STUDY MATERIAL

PROFESSIONAL PROGRAMME

CAPITAL, COMMODITY AND MONEY MARKET

MODULE 3

ELECTIVE PAPER 9.2

THE INSTITUTE OF
Company Secretaries of India
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

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PROFESSIONAL PROGRAMME

CAPITAL, COMMODITY AND MONEY MARKET

Efficient financial systems are indispensable for speedy economic development. The financial system of a country is a conglomeration of sub market, viz. capital, commodity and money market. The flow of funds in these markets is multi directional depending upon liquidity, risk profile, yield pattern, interest rate differential or arbitrage opportunities, regulatory restrictions etc. As the Indian economy gets integrated with the global economy empowered by increasingly sophisticated information and technology systems, there is an acute need for trained professionals to entrust important roles in all the spheres of the financial market activity. This study material has been designed to provide expert knowledge and understanding of various capital market instruments, commodity market products, money market instruments, key features and participants in these markets, raising capital in international market by companies etc.

This study material has been published to aid the students in preparing for the Capital, Commodity and Money Market paper of the CS Professional Programme. It is part of the educational kit and takes the students step by step through each phase of preparation stressing key concepts, pointers and procedures.

Company Secretaryship being a professional course, the examination standards are set very high, with emphasis on knowledge of concepts, applications, procedures, for which sole reliance on the contents of this study material may not be enough. Besides, as per the Company Secretaries Regulations, 1982, students are expected to be conversant with the amendments to the laws made upto six months preceding the date of examination. The material may, therefore, be regarded as the basic material and must be read alongwith the original Bare Acts, Rules, Regulations, Academic Guidance etc.

The subject of Capital, Commodity and Money Market is inherently complicated and is subject to constant refinement through, rules and regulations made thereunder. It is, therefore becomes necessary for every student to constantly update himself with the various legislative changes made from time to time by referring to the Institute's journal e-bulletin 'Student Company Secretary', as well as other professional journals. In the event of any doubt, students may write to the Directorate of Academics of the Institute for clarification at **academics@icsi.edu**.

Although care has been taken in publishing this study material yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf. Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same is brought to its notice.

There is open book examination for this Elective Subject of Professional Programme. This is to inculcate and develop skills of creative thinking, problem solving and decision making amongst students of its professional programme and to assess their analytical ability, real understanding of facts and concepts and mastery to apply, rather than to simply recall, replicate and reproduce concepts and principles in the examination.

SYLLABUS

ELECTIVE PAPER 2: CAPITAL, COMMODITY & MONEY MARKET (100 Marks)

Level of Knowledge: Expert Knowledge

Objective: *To acquire specialized knowledge of Capital, Commodity and Money Market*

Detailed Contents:

1. **Economic Framework**
   - Basic structure of Flow of funds in the economy;
   - Capital Markets its Role in Capital formation, Functions of Liquidity, , Resource Allocation and Transaction Cost-reduction
2. **Legal Framework**
   - Ministry of Finance (Capital Markets Division,Department of Economic Affairs)
   - Ministry of Corporate Affairs
   - Companies Act, 2013
   - SEBI Act, 1992
   - Securities Contracts (Regulation) Act, 1956 (SCRA)
   - Depositories Act, 1996
   - SEBI Regulations and Guidelines– An Overview, SEBI (Prohibition of Insider Trdaing) Regulations, 1992, SEBI (Substantial Acquisitions of Shares and Takeovers) Regulations, 2011 (SAST)
   - Prevention of Money Laundering Act, 2002
   - Grievance Redressal Mechanism: Stock Exchange (Investor Protection Fund), SEBI, Securities Appellate Tribunal (SAT), Supreme Court
   - Enforcement: Economic Offences Wing, Financial Intelligence Unit, Central Bureau of Investigation, Financial Action Task Force (FATF)
3. **Financial Intermediaries Framework**
   - Framework of Market Infrastructure Institutions (MII), Stock Exchanges Clearing Corporations, Custodians,
   - Depositories, Depository Participants, Registrars and Transfer Agents (RTA), Bankers to issue
   - Merchant Bankers, Underwriters, , Investment Advisors, Portfolio Managers, Self Certified Syndicate Banks,
   - Brokers, Sub-brokers, Market-makers
   - Credit Rating Agencies
4. Primary Markets
   - IPO, FPO, Offer for Sale, Private Placement, Preferential Allotment, Institutional Placement Procedures (IPP), Qualified Institutional Placement (QIP), Rights Issue, Bonus Issue

- Prospectus, DRHP, Shelf Prospectus, Red Herring prospectus
- Private Investment in Public Equity (PIPE)
- SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2009
- Lead Manager (Pre & Post Issue Activities)
- Due Diligence Review
- Underwriting obligations
- Basis of Allotment
- Book-building
- Pre-issue and Post-issue activities,
- Green-shoe Option
- Pre-listing and Post-listing activities, Listing Agreement

5. **Secondary Markets**
   - Opening day (listing)
   - Continuing compliance obligations and disclosures: Post-listing activities, Corporate Actions
   - Requirements for Continuing Listing
   - Corporate Governance Norms
   - Disclosures as per Listing Agreement: Price Sensitive Information, Material Changes, Quarterly results
   - Functioning of an Exchange: Margining, Trading, Clearing and Settlement, Trade Guarantee Fund, Trading Software, Arbitration Mechanism
   - Stock Market Indices

6. **Capital Market Investment Institutions**
   - Domestic Financial Institutions (DFI) , Qualified Institutional Buyers (QIB), Foreign Institutional Investors (FII) , Private Equity (PE), Angel Funds, HNIs, Venture Capital (VC), Qualified Foreign Investors (QFI), Mutual Funds, Alternative Investment Funds (AIF), Hedge Funds, Pension Funds

7. **Capital Market Instruments**
   - Equities
   - Preference Shares, Shares with Differential Voting Rights (DVR)
   - Corporate Debt :Non Convertible Debentures (NCD), Partly-and Fully-Convertible Debentures (PCD, FCD)
   - NCDs with or without Call and Put Features
   - Bonds, Foreign Currency Convertible Bonds (FCCB)
   - Indian Depository Receipