comprises a pool of assets that is managed by a collective investment scheme manager and is governed by the Collective Investment Schemes Regulations given by SEBI.
- 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 Schemes) Regulations, 1999.
- SEBI (Collective Investment Schemes) Regulations, 1999 defines Collective Investment Management Company to mean a company incorporated under the Companies Act, 2013 and registered with SEBI under these regulations, whose object is to organize, operate and manage a collective investment scheme.

## GLOSSARY

**Fundamental Attributes** It means the investment objective and terms of a scheme.

**Pooling** Pooling is the basic concept behind collective investments. The money of thousands of individual investors, who share a common investment objective, is pooled together to form a CIS portfolio.

**Ponzi Scheme** A ponzi scheme is an investment from where clients are promised a large profit in short term at little or no risk at all.

**Scheme** It means Collective Investment Scheme.

**Unit Holders** Investors in unit trust/mutual funds.

## SELF TEST QUESTIONS

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

1. What are the restrictions imposed on business activities for Collective Investment Management Company?
2. Explain the scheme or arrangement which are not included in collective investment scheme?
3. What are the obligations of Collective Investment Management Company under the SEBI (Collective Investment Scheme) Regulations, 1999?



# Lesson 14

## SEBI (Ombudsman) Regulations, 2003

### LESSON OUTLINE

- Introduction
- Investor Grievances
- SCORES (SEBI Complaints Redress System)
- When can a case be referred for Arbitration?
- When can SEBI take action for non-resolution of the complaint
- Ombudsman
- Evidence Act not to apply in the Proceedings before Ombudsman
- SEBI (Informal Guidance) Scheme, 2003
- LESSON ROUND UP
- GLOSSARY
- SELF-TEST QUESTIONS

### LEARNING OBJECTIVES

Investor grievance redressal mechanism and protection of retail investor go hand in hand with one another. There is need of transparent, time bound, easier and simpler grievance redressal mechanism for the retail investor.

In order to have resolution of complaints and to have clarity in the minds of investors, SEBI had clear cut defined mechanism specifying there in the nature of complaint and whom to lodge so the investors are not harassed and at the same time to facilitate a quick resolution of the complaint.

Keeping this in view, a company secretaryship student should be aware of various grievance redressal mechanism prescribed by SEBI. So that while entering the professional arena after completing the CS course they can able to advise their Board of directors or client about the same.

In this lesson, a student will be able to know about SCORES, SEBI Ombudsman Regulations and Informal Guidance Scheme, etc.

## INTRODUCTION

The securities market operations promote the economic growth of the country. More efficient is the securities market, the greater is the promotion effect on economic growth. It is, therefore, necessary to ensure that securities market operations are more efficient, transparent and safe. In this context, the investors need protection from the various malpractices and unfair practices made by the corporate and intermediaries. As the individual investors' community and the investment avenues are on the rise, it is interesting to know how the investors shall be protected through various legislations. Securities market in general are to be regulated to improve the market operations in fair dealings and easy to access the market by corporate and investors.

The desired level of economic growth of a country is dependent upon availability of protection to its investors'. Globally, there is increased evidence to suggest that investor protection has assumed an important role in the economic development of a country. Integrity of the financial markets and economic wellbeing of the country depend on corporate accountability and investors' confidence. The global concern to make capital markets safer and transparent can be achieved by strengthening financial system and managing the crisis efficiently.

The revival of investors' protection in the corporate securities market is necessary to make market more efficient by means of converting savings to investment. If the investors are not protected properly by way of providing fair rate of return and safeguarding their capital, the corporate will not be able to mobilize funds from the market at reasonable rate in times to come. In view of the foregoing with a view to gain the confidence of investors in the securities market it is necessary to provide adequate rate of return on investors' capital by corporates through their operational efficiency. This will enable us to bring more investors to the capital market. This can be done by a series of systematic measures which would build their confidence in the systems and processes and protect the interest of investors.

## INVESTOR GRIEVANCES

There will be occasions when an investor has a complaint against, a listed company or an intermediary registered with SEBI. In the event of such complaint, the investor should first approach the concerned company/intermediary against whom there is a complaint. Sometimes the response received may not be satisfactory. Therefore, investors should know as to which authority they should approach, to get their complaints redressed.

## SCORES (SEBI COMPLAINTS REDRESS SYSTEM)

SCORES is a web based centralized grievance redress system of SEBI (<http://scores.gov.in>). SCORES enables investors to lodge and follow up their complaints and track the status of redressal of such complaints online from the above website from anywhere. This enables the market intermediaries and listed companies to receive the complaints online from investors, redress such complaints and report redressal online. All the activities starting from lodging of a complaint till its closure by SEBI would be online in an automated environment and the complainant can view the status of his complaint online. An investor, who is not familiar with SCORES or does not have access to SCORES, can lodge complaints in physical form at any of the offices of SEBI. Such complaints would be scanned and also uploaded in SCORES for processing.

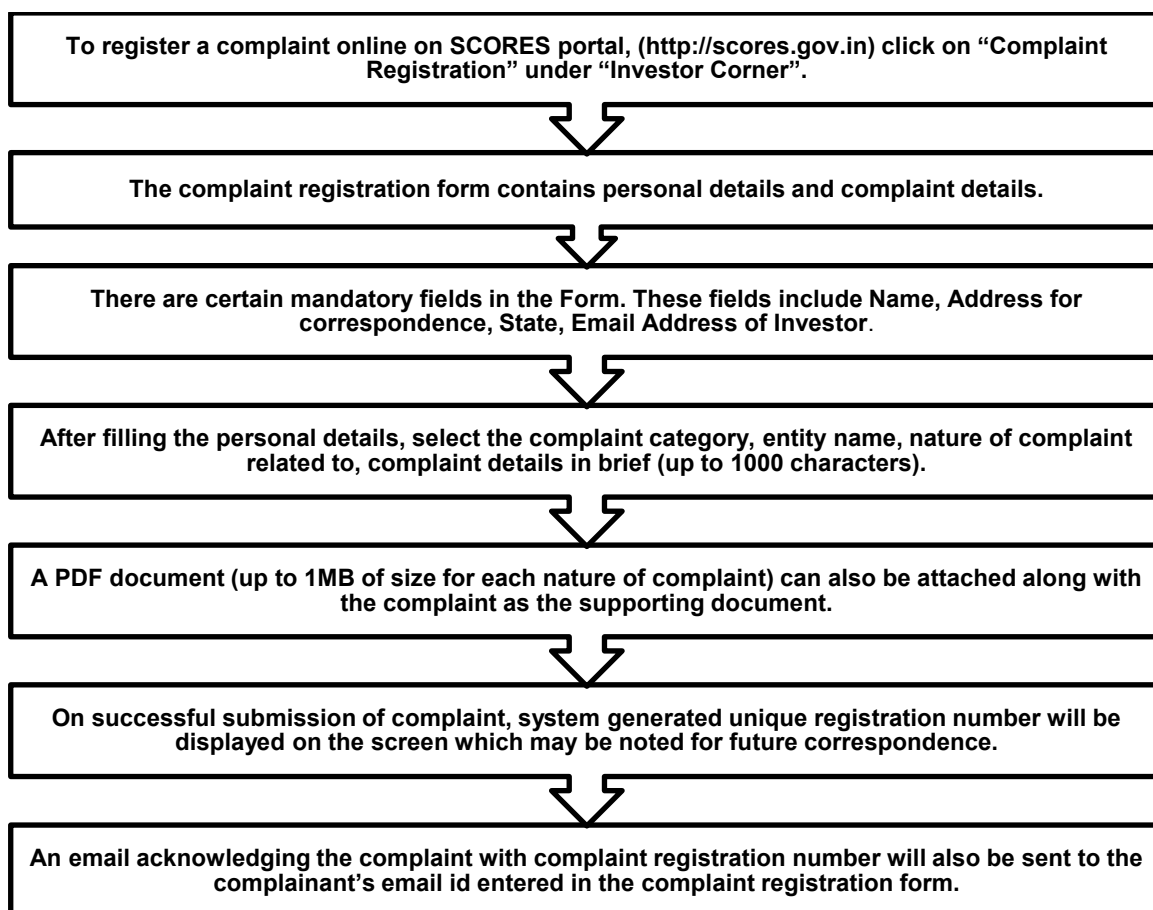
The salient features of SCORES are:

- SCORES is web enabled and provides online access 24 x 7;
- Complaints and reminders thereon can be lodged online at the above website at anytime from anywhere;
- An email is generated instantaneously acknowledging the receipt of complaint and allotting a unique complaint registration number to the complainant for future reference and tracking;



- The complaint forwarded online to the entity concerned for its redressal;
- The entity concerned uploads an Action Taken Report (ATR) on the complaint;
- SEBI peruses the ATR and closes the complaint if it is satisfied that the complaint has been redressed adequately;
- The concerned investor can view the status of the complaint online from the above website by logging in the unique complaint registration number;
- The entity concerned and the concerned investor can seek and provide clarification on his complaint online to each other;
- Every complaint has an audit trail; and
- All the complaints are saved in a central database which generates relevant MIS reports to enable SEBI to take appropriate policy decisions and/or remedial actions, if any.

### **HOW TO LODGE COMPLAINT IN SCORES?**





### WHEN CAN A CASE BE REFERRED FOR ARBITRATION?

If the grievance is not resolved by the Stock Exchange/Depository due to disputes, an investor can file arbitration subject to the Bye-laws, Rules and Regulations of the exchange / Depository. All claims, differences or disputes between the investors and stock brokers/depository participants can be filed for arbitration. To obtain information about when and how to file an arbitration claim, please visit:

- **Bombay Stock Exchange**  
<http://www.bseindia.com/invdesk/Arbitrage.asp>
- **National Stock Exchange**  
[http://www.nseindia.com/content/assist/asst\\_investser.htm](http://www.nseindia.com/content/assist/asst_investser.htm)
- **Central Depository Services Limited**  
<http://www.cdslindia.com/downloads/Operating%20Instruction/Chapters-as-of-June-2011.pdf>
- **National Securities Depository Limited**  
<https://nsdl.co.in>

Simplified arbitration can be a less costly alternative to legal recourse before the courts of law. If the investor has an account with the broker or a depository participant (DP), he/she can choose arbitration to settle disputes. The investor generally cannot pursue an issue through arbitration if it is barred by limitation prescribed. When deciding whether to arbitrate, the investor has to bear in mind that if the broker or DP goes out of business or declares bankruptcy, he/she might not be able to recover money even if the arbitrator or court rules in his/her favor.

However, with certain restriction to the nature of transactions, Stock Exchanges may settle on case to case

basis the claim of an investor up to a limit prescribed in the “Investor protection fund” guidelines of the respective Stock Exchange. The claimant is required to carefully review the rules governing simplified arbitration before filing a claim and should also weigh the costs of arbitrating against the likelihood of being able to collect any award in favor. An investor, who has a claim / counter claim upto Rs.10 lakh and files arbitration reference for the same within six months, need not make any deposit for filing arbitration.

### WHEN CAN SEBI TAKE ACTION FOR NON-RESOLUTION OF THE COMPLAINT?

While the entity is directly responsible for redressal of the complaint, SEBI initiates action against recalcitrant entities on the grounds of their unsatisfactory redressal of large number of investor complaints as a whole.

Which are the matters that are not considered as complaints by SEBI?

- Complaints that are incomplete or not specific
- Allegations without supporting documents
- Offering suggestions or seeking guidance/explanation
- Seeking explanation for non-trading of shares or illiquidity of shares
- Not satisfied with trading price of the shares of the companies
- Non-listing of shares of private offer
- Disputes arise out of private agreement with companies/intermediaries.

### 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 SEBI.

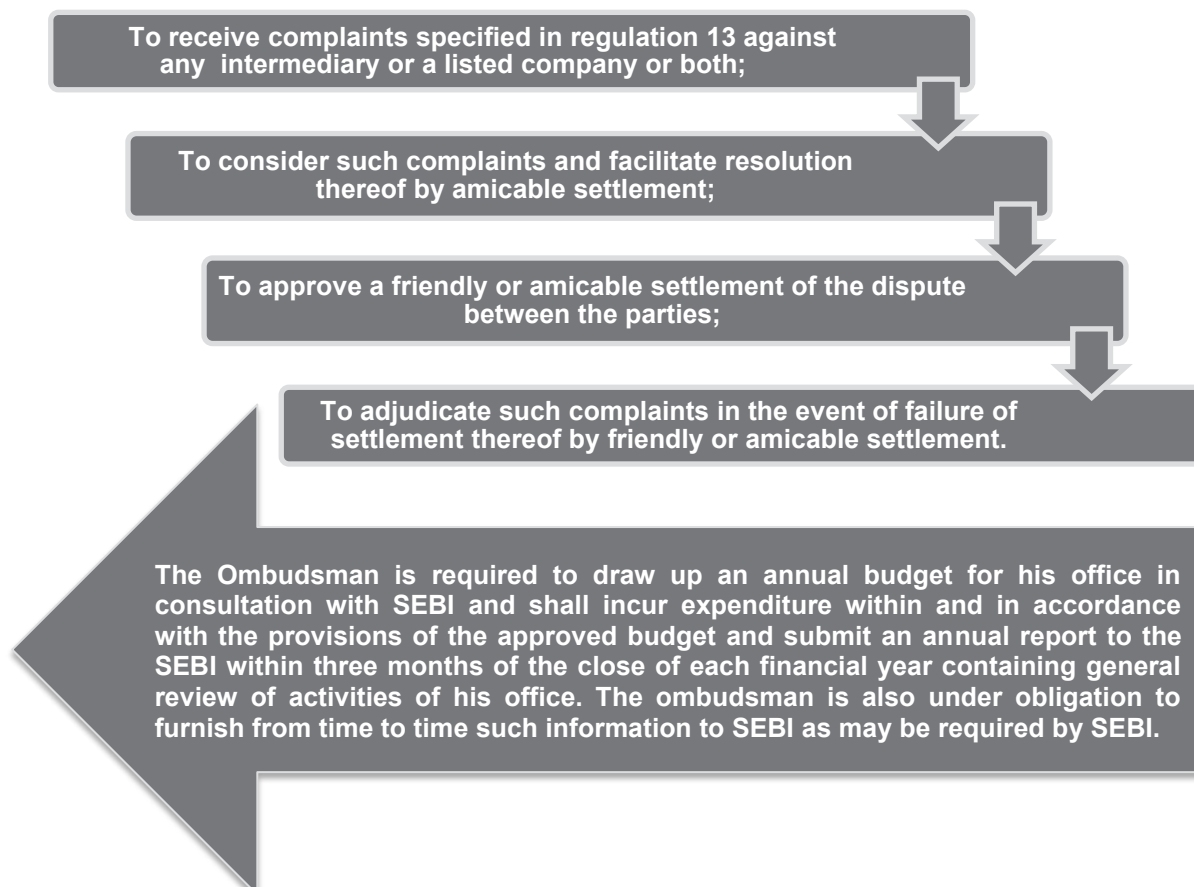
An “investor” means a person who invests or buys or sells or deals in securities.

“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.

### 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



### Procedure for Redressal of Grievance

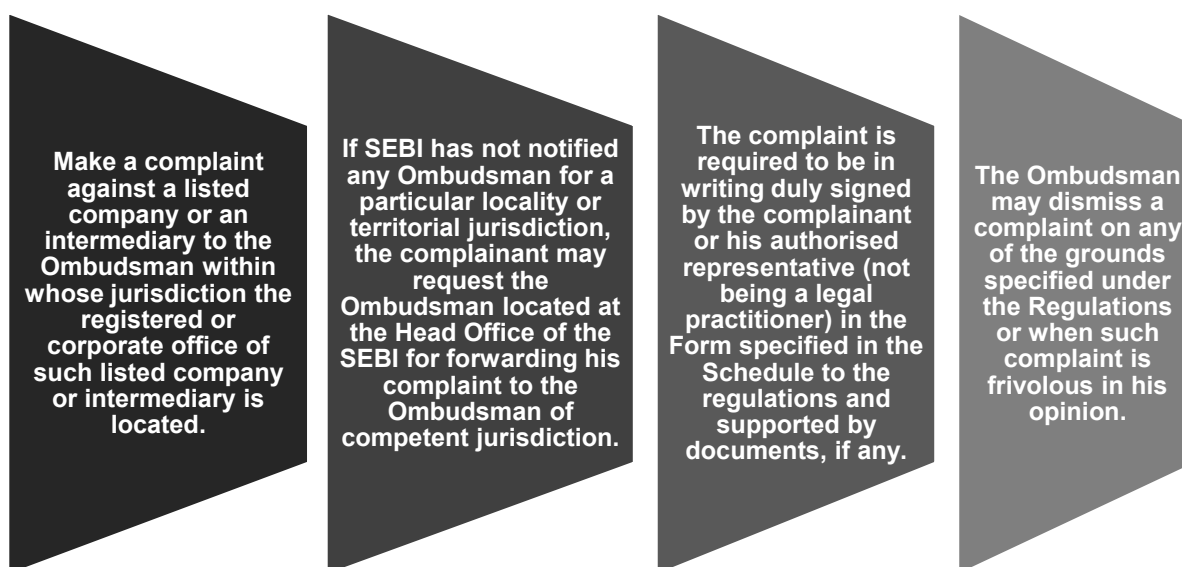
A person may lodge a complaint on any one or more of the following grounds either to SEBI or to the Ombudsman concerned:

- (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 24 of the Companies Act, 2013;
- (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:



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 under clause (a) above;
- (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 SEBI 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.

### 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.
- Such award shall be made within a period of three months from the date of the filing of the complaint.
- 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 file a petition before SEBI within one month from the receipt of the award or corrected award setting out the grounds for review of the award.

### Review of Award

- SEBI may review the award 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, such petition shall not be entertained by SEBI unless the party filing the petition has deposited with SEBI seventy-five percent of the amount mentioned in the award.
  - Further, 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 party so directed shall implement the award within 30 days of receipt of the order of SEBI on review or within such period as may be specified by SEBI in the order disposing off the review petition.
  - 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 SEBI, as the case may be.
- 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.

**EVIDENCE ACT NOT TO APPLY IN THE PROCEEDINGS BEFORE OMBUDSMAN**

In proceedings before the Ombudsman strict rules of evidence under the Evidence Act shall not apply and the Ombudsman may determine his own procedure consistent with the principles of natural justice.

Ombudsman shall decide whether to hold oral hearings for the presentation of evidence or for oral argument or whether the proceeding shall be conducted on the basis of documents and other materials.

However, it shall not be necessary for an investor to be present at the oral hearing of proceedings under these regulations and the Ombudsman may proceed on the basis of the documentary evidence submitted before him.

No legal practitioner shall be permitted to represent the defendants or respondents at the proceedings before the Ombudsman except where a legal practitioner has been permitted to represent the complainants by the Ombudsman.

### **Cost and Interest**

The Ombudsman or SEBI, 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 SEBI 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 SEBI. If any person fails to implement the award or order of SEBI 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 SEBI Act;
- (2) he shall also be liable for –
  - (a) an action under Section 11(4) of the SEBI 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 SEBI 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.

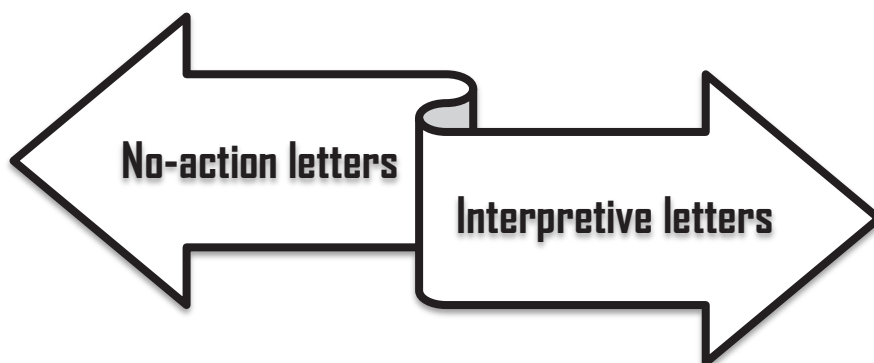
### SEBI (INFORMAL GUIDANCE) SCHEME, 2003

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 SEBI 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. (Now SEBI Takeover Regulation, 2011)

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 prescribed fees 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 request or 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 SEBI, though the SEBI 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 SEBI 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 SEBI, 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 SEBI 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 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.
- 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.
- SCORES is a web based centralized grievance redress system of SEBI which enables investors to lodge and follow up their complaints and track the status of redressal of such complaints online from the above website from anywhere.
- SEBI has issued SEBI (Ombudsman) Regulations, 2003 which deals with establishment of office of Ombudsman, powers and functions of Ombudsman, procedure for redressal of Grievances and implementation of the award.
- SEBI (Informal Guidance) Scheme, 2003 deals with various aspects such as the nature of request fees to be accompanied along with letter disposal of requests, SEBI discretion not request and certain types of request and confidentiality of requests, etc.

### GLOSSARY

<b>Arbitration</b>	Arbitration is a procedure in which a dispute submitted, by agreement of the parties to one or more arbitrators who make a binding decision on the dispute.
<b>Award</b>	It means a finding in the form of direction or an order of an Ombudsman given in accordance with these regulations.
<b>Complainant</b>	It means any investor who lodges complaint with the Ombudsman and includes an investors association recognised by the Board.
<b>Grievance Redress</b>	Grievance Redress mechanism is part and parcel of the machinery of any administration. The grievance redress mechanism of an organisation is the gauge to measure its efficiency and effectiveness as it provides important feedback on the working of the administration
<b>Petition</b>	A formal written request, typically one signed by many people, appealing to authority in respect of a particular cause.

## SELF TEST QUESTIONS

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

1. What is SCORES? Briefly discuss the salient features of SCORES.
2. Who are eligible to make a request under the SEBI (Informal Guidance) Scheme, 2003?
3. Who is Ombudsman? What is the powers and functions of Ombudsman?
4. Discuss the various grounds under which a person can lodge a complaint either to SEBI or to the Ombudsman.
5. Explain the types of requests which is not considered by SEBI.

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# Lesson 15

## Structure of Capital Market

### Part I Primary Market

#### LESSON OUTLINE

##### A. Capital Market Investment Institutions

- Introduction
- National Level Institutions
- State Level Institutions
- Qualified Institutional Buyers
- Foreign Portfolio Investor
- Private Equity
- Angel Fund
- High Net Worth Individuals
- Venture Capital
- Pension Fund
- Alternative Investment Funds

##### B. Capital Market Instruments

- Equity shares
- Shares with Differential Voting Rights
- Preference Shares
- Debentures
- Bonds
- Foreign Currency Convertible Bonds
- Foreign Currency Exchangeable Bonds
- Indian Depository Receipts
- Derivatives
- Warrant

##### C. Aspects of Primary Market

- Book Building
- Anchor Investors
- Application Supported By Block Amount
- Green Shoe Option

#### LEARNING OBJECTIVES

Financial Sector plays an indispensable role in the overall development of a country's economy. The impact of financial sector on the economic performance of country is of great importance. Financial sector mobilizes the savings and channelize these savings across sectors. This boost the economy at global platform as well. One of the most important constituent of this sector is the financial institutions. A financial institution is an establishment which conducts financial transactions such as investments, loans and deposits. Almost everyone deals with financial institutions on a regular basis. Everything from depositing money to taking out loans and exchanging currencies must be done through financial institutions. These institutions provide a variety of financial products and services to fulfil the varied needs of the commercial sector. Besides, they also provide assistance to new enterprises, small and medium enterprises as well as to the industries established in backward areas. Financial institutions can be classified in various categories e.g. Insurance Companies, Pension Fund, Mutual Fund, Capital Market Intermediaries etc.

Keeping in view the role played by the institutions in the development of Capital Market, this lesson is designed to give an overview of different categories of Investment Institutions like Venture Capital, Private Equity, Hedge Funds, Qualified Institutional Buyer, Pension Funds, Foreign Portfolio Investor etc. which are active participant in the Financial Market.

## A. CAPITAL MARKET INVESTMENT INSTITUTIONS

### INTRODUCTION

In any economy, financial Institutions play an important role because all the financial dealings and matters are handled and monitored by such Institutions. The major components of financial Institutions are banks, insurance companies, investment companies, consumer finance companies, and other specialized financial institutes. These institutions provide a variety of financial products and services to fulfil the varied needs of the commercial sector. Besides, they provide assistance to new enterprises, small and medium scale enterprises as well as industries established in backward areas. Thus, they have helped in reducing regional disparities by inducing widespread industrial development.

The Government of India, in order to provide adequate supply of credit to various sectors of the economy, has evolved a well-developed structure of financial institutions in the country. These financial institutions can be broadly categorised into All India institutions and State level institutions, depending upon the geographical coverage of their operations. At the national level, they provide long and medium term loans at reasonable rates of interest.

They subscribe to the debenture of the companies, underwrite public issue of shares, guarantee loans and deferred payments, etc. Though, the State level institutions are mainly concerned with the development of medium and small scale enterprises, but they provide the same type of financial assistance as the national level institutions.

### NATIONAL LEVEL INSTITUTIONS

A wide variety of financial institutions have been set up at the national level. These institutions cater to the diverse financial requirements of the entrepreneurs. They include development banks like IDBI, SIDBI, FIs like IFCI, IIBI; TFCl and Insurance Companies like LIC, GIC, UTI; etc.

**1. All-India Development Banks (AIDBs):-** Includes those development banks which provide institutional credit not only to large and medium scale enterprises but also help in promotion and development of small scale industrial units.

Following are the banks which caters to the need for the growth of different sectors on India :

- **Industrial Development Bank of India (IDBI):-** It was established in July 1964 as an apex financial institution for industrial development in the country. It caters to the diversified needs of medium and large scale industries in the form of financial assistance, both directly and indirectly. Direct assistance is provided by way of project loans, underwriting of and direct subscription to industrial securities, soft loans, technical refund loans, etc. Indirect assistance is provided in the form of refinance facilities to industrial concerns.
- **Industrial Finance Corporation of India (IFCI):-** It was the first development finance institution set up under the IFCI Act 1948. in order to pioneer long-term institutional credit to medium and large scale enterprises. It aims to provide financial assistance to industry by way of rupee and foreign currency loans, underwrites/subscribes the issue of stocks, shares, bonds and debentures of industrial concerns, etc. It has also diversified its activities in the field of merchant banking, syndication of loans, formulation of rehabilitation programmes, assignments relating to amalgamations and mergers, etc.
- **Small Industries Development Bank of India (SIDBI):-** It was set up by the Government of India in April 1990, as a wholly owned subsidiary of IDBI. It is the principal financial institution for promotion, financing and development of small scale industries in the economy. It aims to empower the Micro, Small and Medium Enterprises (MSME) sector with a view to contributing to the process of economic growth, employment generation and balanced regional development.

- **Industrial Investment Bank of India Ltd (IIBI):-** It was set up in 1985 under the Industrial reconstruction Bank of India Act, 1984, as the principal credit and reconstruction agency for sick industrial units. It was converted into IIBI on March 17, 1997, as a full-fledged development financial institution. It assists industry mainly in medium and large sector through wide ranging products and services. Besides project finance, IIBI also provides short duration non-project asset-backed financing in the form of underwriting/direct subscription, deferred payment guarantees and working capital/ other short-term loans to companies to meet their fund requirements.

**2. Specialised Financial Institutions (SFIs):-** These are the institutions which have been set up to serve the increasing financial needs of trade and commerce in the area of venture capital, credit rating and leasing, etc.

Following institutions are considered as SFIs in our country:

- **IFCI Venture Capital Funds Ltd (IVCF):-** IVCF formerly known as Risk Capital & Technology Finance Corporation Ltd (RCTC), is a subsidiary of IFCI Ltd. It was promoted with the objective of broadening entrepreneurial base in the country by facilitating funding to ventures involving innovative product/process/technology. Initially, it started providing financial assistance by way of soft loans to promoters under its 'Risk Capital Scheme'. Since 1988, it also started providing finance under 'Technology Finance and Development Scheme' to projects for commercialisation of indigenous technology for new processes, products, market or services. Over the years, it has acquired great deal of experience in investing in technology-oriented projects.
- **ICICI Venture Funds Ltd:-** Formerly known as Technology Development & Information Company of India Limited (TDICI), it was founded in 1988 as a joint venture with the Unit Trust of India. Subsequently, it became a fully owned subsidiary of ICICI. It is a technology venture finance company, set up to sanction project finance for new technology ventures. The industrial units assisted by it are in the fields of computer, chemicals/polymers, drugs, diagnostics and vaccines, biotechnology, environmental engineering, etc.
- **Tourism Finance Corporation of India Ltd. (TFCI):-** It is a specialised financial institution set up by the Government of India for promotion and growth of tourist industry in the country. Apart from conventional tourism projects, it provides financial assistance for non-conventional tourism projects like amusement parks, ropeways, car rental services, ferries for inland water transport, etc.

**3. Investment Institutions:-** These are the most popular form of financial intermediaries, which particularly catering to the needs of small savers and investors. They deploy their assets largely in marketable securities.

Following are the Investment Institutions established by the Government :

- **Life Insurance Corporation of India (LIC):-** It was established in 1956 as a wholly-owned corporation of the Government of India. It was formed by the Life Insurance Corporation Act, 1956, with the objective of spreading life insurance much more widely and in particular to the rural area. It also extends assistance for development of infrastructure facilities like housing, rural electrification, water supply, sewerage, etc. In addition, it extends resource support to other financial institutions through subscription to their shares and bonds, etc.
- **Unit Trust of India (UTI):-** It was set up as a body corporate under the UTI Act, 1963, with a view to encourage savings and investment. It mobilises savings of small investors through sale of units and channelises them into corporate investments mainly by way of secondary capital market operations.

For more than two decades it remained the sole vehicle for investment in the capital market by the Indian citizens. Thus, its primary objective is to stimulate and pool the savings of the middle and low income groups and enable them to share the benefits of the rapidly growing industrialisation in the country. In December 2002, the UTI Act, 1963 was repealed with the passage of Unit Trust of India



(Transfer of Undertaking and Repeal) Act, 2002, paving the way for the bifurcation of UTI into 2 entities, UTI-I and UTI-II with effect from 1st February 2003.

- **General Insurance Corporation of India (GIC):-** It was formed by the enactment of the General Insurance Business (Nationalisation) Act, 1972(GIBNA), for the purpose of superintending, controlling and carrying on the business of general insurance or non-life insurance. Initially, GIC had four subsidiary branches, namely, National Insurance Company Ltd, The New India Assurance Company Ltd, The Oriental Insurance Company Ltd and United India Insurance Company Ltd. But these branches were delinked from GIC in 2000 to form an association known as 'GIPSA' (General Insurance Public Sector Association).

## STATE LEVEL INSTITUTIONS

Several financial institutions have been set up at the State level which supplement the financial assistance provided by the all India institutions. They act as a catalyst for promotion of investment and industrial development in the respective States. They broadly consist of 'State financial corporations' and 'State industrial development corporations'.

- **State Financial Corporations (SFCs) :-** These are the State-level financial institutions which play a crucial role in the development of small and medium enterprises in the concerned States. They provide financial assistance in the form of term loans, direct subscription to equity/debentures, guarantees, discounting of bills of exchange and seed/ special capital, etc. SFCs have been set up with the objective of catalysing higher investment, generating greater employment and widening the ownership base of industries. They have also started providing assistance to newer types of business activities like floriculture, tissue culture, poultry farming, commercial complexes and services related to engineering, marketing, etc. There are around 18 State Financial Corporations (SFCs) in the country.
- **State Industrial Development Corporations (SIDCs) :-** These corporations have been established under the erstwhile Companies Act, 1956, as wholly-owned undertakings of State Governments. They have been set up with the objectives of promoting industrial development in the respective States and providing financial assistance to small entrepreneurs. They are also involved in setting up of medium and large industrial projects in the joint sector/assisted sector in collaboration with private entrepreneurs or wholly-owned subsidiaries. They undertake a variety of promotional activities such as preparation of feasibility reports; conducting industrial potential surveys; entrepreneurship training and development programmes; as well as developing industrial areas and industrial estates.

## QUALIFIED INSTITUTIONAL BUYERS

QIBs are investment institutions who buy the shares of a company on a large scale. Qualified Institutional Buyers are those Institutional investors who are generally perceived to possess expertise and the financial proficiency to evaluate and to invest in the Capital Markets. According to SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, "Qualified Institutional Buyer" means :

Investment in the company, either domestic or foreign, can be made by many types of investors who are governed by specified sets of regulations. If the investor is not capable, either by his/her individual financial limit or not permitted, to invest individually till he invests a specified statutorily fixed amount, then he usually participates indirectly through certain institutions, through which he can invest limited sums according to the viability of both, himself and institution.

The institution is usually a collective group of people in which a large number of investors repose faith and the institution collects a whopping investible sum from various investors to invest in the market. When investing through the institution, investors usually have limited control on their investments in comparison to the individual



investment as they hand over the amount for investment to the institution and they, in turn, keep experts to have a vigil on the market. Accordingly, experts recommend the investments to be made and thus the institutions in the spree invest in that market.

There are various types of institutions defined in the rules and regulations, but to qualify as a 'Qualified Institutional Buyer' (QIB), certain regulations formulated by the SEBI needs to be kept in mind. As the name itself suggests, it is in the form of an institution and under the institutionalized mechanism, they invest in the company.

According to Regulation 2(1)(zd) of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, Qualified Institutional Investors comprises of —

- (i) a mutual fund, venture capital fund, Alternative Investment Fund and foreign venture capital investor registered with SEBI;
- (ii) a foreign portfolio investor other than Category III foreign portfolio investor, registered with SEBI;
- (iii) a public financial institution as defined in section 4A of the Companies Act, 1956 [now Section 2(72) of the Companies Act, 2013] ;
- (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;
- (xiii) systemically important non-banking financial companies.

SEBI has laid down certain criteria in SEBI (ICDR) Regulations, 2009, under which a QIB is entitled to get the shares upto 50% of the issue if the issue is in accordance with regulation 26(1) with SEBI (ICDR) Regulation 2009 or at least 75% of the issue if the issue is in accordance with regulation 26(2) of SEBI (ICDR) Regulation 2009. QIBs are allocated shares in proportionate basis. QIBs can also act as an anchor investor in Initial Public Offers of the companies.

#### **For Example:**

Company A proposed to issue 7,000 equity shares as a fresh issue pursuant to their Initial Public Offer. If the issue is in accordance with regulation 26(1) of SEBI (ICDR) Regulation, 2009 then the company can issue upto 3500 shares to QIB. If the said issue is in accordance with regulation 26(2) of SEBI (ICDR) Regulation 2009 then the company has to issue at least 5250 shares to QIBs.

### **FOREIGN PORTFOLIO INVESTOR**

Foreign Portfolio Investor (FPI) means a person who satisfies the eligibility criteria prescribed under SEBI (Foreign Portfolio Investors) Regulations, 2014 and has been registered under Chapter II of these regulations, which shall be deemed to be an intermediary in terms of the provisions of the SEBI Act, 1992. All existing

Foreign Institutional Investors (FIIs) and QFIs are to be merged into one category called FPI.

### Categories of FPI

• *Category I FPIs include:*

Government and Government-related investors such as central banks, Governmental agencies, sovereign wealth funds and international or multilateral organisations or agencies.

• *Category II FPIs include:*

- appropriately regulated broad based funds such as mutual funds, investment trusts, insurance/reinsurance companies;
- appropriately regulated persons such as banks, asset management companies, investment managers/advisors, portfolio managers;
- broad based funds that are not appropriately regulated but whose investment manager is appropriately regulated. However, the investment manager of such broad based fund should be registered as a Category II FPI and should undertake that it shall be responsible and liable for all acts of commission and omission of all its underlying broad based funds and other deeds and things done by such broad based funds under these regulations.
- university funds and pension funds; and
- university-related endowments already registered with SEBI as FIIs or subaccounts.

• *Category III FPIs include:*

- It includes all other FPIs which not eligible under Category I and II of FPIs such as endowments, charitable societies, charitable trusts, foundations, corporate bodies, trusts, individuals and family offices.

### ALTERNATIVE INVESTMENT FUNDS

Alternative investment funds (AIFs) are defined in Regulation 2(1)(b) of SEBI (Alternative Investment Funds) Regulations, 2012. It refers to any privately pooled investment fund, (whether from Indian or foreign sources), in the form of a trust or a company or a body corporate or a Limited Liability Partnership (LLP) which are not presently covered by any Regulation of SEBI governing fund management (like, Regulations governing Mutual Fund or Collective Investment Scheme) nor coming under the direct regulation of any other sectoral regulators in India-IRDA, PFRDA, RBI. Hence, in India, AIFs are private funds which are otherwise not coming under the jurisdiction of any regulatory agency in India.

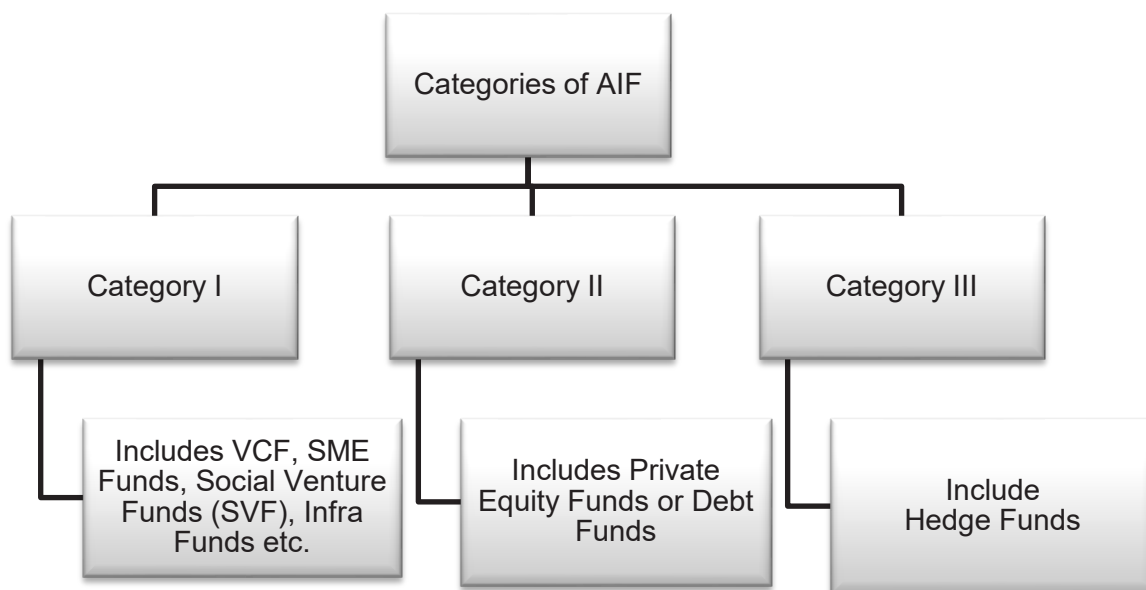
According to SEBI (AIF) Regulations, 2012, "Alternative Investment Fund" means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which,-

- (i) is a privately pooled investment vehicle which collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors; and
- (ii) is not covered under the SEBI (Mutual Funds) Regulations, 1996, SEBI (Collective Investment Schemes) Regulations, 1999 or any other regulations of SEBI to regulate fund management activities.

However, the following shall not be considered as Alternative Investment Fund for the purpose of these regulations, –

- (i) Family trusts set up for the benefit of 'relatives' as defined under Companies Act, 2013.

- (ii) ESOP Trusts set up under the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme), Guidelines, 1999 or as permitted under Companies Act, 2013.
- (iii) Employee welfare trusts or gratuity trusts set up for the benefit of employees.
- (iv) Holding companies within the meaning of Section 2(46) of the Companies Act, 2013.
- (v) Other special purpose vehicles not established by fund managers, including securitization trusts, regulated under a specific regulatory framework.
- (vi) Funds managed by securitisation company or reconstruction company which is registered with the Reserve Bank of India under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
- (vii) Any such pool of funds which is directly regulated by any other regulator in India; Thus, the definition of AIFs includes venture Capital Fund, hedge funds, private equity funds, commodity funds, Debt Funds, infrastructure funds, etc., while, it excludes Mutual funds or collective investment Schemes, family trusts, Employee Stock Option / purchase Schemes, employee welfare trusts or gratuity trusts, 'holding companies' within the meaning of Section 2(46) of the Companies Act, 2013, securitization trusts regulated under a specific regulatory framework, and funds managed by securitization company or reconstruction company which is registered with the RBI under Section 3 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.



One AIF can float several schemes. Investors in these funds are large institutions, high net worth individuals and corporates. In India AIF is regulated by SEBI (Alternative Investment Funds) Regulations, 2012.

## PRIVATE EQUITY

Private equity is a type of equity (finance) and one of the asset classes who takes securities and debt in operating companies that are not publicly traded on a stock exchange. Private equity is essentially a way to invest in some assets that isn't publicly traded, or to invest in a publicly traded asset with the intention of taking it private. Unlike stocks, mutual funds, and bonds, private equity funds usually invest in more illiquid assets, i.e. companies. By purchasing companies, the firms gain access to those assets and revenue sources of the

company, which can lead to very high returns on investments. Another feature of private equity transactions is their extensive use of debt in the form of high-yield bonds. By using debt to finance acquisitions, private equity firms can substantially increase their financial returns.

Private equity consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies. Capital for private equity is raised from retail and institutional investors, and can be used to fund new technologies, expand working capital within an owned company, make acquisitions, or to strengthen a balance sheet. The major of private equity consists of institutional investors and accredited investors who can commit large sums of money for long periods of time.

Private equity investments often demand long holding periods to allow for a turn around of a distressed company or a liquidity event such as IPO or sale to a public company. Generally, the private equity fund raise money from investors like Angel investors, Institutions with diversified investment portfolio like – pension funds, insurance companies, banks, funds of funds etc.

### Types of Private Equity

Private equity investments can be divided into the following categories:

- **Leveraged Buyout (LBO):** This refers to a strategy of making equity investments as part of a transaction in which a company, business unit or business assets is acquired from the current shareholders typically with the use of financial leverage. The companies involved in these type of transactions that are typically more mature and generate operating cash flows.
- **Venture Capital:** It is a broad sub-category of private equity that refers to equity investments made, typically in less mature companies, for the launch, early development, or expansion of a business.
- **Growth Capital:** This refers to equity investments, mostly minority investments, in the companies that are looking for capital to expand or restructure operations, enter new markets or finance a major acquisition without a change of control of the business.

### ANGEL FUND

An angel investor or angel (also known as a business angel, informal investor, angel funder, private investor, or seed investor) is an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity. A small but increasing number of angel investors invest online through equity crowd funding or organize themselves into angel groups or angel networks to share research and pool their investment capital, as well as to provide advice to their portfolio companies.

Angel investments are typically the earliest equity investments made in start-up companies. They commonly band together in investor networks. Often these networks are based on regional, industry in investor or academic affiliation. Angel Investors are often former entrepreneurs themselves, and typically enjoy working with companies at the earliest stages of business formation. As per SEBI (Alternative Investment Fund) Regulations, 2012, angel fund is a sub-category of venture capital. Procurement of funds from angel investors of their further investment has to be conducted as per these regulations.

The effective Angels help entrepreneurs to shape, business models, create business plans and connect to resources - but without stepping into a controlling or operating role. Often Angels are entrepreneurs who have successfully built companies, or have spent a part of their career in coaching young companies.

### HIGH NET WORTH INDIVIDUALS

HNIs or high net worth individuals is a class of individuals who are distinguished from other retail segment based on their net wealth, assets and investible surplus. While there is no standard put forth for the classification, the

definition of HNIs varies with the geographical area as well as financial markets and institutions.

Though there is no specific definition, generally in the Indian context, individuals with over Rs. 2 crore investible surplus may be considered to be HNIs while those with investible wealth in the range of Rs. 25 lac - Rs. 2 crore may be deemed as Emerging HNIs.

If you are applying for a IPO of equity shares in an Indian company, generally, if you apply for amounts in excess of Rs. 2 lakhs, you fall under the HNI category. On the other hand, if you apply for amounts under Rs. 2 lakhs, you are considered as a retail investor. There may be so many ways in which HNIs are categorized and defined, there is no single bracket that could put them under.

SEBI has laid down certain criteria in SEBI (ICDR) Regulations, 2009, under which a HNIs is entitled to get the shares not less than 15% of the issue, if the issue is in accordance with regulation 26(1) with SEBI (ICDR) Regulation 2009 or not more than 15% of the issue if the issue is in accordance with regulation 26(2) of SEBI (ICDR) Regulation 2009. QIBs are allocated shares in proportionate basis. QIBs can also act as an anchor investor in Initial Public Offers of the companies.

## VENTURE CAPITAL

Venture Capital is one of the innovative financing resource for a company in which the promoter has to give up some level of ownership and control of business in exchange for capital for a limited period, say, 3-5 years. Venture Capital is generally equity investments made by Venture Capital funds, at an early stage in privately held companies, having potential to provide a high rate of return on their investments. It is a resource for supporting innovation, knowledge based ideas and technology and human capital intensive enterprises.

Essentially, a venture capital company is a group of investors who pool investments focused within certain parameters. The participants in venture capital firms can be institutional investors like pension funds, insurance companies, foundations, corporations or individuals but these are high risk investments which may give high returns or high loss.

### Areas of Investment

Different venture groups prefer different types of investments. Some specialize in seed capital and early expansion while others focus on exit financing. Biotechnology, medical services, communications, electronic components and software companies seem to be the most likely attraction of many venture firms and receiving the most financing. Venture capital firms finance both early and later stage investments to maintain a balance between risk and profitability.

In India, software sector has been attracting a lot of venture finance. Besides media, health and pharmaceuticals, agri-business and retailing are the other areas that are favoured by a lot of venture companies.

## PENSION FUND

Pension Fund means a fund established by an employer to facilitate and organize the investment of employees' retirement funds which is contributed by the employer and employees. The pension fund is a common asset pool meant to generate stable growth over the long term, and provide pensions for employees when they reach the end of their working years and commence retirement. Pension funds are commonly run by some sort of financial intermediary for the company and its employees like N.P.S. scheme is managed by UTI AMC (Retirement Solutions), although some larger corporations operate their pension funds in-house. Pension funds control relatively large amounts of capital and represent the largest institutional investors in many nations.

Pension funds play a huge role in development of the economy and it play active role in the Indian equity market. This pension fund ensures a change in their investment attitudes and in the regulatory climate, encouraging them to increase their investment levels in equities and would have a massive impact on capital market and on

the economy as a whole.

Pensions broadly divided into two sector:

A-Formal sector Pensions

B-Informal sector Pensions

A. Formal Sector Pensions

Formal sector pensions in India can be divided into three categories; viz pensions under an Act or Statute, Government pensions and voluntary pensions.

### Legislations

There are three defining Acts for pensions in India.

1. **Pensions under the EPF & MP Act 1952:** These include the Employees Provident Fund, Employees Pension Scheme, and Employees Deposit Linked Insurance Scheme,
2. **Pensions under the Coal mines PF & MP Act 1948:** These include Coal mines provident fund, Coal mines pension scheme & Coal mines linked insurance scheme.
3. **Gratuity under the Payment of Gratuity Act, 1972:** There are other provident funds in India like Assam Tea Plantations PF, J&K PF, and Seamens PF etc.

### Government Pension

Government pensions in India are referred under the Directive Principles of State Policy and are therefore not covered under a Statute. The Government amended the regulations to put in place the new pension system.

The old scheme continues for the existing employees (i.e. those who joined service prior to January 1, 2004). Pensions for government employees would include employees of the central as well as the state governments.

- (A) Central Government Pensions like Civil servants pensions, Defences, Railways, Posts.
- (B) State Government Pensions, Bank pensions like Reserve Bank of India (RBI), Public Sector Banks, National Bank for Agriculture and Rural Development (NABARD) and other banks pensions.

Superannuation schemes are also sold in the market. These are typically the retirement plans sold by Mutual funds and Insurance companies (Life Insurance & Postal Life Insurance).

## B. CAPITAL MARKET INSTRUMENTS

### EQUITY SHARES

Equity shares, commonly referred to as ordinary share also represents the form of fractional ownership in which a shareholder, as a fractional owner, undertakes the maximum entrepreneurial risk associated with a business venture. The holder of such shares is the member of the company and has voting rights.

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

Equity capital and further issues of equity capital by a company are generally based on the condition that they will rank *pari passu* along with 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:**

Equity shares, have voting rights at all general meetings of the company. These votes have the affect of the controlling the management of the company.

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.

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.

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

- (a) The right to vote on every resolution placed before the company – (Section 47)
- (b) The rights to subscribe to shares at the time of further issue of capital by the company (Pre-emptive Right) – (Section 62)
- (c) Right to appoint proxy to attend and vote at the meeting on his behalf – (Section 105)
- (d) Right to receive copy of annual accounts of the company – (Section 136)
- (e) Right to receive notice of the meeting of members – (Section 101)
- (f) Right to inspection of various statutory registers maintained by the company – (Section 94)
- (g) Right to requisition extraordinary general meeting of the company – (Section 100)IAL

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 also specifies that the listed entity shall seek to protect and facilitate the exercise of the following rights of shareholders:

- (a) right to participate in, and to be sufficiently informed of, decisions concerning fundamental corporate changes.
- (b) opportunity to participate effectively and vote in general shareholder meetings
- (c) Being informed of the rules, including voting procedures that govern general shareholder meetings.
- (d) opportunity to ask questions to the board of directors, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.
- (e) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors.
- (f) exercise of ownership rights by all shareholders, including institutional investors.
- (g) adequate mechanism to address the grievances of the shareholders.
- (h) protection of minority shareholders from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and effective means of redress.

## SHARES WITH DIFFERENTIAL VOTING RIGHTS

Section 43(a)(ii) of the Companies Act, 2013, authorized equity share capital with differential rights as to dividend, voting or otherwise in accordance with rule 4 of Companies (Share Capital and Debentures) Rules, 2014 which prescribes the following conditions for issue of DVRs :

- (a) the articles of association of the company authorizes the issue of shares with differential rights;

- (b) the issue of shares is authorized by ordinary resolution passed at a general meeting of the shareholders.

Where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot at a general meeting;

- (c) the shares with differential rights shall not exceed twenty-six percent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;
- (d) the company having consistent track record of distributable profit for the last three years;
- (e) the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;
- (f) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;
- (g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or state level financial institution or scheduled bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government. However, a company may issue equity shares with differential rights upon expiry of five years from the end of the financial year in which such default was made good.
- (h) the company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, Securities and Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act under which such companies being regulated by sectoral regulators.
- (i) The explanatory statement to be annexed to the notice of the general meeting should contain the disclosures as mentioned in the rules.
- (j) The Board of Directors shall disclose in the Board's Report for the financial year in which the issue of equity shares with differential rights was completed, the details as mentioned in the rules.  
  
The holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.
- (k) The company shall not convert its existing share capital with voting rights into equity share capital carrying differential voting rights and vice-versa.
- (l) The register of members maintained under section 88 of the Companies Act, 2013, shall contain all the relevant particulars of the shares so issued along with details of the shareholders.

## PREFERENCE SHARES

According to explanation (ii) to Section 43 of Companies Act, 2013 "preference share capital", with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to –

- (a) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
- (b) repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-



up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

- (iii) capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:—
  - (a) that in respect of dividends, in addition to the preferential rights to the amounts specified in sub-clause (a) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;
  - (b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in sub-clause (b) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

In simple terms, the preference shares are those shares which have rights of preference over equity shares in the case of distribution of dividend and distribution of surplus in the case of winding up. They generally carry a fixed rate of dividend and redeemable after specific period of time. According to Section 55 of the Companies Act, 2013, a Company cannot issues preference shares which are irredeemable.

The following kinds of preference shares are issued by the companies:

- Cumulative preference shares
- Non-cumulative preference shares
- Convertible preference shares
- Non-Convertible Redeemable preference shares
- Participating preference share
- Non-participating preference shares

Issuer desirous of making an offer of non-convertible redeemable preference shares to the public is required to list on one or more recognized stock exchanges. Issuer may list its non-convertible redeemable preference shares issued on private placement basis on a recognized stock exchange.

## DEBENTURES

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

Debenture is a document evidencing a debt or acknowledging it and any document which fulfils 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.

4. Debentures holders do not have any voting rights.
5. Compulsory payment of interest. The interest on debenture is payable irrespective of whether there are profits made or not.
6. While issuance of debentures, the company shall ensure that the parameters for designation of deposits under Companies (Acceptance of Deposits) Rules, 2014 are not triggered.

### Categories of Debentures

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)

### Fully Convertible Debentures

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.

### 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. The issuer is required to list its Public issue of NCDs on stock exchange as per SEBI (ISSUE AND LISTING OF DEBT SECURITIES) REGULATIONS, 2008. NCDs can be also issued on private placement basis.

### 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.

### Optionally Fully Convertible Debenture (OFCD)

The Optionally Fully Convertible Debenture is a kind of debenture which can be converted into shares at the expiry of a certain period at a predetermined price, if the debt holder (investor) wishes to do so. The “securities” as defined u/s 2(81)) of Companies Act, 2013 means securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956, and includes hybrids. Hence after analysing the above definitions of “OFCD”, “hybrid” and “securities” it could be rightly concluded that an OFCD being a hybrid security falls under the definition of “securities” as defined u/s 2 (h) of Securities Contract (Regulation) Act, 1956 and u/s 2(81) of Companies Act, 2013 as it inherits the characteristics of debentures initially and also that of the shares at a later stage if the option to convert the securities into shares being exercised by the security holder.

## BONDS

Bonds are the debt security where an issuer is bound to pay a specific rate of interest agreed as per the terms of payment and repay principal amount at a later time. The bond holders are generally like a creditor where a company is obliged to pay the amount. The amount is paid on the maturity of the bond period. Generally these bonds duration would be for 5 to 10 years.

### Characteristics of a Bond

A bond, whether issued by a government or a corporation, has a specific maturity date, which can range from a few days to 20-30 years or even more. Based on the maturity period, bonds are referred to as bills or short-term bonds and long-term bonds. Bonds have a fixed face value, which is the amount to be returned to the investor upon maturity of the bond. During this period, the investors receive a regular payment of interest, semi-annually or annually, which is calculated as a certain percentage of the face value and known as a 'coupon payment.'

### Types of Bond

<b>Government Bonds</b>	<ul style="list-style-type: none"> <li>• These are the bonds issued either directly by Government of India or by the Public Sector Units (PSU's) in India. These bonds are secured as they are backed up with security from Government. These are generally offered with low rate of interest compared to other types of bonds.</li> </ul>
<b>Corporate Bonds</b>	<ul style="list-style-type: none"> <li>• These are the bonds issued by the private corporate companies. Indian corporates issue secured or non secured bonds. However care to be taken to consider the credit rating given by Credit Rating Agencies before investing in these bonds.</li> </ul>
<b>Banks and other financial institutions bonds</b>	<ul style="list-style-type: none"> <li>• These bonds are issued by banks or any financial institution. The financial market is well regulated and the majority of the bond markets are from this segment.</li> </ul>
<b>Tax saving bonds</b>	<ul style="list-style-type: none"> <li>• In India, the tax saving bonds are issued by the Government of India for providing benefit to investors in the form of tax savings. Along with getting normal interest, the bond holder would also get tax benefit. In India, all these bonds are listed in National Stock Exchange and Bombay Stock Exchange in India, hence they can be easily liquidated and sold in the open market.</li> </ul>

### FOREIGN CURRENCY CONVERTIBLE BONDS (FCCBS)

The FCCBs are unsecured instruments which 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. 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.

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 shares at a discount on prevailing Indian market price. In addition, 25% of the FCCB proceeds can be used for general corporate restructuring.

### Example

Suppose a company 'A' issues bonds with following terms –

Issue Price of the Bond Rs. 1000

Coupon rate 2%

Maturity 2 years

Convertible into equity shares @ Rs.800 per share

Now suppose an investor subscribes to 4 of these bonds. Thus the total investment is Rs.4000. On this investment, he is entitled to get an interest @ 2% for 2 years. On the maturity date, i.e. after 2 years, the investor will have an option – to either claim full redemption of the amount from the company or get the bonds converted into fully paid equity shares @ Rs. 800 per share. Thus if he goes for the conversion he will be entitled to 5 (4000/800) equity shares. The choice he makes will depend on the market price of the share on the date of conversion.

If the shares of the company 'A' is trading at lower than Rs.800, let's say Rs.500, the investor will be better off by claiming full redemption of his bonds and buying the shares from the market. In this case, he will get 8 (4000/500) equity shares as against 5 which he was getting on conversion. Similarly if the market price of the share is higher than Rs. 800, the investor will benefit by getting its shares converted. Thus, on the day of maturity, an investor will seek full redemption if the conversion price is higher than the current market price, and will go for conversion if the conversion price is less than the current market price.

## FOREIGN CURRENCY EXCHANGEABLE BONDS (FCEBS)

The FCEB is used to raise funds from the international markets against the security and exchangeability of shares of another company. Foreign Currency Exchangeable Bond (FCEB) means –

- (i) A bond expressed in foreign currency.
- (ii) The principal and the interest in respect of which is payable in foreign currency.
- (iii) Issued by an issuing company, being an Indian company.
- (iv) Subscribed by a person resident outside India.
- (v) Exchangeable into equity shares of another company, being offered company which is an Indian company.
- (vi) Either wholly or partly or on the basis of any equity related warrants attached to debt instruments.

It may be noted that issuing company to be the part of promoter group of offered company and the offered company is to be listed and is to be eligible to receive foreign investment. Under this option, an issuer company may issue FCEBs in foreign currency, and these FCEBs are convertible into shares of another company (offered company) that forms part of the same promoter group as the issuer company. E.g., company ABC Ltd. issues FCEBs, then the FCEBs will be convertible into shares of company XYZ Ltd. that are held by company ABC Ltd. and where companies ABC Ltd. and XYZ Ltd. form part of the same promoter group. Unlike FCCBs that convert into shares of issuer itself, FCEBs are exchangeable into shares of Offered Company (OC). Also, relatively, FCEB has an inherent advantage that it does not result in dilution of shareholding at the OC level.

## INDIAN DEPOSITORY RECEIPTS

According to Section 2(48) of the Companies Act, 2013 “Indian Depository Receipt” means any instrument in the form of a depository receipt created by a domestic depository in India and authorised by a company incorporated outside India making an issue of such depository receipts.

Section 390 of the Companies Act, 2013 and rule 13 of Companies (Registration of Foreign Companies) Rules, 2014 lays down the procedure for issue of Indian Depository Receipts.

Apart from this a company has to comply with Chapter X and XA of SEBI (ICDR) Regulations, 2009 to issue IDRs or a rights issue of IDRs.

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

In an IDR, foreign companies would issue shares, to a domestic (Indian) depository, which would in turn issue depository receipts to investors in India. The actual shares underlying the IDRs would be held by an Overseas Custodian, which shall authorize the Indian depository to issue the IDRs. To that extent, IDRs are derivative instruments because they derive their value from the underlying shares. Standard Chartered PLC is only company to offer IDR in the Indian market. The foreign company issuing IDRs need to comply with the requirements of rules prescribed under Companies Act, SEBI Regulations and RBI notifications/circulars.

## DERIVATIVES

A derivative is a financial instrument that derives its value from an underlying asset. This underlying asset can be stocks, bonds, currency, commodities, metals and even intangible, assets like stock indices. Derivatives can be of different types like futures, options, swaps, caps, floor, collars etc. The most popular derivative instruments are futures and options.

## FUTURE

Future refers to a future contract which means an exchange traded forward contract to buy or sell a predetermined quantity of an asset on a predetermined future date at a predetermined price. Contracts are standardized and there's centralized trading ensuring liquidity.

There are two positions that one can take in a future contract:

- Long Position-This is when a futures contract is purchased and the buyer agrees to receive delivery of the underlying asset. (Stock/Indices/Commodities).
- Short Position-This is when a futures contract is sold and the seller agrees to make delivery of the underlying asset. (stock/Indices/Commodities)

## OPTIONS

Options Contract give its holder the right, but not the obligation, take or make delivery on or before a specified date at a stated price. But this option is given to only one party in the transaction while the other party has an obligation to take or make delivery. Since the other party has an obligation and a risk associated with making the good the obligation, he receives a payment for that. This payment is called as option premium.

Option contracts are classified into two types on the basis of which party has the option:

- Call option - A call option is with the buyer and gives the holder a right to take delivery.
- Put option - The put option is with the seller and the option gives the right to take delivery.

Option Contracts are classified into two types on the basis of time at which the option can be exercised:–

- European Option – European style options are those contracts where the option can be exercised only on the expiration date. Options traded on Indian stock exchanges are of European Style.
- American Option – American style options are those contracts where the option can be exercised on or before the expiration date.

### Example

#### Case 1

Rajesh purchases 1 lot of Infosys Technologies MAY 3000 Put and pays a premium of Rs. 250. This contract allows Rajesh to sell 100 shares of Infosys at Rs. 3000 per share at any time between the current date and the end of May. In order to avail this privilege, all Rajesh has to do is pay a premium of Rs. 25,000 (Rs. 250 a share for 100 shares).

The buyer of a put has purchased a right to sell. The owner of a put option has the right to sell.

#### Case 2

If an investor is of the opinion that a particular stock say “Ray Technologies” is currently overpriced in the month of February and hence expect that there will be price corrections in the future. However he doesn’t want to take a chance, just in case the prices rise. So the best option for the investor would be to take a Put option on the stock.

Lets assume the quotes for the stock are as under:

Spot Rs. 1040

May Put at 1050 Rs.10

May Put at 1070 Rs. 30

So the investor purchases 1000 “Ray Technologies” Put at strike price of Rs.1070 and Put price of Rs. 30/-. The investor pay Rs. 30,000 as Put premium.

The position of investor in two different scenarios have been discussed below:

1. May Spot price of Ray Technologies = ₹1020
2. May Spot price of Ray Technologies = ₹1080

In the first situation you have the right to sell 1000 “Ray Technologies” shares at Rs.1,070/-the price of which is Rs. 1020/-. By exercising the option the investor earn Rs. (1070-1020) =Rs.50 per Put, which amounts to Rs. 50,000/-. The net income in this case is Rs. (50000-30000) =Rs. 20,000.

In the second price situation, the price is more in the spot market, so the investor will not sell at a lower price by exercising the Put. He will have to allow the Put option to expire unexercised. In the process the investor only lose the premium paid which is Rs. 30,000.

While buyer of an options has limited risk (Premium Amount), seller of an option has very high risk (Market Price- Strike Price or Strike Price - Market Price), as the case may be, depending on whether it is an call or put option.

**As of now, all futures and options are Cash settled.**

## WARRANT

Warrant means an option issued by a company whereby the buyer is granted the right to purchase a number of shares (usually one) of its equity share capital at a given exercise price during a given period.

The holder of a warrant has the right but not the obligation to convert them into equity shares. Thus in the true sense, a warrant signifies optional conversion. In case the investor benefits by conversion of warrant, then he will convert the warrants, else he may simply let the warrant lapse. The companies listed on the Exchange can issue warrants in accordance with SEBI (ICDR) Regulation 2009 on rights issue, preferential issue, Qualified Institutional placement, etc.

For example if the conversion price of the warrant is Rs. 70/- and the current market price is Rs.110/-, then the investor will convert the warrant and enjoy the capital gain of Rs.40/-. In case the conversion is at Rs.70/- and the current market price is Rs.40/-, then the investor will simply let the warrant lapse without conversion.

## C. ASPECTS OF PRIMARY MARKET

### BOOK BUILDING

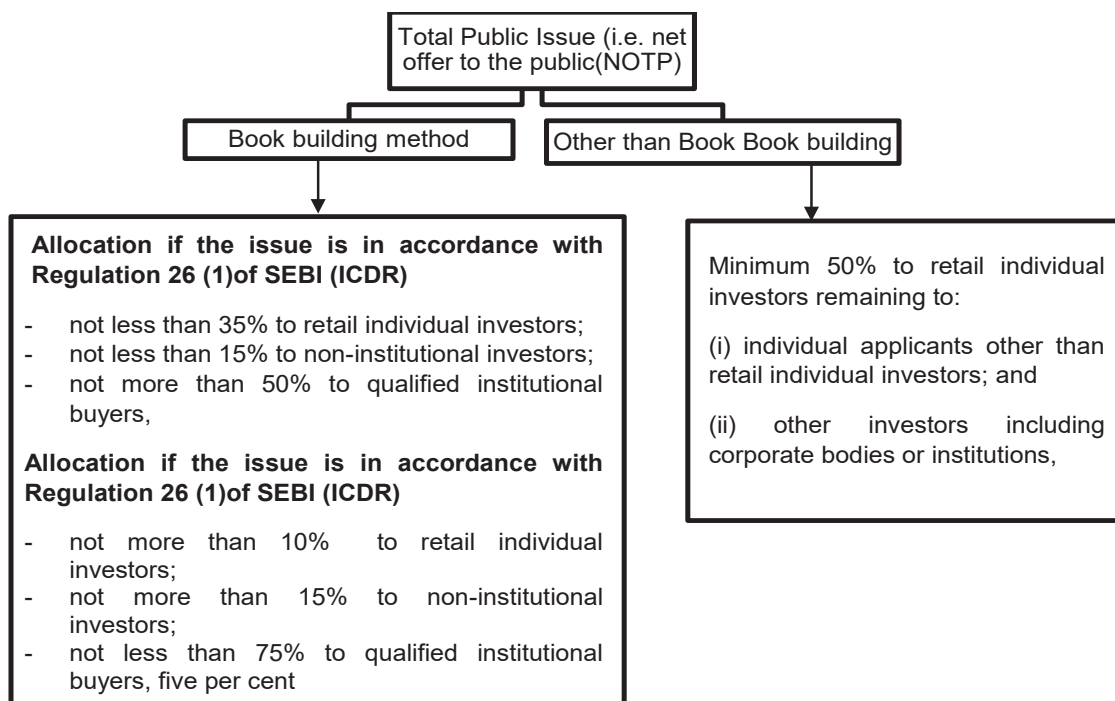
Book building means a process undertaken to elicit demand and to assess the price for determination of the quantum or value of specified securities or Indian Depository Receipts, as the case may be.

SEBI (ICDR) Regulation, 2009 defines book building as follows:

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, in accordance with SEBI (ICDR) Regulation, 2009.

The book building process in India is very transparent. All investors including small investors can see demand for the shares of the company at various price points on the website of the Exchange before applying. According to this method, share prices are determined on the basis of real demand for the shares at various price levels in the market.

#### Offer to Public through Book Building Process



### Book building Process

- Appoints Lead Book Runners/Co Book Runners, Lead Merchant Banker (LMB) to act as Lead Book Runner. If more than one LBM/LBR, inter-se, allocation of responsibilities to be decided.



- Filing of draft offer document with SEBI for obtaining observation and, Exchanges for in-principle approval for listing
- Filing of Red herring prospectus with SEBI, Exchange and Registrar of Companies (RHP)
- The company shall entered into agreement with stock exchange for online offer of securities and make application for In-principle approval.
- Lead Book Runners (LBR) appoints Syndicate members (SM), LBR/SM to underwrite/sub underwrite.
- LBR/SN to finalise bidding/collection centres who are either:
  - (a) SEBI Registered stock broker
  - (b) Self-certified Syndicate Bank (for ASBA facility)
- Pre issue advertisement shall be made.
- Bidding and allocation for anchor investors one day before opening of issue.
- Issue opens and Investor submits forms at bidding centres.
- Electronic Bidding Process and determination of price.
- Registration of final prospectus with ROC.
- Allocation/Manner of Allotment.
- In case of Book Built Issue, the issuer in consultation with merchant banker, fixes the Price band.
- In case of Fixed Price Issue, the issuer in consultation with merchant banker, fixes the price of the shares to be offered (Face Value + Share Premium) and makes on offer. If the investors subscribes minimum 90% of the offer, the issue will be succeeds.

### Example

Let's take an example.

Number of shares issued by the company = 100.

Price band = Rs. 30 – Rs. 40.

Now let's check what individuals have bid for.

Bid	Number of shares	Price per share (Rs.)	Cumulative demand
1	20	40	20
2	10	38	30
3	20	37	50
4	30	36	80
5	20	35	100
6	20	33	120
7	20	30	140

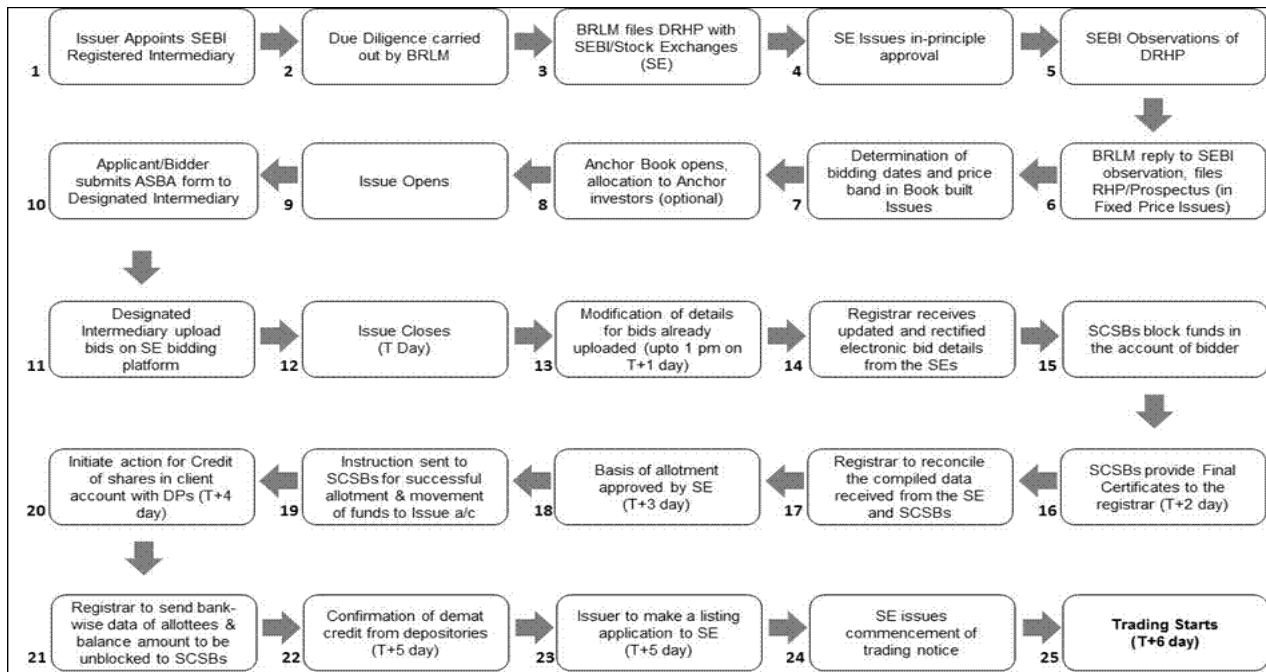
The shares will be sold at the Bid 5 price of 20 shares for Rs.35.

Because Bidders 1 to 5 are willing to pay at least Rs. 35 per share. The total bids from Bidders 1 to 5 ensure all 100 shares will be sold (20 + 10 + 20 + 30 + 20). The cut-off price is therefore Bid 5's price = Rs. 35.



Bidders 1 to 5 get allotments at that price. Bidders 6 and 7 don't get an allotment because their bids are below the cut-off price. On allotment, the extra amount paid will be refunded to the investor. Since the cut-off price is Rs. 35, the 10 shares will cost Rs. 350 (10 x Rs. 35). The balance Rs. 50 will be refunded to the investor.

IPO flow chart



## ANCHOR INVESTORS

Anchor investor means a Qualified Institutional Buyer (QIB) who makes an application for a value of 10 crore rupees or more in a public issue made through the book building process in accordance with these regulations.

Allocation to anchor investors shall be on a discretionary basis and subject to the following:

- Maximum of 2 such investors shall be permitted for allocation upto Rs.10 crore.
- Minimum of 2 and maximum of 15 such investors shall be permitted for allocation above Rs.10 crore and upto Rs. 250 crore, subject to minimum allotment of Rs.5 crore per such investor.
- In case of allocation above Rs.250 crore; a minimum of 5 such investors and a maximum of 15 such investors for allocation upto Rs.250 crore and an additional 10 such investors for every additional Rs.250 crore or part thereof, shall be permitted, subject to a minimum allotment of Rs.5 crore per such investor. The bidding for Anchor Investors shall open one day before the issue opening date.
- Allocation to Anchor Investors shall be completed on the day of bidding by Anchor Investors.
- Shares allotted to the Anchor Investor shall be locked-in for 30 days from the date of allotment in the public issue.

Upto 60% of the portion available for allocation to QIB shall be available to anchor investor(s) for allocation/allotment ("anchor investor portion") and one-third of the anchor investor portion shall be reserved for domestic mutual funds.

## APPLICATION SUPPORTED BY BLOCK AMOUNT (ASBA)

ASBA is an application for subscribing to an issue, containing an authorization to block the application money in a bank account.

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)”. Advantages of ASBA is that the investor continues to receive the interest for amount blocked, until allotment only when shares are allotted, the money moves from the investors accounts. If the concerned investor didn't get allotment. The block is removed hence, there is no concern regarding non receipt or delay in refund, in case of allotment which was the major issue when made of payment was through cheque/DD etc.”

### Process

The ASBA process is mandatory in all public issues made through the book building route. ASBA is an application for subscribing to an issue, containing an authorization to block the application money in a bank account.

## Self-Certified Syndicate Bank

Self-Certified Syndicate Bank (SCSB) is a bank which offers the facility of applying through the ASBA process. A bank desirous of offering ASBA facility shall submit a certificate to SEBI as per the prescribed format for inclusion of its name in SEBI's list of SCSBs.

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.

## 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, then the SCSB 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 of 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.

The process of applying for public issue, rights issue, etc has become very easy for investors. The investors are no more required to wait for receipt of refund in case of the public issue. The ASBA process has also helped to reduce the listing time for IPO to 6 working days from the date of the closure of the equity shares public issue.

## GREEN SHOE OPTION

Green Shoe Option means an option of allocating shares in excess of the shares included in the public issue and operating a post-listing price stabilizing mechanism in accordance with the provisions of Regulation 45 of SEBI (ICDR) Regulations, 2009.

A company desirous of availing this option, should in the resolution of the general meeting authorising the public issue, seek authorisation also for the possibility of allotment of further shares to the 'Stabilising Agent' (SA) at the end of the stabilisation period.

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 was the first to use Green Shoe Option in its public issue through book building mechanism in India.

## ILLUSTRATION

Consider a company planning an IPO of say, 100,000 shares, at a book-built price of Rs. 100/-, resulting in an IPO size of Rs. 100,00,000. As per the ICDR Regulations, the over-allotment component under the Green Shoe mechanism could be up to 15% of the IPO, i.e. up to 15,000 shares, i.e. Green Shoe shares. Prior to the IPO, the stabilising agent would borrow such number of shares to the extent of the proposed Green Shoe shares from the pre-issue shareholders. These shares are then allotted to investors along with the IPO shares. The total shares issued in the IPO therefore stands at 115,000 shares. IPO proceeds received from the investors for the IPO shares, i.e. Rs.100,00,000–100,000 shares at the rate of Rs.100 each, are remitted to the Issuer Company, while the proceeds from the Green Shoe Shares (Rs.15,00,000/-, being 15,000 shares x Rs.100/-) are parked in a special escrow bank account, i.e. Green Shoe Escrow Account. During the price stabilisation period, if the share price drops below Rs.100, the stabilising agent would utilise the funds lying in the Green Shoe Escrow Account to buy these back shares from the open market. This gives rise to the following three situations:

- **Situation #1** - where the stabilising agent manages to buyback all of the Green Shoe Shares, i.e., 15,000 shares;
- **Situation #2** - where the stabilising agent manages to buyback none of the Green Shoe Shares;
- **Situation #3** - where the stabilising agent manages to buy-back some of the Green Shoe Shares, say 10,000 shares.

Let us examine each of these situations separately:

**Situation #1** – Where all Green Shoe Shares are bought back: In this situation, funds in the Green Shoe Escrow Account (Rs.15,00,000, in this case) would be deployed by the stabilising agent towards buying up shares from the open market. Given that the prices prevalent in the market would be less than the issue price of Rs. 100, the stabilising agent would have sufficient funds lying at his disposal to complete this operation. Having bought back all of the 15,000 shares, these shares would be temporarily held in a special depository account with the depository participant (Green Shoe Demat Account), and would then be returned back to the lender shareholders, within a maximum period of two days after the stabilisation period.

**Situation #2** – Where none of the Green Shoe Shares are bought back: This situation would arise in the (very unlikely) event that the share prices have fallen below the Issue Price, but the stabilising agent is unable to find any sellers in the open market, or in an event where the share prices continue to trade above the listing price, and therefore there is no need for the stabilising agent to indulge in price stabilisation activities.

In either of the above-said situations, the stabilising agent is under a contractual obligation to return the 15,000 shares that had initially been borrowed from the lending shareholder(s). Towards meeting this obligation, the issuer company would allot 15,000 shares to the stabilising agent into the Green Shoe Demat Account (the

consideration being the funds lying the Green Shoe Escrow Account), and these shares would then be returned by the stabilising agent to the lending shareholder(s), thereby squaring off his responsibilities.

**Situation #3** – Where some of the Green Shoe Shares are bought back, say 10,000 shares: This situation could arise in an event where the share prices witness a drop in the initial stages of the price stabilisation period, but recover towards the latter stages.

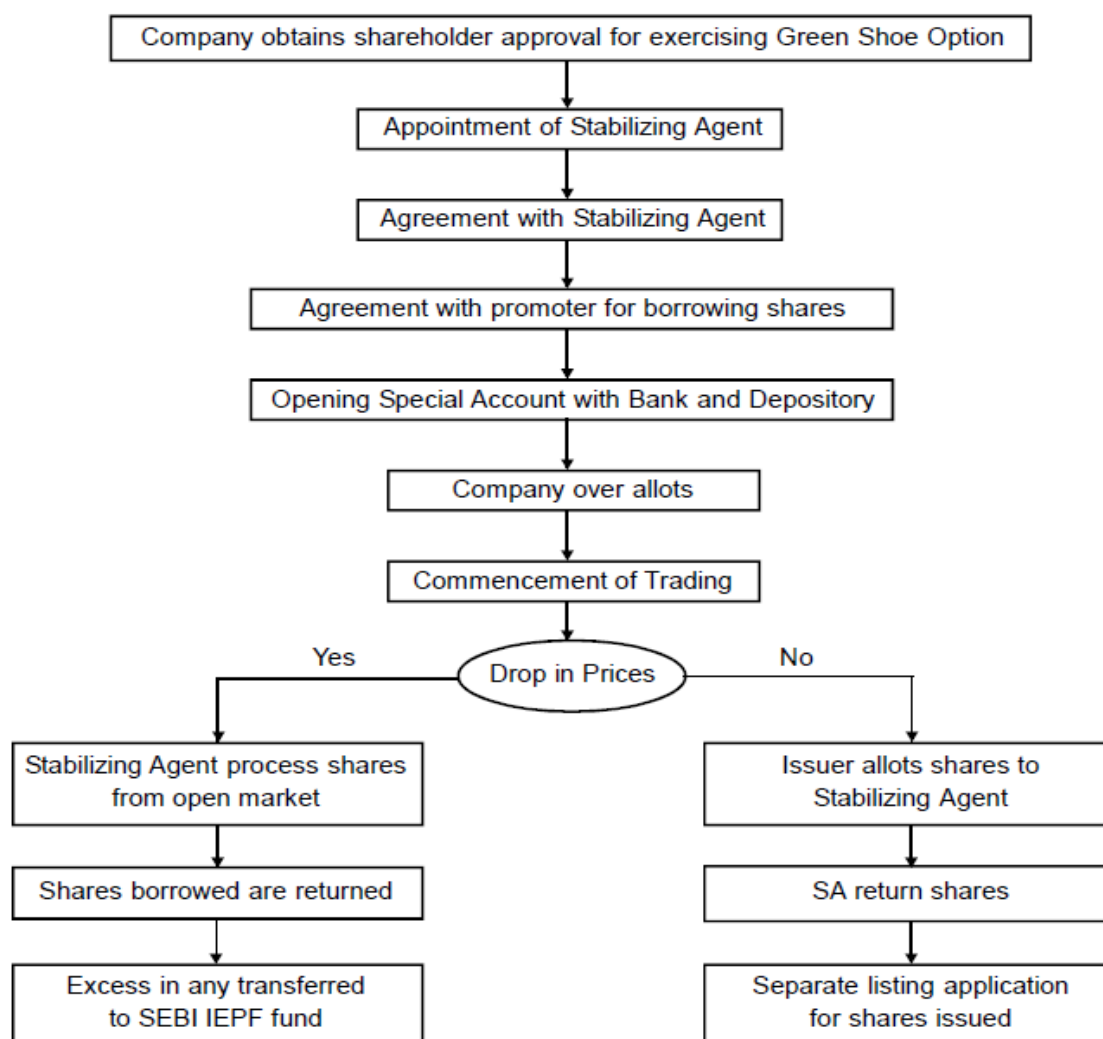
In this situation, the stabilising agent has a responsibility to return 15,000 shares to the lending shareholder(s), whereas the stabilising activities have yielded only 10,000 shares.

Similar to the instance mentioned in Situation #2 above, the issuer company would allot the differential 5,000 shares into the Green Shoe Demat Account to cover up the shortfall, and the Stabilising Agent would discharge his obligation to the lending shareholder(s) by returning the 15,000 shares that had been borrowed from them.

Both in Situation #2 and #3, the issuer company would need to apply to the exchanges for obtaining listing/trading permissions for the incremental shares allotted by them, pursuant to the Green Shoe mechanism.

Any surplus lying in the Green Shoe Escrow Account would then be transferred to the Investor Protection and Education Fund established by SEBI, as required under Regulation 45(9) of the ICDR Regulations and the account shall be closed thereafter.

#### GREEN SHOE OPTION PROCESS



**PART II. SECONDARY MARKET****LESSON OUTLINE**

- Stock Exchange
- Trading Mechanism
- Types of Securities
- Margins
- Book Closure and Record Date
- Bulk deal
- Basis of Sensex
- Nifty
- Market Surveillance
- Risk Management in Secondary Market
- Impact of various policies on Stock Markets
- LESSON ROUND UP
- GLOSSARY
- SELF TEST QUESTIONS

**LEARNING OBJECTIVES**

Index of Stock exchange is taken as a barometer of the economy of a country. It is the most dynamic and organised component of capital market. Especially, in developing countries like India, the stock exchanges play a cardinal role in promoting the level of capital formation through effective mobilisation of savings and ensuring investment safety. It is equally important to have the understanding of the governance of Stock Exchanges, and the services they provide to investors.

This part will enable the students to understand the Operation of stock exchanges, Stock Exchange Trading Mechanism, how NIFTY and SENSEX are calculated etc.

## STOCK EXCHANGE

Stock exchange is a 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.

The Securities Contracts (Regulation) Act, 1956, has defined Stock Exchange :

- (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, 2013 whether under a scheme of corporatisation and demutualisation or otherwise,

for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

Stock exchange as an organized security market provides marketability and price continuity for shares and helps in a fair evaluation of securities in terms of their intrinsic worth. Thus it helps orderly flow and distribution of savings between different types of investments. This institution performs an important part in the economic life of a country, acting as a free market for securities where prices are determined by the forces of supply and demand. Apart from the above basic function it also assists in mobilizing funds for the Government and the Industry and to supply a channel for the investment of savings in the performance of its functions.

The Stock Exchanges in India as elsewhere have a vital role to play in the development of the country in general and industrial growth of companies in the private sector in particular and helps the Government to raise internal resources for the implementation of various development programmes in the public sector. As a segment of the capital market it performs an important function in mobilizing and channelizing resources which remain otherwise scattered. Thus the Stock Exchanges tap the new resources and stimulate a broad based investment in the capital structure of industries.

Indian stock market marks to be one of the oldest stock market in Asia. It dates back to the close of 18th century when the East India Company used to transact loan securities. In the 1830s, trading on corporate stocks and shares in Bank and Cotton presses took place in Bombay. Though the trading was broad but the brokers were hardly half dozen during 1840 and 1850. An informal group of 22 stockbrokers began trading under a banyan tree opposite the Town Hall of Bombay from the mid 1850s, each investing a (then) princely amount of Rupee 1. This banyan tree still stands in the Horniman Circle Park, Mumbai. In 1860, the exchange flourished with 60 brokers.

In fact the 'Share Mania' in India began with the American Civil War broke and the cotton supply from the US to Europe stopped. Further the brokers increased to 250. The informal group of stockbrokers organized themselves as the Native Share and Stockbrokers Association which, in 1875, was formally organized as the Bombay Stock Exchange (BSE). In 1956, the Government of India recognized the Bombay Stock Exchange as the first stock exchange in the country under the Securities Contracts (Regulation) Act. National Stock Exchange of India Ltd. (NSE) was given recognition as a stock exchange under the Securities Contracts (Regulation) Act, 1956 in April 1993, NSE is India's 1st demutualized stock exchange and was demutualized from the date of its inception. NSE commenced operations in the Wholesale Debt Market (WDM) segment in June 1994 and commenced electronic trading in Capital Market 1st time in India in November 1994. NSE is also instrumental in bringing the dematerialization of trading in India.

Since the initiation of the financial liberalisation programme in 1992, there have been substantial regulatory, structural, institutional and operational changes in the securities market of the country. These reforms were carried out with the objective of improving market efficiency, enhancing transparency, preventing unfair trade practices and bringing the Indian securities market up to international standards.



## TRADING MECHANISM

In the Indian securities market various products trade like equity shares, warrants, debenture, etc. The trading in the securities of the company takes place in dematerialised form in India. Dematerialization is the process by which physical certificates of an investor are converted to an equivalent number of securities in electronic form and credited to the investor's account with his Depository Participant (DP). Trading in the securities of the company takes place on the screen based platforms provided by the Exchanges. Currently for equity shares the settlement cycle is (T+2 days) (T means trading day). Any shares which are traded on the Exchange is required to be settled by the clearing corporation of the exchange on 2 working day.

In electronic trading order received are matched electronically on a strict price/time priority and hence cuts down on time, cost and risk of error, as well as on fraud resulting in improved operational efficiency. It enables market participants, irrespective of their geographical locations, to trade with one another simultaneously. It provides full anonymity by accepting orders, big or small, from brokers without revealing their identity, thus providing equal access to everybody. It also provides a perfect audit trail, which helps to resolve disputes by logging in the trade execution process in entirety.

## TYPES OF SECURITIES

<b>Types of Securities</b>	Listed Securities	The securities of companies, which have signed the listing agreement with a stock exchange, are traded as "Listed Securities" in that exchange.
	Permitted Securities	To facilitate the market participants to trade in securities of such companies, which are actively traded at other stock exchanges in India but are not listed on an exchange, trading in such securities is facilitated as "permitted securities" provided they meet the relevant norms specified by the stock exchange.

## 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.

"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 scrip wise 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.

### 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 91 of the Companies Act, 2013 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/record date is necessary for the purpose of paying dividend, rights issue, bonus issue, etc. For the companies whose securities are listed on the Exchange are required to comply with the SEBI (LODR) Regulation 2015. As per SEBI (LODR) Regulation 2015 the companies are required to give 7 working days advance notice of book closure or record date to stock exchange where the securities of the companies are listed

### BLOCK DEAL

The SEBI vide letter MRD/DoP/SE/Cir - 19/05 dated September 02, 2005 and CIR/MRD/DP/118/2017 dated October 26, 2017 guidelines outlining a facility of allowing Stock Exchanges to provide separate trading window to facilitate execution of large trades. The Exchanges have introduced new block window mechanism for the block trades from January 01, 2018.

- Session Timings:
  - a) Morning Block Deal Window: This window shall operate between 08:45 AM to 09:00 AM.
  - b) Afternoon Block Deal Window: This window shall operate between 02:05 PM to 2:20 PM.
- In the block deal the minimum order size for execution of trades in the Block deal window shall be Rs.10 Crore.
- The orders placed shall be within  $\pm 1\%$  of the applicable reference price in the respective windows as stated above.
- The stock exchanges disseminate the information on block deals such as the name of the scrip, name of the client, quantity of shares bought/sold, traded price, etc to the general public on the same day, after the market hours

### BULK DEAL

Bulk deal is a trade, where total quantity bought or sold is more than 0.5% of the number of equity shares of a listed company.

Bulk deal can be transacted by the normal trading window provided by brokers throughout the trading hours in a day. Bulk deals are market driven and take place throughout the trading day.

The stock broker, who facilitates the trade, is required to reveal to the stock exchange about the bulk deals on a daily basis.

Bulk orders are visible to everyone. If the bulk deal happens through a single trade, it should be notified to the exchange immediately upon the execution of the order. If it happens through multiple trades, it should be notified to the exchange within one hour from the closure of the trading.

### BASIS OF SENSEX



Sensitive Index or Sensex is the stock market index indicator for the BSE. It is also sometimes referred to as BSE S&P Sensex. It was first published in 1986 and is based on the market weighed stock index of 30 companies based on the financial performance. The large, established companies that represent various industrial sectors are a part of this.

The calculation of Sensex is done by a Free-Float method that came into existence from September 1, 2003. The level of Sensex is a direct indication of the performance of 30 stocks in the market. The free-float method takes into account the proportion of the shares that can be readily traded in the market. This does not include the ones held by various shareholders and promoters or other locked-in shares not available in the market.

*Steps to calculate Sensex:*

- The market capitalization is taken into account. This is done by multiplying all the shares issued by the company with the price of its stock.
- BSE determines a Free-float factor that is a multiple of the market capitalization of the company. This helps in determining the free-float market capitalization based on the details submitted by the company.
- Ratio and Proportion are used based on the base index of 100. This helps to determine the Sensex.

## NIFTY

National Stock Exchange Fifty or Nifty is the market indicator of NSE. It is a collection of 50 stocks. It is also referred to as Nifty 50. It is owned and managed by India Index Services and Products Ltd. (IISL).

Nifty is calculated through the free-float market capitalization weighted method. It multiplies the Equity capital (expressed in terms of number of shares outstanding) with a price to derive the market capitalization. To determine the Free-float market capitalization, equity capital (as stated earlier) is multiplied by a price which is further multiplied with IWF which is the factor for determining the number of shares available for trading freely in the market. The Index is determined on a daily basis by taking into consideration the current market value (free float market capitalization) divided by base market capital and then multiplied by the Base Index Value of 1000.

## MARKET SURVEILLANCE

Market surveillance plays a vital role in ensuring market integrity which is the core objective of regulators. Market integrity is achieved through combination of surveillance, inspection, investigation and enforcement of relevant laws and rules.

Globally market surveillance is either conducted by the Regulators or Exchanges or both. In India, the primary responsibility of market surveillance has been entrusted to Stock exchanges and is being closely monitored by SEBI.

Millions of Orders are transmitted electronically every minute and therefore surveillance mechanisms to detect any irregularities must also be equally developed. Exchanges adopt automated surveillance tools that analyse trading patterns and are installed with a comprehensive alerts management system.

Market Surveillance is broadly categorised in 2 parts viz, Preventive Surveillance and Post trade Surveillance

### A. Preventive Surveillance –

- **Stringent On boarding norms for Trading Members** - Stringent net worth, back ground, viability etc. checks while on boarding Trading Members.
- **Index circuit filters** - It brings coordinated trading halt in all equity and equity derivative markets at 3 stages of the index movement, either way viz., at 10%, 15% and 20% based on previous day closing index value.

- **Trade Execution Range** - Orders are matched and trades take place only if the trade price is within the reference price and execution range.
- **Order Value Limitation** - Maximum Order Value limit allowed per order.
- **Cancel on logout** - All outstanding orders are cancelled, if the enabled user logs out.
- **Kill switch** - All outstanding orders of that trading member are cancelled if trading member executes kill switch.
- **Risk reduction mode** - Limits beyond which orders level risk management shall be initiated instead of trade level.
- **Compulsory close out** - Incoming order, if it results in member crossing the margins available with the exchange, such order will be partially or fully cancelled, as the case may be, and further disallow the trading member to create fresh positions.
- **Capital adequacy check** - Refers to monitoring of trading member's performance and track record, stringent margin requirements, position limits based on capital, online monitoring of member positions and automatic disablement from trading when limits are breached
- **Fixed Price Band / Dynamic Price band** - Limits applied within which securities shall move; so that volatility is curbed orderliness is brought about. For non-derivative securities price band is 5%, 10% & 20%. For Derivative products an operating range of 10% is set and subsequently flexed based on market conditions.
- **Trade for Trade Settlement** - The settlement of scrip's available in this segment is done on a trade for trade basis and no netting off is allowed.
- **Periodic call auction** - Shifting the security from continuous to call auction method
- **Rumour Verification** - Any unannounced news about listed companies is tracked on online basis and letter seeking clarification is sent to the companies and the reply received is disseminated

#### B. Post trade surveillance -

- **End of day alert** – Alerts generated using statistical tools. The tool highlights stocks which have behaved abnormally from its past behaviour
- **Pattern recognition model** – Models designed using high end tools and trading patterns which itself identifies suspects involving in unfair trading practise.
- **Transaction alerts for member** - As part of surveillance obligation of members the alerts are downloaded to members under 14 different heads.

Preventive approach adapted by Exchange / SEBI has been fruitful. However, they are fully aware that the suite of measure in force have to be upgraded, expanded and added to be able to successful in this preventive approach.

SEBI has introduced various market surveillance measure like price bank, circuit filter, trade for trade segment,

### RISK MANAGEMENT IN SECONDARY MARKET

The performance of secondary market has a vital bearing on the performance of primary market. A number of measures were taken to modernise the stock exchanges in the country. These measures focussed on infrastructure development, transparency, efficiency and enhanced investor protection. Risk management was further strengthened during the year by implementing a comprehensive system of margins, exposure limits and improving the efficiency of clearing and settlement systems through the introduction of settlement guarantee funds. With a view to enhancing market safety, SEBI fixed intra-day trading and gross exposure limits for brokers.

SEBI continued to maintain a constant interface with the stock exchanges on various issues concerning investor protection, automated market infrastructure and overall improvement in quality of intermediation. SEBI also directed its efforts towards encouraging the stock exchanges to become effective as self-regulatory institutions. Automated screen based trading which was introduced in the country through the setting up of the OTCEI and NSE and subsequently introduced by the BSE had brought about a qualitative improvement in the market and its transparency. Transaction costs and time were also significantly reduced. During the year several of the smaller exchanges also introduced on-line screen based trading. The key risk management measures initiated by SEBI include:-

- Categorization of securities into groups 1, 2 and 3 for imposition of margins based on their liquidity and volatility.
- VaR based margining system.
- Specification of mark to Market margins.
- Specification of Intra-day trading limits and Gross Exposure Limits.
- Real time monitoring of the Intra-day trading limits and Gross Exposure Limits by the Stock Exchanges.
- Specification of time limits of payment of margins.
- Collection of margins on upfront basis.
- Index based market wide circuit breakers.
- Automatic de-activation of trading terminals in case of breach of exposure limits.
- VaR based margining system has been put in place based on the categorization of stocks based on the liquidity of stocks depending on its impact cost and volatility. It addresses 99% of the risks in the market.
- Additional margins have also been specified to address the balance 1% cases.
- Collection of margins from institutional clients on T+1 basis.

## IMPACT OF VARIOUS POLICIES ON STOCK MARKETS

### 1. FED Policy

The Federal Reserve System is the central bank of the United States. It performs five general functions to promote the effective operation of the U.S. economy and, more generally, the public interest. The Federal Reserve:

- conducts the nation's monetary policy to promote maximum employment, stable prices, and moderate long-term interest rates in the U.S. economy;
- promotes the stability of the financial system and seeks to minimize and contain systemic risks through active monitoring and engagement in the U.S. and abroad;
- promotes the safety and soundness of individual financial institutions and monitors their impact on the financial system as a whole;
- fosters payment and settlement system safety and efficiency through services to the banking industry and the U.S. government that facilitate U.S.-dollar transactions and payments; and
- promotes consumer protection and community development through consumer-focused supervision and examination, research and analysis of emerging consumer issues and trends, community economic development activities, and the administration of consumer laws and regulations.

### How change in US Fed rate can impact India?

The Fed Funds Rate is the interest rate at which the top US banks borrow overnight money from common reserves. All American banks are required to park a portion of their deposits with the Federal Reserve in cash, as a statutory requirement.

Actually, fed fund rate gives the direction in which US interest rates should be heading at any given point of time. If the Fed is increasing the interest rates, lending rates for companies and retail borrowers will go up and vice versa. In India, hike in repo rate may not impact the countries outside India. On the other hand, US interest rates matter a lot to global capital flows. Some of the world's richest institutions and investors have their base in USA. They constantly compare Fed rates with interest rates across the world to make their allocation decisions.

In the globalised world, markets are connected. An increase in Fed rates will be negative in general for the US stock market and if it leads to another round of sell-offs, it will also have ripple effects on the Indian market.

Any changes in the Fed Fund Rates impact the domestic borrowing market to a large extent. For instance, if the Fed rates go up, it will make the RBI hesitant in cutting rates at that time. The reason is that if RBI cut rates it will lead to heavy pullout of foreign investors from the Indian bond market.

#### Rupee Vs Dollar:

If the Fed rates are hiked, the value of the dollar would go up, thus weakening Indian rupee in comparison. This might hurt India's forex reserves and imports. However, the weaker rupee is good for India's exports but low global demand and stiff competition would not leave much room for Indian exporters to capitalise the situation. DBS said that India's financing requirements will keep the rupee vulnerable to rising US rates this year.

#### Bond market pressure:

Due to the higher Fed rates, US' 10-year bond yields are expected to go up, which will also put pressure on India's 10-year government bond yields.

#### RBI repo rate:

With higher Fed rates weakening the Rupee, India's imports bill is likely to go up putting pressure on the RBI to either increase repo rates or at least refrain from cutting rates in the upcoming monetary policy meetings.

## 2. Credit Policy of RBI

The Reserve Bank of India has a credit policy which aims at pursuing higher growth with price stability. Higher economic growth means to produce more quantity of goods and services in different sectors of an economy; The term monetary policy is also known as RBI's credit policy or money management policy. It is basically the central bank's view on what should be the supply of money in the economy and also in what direction the interest rates should move in the banking system. It refers to the use of credit policy instruments which are at the disposal of central bank to regulate the availability, cost and use of money and credit to promote economic growth, price stability, optimum levels of output and employment, balance of payments equilibrium, stable currency or any other goal of government's economic policy.

The credit policy aims at increasing finance for the agriculture and industrial activities. When credit policy is implemented, the role of other commercial banks is very important. Commercial banks flow of credit to different sectors of the economy depends on the actual cost of credit and availability of funds in the economy.

The objectives of a monetary policy are similar to the five year plans of our country. In a nutshell it is basically a plan to ensure growth and stability of the monetary system. The significance of the monetary policy is to attain the following objectives.

1. **Rapid Economic Growth:** It is an important objective as it can play a decisive role in the economic

growth of country. It influences the interest rates and thus has an impact on the investment. If the RBI adopts an easy credit policy, it would be doing so by reducing interest rates which in turn would improve the investment outlook in the country. This would in turn enhance the economic growth. However faster economic growth is possible if the monetary policy succeeds in maintaining income and price stability

2. **Exchange Rate Stability:** Another important objective is maintaining the exchange rate of the home currency with respect to foreign currencies. If there is volatility in the exchange rate, then the international community loses confidence in the economy. So it is necessary for the monetary policy to maintain the stability in exchange rate. The RBI by altering the foreign exchange reserves tries to influence the demand for foreign exchange and tries to maintain the exchange rate stability.
3. **Price Stability:** The monetary policy is also supposed to keep the inflation of the country in check. Any economy can suffer both inflation and deflation both of which are harmful to the economy. So the RBI has to maintain a fair balance in ensuring that during recession it should adopt an 'easy money policy' whereas during inflationary trend it should adopt a 'dear money policy'
4. **Balance of Payments (BOP) Equilibrium:** Another key objective is to maintain the BOP equilibrium which most of the developing economies don't tend to have. The BOP has two aspects which are 'BOP surplus' and 'BOP deficit'. The former reflects an excess money supply in the domestic economy, while the latter stands for stringency of money. If the monetary policy succeeds in maintaining monetary equilibrium, then the BOP equilibrium can be achieved.
5. **Neutrality of Money:** RBI's policy should regulate the supply of money. It is possible that the change in money supply causes disequilibrium and the monetary policy should neutralize it. However this objective of a monetary policy is always criticized on the ground that if money supply is kept constant then it would be difficult to attain price stability.

**Bank Rate:** is the rate at which RBI discount bills for commercial banks. This banking system involves commercial and Co-operative Banks, Industrial Development Bank of India, IFC, EXIM Bank and other approved financial institutions. Funds are provided through lending directly or rediscounting or buying money market instruments like Commercial Bills or Treasury Bills. Increase in Bank Rate increases the cost of borrowing by commercial banks which results in the reduction of credit volume to the banks and hence declines the money supply. Increase in Bank Rate means tightening of RBI's Monetary Policy.

#### ***Various Quantitative instrument of Credit Policy***

**Repo Rate:** The rate at which the Commercial Banks borrow money from RBI. Reduction in Repo Rate helps the Commercial Banks to get money at a cheaper rate and an Increase in Repo Rate discourages the Commercial Banks to get money as the rate increases and becomes expensive. The increase in the Repo Rate will increase the cost of borrowing and lending of the banks which will discourage the public to borrow money and encourages them to deposit.

**Cash Reserve Ratio (CRR) :** Cash reserve ratio is the amount which the commercial banks have to maintain as cash deposit with the Reserve Bank of India. RBI may increase the CRR if it thinks that there is large amount of money supply in the economy. Conversely, it will decrease the CRR if it is of the opinion that inflation is in control and the industry needs a monetary boost up. The reduction in CRR will provide more money in the hands of commercial banks which it will pass it on to the industry. More money in the hands of industry will boost up production, consumption and employment. The cash reserve ratio as on 22nd August, 2017 is 4%.

**Statutory Liquidity Ratio (SLR) :** Statutory Liquidity Ratio is the amount which commercial banks have to keep it with itself. So, SLR is the amount of money which banks have to keep in its custody at all times. SLR is also a very powerful tool to control liquidity in the economy. To encourage industries to boost up their production, SLR may be decreased to put more money in the hands of commercial banks. An increase in SLR

is used as an inflation control measure to control price rise.

**Reverse Repo Rate (RRR):** is the rate at which the RBI borrows money from the Commercial Banks. An increase in the reverse repo rate will decrease the money supply and vice-versa, other things remaining constant. An increase in Reverse Repo Rate means that Commercial Banks will get more incentives to park their funds with the RBI, therefore decreasing the supply of money in Market. An increase in the Repo Rate and the Reverse Repo rate indicates strengthening of RBI's Monetary Policy.

### 3. Inflation Index

An index is just a collection of data that serves as a baseline for future reference. We use the index model in all areas of life, from the stock market, to inflation. We index wage levels, corporate profits as a percentage of GDP, and almost anything else that can be measured. We do this to compare where we are now to where we have been in the past.

An inflation index is an economic tool used to measure the rate of inflation in an economy. There are several different ways to measure inflation, leading to more than one inflation index with different economists and investors preferring one method to another, sometimes strongly.

#### Inflation Indices

In India, Consumer Price Index (CPI) and Wholesale Price Index (WPI) are two major indices for measuring inflation. In United States, CPI and PPI (Producer Price Index) are two major indices.

The Wholesale Price Index (WPI) was main index for measurement of inflation in India till April 2014 when RBI adopted new Consumer Price Index (CPI) (combined) as the key measure of inflation.

#### a. Wholesale Price Index

Wholesale Price Index (WPI) is computed by the Office of the Economic Adviser in Ministry of commerce & Industry, Government of India. It was earlier released on weekly basis for Primary Articles and Fuel Group. However, since 2012, this practice has been discontinued. Currently, WPI is released monthly.

Salient notes on WPI are as follows:

#### Base Year

Current WPI Base year is 2004-05=100. Its worth note that the base year for CPI is 2012 currently. This is one reason for increasing difference between CPI and WPI in recent times.

#### Items

There are total 676 items in WPI and inflation is computed taking 5482 Price quotations. These items are divided into three broad categories viz. (1) Primary Articles (2) Fuel & power and (3) Manufactured Products.

WPI does not take into consideration the retail prices or prices of the services.

#### b. Consumer Price Index

Consumer Price Indices (CPI) released at national level are:

- CPI for Industrial Workers (IW)
- CPI for Agricultural Labourers (AL)/ Rural Labourers (RL)
- CPI (Rural/Urban/Combined).

While the first two are compiled and released by the Labour Bureau in the Ministry of Labour and Employment, the third by the Central Statistics Office (CSO) in the Ministry of Statistics and Programme Implementation. In



India, RBI uses CPI (combined) released by CSO for inflation purpose. Important notes on this index are as follows

### Base Year

Base year for CPI (Rural, Urban, Combined) is 2012=100.

### Number of items

The number of items in CPI basket include 448 in rural and 460 in urban. Thus, it makes it clear that CPI basket is broader than WPI basket. The items in CPI are divided into 6 main groups.

### Key differences between WPI & CPI

- Primary use of WPI is to have inflationary trend in the economy as a whole. However, CPI is used for adjusting income and expenditure streams for changes in the cost of living.
- WPI is based on wholesale prices for primary articles, administered prices for fuel items and ex-factory prices for manufactured products. On the other hand, CPI is based on retail prices, which include all distribution costs and taxes.
- Prices for WPI are collected on voluntary basis while price data for CPI are collected by investigators by visiting markets.
- CPI covers only consumer goods and consumer services while WPI covers all goods including intermediate goods transacted in the economy.
- WPI weights primarily based on national accounts and enterprise survey data and CPI weights are derived from consumer expenditure survey data.

### Impact of Policies on Indian Stock Market

Since monetary policies are influenced by inflation and inflationary expectations in the economy it is therefore, critical that inflation index should be able to predict future inflation with reasonable accuracy. Generally, when a country is operating in a low interest rate regime, borrowers can borrow money at a lower interest rate. This aids in increased purchasing power of the consumers. The demand for the goods increase and subsequently sensing a higher demand, the prices will also raise. This condition drives the inflation rates higher. When the inflation rates raise more than the optimal levels, the Reserve Bank of India (RBI) steps into increase interest rate to control inflation rate. When inflationary pressure starts building in the economy RBI hikes the repo rate and/or cash reserve ratio (CRR) to manage the money supply causing higher inflation.

Maintaining an optimal inflation rate is the primary task of Monetary Policy decision makers of any nation. An optimal inflation rate ensures a healthy economy. More often than not, the policy makers tend to spur growth in a stalled economy by slashing the interest rates, thereby increasing the money available in the markets. However, in order to implement such rate cuts the inflation rate should be at an optimal level. So, it becomes a prime responsibility of Reserve Bank to monitor Wholesale Price Index (WPI) and Consumer Price Index (CPI) to ensure that economy is balance.

A rise in the inflation rate impacts market sentiments. A higher inflation rate drives the interest rates higher and hence borrowing becomes costly for the banks, corporates and financial institutions. Therefore, the valuations of capital-intensive companies and sectors may come under pressure as their margins decrease due to the higher interest burden.

However, the markets are governed by many factors and the direction cannot be determined by reading just one factor. Global sentiments and global funds inflows are other crucial factors that impact the direction of stock markets significantly.

### LESSON ROUND UP

- A wide variety of financial institutions have been set up at the national level. They include development banks like IDBI, SIDBI, IFCI, IIBI; specialised financial institutions like IVCF, ICICI Venture Funds Ltd, TFCI and investment institutions like LIC, GIC, UTI; etc.
- All FPIs are required to be mandatorily registered into three broad categories i.e. Category I, Category II, Category III under SEBI (Foreign Portfolio Investors) Regulations, 2014
- Venture Capital is generally equity investments made by Venture Capital funds, at an early stage in privately held companies, having potential to provide a high rate of return on their investments.
- Debenture is a document evidencing a debt or acknowledging it and any document which fulfils either of these conditions is a debenture.
- The FCCBs are unsecured instruments which carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company.
- Issue of IDRs is regulated by section 390 of the Companies Act, 2013, Rule 13 of the Companies (Registration of Foreign Companies) Rules, 2014 and Chapter X & XA of SEBI (ICDR) Regulations, 2009.
- 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.
- ASBA is an application for subscribing to an issue, containing an authorization to block the application money in a bank account.
- Stock exchange is a market place for buying and selling of securities and ensuring liquidity to them in the interest of the investors.
- Securities traded in the stock exchanges can be classified as Listed cleared Securities and Permitted Securities.
- The trading in the securities of the company takes place in dematerialised form in India.
- There are various factors and monetary policies which has a significant impact on the working of stock markets in India like RBI Monetary Policy, Consumer Price Index (CPI) , Wholesale Price Index (WPI) and US FED Policy

### GLOSSARY

<b>Circuit Breaker</b>	A system to curb excessive speculation in the stock market, applied by the Stock Exchange authorities, when the index spurts or plunges by more than a specified per cent. Trading is then suspended for some time to let the market cool down.
<b>Clearing</b>	Settlement or clearance of accounts, for a fixed period in a Stock Exchange
<b>Closing Price</b>	The rate at which the last transaction in a security is struck before the close of the trading hours.
<b>Credit Risk</b>	The risk that a counterparty will not settle an obligation for full value, either when due or at any time thereafter. Credit risk includes pre-settlement risk (replacement cost risk) and settlement risk (Principal risk).
<b>Demutualization</b>	Process of transition from “mutually-owned” association to a company “owned by shareholders”. In other words, transformation of the legal structure from a mutual



	form to a business corporation form and privatisation of the corporations so constituted, is referred to as demutualization.
<b>Fill or Kill (FoK) Order</b>	An order that requires the immediate purchase or sale of a specified amount of stock, though not necessarily at one price. If the order cannot be filled immediately, it is automatically cancelled (killed)
<b>Interest Rate Risk</b>	The risk that movements in the interest rates may lead to a change in expected return.
<b>Liquidity Adjustment Facility (LAF)</b>	Under the scheme, repo auctions (for absorption of liquidity) and reverse repo auctions (for injection of liquidity) will be conducted on a daily basis (except Saturdays). It will be same-day transactions, with interest rates decided on a cut-off basis and derived from auctions on a uniform price basis.
<b>Mark to market margin (MTM)</b>	Collected in cash for all Futures contracts and adjusted against the available Liquid Net worth for option positions. In the case of Futures Contracts MTM may be considered as Mark to Market Settlement.
<b>Market Maker</b>	A member firm who give two way quotation for particular security (ies) and who is under an obligation to buy and sell them subject to certain conditions such as overall exposure, spread etc.
<b>Netting:</b>	A system whereby outstanding financial contracts can be settled at a net figure, i.e. receivables are offset against payables to reduce the credit exposure to a counterparty and to minimize settlement risk.
<b>Screen based trading</b>	Form of trading that uses modern telecommunication and computer technology to combine information transmission with trading in financial markets.
<b>Trading member</b>	A member of the derivatives exchange or derivatives segment of a stock exchange who settles the trade in the clearing corporation or clearing house through a clearing member.

### SELF TEST QUESTIONS

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

1. Briefly explain about different types of national level financial institutions.
2. What do you understand by private equity? Discuss about different categories of private equity.
3. What are the conditions for issue of Shares with differential voting rights under Companies Act, 2013?
4. What do you understand by Book Building? Explain briefly the book building process.
5. Briefly explain about the impact of various monetary policies on Indian stock market.



# Lesson 16

## Securities Market Intermediaries

### LESSON OUTLINE

- Introduction
- Internal Audit of Intermediaries by Company Secretary in Practice
- Role of Company Secretary
- LESSON ROUND UP
- GLOSSARY
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

Intermediaries are service providers and are an integral part of any financial system. SEBI regulates various intermediaries in the primary and secondary markets through its various Regulations for these respective intermediaries. SEBI has defined the role of each of the intermediary, the eligibility criteria for granting registration, their functions and responsibilities and the code of conduct to which they are bound. These Regulations also empower SEBI to inspect the functioning of these intermediaries and to collect fees from them and to impose penalties on erring entities.

This lesson will enable the students to know about the role and responsibilities of intermediaries and regulatory framework of the intermediaries operating in the Primary and the Secondary markets. Further, the student will be get to know about the internal audit of various intermediaries where a Company Secretary is authorised to conduct such audit.

## INTRODUCTION

The capital market intermediaries are vital link between investor, issuer and regulator. The objective of these intermediaries is to smoothen the process of investment and to establish a link between the investors and the users of funds.

Corporations and Governments do not market their securities directly to the investors. Instead, they hire the services of the market intermediaries to represent them to the investors. Investors, particularly small investors, find it difficult to make direct investment. A small investor desiring to invest may be able to diversify across issuers to reduce risk. He may not be equipped to assess and monitor the credit risk of issuers. Market intermediaries help investors to select investments by providing investment consultancy, market analysis and credit rating of investment instruments.

In order to operate in secondary market, the investors have to transact through share brokers. Registrars and Share Transfer Agents, Custodians and Depositories Participants are capital market intermediaries that provide important infrastructure services for both primary and secondary markets.

According to SEBI (Intermediaries) Regulations, 2008, “intermediary” means a person mentioned in clauses (b) and (ba) of sub-section (2) of section 11 and sub-section (1) and (1A) of section 12 of the Act and includes an asset management company in relation to the SEBI (Mutual Funds) Regulations, 1996, a clearing member of a clearing corporation or clearing house and a trading member of a derivative segment or currency derivatives segment of a stock exchange **but does not include foreign institutional investor, foreign venture capital investor, mutual fund, collective investment scheme and venture capital fund.**

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.

These Regulations also empower SEBI to inspect the functioning of these intermediaries and to collect fees from them and to impose penalties on erring entities. 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 advisers and such other intermediaries who may be associated with securities market in any manner.

The following market intermediaries are involved in the Securities Market:

- Merchant Bankers
- Registrars and Share Transfer Agents
- Underwriters
- Bankers to an issue
- Debenture Trustees
- Stock-brokers and sub-brokers
- Portfolio managers
- Custodians of Securities
- Investment Advisers
- Research Analysts
- Credit Rating Agencies
- Depository Participant

**REGULATORY FRAMEWORK OF INTERMEDIARIES**

SI No.	Intermediary Name	Definition	Role and Responsibilities	SEBI Regulation	Net worth Requirement
1.	Merchant Banker	'Merchant Banker' means any person engaged in the business of issue management either 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.	It is necessary for an issuer to appoint a merchant banker for : (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	SEBI (Merchant Bankers) Regulations, 1992	Not less than five crore rupees.
2.	Registrars and Share Transfer Agents	'Registrar to an Issue' means the person appointed by a body corporate or any person or group of persons to carry on the following activities on its or his or their behalf : (i) collecting application for investor in respect of an issue;	<b>Pre-issue Activities</b> <ul style="list-style-type: none"> <li>• Sending instructions to Banks for reporting of collection figures and collection of applications.</li> <li>• Providing Practical inputs to the Lead Manager and Printers regarding the design of the Bid cum-</li> <li>• Application form.</li> </ul>	SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993	Capital adequacy requirement (networth) for category I is Rs. 50,00,000 and category II is Rs. 25,00,000.

		<p>(ii) keeping a proper record of applications and monies received from investors or paid to the seller of the securities; and</p> <p>(iii) assisting body corporate or person or group of persons in</p> <p>(a) determining the basis of allotment of the securities in consultation with the stock exchange;</p> <p>(b) finalising the list of person entitled to allotment of securities;</p> <p>(c) processing and dispatching of allotment letters, refund orders or certificates and other related documents in respect of the issue;</p> <p>'Share Transfer Agent' means:</p> <p>(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;</p> <p>(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.</p>	<ul style="list-style-type: none"> <li>Facilitate and establish information flow system between clients, Banks and Managers to the issue.</li> <li>Liaison with Regulatory Authorities such as SEBI &amp; Stock Exchanges.</li> </ul> <p><b>Activities during the Issue</b></p> <ul style="list-style-type: none"> <li>Collection and Reporting of daily Collection figures.</li> <li>Collection of Data and Forms from Banks.</li> <li>Liaising with clients and Intermediaries to the Issue.</li> </ul> <p><b>Post Issue Activities</b></p> <ul style="list-style-type: none"> <li>Data capturing &amp; validation</li> <li>Reconciliation</li> <li>Provide Allotment Alternatives in consultation with Client / Merchant Banker and Stock Exchanges</li> <li>Facilitating Listing</li> <li>Uploading of data to the Depositories for crediting of securities electronically</li> <li>Dispatch of Refund orders / Share Certificates / Credit Advise</li> <li>Periodic Report submission to Regulatory Authorities</li> <li>Reconciliation of Refund payments</li> <li>Attending to post issue Investor queries</li> <li>Web-based investor enquiry system for allotment / refund details</li> </ul> <p><b>Share Transfer Agent Services</b></p>		
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3.	Underwriters	<p>Underwriter means a person who engages in the business of underwriting of an issue of securities of a body corporate. 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.</p> <p><b>Underwriting is compulsory for a public issue.</b></p>	It is the underwriter who agrees to take up securities which are not fully subscribed in a public issue. The Underwriter makes a commitment to get the issue subscribing either by others or by themselves.	SEBI (Under Writers) Regulations, 1993	Not less than Rs. 20 lakhs.
4.	Bankers to an issue	<p>Banker to an Issue means a scheduled bank carrying on all or any of the following activities:</p> <p>(i) Acceptance of application and application monies;</p> <p>(ii) Acceptance of allotment or call monies;</p> <p>(iii) Refund of application monies;</p> <p>(iv) Payment of dividend or interest warrants.</p>	Bankers to the issue, as the name suggests, carries out all the activities of ensuring that the funds are collected and transferred to the Escrow accounts. 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.	SEBI (Bankers To an Issue) Regulations, 1994	--
5.	Debenture Trustees	Debenture Trustee' means a trustee of a trust deed for securing any issue of debentures of a body corporate.	<ul style="list-style-type: none"> <li>– Call for periodical reports from the body corporate, i.e., issuer of debentures.</li> <li>– Take possession of trust property in accordance with the provisions of the trust deed.</li> <li>– Enforce security in the interest of the debenture holders.</li> </ul>	SEBI (Debenture Trustees) Regulations, 1993	Not less than Rs. 2 crores

			<ul style="list-style-type: none"> <li>– Ensure on a continuous basis that the property charged to the debenture is available and adequate at all times to discharge the interest and principal amount payable in respect of the debentures and that such property is free from any other encumbrances except those which are specifically agreed with the debenture trustee.</li> <li>– 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.</li> <li>– 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.</li> <li>– To ascertain that the debentures have been converted or redeemed in accordance with the provisions and conditions under which they are offered to the debenture holders.</li> <li>– Inform the SEBI immediately of any breach of trust deed or provision of any law.</li> <li>– Appoint a nominee director on the board of the body corporate when required.</li> </ul>		
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6.	Stock-brokers and sub-brokers	<ul style="list-style-type: none"> <li>• Stock-broker means a member of stock exchange and they are the intermediaries who are allowed to trade in securities on the exchange of which they are members. They buy and sell on their own behalf as well as on behalf of their clients.</li> <li>• Sub-broker means any person not being a member of stock exchange who acts on behalf of a stock broker as an agent or otherwise for assisting the investors in buying, selling or dealing in securities through such stock brokers and includes a trading members.</li> </ul>	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. 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.	SEBI (Stock Brokers & Sub-Brokers) Regulations, 1992	As specified in Schedule VI of the Regulation.
7.	Portfolio managers	<p>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.</p> <p>“Discretionary portfolio manager” is defined as portfolio manager who exercises or may exercise, under a contract relating to portfolio management, exercise any degree of discretion as to the investment or the management of the portfolio of the securities or the funds of the client.</p> <p>“Portfolio” means the total holdings of securities belonging to any person.</p>	A portfolio manager plays a pivotal role in deciding the best investment plan for an individual as per his income, age as well as ability to undertake risks. A portfolio manager is responsible for making an individual aware of the various investment tools available in the market and benefits associated with each plan. Make an individual realize why he actually needs to invest and which plan would be the best for him. A portfolio manager is responsible for designing customized investment solutions for the clients according to their financial needs.	SEBI (Portfolio Managers) Regulations, 1993	Not less than Rs. 2 crores

8.	Custodians of Securities	A custodian is a person who carries on the business of providing custodial services to the client. The custodian keeps the custody of the securities of the client. The custodian also provides incidental services such as maintaining the accounts of securities of the client, collecting the benefits or rights accruing to the client in respect of securities.	<ul style="list-style-type: none"> <li>• Administrate and protect the assets of the clients.</li> <li>• Open a separate custody account and deposit account in the name of each client.</li> <li>• Record assets.</li> <li>• Conduct registration of securities.</li> </ul>	SEBI (Custodian of Securities) Regulations, 1996	Minimum of Rs. 50 crores.
9.	Investment Advisers	“Investment Adviser” means any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called.	Investment advisers are those, who guide one about his or her financial dealings and investments. Basically Investment adviser give advice and provide services related to the investment management process. The Investment adviser shall done the risk profiling for clients to assess their risks.	SEBI (Investment Advisers) Regulations, 2013	A minimum net worth of RS. 25 lakh while individuals and partnership firms will require to possess tangible assets worth at least Rs. 1 lakh.
10.	Research Analysts	“Research analyst” means a person who is primarily responsible for,- i. preparation or publication of the content of the research report; or ii. providing research report; or iii. making ‘buy/sell/hold’ recommendation; or iv. giving price target; or	They study Companies and industries, analyse raw data, and make forecasts or recommendations about whether to buy, hold or sell securities. They analyse information to provide recommendations about investments in securities to their clients. Investors often view analysts as experts and important sources of information about the securities they review and often rely on their advice. There are basically three broad types of analysts, viz. sell-side analysts, buy-side analysts and independent analysts.	SEBI (Research Analysts) Regulations, 2014	<ul style="list-style-type: none"> <li>• Body corporate or limited liability partnership firm – not less than Rs. 25 Lakh</li> <li>• Individual or partnership firm shall have net tangible assets of value not less than Rs. 1 Lakh</li> </ul>

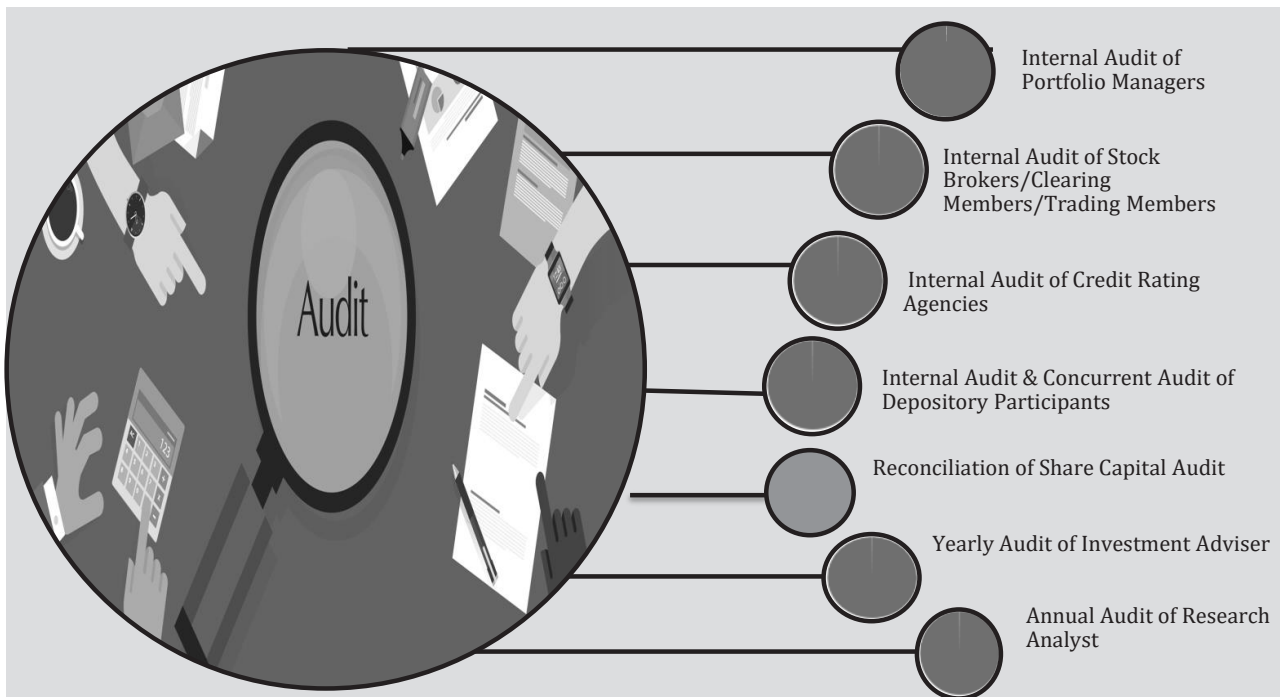
		v. offering an opinion concerning public offer, with respect to securities that are listed or to be listed in a stock exchange, whether or not any such person has the job title of 'research analyst' and includes any other entities engaged in issuance of research report or research analysis.			
11.	Credit Rating Agencies	"Credit rating agency" means a body corporate which is engaged in, or proposes to be engaged in, the business of rating of securities offered by way of public or rights issue.	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 mobilization 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.	SEBI (Credit Rating Agencies) Regulations, 1999	Minimum net worth of Rs. 5 crores
12.	Depository Participant	A DP is an agent of the depository through which it interfaces with the investor and provides depository services.	Depository Participant (DP) is described as an Agent (law) of the depository. They are the intermediaries between the depository and the investors.  They execute pledge requests and off market transfers and on market transfer request of the investors who hold shares in demat form.  Further transmission requests of investors shall also be handled. Demat/Remat requests also handled in consultation with RTI/ STAs.	SEBI Depositories and Participants) Regulations, 1996	Depository- Not less than Rs. one hundred crores  Participant- Regulation 19

**Apart from the above respective SEBI regulations, Intermediaries are also governed by the following regulations:**

- SEBI {KYC (Know Your Client) Registration Agency (KRA)}, Regulations, 2011
- SEBI (Intermediaries) Regulations, 2008
- Prevention of Money Laundering Act, 2002 and SEBI master circular on PMLA

### INTERNAL AUDIT OF INTERMEDIARIES BY COMPANY SECRETARY IN PRACTICE

Efficient internal control systems and processes are pre-requisite for good governance. The governance being a dynamic concept requires constant evaluation and monitoring of the systems and processes. In the context of Capital Markets, capital markets intermediaries are an important constituent of overall governance framework. Being an important link between regulators, investors and issuers, they are expected to ensure that their internal controls are so efficient that ensure effective investor service at all times and provide regulators comfort as to the compliance of regulatory prescription. It is in this direction that SEBI has authorised Practising Company Secretaries to undertake internal audit of various capital market intermediaries.



### ROLE OF COMPANY SECRETARY

Every market intermediaries shall appoint a company secretary as 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 the Central Government and for redressal of investors' grievances. The compliance officer shall immediately and independently report to SEBI for any non-compliance observed by him.

### LESSON ROUND UP

- The role of intermediaries makes the market vibrant, and to function smoothly and continuously. Intermediaries possess professional expertise and play a promotional role in organising a perfect match between the supply and demand for capital in the market.

- 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.
- Merchant Bankers are the key intermediaries between the company and issue of capital. The activities of the Merchant Bankers in the Indian capital market are regulated by SEBI (Merchant Bankers) Regulation, 1992.
- Underwriting is compulsory for a public issue. It is necessary for a public company which invites public subscription for its securities to ensure that its issue is fully subscribed.
- Bankers to the issue, as the name suggests, carries out all the activities of ensuring that the funds are collected and transferred to the Escrow accounts.
- 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 portfolio manager 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.
- 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.
- Investment adviser means any person, who for consideration is engaged in the business of providing investment advice to clients or other group of persons and includes any person who holds out himself as an investment adviser, by whatever name called.

## GLOSSARY

<b>Financial Planning</b>	It includes analysis of client's current financial situation, identification of their financial goals, and developing and recommending financial strategies to realize such goals.
<b>Institutional Investors</b>	Organisations those invest including insurance companies, depository institutions, pension funds, investment companies and endowment funds.
<b>KYC</b>	Know your Client (KYC) means the procedure prescribed by SEBI for identifying and verifying the Proof of Address, Proof of Identity and compliance with rules, regulations, guidelines and circulars issued by SEBI or any other authority for Prevention of Money Laundering from time to time.
<b>Netting</b>	A system whereby outstanding financial contracts can be settled at a net figure, i.e. receivables are offset against payables to reduce the credit exposure to a counterparty and to minimize settlement risk.
<b>Portfolio Investment</b>	A collection of securities owned by an individual or an institution (such as a mutual fund) that may include stocks, bonds and money market securities.
<b>Profit</b>	Profit which results from the difference between the purchase and selling prices of a security. Trading profit is short term while investment profit is medium or long term.

## SELF TEST QUESTIONS

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

1. Discuss the types of market intermediaries in the Securities market.
2. Explain the Role and Responsibilities of Registrar and Share Transfer Agent in Pre-Issue and Post-Issue Activities.
3. What is meant by Research Analysts? Elucidate the capital adequacy norms laid down under SEBI (Research Analysts) Regulations, 2014 for registration as a Research Analysts.
4. Explain the internal audit of intermediaries by Company Secretary in Practice.
5. Write short notes on:
  - a) Merchant Banker
  - b) Debenture Trustee
  - c) Custodian of Securities
  - d) Investment Advisers

[illegible]

## GLOSSARY

<b>Accounting Standard</b>	Accounting Standards are codified or written statements of accounting rules and guidelines for preparation and presentation of financial statements. They are policy documents issued by an expert accounting body or by the Government or other regulatory body.
<b>Admission to Dealing</b>	The process of granting permission to the securities of a company to be listed in a Stock Exchange and to provide trading facilities for the securities in the market.
<b>Annual Return</b>	The change in percentage in the Net Asset Value (NAV) of a fund over one year based on the assumption that distributions such as dividend payment and bonuses have been reinvested.
<b>Appointed date</b>	It means the date which SEBI may, by notification in the Official Gazette, appoint and different appointed dates may be appointed for different recognized stock exchanges.
<b>Arbitration</b>	Arbitration is a procedure in which a dispute submitted, by agreement of the parties to one or more arbitrators who make a binding decision on the dispute.
<b>Average market capitalisation of public shareholding</b>	It means 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 of Directors/ shareholders, as the case may be, divided by the number of trading days.
<b>Award</b>	It means a finding in the form of direction or an order of an Ombudsman given in accordance with these regulations;
<b>Basis of allotment</b>	An allotment pattern of an issue among different categories of applicant.
<b>Beneficial owner (BO)</b>	The true owner of a security or property, which may be registered in another name. Means a person whose name appears as such on the records of the depository.
<b>Bid</b>	An offer of a price to buy as in an auction. Business on the Stock Exchange is done through bids. Bid also refers to the price one is willing to pay for a security.
<b>Book Closure</b>	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.
<b>Chinese Walls</b>	Artificial barriers to the flow of information set up in large firms to prevent the movement of sensitive information between departments.
<b>Circuit Breaker</b>	A system to curb excessive speculation in the stock market, applied by the Stock Exchange authorities, when the index spurts or plunges by more than a specified per cent. Trading is then suspended for some time to let the market cool down.
<b>Clearing</b>	Settlement or clearance of accounts, for a fixed period in a Stock Exchange
<b>Closing Price</b>	The rate at which the last transaction in a security is struck before the close of the trading hours.
<b>Commodity Derivative</b>	It means a contract - (i) for the delivery of such goods, as may be notified by the Central Government in the Official Gazette, and which is not a ready delivery contract; or (ii) for differences, which derives its value from prices or indices of



prices of such underlying goods or activities, services, rights, interests and events, as may be notified by the Central Government, in consultation with SEBI, but does not include securities as referred to in sub-clauses (A) and (B) of clause (ac) of Section 2 under Securities Contracts (Regulations) Act, 1956.

<b>Complainant</b>	It means any investor who lodges complaint with the Ombudsman and includes an investors association recognised by the Board.
<b>Compounding of offences</b>	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 charges.
<b>Competitive Bid</b>	An offer made by a person other than the acquirer who has made the first public announcement.
<b>Contra Trade</b>	Contra trading involves buying and selling the same shares without paying for them.
<b>Control of management</b>	The right to appoint directly or indirectly or by virtue of agreements or in any other manner majority of directors on the Board of the target company or to control management or policy decisions affecting the target company.
<b>Corporate restructuring</b>	Involves making radical changes in the composition of the businesses in the company's portfolio.
<b>Credit Risk</b>	The risk that a counterparty will not settle an obligation for full value, either when due or at any time thereafter. Credit risk includes pre-settlement risk (replacement cost risk) and settlement risk (Principal risk).
<b>Delisting Exchange</b>	The exchange from which securities of a company are proposed to be delisted.
<b>Diluted Earning Per Shares</b>	EPS is which accrues to the shareholder of the company. Dilution is a reduction in EPS or an increase in loss per share resulting from the assumption, that convertible instruments are converted, that options or warrants are exercised or the ordinary shares are issued.
<b>Demutualization</b>	Process of transition from "mutually-owned" association to a company "owned by shareholders". In other words, transformation of the legal structure from a mutual form to a business corporation form and privatisation of the corporations so constituted, is referred to as demutualization.
<b>Disinvestment</b>	Disinvestment means the direct or indirect sale by the Central Government or any State Government or by a government company, as the case may be, of shares or voting rights in, or control over, a target company, which is a public sector undertaking;
<b>Diversification</b>	The process of investing across different asset classes (equity, debt, property, etc.) and across different investments within each asset class (for instance, investing across equity shares of various companies in case of equity) to reduce risk.
<b>Dividend Payable</b>	A current liability showing the amount due to stock holders/shareholders for dividend declared but not paid
<b>Earnings per share (EPS)</b>	It is the portion of a company's profit allocated to each outstanding share of common stock and it serves as an indicator of a company's profitability.
<b>Encumbrance</b>	It shall include a pledge, lien or any such transaction, by whatever name called.



<b>Fill or Kill (Fok) Order</b>	An order that requires the immediate purchase or sale of a specified amount of stock, though not necessarily at one price. If the order cannot be filled immediately, it is automatically cancelled (killed)
<b>Financial Planning</b>	It includes analysis of client's current financial situation, identification of their financial goals, and developing and recommending financial strategies to realize such goals.
<b>Financial year</b>	It means the period of twelve months commencing on the first day of April every year. However, a company may at its option have a financial year commencing on a date other than the first day of April.
<b>Firm Allotment</b>	Allotment on a firm basis in public issues by an issuing company made to Indian and multilateral development financial institutions, Indian mutual funds, foreign portfolio investors including non-resident Indians and overseas corporate bodies and permanent/regular employees of the issuer company.
<b>Fundamental Attributes</b>	It means the investment objective and terms of a scheme.
<b>General Corporate Purpose</b>	It include such identified purposes for which no specific amount is allocated or any amount so specified towards General Corporate Purpose or any such purpose by whatever name called, in the draft offer document filed with SEBI.
<b>Grievance Redress</b>	Grievance Redress mechanism is part and parcel of the machinery of any administration. The grievance redress mechanism of an organisation is the gauge to measure its efficiency and effectiveness as it provides important feedback on the working of the administration
<b>Injunction</b>	A court order by which an individual is required to perform, or is restrained from performing, a particular act.
<b>Intellectual Property</b>	It is a category of property that includes intangible creations of the human intellect, and primarily encompasses copyrights, patents, and trademarks. It also includes other types of rights, such as trade secrets, publicity rights, moral rights, and rights against unfair competition.
<b>Institutional Investors</b>	Organisations those invest including insurance companies, depository institutions, pension funds, investment companies and endowment funds.
<b>Interest Rate</b>	The risk that movements in the interest rates may lead to a change in expected return.
<b>Investing</b>	It means a body corporate whose investment in the company would result in the company
<b>Investment objective</b>	Every mutual fund scheme has an investment objective according to which the fund manager has to make investments for the scheme. For example, in case of an equity fund, the investment objective may be to invest in large cap companies across a range of sectors in order to give investors capital appreciation.
<b>Investing Company/ Venture of a Company</b>	It means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.
<b>ISIN</b>	International Securities Identification Number (ISIN) is a code that uniquely identifies a specific security, which is allocated at the time of admitting the same in the depository system.

<b>Interim Dividend</b>	A dividend payment made during the course of a companies financial year. Interim dividend, unlike the final dividend does not have to be agreed in a general meeting.
<b>Grant</b>	It means issue of option to employees under the scheme.
<b>Joint Account</b>	It means a bank or a demat account in the names of more than one person (maximum three in case of a demat account). All the account holders must give their signature to operate a demat account held jointly.
<b>Odd Lot</b>	Anything less than the standard unit of trading
<b>Offer for sale</b>	An offer of securities by existing shareholder(s) of a company to the public of subscription, through an offer document.
<b>Open Market</b>	Purchase or sale of government securities by the monetary authorities (RBI in India) to increase or decrease the domestic money supply.
<b>Option grantee</b>	It means an employee having a right but not an obligation to exercise an option in pursuance of ESOS.
<b>Ordinance</b>	An ordinance is an executive order issued by the President of India that holds the same force and effect on an Act passed by the Parliament.
<b>KYC</b>	Know Your Client (KYC) means the procedure prescribed by SEBI for identifying and verifying the Proof of Address, Proof of Identity and compliance with rules, regulations, guidelines and circulars issued by SEBI or any other authority for Prevention of Money Laundering from time to time.
<b>Liquidity Adjustment Facility (LAF)</b>	Under the scheme, repo auctions (for absorption of liquidity) and reverse repo auctions (for injection of liquidity) will be conducted on a daily basis (except Saturdays). It will be same-day transactions, with interest rates decided on a cut-off basis and derived from auctions on a uniform price basis.
<b>Listing Agreement</b>	An agreement which has to be entered into by companies when they seek listing for their shares on a stock exchange. Companies is are called upon to keep the stock exchange fully informed of all corporate developments having a bearing on the market price of shares like dividend, rights, bonus shares, etc.
<b>Mark to market margin (MTM)</b>	Collected in cash for all Futures contracts and adjusted against the available Liquid Net worth for option positions. In the case of Futures Contracts MTM may be considered as Mark to Market Settlement.
<b>Market Maker</b>	A member firm who give two way quotation for particular security(ies) and who is under an obligation to buy and sell them subject to certain conditions such as overall exposure, spread etc.
<b>Maturity</b>	Some investments such as close-ended funds have a maturity date, which is the date on which the investor is paid back his principal amount as well as all income due to him on that investment.
<b>Netting</b>	A system whereby outstanding financial contracts can be settled at a net figure, i.e. receivables are offset against payables to reduce the credit exposure to a counterparty and to minimize settlement risk.
<b>Petition</b>	A formal written request, typically one signed by many people, appealing to authority in respect of a particular cause.

<b>Pooling</b>	Pooling is the basic concept behind collective investments. The money of thousands of individual investors, who share a common investment objective, is pooled together to form a CIS portfolio.
<b>Ponzi Scheme</b>	A ponzi scheme is an investment from where clients are promised a large profit in short term at little or no risk at all.
<b>Pledge</b>	Any person having a demat account can pledge securities against loan / credit facilities extended by a pledgee, who too has a demat account with a DP.
<b>Portfolio Investment</b>	A collection of securities owned by an individual or an institution (such as a mutual fund) that may include stocks, bonds and money market securities.
<b>Price Band</b>	The range within which the price of a security or the index of a currency is permitted to move within a given period.
<b>Profit</b>	Profit which results from the difference between the purchase and selling prices of a security. Trading profit is short term while investment profit is medium or long term.
<b>Public Announcement</b>	A public announcement is an announcement made in the newspapers by the acquirer primarily disclosing his intention to acquire shares of the target company from existing shareholders by means of an open offer.
<b>Public Shareholders</b>	It means the holders of equity shares, other than the following: (a) promoters; (b) holders of depository receipts issued overseas against equity shares held with a custodian and such custodian.
<b>Punitive</b>	It implies involving or inflicting punishment.
<b>RRN</b>	A system generated unique number when a remat request is set up.
<b>Record Date</b>	A 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.
<b>Repurchase/ Redemption</b>	When a mutual fund investor wants to exit from his mutual fund investment, he can sell back the units to the mutual fund and receive cash. The mutual fund 'repurchases' his units and the investor is said to 'redeem' his units.
<b>SAT</b>	Securities Appellate Tribunal is a quasi-judicial body established by Central Government by notification to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under SEBI Act or any other law for the time being in force.
<b>Scheme</b>	It means Collective Investment Scheme.
<b>Screen based trading</b>	Form of trading that uses modern telecommunication and computer technology to combine information transmission with trading in financial markets.
<b>Special Resolution</b>	A special resolution is a resolution of a company's shareholders which requires at least 75% of the votes cast by the shareholders in favour of it in order to pass.
<b>Stakeholder</b>	Any individual or group who has an interest in a firm; in addition to shareholders and bondholders, includes labor, consumers, suppliers, the local community and so on.
<b>Stock Exchange</b>	Anybody of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating controlling the business of buying, selling or dealing in securities.

<b>Takeover</b>	Takeover is a corporate device whereby one company acquires control over another company, usually by purchasing all or majority of its shares.
<b>Trading member</b>	A member of the derivatives exchange or derivatives segment of a stock exchange who settles the trade in the clearing corporation or clearing house through a clearing member.
<b>Transmission</b>	Transmission of securities denotes a process by which ownership of securities is transferred to a legal heir or to some other person by operation of law. In case of transmission transfer deed and stamp duty are not required
<b>Tribunal</b>	Article 227 of the Constitution of India defines 'tribunal' as a person or a body other than a Court set up by the State for deciding rights of contending parties in accordance with rules framed for regulation having force of law.
<b>Trustee</b>	Legal Custodian who looks after all the monies invested in a unit trust or mutual fund.
<b>Valuer</b>	It means a Chartered Accountant or a merchant banker appointed to determine the value of the intellectual property rights or other value addition.
<b>Vesting</b>	The process by which the employee is given the right to apply for shares of the company against the option granted to him in pursuance of ESOS.
<b>Vesting Period</b>	It means the period during which the vesting of option, SAR or a benefit granted under any of the schemes takes place.
<b>Unit Holders</b>	Investors in unit trust/mutual funds.
<b>Working Days</b>	It means the working days of the SEBI.
<b>Weighted average number of total shares</b>	Weighted average number of total shares means the number of shares at the beginning of a period, adjusted for shares cancelled, bought back or issued during the aforesaid period, multiplied by a time-weighting factor.

## CASE LAWS

## Lesson 6

## An Overview of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

- I. Autoport Limited (“**Acquirer**”) is an unlisted public company involved in dealing, distributing, repairing and exporting automobile components, spare parts, car accessories, and the like. It is also a part of the promoter group of Genesis Limited (“**Company**”), a company listed on BSE Limited and National Stock Exchange of India Limited, carrying out the manufacturing of automobiles. The Company wishes to restructure its group structure in order to improve its operational efficiency, and hence, the Acquirer has agreed to enter into a scheme of arrangement where the shares held by the promoter group companies will be transferred to it. Post-merger, the shareholding of the Acquirer in the Company will increase from 1.10% to 22.81%. However, the overall promoter shareholding will remain unchanged and no additional shareholding or management rights will be transferred to the Acquirer. Assume that you are the legal advisor to the Acquirer, and accordingly answer the following:
- Will the transfer of shares trigger an obligation to make an open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“**SAST Regulations**”) on the Acquirer?
  - Even if we assume that the Acquirer does trigger the obligation to make an open offer, will the Acquirer be permitted to avail of any general exemption (“**Exemption**”) under the SAST Regulations that will in effect exempt the Acquirer from the obligation to make an open offer?
  - If the Acquirer can avail of any Exemption under (b) above, what are the conditions that the Acquirer will be required to comply with in order to avail such an Exemption?
  - Is the Acquirer required to obtain any prior approval from SEBI in order to avail the Exemption for the same?
  - What are the disclosure requirements under the SAST Regulations, if any, that the parties to the scheme will have to comply with?
  - Is there any other possible manner in which the transfer of shares can be effected in favour of the Acquirer without the Acquirer triggering the obligation to make an open offer in accordance with SAST Regulations?

**Answer**

The above problem is based on the informal guidance dated November 29, 2017 bearing reference number SEBI/HO/CFD/DCR1/OW/P/2017/29408 issued by SEBI in the matter of M/s. Kamat Hotels (India) Limited.

- Regulations 3, 4 and 5 of the SAST Regulations set out the events that trigger an obligation to make an open offer on the acquirer (along with persons acting in concert). The said triggers in brief are as follows:
  - Acquisition (directly or indirectly) of such shares or voting rights in an Indian listed company whereby the acquirer becomes entitled to exercise 25% or more of the voting rights in such Indian listed company;
  - Where an acquirer (along with persons acting in concert with him) is already entitled to exercise 25% or more of the voting rights in an Indian listed company, and acquires (directly or indirectly) additional shares or voting rights entitling an acquirer to exercise more than 5% voting rights in an Indian listed company, in a financial year; and

- Acquisition (directly or indirectly) of control.

Since the Acquirer, in the above facts, does not attract any of the triggers set out above, the transfer of shares will not impose any obligation on the Acquirer to make an open offer under the SAST Regulations.

- b. Even if we assume that the triggers set out above were to be met, still the Acquirer can avail an exemption from making an open offer under Regulation 10(1)(d)(iii) of the SAST Regulations. The provision allows an acquirer to acquire shares/ voting rights/ control in accordance with a scheme of arrangement pursuant to an order of a court, tribunal or a competent authority, such scheme of arrangement not directly involving the target company as the transferor or transferee company, without the need to make an open offer despite triggering an open offer obligation under Regulations 3, 4 and 5 of the SAST Regulations. Therefore, the transfer of shares to the Acquirer pursuant to a merger, being a scheme sanctioned by the National Company Law Tribunal would be exempted from the obligation to make an open offer.
  - c. Regulation 10(1)(d)(iii) of the SAST Regulations provides an exemption from making an open offer to an acquirer subject to the following conditions:
    - The consideration paid in terms of cash and cash equivalents is less than 25% of the consideration paid under the scheme; and
    - Post implementation of the scheme, the persons holding at least 33% of voting rights in the combined entity are the same as the persons who held the entire voting rights before the implementation of the scheme.
  - d. Since the provision under which the Acquirer can avail an exemption from making an open offer falls under Regulation 10, it is not required to apply to SEBI for any grant of exemption, which would be the case only if the Acquirer desires to avail an exemption under Regulation 11 of the SAST Regulations.
  - e. The Acquirer and promoter group companies will be required to make a disclosure of change in shareholding under Regulation 29(2) of the SAST Regulations. According to Regulation 29(3), the disclosure should be made within 2 working days of such acquisition to the Company at its registered office and to BSE Limited and National Stock Exchange of India Limited (stock exchanges where the shares of the Company are listed).
  - f. In the absence of a scheme of arrangement, the transfer of shares would qualify as an inter-se transfer between promoters under Regulation 10(1)(a)(ii) of the SAST Regulations, provided that the Acquirer and promoter group companies have been named as promoters in the shareholding pattern filed by the Company in terms of the listing agreement or under the SAST Regulations, for at least 3 years prior to the acquisition.
- II. ABC Limited ("**Company**") is a SEBI registered debenture trustee providing a wide range of fiduciary trusteeship services to banks, financial institutions, corporate and non-corporate entities. It is mainly involved in acting as a trustee for bonds, debentures, etc. for banks, financial institutions, etc. In its capacity as a trustee, it accepts pledge of shares of listed companies as security offered against the loans granted by such banks and financial institutions. However, the Company can exercise the voting rights in respect of the securities pledged with it only on the instruction of the clients or ultimate beneficiaries, even during invocation of such securities. Such transactions are undertaken by the Company in the ordinary course of its business activities and not for the purpose of substantial acquisition of shares or voting rights or control of the target company. In view of the above facts, answer the following questions:



- a. Is the Company required to make any disclosure (“**Disclosure**”) under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“**SAST Regulations**”)?
- b. Is there any exemption (“**Exemption**”) available to acquirers from making the Disclosure under (a) above, that will in effect exempt the acquirer from the obligation to make disclosures on acquisition of shares?
- c. Will the Company qualify for the Exemption from making disclosures on acquisition under (b) above?
- d. Will the Company be required to make an open offer under the SAST Regulations in its capacity as a debenture trustee?

### Answer

The above problem is based on the informal guidance dated April 12, 2012 bearing reference number CFD/DCR/IG/SKM/8243/12 issued by SEBI in the matter of IL&FS Trust Company Limited and informal guidance dated April 26, 2012 bearing reference number CFD/DCR/IG/SKM/OW/9400/2012 issued by SEBI in the matter of IDBI Trusteeship Services Limited.

- a. The Company will be required to make a disclosure of acquisition of shares under Regulation 29 of the SAST Regulations, in every instance of accepting a pledge as security on behalf of the bank or financial institution. Such disclosure is required to be made within 2 working days of the acquisition to the target company (i.e. the listed company whose shares are pledged) at its registered office and to the stock exchanges where the shares of the target company are listed.
  - b. The proviso to Regulation 29 of the SAST Regulations exempts scheduled commercial banks and public financial institutions from making disclosures on acquisition of shares in their capacity as a pledgee in connection with a pledge of shares for securing indebtedness in the ordinary course of business.
  - c. The Company will not qualify for the exemption stated in the proviso to Regulation 29 because there is no express provision in the SAST Regulations providing an exemption to debenture trustees acting as a custodian/agent for pledged shares on behalf of lenders.
  - d. Since there is no express provision in the SAST Regulations providing an exemption from making an open offer to debenture trustees acting as a custodian/agent for pledged shares on behalf of lenders, the Company will have to make an open offer if it triggers the threshold limits mentioned in Regulation 3 or on acquisition of control under Regulation 4 or on indirect acquisition of shares or voting rights or control under Regulation 5 of the SAST Regulations.
- III. Pharmatech (“**Target Company**”) is a public limited company, listed on BSE Limited, engaged in the business of manufacturing and marketing of pharmaceutical products. As per the shareholding pattern filed by the Target Company for the quarter ended December 31, 2017 the promoters of the Target Company are Star Pharmaceutical Industries Limited (“**Star Pharma**”) and Daisan Company Limited (“**Daisan**”) which hold 46.84% and 20% of the equity shares of the Target Company respectively. Pursuant to an acquisition of 20% of the total equity share capital of the Target Company in 2011, Daisan was included as part of the promoter and promoter group of the Target Company for the first time in the shareholding pattern filed for the quarter ended December 31, 2012. In the same shareholding pattern, Prax Laboratories Limited (“**Prax**”) was also included as part of the promoter and promoter group of the Target Company. However, pursuant to a merger of Star Pharma and Prax, Prax was replaced by Star Pharma as part of the promoter and promoter group of the Target Company in the shareholding pattern filed for the quarter ended March 31, 2017. Though the merger became effective from April 1, 2016, Star Pharma was included in the shareholding pattern only after receipt of requisite approvals

i.e. March 31, 2017. Star Pharma is now exploring a potential acquisition of 20% equity shares of the Target Company held by Daison. In view of the above facts, answer the following questions:

- a. Would the acquisition of shares by Star Pharma trigger an obligation to make an open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“**SAST Regulations**”)?
- b. Can the acquisition of shares by Star Pharma be considered as an inter-se transfer of shares between promoters? Why?
- c. What would be considered as the period of holding of Star Pharma in respect of 46.84% shares of the Target Company?
- d. Can Star Pharma complete its acquisition of 20% equity shares of the Target Company through a creeping acquisition of 5% in each financial year or can such an acquisition under Regulation 3(2) of the SAST Regulations be made only once considering the words ‘any financial year’ in Regulation 3(2)?
- e. If there was a possibility of postponing the acquisition, what date would you suggest as the date for acquisition in view of the SAST Regulations?

#### **Answer**

The above problem is based on the informal guidance dated March 27, 2012 bearing reference number CFD/DCR/TO/7197/12 issued by SEBI in the matter of Khaitan Electricals Limited and the informal guidance dated June 1, 2016 bearing reference number CFD/DCR2/OW/2016/15709 issued by SEBI in the matter of Zenotech Laboratories Limited.

- a. As per Regulation 3(2) of the SAST Regulations, an acquisition of shares or voting rights entitling the acquirer to exercise more than 5% of the voting rights in a financial year, where the acquirer (along with persons acting in concert) already holds 25% or more of the voting rights in the target company, triggers an obligation on the part of the acquirer to make a public announcement of an open offer for acquiring such shares. Since Star Pharma already holds 46.84% shares of the Target Company (i.e. more than 25% voting rights), a further acquisition of 20% of equity shares of the Target Company would necessarily require it to make an open offer.
- b. The acquisition of 20% shares by Star Pharma from Daison cannot qualify as an inter-se transfer of shares between promoters because Star Pharma does not fulfil the condition for inter-se transfer under Regulation 10(1)(a)(ii) of the SAST Regulations. This regulation requires the person to be named as a promoter in the shareholding pattern filed by the target company in terms of the listing agreement or under the SAST Regulations for at least 3 years prior to the proposed acquisition. In this respect, even though Daison has been named as a promoter in the filings for the past 5 years, Star Pharma has been named as such only since the quarter ended March 31, 2017 i.e. less than even 1 year. Hence, such transaction, as of date, cannot qualify for an inter-se transfer between promoters under Regulation 10(1)(a)(ii) of the SAST Regulations.
- c. The period of holding of Star Pharma in respect of 46.84% of shares of the Target Company will start only from the date on which it was first included as part of the promoter and promoter group of the Target Company in the shareholding pattern filed by the Target Company i.e. from March 31, 2017. Hence, the period of holding, as of date, would be around 11 months.
- d. Star Pharma can complete its acquisition of 20% shares of the Target Company by way of a creeping acquisition in ‘every’ financial year i.e. it can acquire up to 5% of the shares of the Target Company in every financial year, without attracting the obligation to make a public announcement of open offer under Regulation 3(2) of the SAST Regulations.



- e. In order to avail the exemption from an obligation to make an open offer in terms of an inter-se promoter transfer under Regulation 10(1)(a)(ii) of the SAST Regulations, both Star Pharma and Daison are required to be named as part of the promoter and promoter group of the Target Company in its shareholding pattern for at least 3 years prior to the acquisition. Since Star Pharma was first named as such only for the quarter ending March 31, 2017, it will complete 3 years of being named as a part of the promoter and promoter group of the Target Company in its shareholding pattern filed on March 31, 2020. Hence, to take advantage of the exemption under Regulation 10(1)(a)(ii), the proposed acquisition should ideally take place post March 31, 2020.
- IV. CT Limited ("**Target Company**") is a non-banking finance company registered under the Companies Act, 1956 and listed on BSE Limited. The Company has 2 promoters, namely Mr. X and Mr. Y that hold paid up equity shares representing 30.03% and 42.02% respectively, making the aggregate shareholding of the promoters in the Target Company 72.05%. The board of directors of the Target Company, in its meeting held on January 27, 2017 proposed to issue upto 75,00,000 warrants convertible into equity shares of the Target Company within a period of 18 months, on a preferential basis to Mr. X. On receiving in-principle approval from BSE Limited, the board of directors allotted the said warrants to Mr. X on May 22, 2017. Thereafter, on the request of Mr. X, The board of directors, in its meeting held on July 28, 2017 allotted 10,00,000 equity shares in lieu of conversion of warrants. Pursuant to the conversion, the shareholding of Mr. X increased from 30.03% to 38.26% of the paid up share capital of the Target Company. However, Mr. Y, in the meantime, sold 1,13,698 shares on July 21, 2017 and 70,250 shares on July 28, 2017, thereby reducing the overall promoter shareholding from 72.05% to 71.87% of the paid up share capital of the Target Company. In view of the above facts, answer the following questions:
- Would Mr. X be required to make an open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**SAST Regulations**")?
  - Would the obligation to make an open offer apply to Mr. X in view of the fact that the aggregate promoter shareholding, post conversion, does not breach the stipulated thresholds under the SAST Regulations?
  - What are the disclosure requirements under the SAST Regulations, if any, that Mr. X will have to comply with?

### Answer

The above problem is based on the informal guidance dated March 1, 2016 bearing reference number SEBI/HO/CFD/DCR1/OW/P/2016/5575 issued by SEBI in the matter of M/s. Capital Trust Limited.

- Regulations 3, 4 and 5 of the SAST Regulations set out the events that trigger an obligation to make an open offer on the acquirer (along with persons acting in concert). The said triggers in brief are as follows:
  - Acquisition (directly or indirectly) of such shares or voting rights in an Indian listed company whereby the acquirer becomes entitled to exercise 25% or more of the voting rights in such Indian listed company;
  - Where an acquirer (along with persons acting in concert with him) is already entitled to exercise 25% or more of the voting rights in an Indian listed company, and acquires (directly or indirectly) additional shares or voting rights entitling an acquirer to exercise more than 5% voting rights in an Indian listed company, in a financial year; and
  - Acquisition (directly or indirectly) of control.

Since Mr. X, in the above facts, already holds 30.03% shares in the Target Company [which

is above the 25% limit specified in Regulation 3(2)], and by virtue of conversion of warrants, has acquired an additional 8.23% of the paid up share capital of the Target Company [which is above the 5% limit specified in Regulation 3(2)], he is clearly required to make a public announcement of an open offer under Regulation 3(2) of the SAST Regulations.

- b. Regulation 3(3) of the SAST Regulations provides that the requirement to make an open offer under Regulation 3(2) is attracted irrespective of whether there is a change in aggregate shareholding with persons acting in concert. Hence, even though the conversion of warrants by Mr. X does not cause the aggregate promoter shareholding to breach the stipulated thresholds under Regulation 3(2), due to the sale of shares by Mr. Y, Mr. X, in his individual capacity would be required to make an open offer under Regulation 3(2) of the SAST Regulations.
  - c. Mr. X will be required to make a disclosure of change in shareholding under Regulation 29(2) of the SAST Regulations. According to Regulation 29(3), the disclosure should be made within 2 working days of such acquisition to the Target Company at its registered office and to BSE Limited (stock exchange where the shares of the Target Company are listed).
- V. Apex Industries Limited ("**Target Company**") is an Indian company engaged in the business of manufacturing performance emulsion polymers. The equity shares of the Target Company are listed on National Stock Exchange of India Limited and BSE Limited. Sal Investments and Trading Company Private Limited ("**Sal**") owns a 5.46% stake in the Target Company. Dhum Investments and Trading Company Private Limited ("**Dhum**") owns a 16% stake in the Target Company. Triv Investments and Trading Company Limited ("**Triv**") owns a 19.07% stake in the Target Company. Sal, Dhum and Triv have also been classified as promoters of the Target Company in its shareholding pattern for over 3 years and their shareholders are also directly or indirectly shareholders of the Target Company. With a view to consolidate their holdings, Sal, Dhum and Triv are proposed to be amalgamated through a scheme of arrangement, pursuant to which Sal's shareholding in the Target Company will increase from 5.46% to 40.53% as the shares held by Dhum and Triv will be transferred and vested in Sal and their shareholders will become shareholders of Sal. The entire consideration for the amalgamation would be discharged by Sal by issue of its shares. The scheme is likely to be completed and approved by the National Company Law Tribunal sometime during the financial year 2019-2020. In order to further consolidate their holdings into Sal, apart from the scheme of arrangement, the individual promoters, Dhum and Triv, are proposing to transfer all/ part of the shares held by them in the Target Company to Sal in the financial year 2019-2020. In view of the above facts, answer the following questions:
- a. Would the transfer and vesting of shares of the Target Company in Sal, pursuant to the scheme of arrangement, be exempt from open offer obligations ("**First Exemption**") under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**SAST Regulations**")?
  - b. What conditions would it be required to fulfil to avail the First Exemption, under (a) above?
  - c. Would Sal be permitted to avail of any general exemption ("**Second Exemption**") under the SAST Regulations that will in effect exempt it from the obligation to make an open offer with respect to the acquisition of shares from individual promoters of the Target Company? What conditions would it be required to fulfil to avail the Exemption?
  - d. What are the post-acquisition requirements, if any, that Sal would have to comply with in availing the exemptions under (a) and (b) above?
  - e. Whether the proposed transfer of shares from individual promoters to Sal can be undertaken in different tranches?
  - f. Would Sal be permitted to separately acquire up to 5% stake in the Target Company from the

open market in the financial year 2019-2020 through creeping acquisition under Regulation 3(2) of the SAST Regulations?

**Answer**

The above problem is based on the informal guidance dated January 20, 2016 bearing reference number SEBI/HO/CFD/DCR1/P/2016/712/1 issued by SEBI in the matter of M/s. Apcotex Industries Limited and informal guidance dated January 25, 2016 bearing reference number CFD/DCR1/OW/P/2016/1716 issued by SEBI in the matter of M/s. L T Foods Limited.

- a. Sal is eligible to avail an exemption under Regulation 10(1)(d)(iii) of the SAST Regulations since the acquisition of shares of the Target company is being made pursuant to a scheme of arrangement sanctioned by the National Company Law Tribunal.
- b. Regulation 10(1)(d)(iii) of the SAST Regulations provides an exemption from making an open offer to an acquirer subject to the following conditions:
  - The consideration paid in terms of cash and cash equivalents is less than 25% of the consideration paid under the scheme; and
  - Post implementation of the scheme, the persons holding at least 33% of voting rights in the combined entity are the same as the persons who held the entire voting rights before the implementation of the scheme.

Since the entire consideration is being discharged by Sal by issue of its shares, there is no portion of the consideration being paid in terms of cash and cash equivalents. Additionally, post-merger, since Sal will issue its shares to the shareholders of Dhum and Triv, such shareholders will hold more than 33% stake in Sal. Therefore, Sal would be in compliance with the conditions to avail an exemption under Regulation 10(1)(d)(iii) of the SAST Regulations.

- c. The acquisition of shares would qualify as an inter-se transfer between promoters under Regulation 10(1)(a)(ii) of the SAST Regulations, since all the individual promoters, Sal, Dhum and Triv have been named as promoters in the shareholding pattern filed by the Target Company for at least 3 years prior to the acquisition. Sal is required to intimate National Stock Exchange of India Limited and BSE Limited (stock exchanges where the shares of the Target Company are listed) regarding the details of the proposed acquisition at least 4 working days prior to the proposed acquisition under Regulation 10(5) of the SAST Regulations.
- d. Sal will be required to file a report under Regulation 10(6) of the SAST Regulations with National Stock Exchange of India Limited and BSE Limited (stock exchanges where the shares of the Target Company are listed) not later than 4 working days from the acquisition. Additionally, under Regulation 10(7), it is required to submit a report along with supporting documents to SEBI, providing all details in respect of the acquisitions, along with a non-refundable fee of Rs. 1,50,000 within 21 working days from the date of acquisitions.
- e. The proposed transfer of shares from the individual promoters to Sal can be carried out in different tranches subject to prior intimation to National Stock Exchange of India Limited and BSE Limited under Regulation 10(5) of the SAST Regulations followed by filing of post-acquisition reports stipulated under Regulation 10(6) and 10(7) of the SAST Regulations.
- f. Since the acquisition of shares of the Target Company by Sal are exempt from the obligation to make an open offer under Regulation 10 of the SAST Regulations, Sal would be permitted to additionally acquire upto 5% stake in the Target Company through the creeping acquisition route under Regulation 3(2) of the SAST Regulations.

VI. S Systems International Limited (“**Target Company**”) is an Indian public limited company listed on BSE Limited and National Stock Exchange of India Limited. On December 15, 2016, one of the shareholders of the Company, Mr. Rakesh Sinha (“**Acquirer**”) made a public announcement for an open offer (“**Open Offer**”) for the acquisition of 33,45,242 equity shares of the Target Company, constituting 26% of the expanded equity share capital of the Target Company (i.e. assuming full conversion of outstanding options under ESOP/ESOS schemes of the Target Company). During the period between the date of the public announcement and the issuance of detailed public statement, the Acquirer had acquired 9,24,142 equity shares of the Target Company, constituting 7.18% of the expanded equity share capital of the Target Company. As per the post offer public announcement dated January 21, 2018 issued by the Acquirer, the Acquirer had acquired 590 equity shares of the Target Company in the open offer. The Acquirer continued to acquire shares of the Target Company, as a consequence of which, the Acquirer’s holding in the Target Company increased to 34.82% with the promoter and promoter group holding of 50.17% and the remaining 15.01% being held by other public shareholders. The Acquirer is neither a promoter nor a part of the promoter group nor is a person acting in concert with the promoters of the Target Company. In view of the above facts, answer the following questions:

- a. Would the shareholding of the Acquirer in the Target Company, following all the acquisitions referred above, be treated as part of the non-public shareholding of the Target Company as contemplated under Regulation 7(4) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“**SAST Regulations**”)?
- b. Would the Acquirer be required to reduce its shareholding in the Target Company in terms of Regulation 7(4) of the SAST Regulations?
- c. If a person intended to make a competing offer upon the public announcement of the Open Offer, what would be the basis for calculating the minimum size of such competing offer?
- d. Would the competing offer under (c) above have to adhere to the minimum offer size as contemplated under Regulation 7(1) of the SAST Regulations?

#### Answer

The above problem is based on the informal guidance dated July 10, 2012 bearing reference number CFD/DCR/IG/CB/15173/12 and informal guidance dated January 8, 2014 bearing reference number CFD/PC/AT/KJ/OW/817/2014 issued by SEBI in the matter of M/s. R Systems International Limited.

- a. The term ‘public shareholding’ has been defined under Rule 2(e) of the Securities Contracts (Regulation) Rules, 1957 (“**SCRR**”) as *“equity shares of the company held by public and shall exclude shares which are held by custodian against depository receipts issued overseas”*. Further, the term ‘public’ has been defined under Rule 2(d) of the SCRR as *“persons other than the promoter and promoter group and subsidiaries and associates of the company”*. Since the Acquirer clearly falls within the ambit of the term ‘public’ as defined under the SCRR, and consequently forms part of the public shareholding of the Target Company, the shareholding of the Acquirer will not be treated as the non-public shareholding of the Target Company.
- b. Regulation 7(4) of the SAST Regulations imposes an obligation on an acquirer to bring down its shareholding to the level specified for maximum permissible non-public shareholding within the time permitted under the SCRR, in the event shares accepted in the open offer exceeds the shareholding of the acquirer taken together with persons acting in concert beyond the maximum permissible non-public shareholding. However, Regulation 7(4) will not be applicable in the present case as post offer shareholding of the Acquirer, which forms part of the public shareholding of the Target Company, was 34.82%, and hence the acquisitions by the Acquirer did not breach the maximum permissible non-public shareholding of the Target Company.

- c. Regulation 20(2) of the SAST Regulations provides that in the event of a competing offer, the same shall be for such number of shares which, when taken together with shares held by such competing acquirer along with persons acting in concert with him, shall be at least equal to the holding of the original acquirer including the number of shares proposed to be acquired by such acquirer under the offer and any underlying agreement for sale of shares of the target company pursuant to which such open offer is made.
  - d. Determination of minimum offer size requirement for a competing offer would have to be in accordance with Regulation 20(2) read with Regulation 20(10) of the SAST Regulations. Regulation 20(10) states that except for variations made under Regulation 20, all the provisions of the SAST Regulations are applicable to every competing offer. Since Regulation 20(2) operates as a variation in respect of determination of minimum offer size requirement for a competing offer, such a competing offer is not required to adhere to the minimum offer size of 26% as contemplated under Regulation 7(1) of the SAST Regulations.
- VII. PML Limited ("**Company**") is an Indian public limited company listed on BSE Limited. The Company was initially promoted by Mr. John Gregory, who together with his wife, Mrs. Dina Gregory holds 21.15% of the equity share capital of the Company as on date. The total promoter and promoter group holding, as on date, is 64.31% of the shares of the Company. On March 23, 1995, Mr. Gregory entered into a promotional agreement with M/s. Kerala State Industrial Development Corporation Limited ("**KSIDC**"), which provides that both parties shall support each other during the currency of the agreement on all matters coming up before the general meeting of the Company. The shareholding of Mr. Gregory, Mrs. Gregory and KSIDC, as on date, constitutes 29.91% of the equity share capital of the Company. Mr. Gregory and his wife have entered into a shareholders' agreement with M/s. ALP Paribas SA under which Mr. Gregory, Mrs. Gregory, the Company and M/s. ALP Paribas SA undertook to take such actions as may be necessary to give effect to the provisions of, and comply with their obligations under the shareholders' agreement. Further, it was confirmed in the said shareholders' agreement that the director nominated by KSIDC shall be a promoter director. Another shareholder, Mr. Elton George, who is also a director in the Company and holds 4.27% of its equity shares intends to enter into a shareholders' voting agreement ("**Agreement**") with Mr. Gregory under which both Mr. Gregory and Mr. George intend to support each other on all matters coming up before the board and general meetings of the Company. Mr. George is not related to the promoter, Mr. Gregory, and was de-classified as a promoter of the Target Company on May 6, 2006. In view of the above facts, answer the following questions:
- a. Would Mr. Gregory, Mrs. Gregory and KSIDC be deemed to be persons acting in concert under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**SAST Regulations**")?
  - b. Would the execution of the Agreement attract Regulation 3(1) of the SAST Regulations which will in effect require Mr. Gregory to make a public announcement of an open offer?
  - c. Would the execution of the Agreement attract any other provision of the SAST Regulations that would require Mr. Gregory to make a public announcement of an open offer?

### Answer

The above problem is based on the informal guidance dated November 14, 2014 bearing reference number CFD/PC/IG/32340/OW/2014 issued by SEBI in the matter of M/s. Geojit BNP Paribas Financial Services Limited.

- a. Regulation 2(1)(q) of the SAST Regulations include promoters and members of the promoter group under the category of persons deemed to be persons acting in concert. Since Mr. Gregory,



Mrs. Gregory and KSIDC are members of the promoter group, they would be deemed to be persons acting in concert in terms of Regulation 2(1)(q) of the SAST Regulations.

- b. Since Mr. George would be voting with the existing promoters on all matters, he would be deemed to be a person acting in concert with the promoter group, and thus he would become a part of the promoter group. Hence, the promoter and promoter group shareholding would increase from 64.31% to 68.58% of the shares of the Target Company, which is well within the limits specified in Regulation 3(1) of the SAST Regulations (i.e. less than 25% of shares of the target company). Hence, the execution of the Agreement would not attract the provisions of Regulation 3(1) of the SAST Regulations.
- c. Since, by virtue of the Agreement, Mr. George would exercise control with Mr. Gregory and other members of the promoter group, such acquisition of control through the proposed Agreement would attract Regulation 4 of the SAST Regulations. In terms of the same, Mr. George would be required to make a public announcement of an open offer.

VIII. Claris Scientific Limited ("**Company**") is a public limited company whose shares are listed on BSE Limited. The promoters of the Company held 65.35% of the paid up equity share capital of the Company as on March 31, 2017. The promoters hold 74,00,000 convertible warrants which will entitle them to receive 1 equity share against each warrant held by them. On December 2, 2017, some of the entities belonging to the promoter group converted 24,00,000 warrants into shares, as a result of which the promoter shareholding increased by 3.68%. Mr. Amish Kumar ("**Transferor**"), one of the promoters of the Company, holds 19.87% of the equity share capital of the Company and proposes to gift shares constituting 2.30% of the equity share capital of the Company to an immediate relative ("**Transfer**"). In view of the above facts, answer the following questions:

- a. Would the proposed Transfer trigger an obligation upon the Transferor to make an open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**SAST Regulations**")?
- b. Would the proposed Transfer be considered for the purpose of calculating the creeping acquisition limit of 5% under Regulation 3(2) of the SAST Regulations?
- c. Would the promoters be permitted to avail of any general exemption ("**Exemption**") under the SAST Regulations that will in effect exempt the acquirer from making an open offer?
- d. Would the promoters be permitted to avail of any general exemption ("**Exemption**") under the SAST Regulations that will in effect exclude the proposed Transfer for the purpose of the creeping acquisition limit under Regulation 3(2) of the SAST Regulations?

#### Answer

The above problem is based on the informal guidance dated February 5, 2015 bearing reference number CFD/PC/IG/3997/OW/2015 issued by SEBI in the matter of M/s. Sequent Scientific Limited.

- a. In terms of Regulation 3(2) and 3(3) of the SAST Regulations, an obligation to make an open offer would arise if the acquirer (along with persons acting in concert) is already entitled to exercise 25% or more of the voting rights in an Indian listed company, and acquires additional shares or voting rights entitling it to exercise more than 5% voting rights in an Indian listed company, in a financial year. By virtue of conversion of warrants into shares, the promoter shareholding in the Company has already increased by 3.68%. Therefore, a further transfer (by way of gift) of shares constituting 2.30% of the equity share capital of the Company to an immediate relative in the same financial year would increase the gross acquisition of shares by the promoter group in excess of the 5% threshold under Regulation 3(2) of the SAST Regulations, hence triggering the requirement to make an open offer.

- b. In terms of the explanation to Regulation 3(2) of the SAST Regulations, while calculating the limit of 5% of shares, the gross acquisition alone is to be taken into account regardless of an intermittent fall in shareholding or voting rights. Therefore, the proposed Transfer would be considered for the purpose of calculating the creeping acquisition limit of 5% under Regulation 3(2) of the SAST Regulations.
  - c. The Transfer would qualify as an inter-se transfer between immediate relatives under Regulation 10(1)(a)(i) of the SAST Regulations, and hence is exempt from the requirement to make an open offer under the SAST Regulations.
  - d. The Transfer would qualify as an inter-se transfer between immediate relatives under Regulation 10(1)(a)(i) of the SAST Regulations but it would still be considered for the purpose of calculating the creeping acquisition limit of 5% under Regulation 3(2) of the SAST Regulations.
- IX. Azhurst Limited ("**Company**") is a public company listed on BSE Limited and engaged in carrying out the business of manufacturing and marketing of pharmaceutical products. Dr. A M Shankar ("**Acquirer**"), along with various members of his family and certain entities within their control own and hold equity shares of the Company and have been classified as members of the promoter and promoter group of the Company (collectively "**Group**") in the latest shareholding pattern filed by the Company in terms of Clause 35 of the listing agreement. The Group in exclusion of the Acquirer, together hold 46.04% of the equity share capital of the Company. As part of a voluntary and consensual family understanding, the Group is proposing to enter into an agreement ("**Agreement**") providing for the manner in which the Group will exercise votes in respect of the Company. The Agreement provides that all the parties thereof are required to jointly act as a single unit, subject to and under the direction of the Acquirer during his lifetime, and Dr. P M Shankar after the demise or on the incapacity of the Acquirer to act. The Agreement also provides for a pre-emptive right in case the shareholders choose to transfer their shares. There is no proposed transfer of any shares of the Company and the aggregate voting rights of the Group would not change on account of the Agreement. In view of the above facts, answer the following questions:
- a. Would the Group be considered as persons acting in concert in terms of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**SAST Regulations**")?
  - b. Would the arrangement of voting rights in the manner set out in the Agreement lead to an acquisition of control by the Acquirer, as contemplated under Regulation 4 of the SAST Regulations?
  - c. Would the arrangement of voting rights in the manner set out in the Agreement trigger an obligation on the Acquirer to make an open offer in terms of the SAST Regulations?
  - d. If the answer to the above question under (a) is affirmative, would the Acquirer be permitted to avail of any general exemption ("**Exemption**") under the SAST Regulations that will in effect exempt it from making an open offer?
  - e. Assuming that the Agreement is executed, would the Group be permitted to avail of the Exemption despite the change in member under whose direction the voting would be done pursuant to demise or incapacity of the Acquirer?

### Answer

The above problem is based on the informal guidance dated February 2, 2015 bearing reference number CFD/PC/IG/CB/3565/15 issued by SEBI in the matter of M/s. CIPLA Limited.

- a. By virtue of being identified as the promoter and promoter group of the Company in its shareholding pattern, the Group would be deemed to be persons acting in concert under Regulation 2(1)(q)(2) (iv) of the SAST Regulations.

- b. The term 'control' has been defined under Regulation 2(1)(e) of the SAST Regulations to include the right to appoint majority of directors 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 shareholding or management rights or shareholders agreements or voting agreements or in any other manner. Hence, the Agreement would clearly lead to an acquisition of control by the Acquirer since it allows him to control the management and policy decisions in the meetings of the Company by virtue of directing the other parties to act as per his directions.
  - c. The Agreement provides that the Group is required to act jointly and as a single unit on the directions of the Acquirer, implying that the Acquirer would, in effect, be the single largest holder of voting rights in the Company. Therefore, the proposed transaction would lead to an acquisition of voting rights constituting 46.04% in the Company, which is in excess of the threshold under Regulation 3(1) and thus, would entail an acquisition of control of the Company in favour of the Acquirer under Regulation 4 of the SAST Regulations. Thus, the Acquirer will be required to make a public announcement of an open offer under Regulation 3(1) read with Regulation 3(3) and Regulation 4 of the SAST Regulations.
  - d. The acquisition of voting rights pursuant to the Agreement would be exempt in terms of an inter-se transfer between promoters under Regulation 10(1)(a)(ii) and an inter-se transfer between persons acting in concert under Regulation 10(1)(a)(iv) of the SAST Regulations subject to the Group being named as the promoters in the shareholding pattern filed by the Company in terms of the listing agreement or the SAST Regulations for at least 3 years prior to the execution of the proposed Agreement or as persons acting in concert for at least 3 years prior to the execution of the proposed Agreement pursuant to filings under the listing agreement.
  - e. The Agreement stipulates that pursuant to the demise or incapacity of the Acquirer to act, the right to direct the manner in which the Group will exercise votes in respect of the Company will lie with Mr. P M Shankar, in effect implying that there will be an acquisition of voting rights in excess of the triggers under Regulation 3(1) read with Regulation 3(3) and an acquisition of control under Regulation 4 of the SAST Regulations in favour of Mr. P M Shankar. However, Mr. P M Shankar will also be eligible to avail the exemption under Regulation 10(1)(a)(ii) and Regulation 10(1)(a)(iv) of the SAST Regulations subject to Mr. P M Shankar and the Group being named as the promoters in the shareholding pattern filed by the Company in terms of the listing agreement or the SAST Regulations for at least 3 years prior to the acquisition or as persons acting in concert for at least 3 years prior to the acquisition pursuant to filings under the listing agreement.
- X. Silver Coin Limited ("**Target Company**") is a public limited company whose shares are listed on BSE Limited and National Stock Exchange of India Limited. Mr. Pranav Jain and Print Holdings Private Limited (collectively the "**Acquirers**") together with P.J. Financial Services Private Limited (person acting in concert) ("**PAC**") collectively held 6.47% of the equity share capital of the Target Company. On November 12, 2015, the Acquirers, along with PAC made a public announcement of a voluntary open offer to acquire 44,02,201 equity shares constituting 25% of the equity share capital of the Target Company. During the examination of draft letter of offer ("**DLO**"), certain complaints were received by SEBI against the Acquirers and PAC as well as against the Target Company and its promoters, some of which involved disputes which were not within the jurisdiction of SEBI as the proper forum for them was the National Company Law Tribunal. In investigating the same, SEBI had taken over 2 years for offering its comments on the DLO, during which period, the Target Company, by way of a special resolution by postal ballot, had availed huge high cost borrowing from banks and financial institutions against its property including 18.7% shares out of the promoter's shareholding, effectively encumbering material assets of the Target Company and depleting its fixed assets. On August 2, 2017, citing the ground that SEBI had delayed in taking a decision on the DLO during which period the financial position



of the Target Company had deteriorated substantially, which defeated the object of the open offer, the Acquirers sought permission to withdraw the offer under Regulation 27(1)(d) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**SAST Regulations**"). Assume that you are the legal advisor to SEBI, and accordingly answer the following questions:

- a. What is the prescribed time under the SAST Regulations within which SEBI is required to offer its comments on the draft letter of offer?
- b. Is the timeline laid down under the SAST Regulations required to be strictly adhered to by SEBI, in respect of offering its comments on the draft letter of offer?
- c. Was the act of dealing with the property by the Target Company valid in terms of the SAST Regulations?
- d. Can the Acquirers be permitted to withdraw the open offer on the ground that SEBI had delayed in offering its comments on the DLO filed by the Acquirers?
- e. What are the permissible grounds under the SAST Regulations that permit an acquirer to withdraw an open offer?

### Answer

The above problem is based on the judgment of the Supreme Court dated November 7, 2016 in the matter of Pramod Jain and Ors. Vs Securities and Exchange Board of India [(2016) 10 SCC 243].

- a. Regulation 16(4) of the SAST Regulations lays down a period of 15 days within which SEBI is required to offer its comments on the draft letter of offer, on the expiry of which period it is deemed that SEBI has no comments to offer. However, if clarifications or additional information is sought by SEBI, such period is extended to the fifth working day from the date of receipt of a satisfactory reply to the clarification or additional information sought.
- b. The timeline prescribed under Regulation 16(4) SAST Regulations may not be adhered to by SEBI when it justifiably takes time in dealing with the complaints, as in the facts of the present case, that SEBI could not look into certain complaints for which the right forum was the National Company Law Tribunal.
- c. In terms of Regulation 26(2) of the SAST Regulations, the act of the Target Company in encumbering its material assets and effecting material borrowings was valid because the Target Company had availed the approval of its shareholders by way of a special resolution by postal ballot.
- d. The general principle under Regulation 23 of the SAST Regulations is that an open offer cannot be withdrawn, unless any of the exceptions specified under the said regulation are met. Hence, a mere delay by SEBI in offering its comments on the DLO would not entitle the Acquirers from withdrawing the open offer.
- e. Regulation 23 states specific grounds under which an acquirer is permitted to withdraw an open offer. They are as follows:
  - Final refusal of statutory obligations required for the open offer/ effecting an acquisition attracting the obligation to make an open offer (provided specific disclosures regarding such requirements for approval were made in the detailed public statement and letter of offer); or
  - Death of the acquirer (being a natural person); or
  - Any condition stipulated in the agreement for acquisition attracting the obligation to make an open offer is not met for reasons outside the reasonable control of the acquirer and such

agreement is rescinded (provided specific disclosures regarding such conditions were made in the detailed public statement and letter of offer); or

- Circumstances that merit withdrawal, in SEBI's opinion (such order permitting withdrawal must be a reasoned order that must be hosted on SEBI's website).

XI. RLL Limited ("**RLL**") is a public limited company listed on BSE Limited. On October 3, 2015, RLL entered into a share purchase and share subscription agreement ("**First Agreement**") jointly with Hypertech Laboratories Limited ("**Hypertech**") and its promoter Mr. Jay Shah. The First Agreement provided for RLL to purchase 78,78,906 equity shares representing 27.35% of the fully paid-up equity share capital of Hypertech from its promoters and to subscribe to 54,89,536 fully paid-up equity shares of Hypertech under a preferential allotment by Hypertech. The share purchase transaction between RLL and the promoters of Hypertech was completed on November 8, 2015 and at the annual general meeting of Hypertech held on the same day, its shareholders approved the preferential allotment of shares to RLL. On November 23, 2015, RLL was duly allotted 54,89,536 fully paid-up equity shares of Hypertech. Having entered into the First Agreement, RLL made an open offer to acquire 26% of the equity shares of Hypertech from its public shareholders on October 5, 2015, post which RLL's shareholding in Hypertech stood at 46.85%. M/s. Storm Company Limited ("**Storm**") intends to enter into a share purchase and share subscription agreement ("**Second Agreement**") jointly with RLL and its promoters, under which Storm would acquire 30.91% of the fully paid-up equity share capital of RLL from its promoters and additionally subscribe to (i) shares representing 11% of the fully paid-up equity share capital of RLL; and (ii) 2,38,34,333 share warrants, each warrant exercisable for 1 share of RLL. Post execution of the Second Agreement, the shareholding of Storm in RLL would increase from 0% to over 50%. Assume that you are the legal advisor to Storm and accordingly answer the following questions:

- Will the acquisition pursuant to the Second Agreement trigger an obligation on Storm to make an open offer to the shareholders of RLL under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**SAST Regulations**")?
- Will the acquisition pursuant to the Second Agreement lead to an indirect acquisition of Hypertech by Storm?
- Will the acquisition pursuant to the Second Agreement trigger an obligation on Storm to make an open offer to the shareholders of Hypertech under the SAST Regulations?
- Will Storm and RLL be considered as persons acting in concert after the execution of the Second Agreement?

### Answer

The above problem is based on the judgment of the Supreme Court dated July 8, 2010 in the matter of M/s. Daiichi Sankyo Company vs Jayaram Chigurupati [(2010) 7 SCC 449].

- On allotment of shares pursuant to the Second Agreement, the shareholding (and in turn voting rights) of Storm in RLL would increase from 0% to over 50%, hence exceeding the limits specified under Regulation 3(1) of the SAST Regulations. Thus, such acquisition would trigger an obligation on Storm to make an open offer to the shareholders of RLL under the SAST Regulations.
- On acquiring shares pursuant to the Second Agreement, Storm would effectively acquire over 50% voting rights in RLL. RLL, pursuant to the First Agreement, already holds 46.85% of the equity shareholding of Hypertech. Therefore, the acquisition of RLL's shares (and in turn voting rights) by Storm would lead to an indirect acquisition of voting rights in Hypertech.
- Since the acquisition of shares of RLL by Storm would lead to an indirect acquisition of voting

rights over Hypertech, Storm would be required to make a public announcement of an open offer in terms of Regulation 5 of the SAST Regulations.

- d. As per Section 2(87) of the Companies Act, 2013, on acquisition of over 50% of shareholding in RLL by Storm, RLL would, in effect, become a subsidiary of Storm. Regulation 2(1)(q)(2)(i) of the SAST Regulations states that a holding and subsidiary company are deemed to be persons acting in concert, unless the contrary is established. However, there can be no persons acting in concert unless there is a common objective or purpose of acquisition of shares or voting rights or control over a target company as per Regulation 2(1)(q)(1) of the SAST Regulations. Therefore, Storm and RLL would be considered persons acting in concert, not solely by virtue of the holding company-subsidary company relationship but if they have a common objective or purpose of acquisition of shares or voting rights or control over the target company, being Hypertech in this case.

### Lesson 8

#### SEBI (Delisting of Equity Shares) Regulations, 2009

- I. Oracle Limited (“**Company**”) is a public company which has its shares listed on BSE Limited and National Stock Exchange of India Limited. The engineering business of the Oracle Group is presently held under the Company and Symphony Engineering Limited (“**SEL**”), a subsidiary of the Company. The equity shares of SEL were listed on Ahmedabad Stock Exchange in May, 1965 and were subsequently delisted in June, 2015, in accordance with Chapter III of the SEBI (Delisting of Equity Shares) Regulations, 2009 (“**Delisting Regulations**”). It is proposed to consolidate the engineering business in a single company, for which, the Company will incorporate a wholly owned subsidiary i.e. New Company (“**New Co.**”) and will demerge its engineering undertaking into New Co. It is also proposed to simultaneously either merge SEL into the New Co. or demerge the engineering undertaking of SEL into the New Co. As a reason for the aforesaid demerger, New Co. will issue equity shares to the shareholders of the Company and SEL as a consideration for demerger. In order to implement the identified alternative, the Company, SEL and the New Co. would enter into a scheme of arrangement under Sections 230-232 of the Companies Act, 2013. The equity shares of New Co. are proposed to be listed in accordance with the relevant SEBI laws. In view of the above facts, answer the following questions:
  - a. Is there any restriction on listing of equity shares that have been delisted by voluntary delisting under Chapter III of the Delisting Regulations?
  - b. Would the listing of equity shares issued by New Co. to the shareholders of the Company and SEL be permissible under the Delisting Regulations?
  - c. Is there any restriction on listing of equity shares that have been compulsorily delisted under Chapter V of the Delisting Regulations?

#### Answer

The above problem is based on the informal guidance dated September 5, 2017 bearing reference number SEBI/HO/CFD/DCR1/OW/P/2017/0000021177/1 issued by SEBI in the matter of M/s. Arvind Limited.

- a. Regulation 30(1)(a) of the Delisting Regulations provides that an application for listing equity shares that have been delisted under Chapter III cannot be made until the expiry of a period of 5 years from the delisting.
- b. Since the issuance of equity shares by New Co. are distinct from the equity shares of SEL that were delisted from the Ahmedabad Stock Exchange in 2015, they can be issued under the Delisting Regulations.

- c. Regulation 30(1)(b) of the Delisting Regulations provides that an application for listing equity shares that have been delisted under Chapter V cannot be made until the expiry of a period of 10 years from the delisting.
- II. Clover Plus Industries Limited ("**Company**") is a company incorporated under the provisions of the Companies Act, 1956. The Company was listed on Delhi Stock Exchange ("**DSE**") for the last fifteen years. However, post de-recognition of DSE by SEBI, the Company was listed with the Metropolitan Stock Exchange of India Limited ("**MSEI**"). The date of listing of the Company on MSEI is February 13, 2017. The Company has been listed on MSEI since then and is not listed on any other stock exchange. The promoters of the Company are now exploring the possibility to voluntarily delist the Company under the SEBI (Delisting of Equity Shares) Regulations, 2009 ("**Delisting Regulations**") by providing an exit opportunity to all the public shareholders. Assume that you are the legal advisor to the Company and accordingly answer the following questions:
- a. What is the minimum period prescribed under the Delisting Regulations, for which the equity shares of the Company should be listed on a recognized stock exchange before the Company can apply for delisting of such shares?
  - b. What are the circumstances/ conditions under which equity shares of a company cannot be delisted as per the Delisting Regulations?
  - c. Is the Company eligible for voluntary delisting in terms of Regulation 4(1)(c) of the Delisting Regulations?

### Answer

The above problem is based on the informal guidance dated November 3, 2016 bearing reference number SEBI/HO/CFD/DCR1/OW/P/2016/30240/1 issued by SEBI in the matter of Fiber Plus Industries Limited.

- a. Regulation 4(1)(c) of the Delisting Regulations lays down the minimum period of 3 years for which the class of equity shares of a company should be listed on any recognized stock exchange before an application for delisting such class of shares can be made.
  - b. Regulation 4 of the Delisting Regulations lays down that equity shares of a company cannot be delisted in the following circumstances/ conditions:
    - Pursuant to a buy-back of equity shares by the company
    - Pursuant to a preferential allotment made by the company
    - Unless a period of 3 years has elapsed since the listing of that class of equity shares on any recognized stock exchange
    - If any instruments issued by the company, which are convertible into the same class of equity shares that are sought to be delisted, are outstanding.
  - c. Since the equity shares of the Company were listed on the DSE for the past 15 years, which is well above the minimum time period of listing of 3 years required under Regulation 4(1)(c) of the Delisting Regulations, the Company is eligible for voluntary delisting.
- III. XYZ Limited ("**Company**") is a public company which has its equity shares listed on BSE Limited. The promoters of the Company hold 59.5% shares in the Company and the remainder share capital is held by the public. The public shareholding of the Company includes certain independent non-resident private equity investors ("**PE Investors**") that invested in the Company through primary purchases at different times during the period 2009 and 2010, and currently hold 16.5% of the share capital of the Company. The promoters of the Company are desirous of delisting the Company from all the stock exchanges

on which it is listed by providing an exit opportunity to the public shareholders of the Company. For the sole purpose of financing the delisting of the Company, the promoters are looking to avail of financial assistance from the PE Investors (**“Proposed Arrangement”**). The Proposed Arrangement, if entered into, would only be for the purpose delisting such that in the event the proposed delisting offer of the Company is not successfully completed for any reason whatsoever, no subsisting arrangements or cooperation will continue between the promoters and PE Investors and the parties resume status quo. In view of the above facts, answer the following questions:

- a. Would the promoters and PE Investors be regarded as persons acting in concert (**“PACs”**) in view of the Proposed Arrangement under the SEBI (Delisting of Equity Shares) Regulations, 2009 (**“Delisting Regulations”**)?
- b. Is there any prohibition on the Proposed Arrangement under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (**“SAST Regulations”**)?
- c. Which category of persons is the Company required to provide an exit opportunity for voluntary delisting under the Delisting Regulations?

### Answer

The above problem is based on the informal guidance dated August 7, 2012 bearing reference number CFD/DCR/TO/IG/SS/OW/17713/12 issued by SEBI in the matter of M/s. IDFC Capital Limited.

- a. As per Regulation 2(2) of the Delisting Regulations read with Regulation 2(1)(q) of the SAST Regulations, persons, who with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to an agreement or understanding (formal or informal), directly/indirectly co-operate for acquisition of shares or voting rights in, or exercise of control over the target company are considered as PACs. Since under the Proposed Arrangement, the PE Investors would agree to finance the promoters to acquire shares in the delisting offer which would be considered as a direct co-operation for acquisition of shares of the Company, the PE Investors would be treated as PACs with the promoters.
- b. The Proposed Arrangement is prohibited under the proviso to Regulation 3(2) of the SAST Regulations which prohibits a person, holding more than 25% and less than 75% shares (75% being the maximum permissible non-public shareholding for listed companies) from acquiring or entering into an agreement to acquire shares/voting rights which would take the aggregate shareholding of such person beyond 75%. Thus the promoters holding 59.5% shares are prohibited under the SAST Regulations from entering into the Proposed Arrangement with the PE Investors holding 16.5% since it would take their combined shareholding up to 76%.
- c. Regulation 5 of the Delisting Regulations requires the Company to provide an exit opportunity to all public shareholders holding equity shares of the class which are sought to be delisted since the promoters seek to carry out voluntary delisting of the Company from all the recognized stock exchanges where it is listed.

## Lesson 11

### SEBI (Prohibition of Insider Trading) Regulations, 2015

- I. Morgan Care Limited (**“MCL”**) is a public limited company, which has its equity shares listed on both BSE Limited and National Stock Exchange of India Limited. Carlton Price Private Limited (**“CPPL”**) is a part of the promoter group of MCL since it is closely held by certain promoters of MCL. However, currently CPPL neither holds any equity shares in MCL nor has any role in the management of MCL. The ‘Promoter and Promoter Group’ of MCL collectively hold 65.44% of the total paid-up capital of MCL, as on date. Being a public listed company, MCL has issued a ‘Code of practice and procedures

for fair disclosure of unpublished price sensitive information (“**UPSI**”) and code of conduct to regulate, monitor and report trading by insiders of MCL (“**CoC**”) in accordance with the SEBI (Prohibition of Insider Trading Regulations), 2015 (“**PIT Regulations**”). CPPL now intends to acquire 50,000 equity shares, constituting 0.06% of the paid-up capital of MCL (“**Proposed Acquisition**”), which is beyond the thresholds stipulated by the board of directors of MCL for trading by designated persons. In view of the above facts, answer the following questions:

- a. What category of persons are required to obtain a pre-clearance from the compliance officer of a listed entity prior to trading?
- b. Will CCPL be required to obtain a pre-clearance from the compliance officer of MCL for the Proposed Acquisition?
- c. Does the compliance officer have discretionary powers under the PIT Regulations to reject a pre-clearance request on any reason it deems fit?
- d. Is the compliance officer required to consider certain factors while approving or rejecting an application seeking pre-clearance for a proposed transaction?
- e. Is there any provision in the PIT Regulations that provides for the examination of acts of a compliance officer?

#### Answer

The above problem is based on the informal guidance dated February 3, 2017 bearing reference number ISD/OW/2700/2017 issued by SEBI in the matter of Kirloskar Chillers Private Limited.

- a. Clause 6 of Schedule B of the PIT Regulations states that pre-clearance is required to be obtained only by ‘designated persons’ (i.e. employees and connected persons designated as such on the basis of their functional role in the organization) if the value of the proposed trades is above such thresholds as stipulated by the board of directors of the listed company.
- b. CCPL will be required to obtain a pre-clearance from the compliance officer of MCL for the Proposed Acquisition only if it is designated as a ‘designated person’ by the board of directors of MCL, in consultation with the compliance officer.
- c. The compliance officer, under the provisions of the PIT Regulations, is entrusted with ensuring adherence to the PIT Regulations and in rejecting a pre-clearance request, the compliance officer is required to ensure compliance in letter and spirit to the PIT Regulations i.e. to ensure that no undue advantage accrues to certain categories of investors on account of their access to UPSI and not for any ulterior motive.
- d. The compliance officer is required to approve or reject a request for pre-clearance after necessary assessment as per the PIT Regulations and the Code of Conduct of the company. Clause 7 of Schedule B of the PIT Regulations requires the compliance officer to maintain a list of such securities as a ‘restricted list’ which is to be used as a basis for approving or rejecting applications for pre-clearance of trades and Clause 8 requires a compliance officer to have regard to whether a declaration (from the applicant seeking pre-clearance to the effect that he is not in possession of UPSI) is reasonably capable of being rendered inaccurate.
- e. Regulation 2(1)(c) of the PIT Regulations lays down that the compliance officer acts under the overall supervision of the board of directors of the listed company or the head of the organization (as the case may be). Additionally, Clause 1 of Schedule B of the PIT Regulations requires the compliance officer to report to the board of directors and provide reports to the Chairman of the audit committee/ board of directors. Hence, any act of the compliance officer may be referred to



the board of directors and the audit committee for examination with the extant laws and relevant facts of the case.

- II. KJF Limited (“**Company**”) is a public limited company, which has its equity shares listed on BSE Limited. Mr. Ram Prakash (“**Promoter**”) holds equity shares constituting 13% of the equity share capital of the Company and has been included in the category of ‘Promoter and Promoter Group’ of the Company in its shareholding pattern filed for the quarter ended December 31, 2017. The total shareholding of the promoter and promoter group of the Company, as per the latest shareholding pattern filed by the Company is 53,34,456 equity shares of the Company constituting 24% of its equity share capital. Ms. Radhika Sharma (“**Director**”) is one of the directors on the board of directors of the Company and currently holds 1.02% of the equity share capital of the Company. The Company intends to enter into a scheme of arrangement pursuant to which the existing shareholders of the Company, including the Promoter, would be allotted bonus shares constituting 35,12,313 equity shares of the Company aggregating to 4% of the Company’s equity shareholding. The details of the scheme have already been disclosed by the Company to the relevant authorities. Further, the Director wishes to transfer, by way of gift, 11,45,632 equity shares belonging to her to an immediate relative. In view of the above facts, answer the following questions:
- Whether the Promoter would be required to make a disclosure under Regulation 7(2) of the SEBI (Prohibition of Insider Trading) Regulations, 2015 (“**PIT Regulations**”)?
  - Whether the Director would be required to make a disclosure under Regulation 7(2) of the PIT Regulations, considering that the trade value is nil?
  - In case the answer to (b) above is in the affirmative, what is the time period within which the Director will be required to make a disclosure under Regulation 7 of the PIT Regulations?
  - In case the answer to (b) above is in the affirmative, at what value should the transaction, in the above facts, be disclosed by the Director?

### Answer

The above problem is based on the informal guidance dated April 28, 2017 bearing reference number ISD/OW/9966/2017 issued by SEBI in the matter of Kotak Mahindra Bank Limited.

- Since the promoter has no role in the transaction involving the allotment of bonus shares, and the transaction is already in the public domain by virtue of being disclosed by the Company to the relevant authorities, the Promoter would not be required to make a disclosure to the Company under Regulation 7(2) of the PIT Regulations.
- The transaction by the Director involving a gift of shares to an immediate relative would be required to be disclosed to the Company by the Director under Regulation 7(2) of the PIT Regulations, if the value of the shares transferred are in excess of ten lakh rupees, or if such gift along with other transactions executed by the Director in a calendar quarter aggregate to a traded value in excess of ten lakh rupees.
- If the value of the shares transferred or aggregate value of transactions executed by the Director in a calendar quarter are in excess of ten lakh rupees, the time period within which the Director will be required to make a disclosure to the Company regarding the number of shares disposed under Regulation 7(2) of the PIT Regulations is within two trading days of such transaction.
- In the transaction involving the gift of shares by the Director, the value of shares disposed of would be calculated as the prevailing market value of the equity shares of the Company on the day of disposal.

- III. Transient Trading Company (India) Limited ("**TTCL**") is a company listed on the National Stock Exchange of India Limited and Calcutta Stock Exchange Limited. M/s. Genesis Private Limited ("**GPL**") is a joint promoter of TTCL and has recently acquired 27.69% of the paid up share capital of TTCL through an open offer. GPL also has two nominees on the board of directors of TTCL. One of the said two nominees is a director in GPL itself and the other is the managing director of M/s. Phoenix Capital Limited ("**PCL**"). PCL has promoted a private equity fund names M/s. Phoenix Capital Growth Fund, which acted in concert with GPL in the aforesaid open offer, which now stands completed. GPL, despite being an insider, now proposes to acquire further shares of TTCL ("**Proposed Acquisition**") in accordance with the provisions of the SEBI (Prohibition of Insider Trading) Regulations, 2015 ("**PIT Regulations**"). In view of the above facts, answer the following questions:
- What are the ways in which GPL can undertake the Proposed Acquisition in terms of the PIT Regulations considering it is an insider in possession of unpublished price sensitive information ("**UPSI**")?
  - Would a trading plan formulated for the Proposed Acquisition require prior approval of any authority/person?
  - Can a trading plan under the PIT Regulations include a condition of 'maximum value per share not exceeding a certain amount' along with the specification of number of shares to be purchased during the trading plan period?
  - Can GPL deviate from the trading plan once it is approved?

#### Answer

The above problem is based on the informal guidance dated November 1, 2016 bearing reference number ISD/OW/30056/2016 issued by SEBI in the matter of Tide Water Oil Company (India) Limited.

- Despite being an insider in possession of UPSI, GPL can undertake the Proposed Acquisition in the following circumstances under Regulation 4 of the PIT Regulations:
    - An off-market inter-se transfer with another promoter(s) who is in possession of the same UPSI without being in breach of Regulation 3 of the PIT Regulations where both parties have made a conscious and informed trade decision; or
    - When the individuals in possession of UPSI are different from those taking trading decisions and such decision making individuals were not in possession of UPSI when they took the decision to trade, appropriate and adequate arrangements are in place to ensure that the PIT Regulations aren't violated, there is no communication of UPSI among such individuals and there is no evidence of such arrangements having been breached; or
    - Pursuant to a trading plan set up under Regulation 5 of the PIT Regulations.
  - Regulation 5 of the PIT Regulations requires an insider formulating a trading plan to present it to the compliance officer for approval.
  - Under Regulation 5(2)(v) of the PIT Regulations, the inclusion of a condition on the purchase of shares subject to a certain limit on the price of shares may lead to a deviation from the number of shares that may be specified in a trading plan, thereby defeating the restriction under Regulation 5(4) of the PIT Regulations. Hence, such a condition cannot be included in a trading plan set up under the PIT Regulations.
  - Regulation 5(4) lays down that once a trading plan is approved, it cannot be revoked and the insider is required to mandatorily implement the plan without any deviations.
- IV. ABC Bank Limited ("**Bank**") is a bank listed on BSE Limited. Some of the employees of the Bank, who



may be in possession of unpublished price sensitive information (“**UPSI**”) of the Bank or other listed companies with whom the Bank deals, are consequently restricted from dealing in securities of the Bank or such other listed companies. Such employees propose to invest their funds in the securities market through portfolio management schemes, which deal in securities with the funds of investors (investors including employees of the Bank and their relatives) as per the portfolio manager’s own discretion with no direct/indirect control/influence of the investor over the investment making decisions (“**Discretionary Portfolio Management Scheme**”). Under such a scheme, the day to day investment discretion for the account(s) are fully delegated to the portfolio manager and are not shared with the investor. The portfolio manager does not discuss any potential investment/disinvestment decision with the investor and the investor does not make any suggestions regarding such investment/disinvestment decisions. The portfolio is standard portfolio and is not altered specifically for an investor and the portfolio manager does not accept specific buy or sell orders of any security at the direction of its client. Further, investments in securities of companies as part of the Discretionary Portfolio Management Scheme are identifiable and the securities in the portfolio are mandatorily held in a separate demat account with power of attorney in favour of the portfolio manager. However, the portfolio manager, while exercising his discretion makes investment/disinvestment decisions in securities which may include securities of the Bank or securities of a listed company for which the employee or his relative may be in possession of UPSI by virtue of being an employee of the Bank, but the employee or his relative has no control directly/indirectly over investment making decisions of the portfolio manager, to which effect the employees even furnish a declaration. In view of the above facts, answer the following questions:

- a. Is there a bar on insiders from trading in securities of a company when in possession of UPSI under the SEBI (Prohibition of Insider Trading) Regulations, 2015 (“**PIT Regulations**”)?
- b. What is the presumption under the PIT Regulations regarding trading in securities by an insider when he is in possession of UPSI?
- c. Are deals under the Discretionary Portfolio Management Scheme on behalf of the employees of the Bank or their relatives in compliance with the provisions of the PIT Regulations?
- d. Whether deals under the Discretionary Portfolio Management Scheme can be undertaken when the trading window of the Bank or the company with which the Bank deals with is closed?

### Answer

The above problem is based on the informal guidance dated July 25, 2016 bearing reference number ISD/OW/20812/2016 issued by SEBI in the matter of HDFC Bank Limited.

- a. Regulation 4(1) of the PIT Regulations states that no insider shall deal in securities that are listed or proposed to be listed on a stock exchange when in possession of UPSI.
- b. The explanatory note to Regulation 4 provides a presumption that trades executed by a person in possession of UPSI have been motivated by the knowledge and awareness of such information in his possession.
- c. Regulation 4(1) read with its explanatory note provides that dealing in securities, whether direct or indirect, is not relevant, but that any insider, when in possession of UPSI, should not deal in securities of the company to which the UPSI pertains. Hence, even while dealing in securities through the Discretionary Portfolio Management Scheme, the trades of an insider would be assumed to be motivated by the knowledge and awareness of such UPSI, and therefore such trades will not be in compliance with the provisions of the PIT Regulations.
- d. Clause 4 of Schedule B of the PIT Regulations mandates the operation of a notional trading window as an instrument of monitoring trading by designated persons, which is required to be closed when the compliance officer determines that the designated persons can reasonably be

expected to be in possession of UPSI. Thus Regulation 4(1) read with Clause 4 of Schedule B of the PIT Regulations infers that dealings through the Discretionary Portfolio Management Scheme, when the trading window is closed will also be assumed to be motivated by the knowledge and awareness of UPSI. Therefore, such trades cannot be undertaken in terms of the PIT Regulations.

- V. ABC Capital Markets Limited ("**Intermediary**") is a Category-I Merchant Banker. In accordance with the SEBI (Prohibition of Insider Trading) Regulations, 2015 ("**PIT Regulations**"), the Intermediary is maintaining a restricted list ("**Restricted List**") which includes all the companies in which the Intermediary is handling any assignment or is privy to any unpublished price sensitive information ("**UPSI**"). The Intermediary and its employees are not permitted to trade in the shares of the companies included in the Restricted List. Hence, trading is only allowed in the shares of the companies with which the Intermediary is not connected in any way and about which it does not have any UPSI. In view of the above facts, answer the following questions:
- What is meant by the term 'contra trade'? What is the restriction with respect to executing contra trade under the PIT Regulations?
  - Is the contra-trade restriction under the PIT Regulations applicable on the Intermediary and its employees with respect to trading in shares of listed companies which are not included in the Restricted List?
  - Is there a requirement under the PIT Regulations to impose a contra trade restriction for securities of listed companies where no connection and possession or access to UPSI is envisaged?

#### Answer

The above problem is based on the informal guidance dated November 25, 2016 bearing reference number SEBI/HO/ISD/ISD/OW/P/2016/32258/1 issued by SEBI in the matter of SBI Capital Markets Limited and the informal guidance dated December 23, 2016 bearing reference number ISD/OW/3644/2016 issued by SEBI in the matter of Prabhudas Lilladher Private Limited.

- Contra trade means opposite trading or reversal of the actual position. Clause 10 of Schedule B of the PIT Regulations imposes a restriction on designated persons to execute a contra trade in those securities of which the designated persons are reasonably expected to have access to UPSI during a period as specified in the code of conduct of a company formulated under the PIT Regulations.
  - The contra trade restriction on the Intermediary and its employees with respect to trading in securities of listed companies which are not included in the Restricted List would depend on the connection the Intermediary or its designated employee has with the concerned listed company and subsequent possession of or access to UPSI. Such restriction would be applicable on the Intermediary and its employees if they are connected persons with the listed company and possess or have access to UPSI.
  - The contra trade restriction on the Intermediary and its employees is not required to be applicable with respect to securities of listed companies where no connection and possession or access to UPSI by the Intermediary or its employees is envisaged.
- VI. Artemis Technologies Limited ("**Company**") is a public company which has its equity shares listed on BSE Limited. The Company has implemented the facility of a cashless employee stock option plan ("**ESOP Plan**") for its employees. This cashless ESOP Plan is operated through a trust, the Artemis Employee Welfare Trust ("**Trust**") in accordance with the SEBI (Share Based Employee Benefits) Regulations, 2014 ("**SBEB Regulations**") which is classified as an insider for the purposes of the SEBI (Prohibition of Insider Trading) Regulations, 2015 ("**PIT Regulations**"). The Trust acts as a mechanism for implementing the ESOP Plan by undertaking trades on behalf of the employees. The Trust either

applies for shares to the Company and such shares are issued to it, or the Trust acquires shares through secondary market purchase for the purpose of ESOP plan. However, all sales are undertaken only on the basis of exercise by the relevant employee. In view of the above facts, answer the following questions:

- a. Would the exercise of ESOP by any person, including a designated person, and the sale of the resultant shares attract any contra-trading restrictions under the PIT Regulations?
- b. Would the exercise of ESOPs by the Trust for employees who are not designated persons, attract contra trade restrictions under the PIT Regulations?
- c. Would the acquisition of shares (whether by subscription or secondary acquisition) by the Trust to give effect to ESOPs, be considered as a 'trade' for the purpose of the contra trading restrictions imposed under the PIT Regulations?
- d. Would the restriction on contra trade by designated persons be applicable only in respect of the Company's own securities or for all listed securities?
- e. Would the exemption on applicability of contra trade in respect of buy backs, open offers, rights issues, etc. also be applicable in case of securities subscribed in an initial public offer?

#### Answer

The above problem is based on the informal guidance dated October 30, 2015 bearing reference number ISD/OW/30679/2015 issued by SEBI in the matter of KPIT Technologies Limited and the informal guidance dated November 2, 2016 bearing reference number ISD/OW/30123/2016 issued by SEBI in the matter of Kotak Mahindra Bank Limited.'

- a. In terms of the guidance note dated August 24, 2015 released by SEBI on the PIT Regulations, exercise of ESOPs is not considered as 'trading' except for the purpose of disclosures under Chapter III of the PIT Regulations. Hence, the exercise of ESOP by any person, including a designated person, and the sale of the shares so acquired would not attract contra trade restrictions.
  - b. Since exercise of ESOPs is not considered as 'trading' except for the purpose of disclosures under Chapter III of the PIT Regulations, the exercise of ESOPs by the Trust for employees who are not designated persons would not attract contra trade restrictions under the PIT Regulations.
  - c. Since the Trust is not undertaking trades in its own capacity but acting solely on behalf of the Company's employees to give effect to the exercise of ESOPs, and the exercise of ESOPs is not considered 'trading' except for the purpose of disclosures under Chapter III of the PIT Regulations, the acquisition of shares by the Trust to give effect to the exercise of ESOPs by employees will not be considered as a 'trade' for the purpose of contra trade restrictions.
  - d. Contra trade restriction under the PIT Regulations is applicable in respect of those securities of which the unpublished price sensitive information is available with the designated persons. Therefore, the restriction on contra trade by designated persons will be applicable to all securities of which the unpublished price sensitive information is available with the designated persons.
  - e. The exemption on applicability of contra trade in respect of buy backs, open offers, rights issues, etc. is not applicable in case of securities subscribed in an initial public offer as there is no provision in the PIT Regulations to this effect.
- VII. Southern Oil Limited ("**Company**") is a public company which has its equity shares listed on BSE Limited and National Stock Exchange of India Limited. Dhruv Trading and Investments Private Limited ("**DTPL**"), a non-banking financial company registered with the Reserve Bank of India, belongs to the

'Promoter and Promoter Group' of the Company. DTPL, along with its two wholly owned subsidiaries, Ornate Holding and Trading Company Private Limited ("**Ornate**") and Casper Holding and Trading Company Private Limited ("**Casper**"), holds 16.29% of the paid up equity share capital of the Company. The aggregate shareholding of the entire promoter and promoter group in the Company, none of which are financial institutions, is 52.79%. DTPL, Ornate and Casper intend to borrow from financial institutions on an ongoing basis, the borrowing generally being in the form of term loans with a tenor of 2 to 3 years which is to be secured by pledging the shares of the Company in favour of the lenders ("**Proposed Action**"). At the time of maturity or call/put option of the term loans, DTPL, Ornate and Casper would have to pledge and de-pledge shares of the Company in favour of the concerned lenders as per the mandate under the loan agreement, which might result in pledging and simultaneously de-pledging of the Company's shares within a period of 6 months. Since DTPL, Ornate and Casper are part of the promoter/promoter group of the Company, they are perpetually in possession of unpublished price sensitive information ("**UPSI**") relating to the Company. In view of the above facts, answer the following questions:

- a. Would the Proposed Action be considered as a 'trade' in terms of the SEBI (Prohibition of Insider Trading) Regulations, 2015 ("**PIT Regulations**")?
- b. Is there a prohibition in the PIT Regulations on the Proposed Action being executed when in possession of UPSI?
- c. Is there any way in which the Proposed Action can be undertaken despite the prohibition imposed on it under the PIT Regulations?
- d. Would the Proposed Action be permitted when the trading window of the Company is closed?

### Answer

The above problem is based on the informal guidance dated November 9, 2015 bearing reference number ISD/OW/31420/2015 issued by SEBI in the matter of Geetanjali Trading and Investments Private Limited.

- a. Regulation 2(1)(l) of the PIT Regulations defines trading to mean and include subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell or deal in any securities. The explanatory note to Regulation 2(1)(l) clarifies that pledging of securities would also be included within the definition of 'trade' and 'trading' under Regulation 2(1)(l) of the PIT Regulations. Hence, the Proposed Action would be considered as a 'trade' in terms of the PIT Regulations.
- b. Regulation 4(1) of the PIT Regulations prohibits insiders from trading in securities that are listed or proposed to be listed on a stock exchange when in possession of UPSI. Since DTPL, Ornate and Casper are perpetually in possession of UPSI, they would be considered insiders in terms of Regulation 2(1)(g) of the PIT Regulations. Hence, the execution of the Proposed Transaction would constitute trading in listed securities by insiders when in possession of UPSI and will be prohibited under Regulation 4(1) of the PIT Regulations.
- c. The Proposed Transaction can be undertaken in the following circumstances, as laid down in Regulation 4 of the PIT Regulations:
  - When the individuals in possession of UPSI are different from those taking trading decisions and such decision making individuals were not in possession of UPSI when they took the decision to trade, appropriate and adequate arrangements are in place to ensure that the PIT Regulations aren't violated, there is no communication of UPSI among such individuals and there is no evidence of such arrangements having been breached; or
  - Pursuant to a trading plan under Regulation 5 of the PIT Regulations.

- d. The Guidance Note on the PIT Regulations dated August 24, 2015 clarifies that the creation and invocation of pledge for enforcement of security when in possession of UPSI would be allowed when the trading window is closed, if the pledger or pledgee demonstrates that the creation of pledge or invocation of pledge was bona fide and prove their innocence under the proviso to Regulation 4(1) of the PIT Regulations. Hence, the Proposed Action would be permitted even when the trading window of the Company is closed, however the onus to demonstrate the bona fide intention behind such action would lie with DTPL, Ornate, Casper and the financial institution acting as pledgee.

### Lesson 13

#### Collective Investment Scheme

##### 1. *Rose Valley Real Estate and Construction Limited Case (2011)*

In this matter, SEBI had observed that Rose Valley Real Estate and Construction Ltd. ("**Rose Valley**") was mobilizing funds under CIS without obtaining a certificate of registration as required under Section 11AA of the Act. Rose Valley in turn moved the High Court challenging the constitutional validity of the said Act. The Calcutta High Court dismissed the said Writ Petition filed by Rose Valley challenging the constitutional validity of SEBI's power in regulating CIS. Dismissing the Writ Petition, the High Court observed that the Section 11AA of the Act is legal and the provisions provided in it were valid. The High Court also slapped a fine of Rs. 10 lakhs on Rose Valley.

SEBI, held that Rose Valley was raising funds through sale of plots of land and pooling the same to develop the land and providing investors a return on the amount invested at the end of the scheme in the form of credit value. Investors could utilize the credit value to either adjust partly against the cost of land or to get refund for the investments made. "These activities were akin to the features of CISs, specified under the Section 11AA of the Act". SEBI had further directed Rose Valley not to collect any money from investors or to launch any scheme and not to dispose of any of the properties of the scheme. SEBI had also in another case imposed a penalty of Rs. 1 crore on Rose Valley for not providing details sought by the market regulator in a case charging the company with issuing debentures illegally.

SEBI had also barred Rose Valley Hotels and Entertainment from collecting money from investors under its 'holiday membership' schemes alleging that such schemes were CIS in nature and required a certificate of registration. SEBI had begun the investigation of the case after it received a letter in June, 2012 from the Additional Director-General of Police, Guwahati, Assam, alleging that Rose Valley Hotels and Rose Valley Real Estates Constructions Ltd. had collectively raised Rs. 1,006.70 crores until February 2012. It was pointed out that Rose Valley Hotels had launched a scheme called Rose Valley Holiday Membership Plan in 2010. Under the scheme, an investor can book a holiday package by paying monthly installments. Upon maturity or the completion of the installment tenure, the investor can either opt for a holiday, which includes hotel accommodation and services, or a return on the investment with annualized interest.

SEBI had sought various details on the scheme that included the number of individuals who had subscribed to the plan and the total amount refunded by the Company towards principal investment and interest. Rose Valley Hotels, however, contended that it was in the time share business, which did not fall under SEBI's purview. SEBI, in his order stated that the scheme had all the ingredients of a CIS. He added that the contribution made in the form of monthly installments by investors were pooled and utilised for the purpose of the holiday membership plan. Moreover, such contributions are made by the investors with a view to receiving profits or income in the form of returns with annualized interest. It had also directed Rose Valley Hotels not to collect any more money from investors either through existing schemes or via new ones.

##### 2. *Maitreya Services Pvt. Ltd. Case (2013)*

SEBI began the probe against Maitreya Services Pvt. Ltd. ("**Maitreya**") after a reference from the Income Tax



department in September 2010 alleging violation of SEBI regulations by Maitreya. During the inquiry, Maitreya submitted that it carries out the business of real estate and its business includes buying and selling of land, development of the land, construction and other land related activities. SEBI found that Maitreya had launched various schemes under which money was collected from the public. These schemes differed on the basis of the periodic payment to be made by the investor, and the time period for which such investments were to be made. In the course of its inquiry, the SEBI found that the Company had launched and operated CIS without obtaining registration in terms of section 12(1B) of the Act and regulation 3 of the Regulations and an amount of Rs. 804 crores was outstanding with it was to be repaid to investors. In view of the same, a show cause notice was issued to Maitreya and its directors asking them to show cause as to why suitable action should not be initiated against them for the violation of regulation 3 of the Regulations read with section 11AA of Act.

In reply to the show-cause notice by SEBI, Maitreya denied being in CIS operations and refuted all charges leveled against it and requested that the proceedings be terminated and discharged from the show-cause notice. In 2012, Maitreya sought to settle the proceedings through a consent procedure but that was rejected by SEBI. SEBI's probe found that Maitreya had mobilized Rs. 1,332 crores from the public as "advances" as on March 31, 2011 and had repaid Rs. 538 crores as "repayment" to investors, resulting in an amount of Rs. 794 crores as outstanding to be repaid as on that date. SEBI also found that the assets were insufficient to meet the liabilities and its repayment obligations were almost double the value of its total movable and immovable assets.

In view of the foregoing, SEBI ordered for winding up of CIS being run in the garb of real estate business, asking the entity concerned to refund the money to investors within three months. SEBI also barred Maitreya, and its directors from accessing the securities market till the time all its CIS are wound up and decided to initiate prosecution proceedings against them. SEBI also made a reference to the police to register a civil/criminal case against Maitreya and their Directors and persons in charge of the CIS business for "offences of fraud, cheating, criminal breach of trust and misappropriation of public funds".

### 3. *Alchemist Infra Realty Ltd Case (2013)*

SEBI received an anonymous letter which alleged that Alchemist Infra Realty Ltd. ("**Alchemist**") was mobilizing money from its investors. In order to ascertain whether Alchemist was operating CIS, SEBI initiated an inquiry against it. On perusal of various documents provided by Alchemist and inquiring into its affairs, SEBI found that the scheme/arrangement is in the nature of CIS and issued a show cause notice to Alchemist and its Directors advising them to show cause as to why appropriate action including directions under section 11 and 11B of the Act read with regulation 65 of Regulations should not be issued against all of them for the alleged violations.

The charge against Alchemist, as per show cause notice, is that its scheme/arrangement are in the nature of CIS and that it is offering/launching them without obtaining registration from SEBI for carrying on such CIS in contravention of section 12(1B) of the Act and regulation 3 of Regulations. Meanwhile, Alchemist had filed an application for a consent order which was rejected by SEBI. To stop the illegal business, SEBI issued following directions to safeguard the interests of the investors :

- (a) Alchemist shall not collect any money from investors or launch or carry out any scheme which has been identified as a CIS in the order.
- (b) Alchemist and its Directors shall wind up the existing CIS and refund the money collected by it under the schemes with returns which are due to its investors as per the terms of offer within a period of three months from the date of the order and submit a winding up report to SEBI.
- (c) Alchemist and its Directors are restrained from accessing the securities market till all the CIS are wound up by it and all the monies mobilized through such schemes are refunded to its investors with returns.

SEBI also found that the Investment Application Forms of Alchemist mentioned that it was a part of 'Alchemist Group', which was engaged in diverse activities such as steel, food and beverages, IT, healthcare, media, aviation, realty, hospitality, education and tea estate, among others, with asset base of over Rs 5,000 crores.

Thus, an Investor/Applicant was misled to believe that the company, Alchemist Infra Realty Ltd, is part of the Alchemist Group, whereas the company had contended that it was not associated with the Alchemist Group.

Alchemist and its Directors filed an appeal before the Securities Appellate Tribunal (SAT) challenging the order. The SAT disposed of the appeal by way of common order and granted 18 months to refund the money (estimated Rs. 1000 crores) in view of the “long and tedious process of implementing the scheme of repayment” to 1.5 million investors.

#### 4. Rich Infra Developers India Ltd. Case (2015)

SEBI received a complaint alleging that Rich Infra Developers India Ltd. (“**Rich Infra**”) was giving huge returns to investors towards the investments in the company. As a matter of preliminary examination into whether or not Rich Infra is carrying on the activities of CIS, SEBI sought certain information from the company.

Meanwhile, SEBI received another complaint by email from a person who had invested Rs. 6.2 lakhs in Rich Infra alleging that the company failed to repay the amount on maturity. The complainant also stated there are several other investors from Odisha who had deposited Rs. 12 lakhs in the company and they did not receive repayment.

SEBI informed Rich Infra and its Directors that the information provided by the company did not include schemes seeking deposits from public for farming and development of agricultural land. Meanwhile, SEBI received a complaint alleging that Rich Infra is promising huge returns or an option to take land. The money invested is for the development of the land however, the land could be located anywhere in India. Rich Infra allotted a plot of 4000 sq. ft for a consideration of Rs. 2,00,000/- and at the end of the term, that is, six years, the investor is entitled to an amount of Rs. 4,05,457/- as ‘Consideration value at the time of maturity’. However, there are no specifications as to the plot/the details to identify the property.

The main contention raised by Rich Infra was: “.....*We are not involved in the activities of collecting money from general public. We are dealing in real estate activities i.e., selling of plots/flats/farm houses/commercial shops/agriculture land/residential properties, etc., which are being sold to prospective customers/buyers.*” In this context, Rich Infra has been inviting applications for advance against plot/ land, for agricultural/residential/ commercial purpose. As already mentioned in the preceding paragraph, no plot/land is identified or distinguished by company. Hence, it is apparent that that the schemes offered by Rich Infra are nothing but a ‘collective investment scheme’ clothed in the guise of a real estate scheme. It is pertinent to note that the most essential feature of a real estate transaction which is a clearly distinguishable immovable property say, a flat or plot which is identifiable by its description, etc. is absent in the schemes offered by Rich Infra. Admittedly, Rich Infra had mobilized funds from public in lieu of allotment of property and also claimed repayments made to some of the investors. However, the company has failed to submit the relevant details of amount mobilized from these investors or a list of all its investors, despite being given several opportunities to do so.

Hence, SEBI directed Rich Infra and its Directors :

- (a) not to collect any fresh money from investors under its existing schemes;
- (b) not to launch any new schemes or plans or float any new companies to raise fresh moneys; (c) to immediately submit the full inventory of the assets including land obtained through money raised by Rich Infra;
- (d) not to dispose of or alienate any of the properties/assets obtained directly or indirectly through money raised by Rich Infra; and
- (e) not to divert any funds raised from public at large which are kept in bank account(s) and/or in the custody of Rich Infra.





**EXECUTIVE PROGRAMME**  
**SECURITIES LAWS AND CAPITAL MARKETS**

**EP-SLCM**

**TEST PAPER**

**A Guide to CS Students**

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In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

*Explanation* – Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute".

**EXECUTIVE PROGRAMME**  
**SECURITIES LAWS AND CAPITAL MARKETS**  
**TEST PAPER**

(This Test Paper is for recapitulate and practice for the students. Students need not to submit responses/ answers to this test paper to the Institute)

*Time allowed: 3 hours*

*Maximum Mark: 100*

**PART I – SECURITIES LAWS (70 MARKS)**

**Question No. 1**

- (i) Examine with reference to the provisions of the Securities Contracts (Regulation) Act, 1956 whether it is possible for City Stock Exchange Limited, a company incorporated under the Companies Act, 2013 and a recognized Stock Exchange, to insist that its members should appoint only other members as their proxies to attend and vote at the meeting of the Stock Exchange. **(5 marks)**
- (ii) SEBI received complaints from some investors alleging that Sunaina Ltd. and some brokers are indulging in price manipulation in the shares of Sunaina Ltd. Explain the powers that can be exercised by SEBI under the Securities and Exchange Board of India Act, 1992 in case the allegations are found to be correct. **(5 marks)**
- (iii) Elucidate the eligibility criteria for a depository to provide depository services in India. **(5 marks)**
- (iv) The paid-up capital of Dharma Ltd. is Rs. 10,40,00,000 and through preferential allotment the company wants to raise its capital to 30,00,00,000. Present holding of promoters is 42 %, whether the promoter group can maintain the same holding in new issue also? Critically examine the applicability of SEBI (ICDR) Regulations with respect to the promoter's contribution in a preferential issue of shares? **(5 marks)**

**Attempt all parts of either Question No. 2 or 2A**

- (i) What do you mean by Vigil Mechanism? Explain. **(3 marks)**
- (ii) ABC Ltd (Acquirer) alongwith Person acting in concert (PAC) holds 24% shares in XYZ Ltd. (Target Company). ABC Ltd. planning to acquire 5% shares of XYZ Ltd. Whether above acquisition of shares would attract the provisions of Regulation 3(2) of SEBI (SAST) Regulations, 2011 requiring open offer to the shareholders of the Target Company? **(4 marks)**
- (iii) The position of capital and reserves as on 31st March, 2018 of Nidhi Ltd. are given below:

Equity shares (Fully paid-up of face value Rs.10 each)	1,00,00,000
Equity shares (Rs.5 is paid-up on face value of Rs.10 each)	1,00,00,000
Equity shares with differential voting rights (Fully paid-up of face value of Rs.10 each)	1,00,00,000
Preference shares (Fully paid-up of Rs.100 each)	1,00,00,000
Free reserves	7,50,00,000

The Company wanted to place proposal before the Board for buy-back of its 100% preference share capital. You, as a Company Secretary, advise your Board on the following issues:

- Maximum limit upto which Board can approve buy-back of shares.
- Maximum limit upto which shareholders can approve buy-back of shares.

- Maximum limit upto which company can buy-back its own shares.
- The situation in which further offer of buy-back can be given by the company within a period of 365 days.

**(8 marks)****OR****Question No.2A**

- (i) PQR Ltd is an unlisted public company who have entered into listing agreement on 20 February, 2018 as per SEBI (LODR), 2015 on National Stock Exchange (NSE). PQR Ltd is planning to conduct Board meeting of the directors on 20 March, 2018. Whether the company needs to give prior intimation to NSE. If yes, explain the matters for which the prior intimation of board meeting shall be given to NSE.

**(4 marks)**

- (ii) On March 20, 2017, ABC Ltd. a company listed on BSE (target Company) had allotted 2,70,00,000 warrants to two promoters viz; PB Private Limited and SN Private Limited and 90,00,000 warrants to non- promoters. On November 27, 2015, the target company allotted 20,00,000 GDRs with 6,00,00,000 underlying shares to non -promoters. Pursuant to the issuance of GDR, the individual shareholding of PB Private Limited reduced from 11.57% to 6.08% and that of SN Private Limited reduced from 1.92% to 1.01%. On March 19, 2018, the target company allotted 5,40,00,000 equity shares to PB Private Limited and SN Private Limited pursuant to conversion of the 2,70,00,000 warrants. Consequent to which the voting rights of PB Private Limited and SN Private Limited individually increased from 11.57% to 24.98% and from 1.92% to 20.36% and the voting rights of the promoter group collectively increased from 50.23% to 62.92% that has resulted into triggering of Regulation 3(2) of SEBI (SAST) Regulations, 2011. However, the Noticees have failed to make public announcement to the shareholders of Target Company.

Keeping in view the above facts, whether the above acquisition of shares on conversion of warrants would be govern by the provisions of SEBI (SAST) Regulations, 2011? If yes, whether the same would attract the provisions of Regulation 3(2) of SEBI (SAST) Regulations, 2011 requiring open offer to the shareholders of the Target Company?

**(7 marks)**

- (iii) SB India Limited, a company listed on Bombay Stock Exchange (BSE) with share capital 1,00,00,00 (face value Rs.10 each). The Company is planning to place a proposal before the Board for buy-back of its 50% share capital from existing shareholders. You, as a Company Secretary, elucidate the provisions of Board Resolution with respect to buy-back of securities.

**(4 marks)****Question No. 3**

- (i) Briefly explain the agencies involved in delisting process and its functions. **(3 marks)**
- (ii) Mr. Ramesh Virani is appointed as the nominee director on the Board of XYZ Ltd. by Navneet Financial Services Ltd.? XYZ Ltd. has issued ESOS to Mr. Ramesh Virani as its employee. Whether Mr Ramesh Virani is eligible to receive the option granted by XYZ Ltd.? If so, describe the approval and eligibility conditions required to be comply for ESOS under SEBI (Share Based Employee Benefits) Regulations, 2014? **(10 marks)**
- (iii) State the provisions with respect to pricing of sweat equity shares under SEBI (Issue of Sweat Equity) Regulations, 2002. **(2 marks)**

**Question No. 4**

- (i) Divya is Managing Director of AB Ltd., a wholly owned subsidiary of PEEKAY Ltd., a listed company. AB Ltd. incurred a huge loss of Rs. 125 crore on 31st March, 2017. However, PEEKAY Ltd. informed this loss to stock exchange on 30th April, 2017. Divya's husband Pradeep, who received information of this loss from Divya, sold 2,60,000 shares of PEEKAY Ltd. on 24th April, 2017. Examine the relevant provisions and state is Divya amounting to be held for insider trading? **(8 marks)**
- (ii) If Sahil invests Rs.10,000 in a scheme that charges 2% front end load at an NAV of Rs.10 per unit, what shall be the public offer price? **(3 marks)**
- (iii) What are the restrictions imposed on business activities for CIMC under SEBI (Collective Investment Scheme) Regulations, 1999? **(4 marks)**
- (iv) State the powers and functions of the 'Ombudsman' under the SEBI (Ombudsman) Regulations, 2003. **(5 marks)**

**PART II – CAPITAL MARKET AND INTERMEDIARIES (30 MARKS)****Attempt all parts of either Question No. 5 or Question No 5A****Question No. 5**

- (i) What do you mean by Private equity? Briefly explain the various categories of private equity. **(5 marks)**
- (ii) Mr Aniket holds the equity shares of GKP Limited. Mr. Aniket has requested the company to issue a shares with differential voting rights in respect of the equity shares held by him. What are the conditions required to be fulfilled by GKP Limited. to issue shares with differential voting rights to Mr. Aniket? **(5 marks)**
- (iii) ABC Ltd. issued 15 lakh shares of Rs 100 each. Green shoe option was exercised by the company prior to the issue. After listing, the share prices of ABC Ltd. plunged to Rs. 90. Stabilizing agents decided to buy shares from the market. How many shares can be purchased by the stabilizing agents to arrest the reduction in share prices? **(5 marks)**

**OR****Question No. 5A**

- (i) Describe the impact of various monetary policies on Indian stock market. **(5 marks)**
- (ii) Define and state the role and responsibilities of Research Analysts. **(5 marks)**
- (iii) Capital market intermediaries are vital link between SEBI and investors in a Public Issue. Comment. **(5 marks)**

**Question No. 6**

- (i) What do you understand by Market surveillance? Briefly explain the different types of Market surveillance. **(7 marks)**
- (ii) Write short notes on the following:
  - (a) Merchant Banker
  - (b) Registrar and Share Transfer Agent **(4 marks each)**

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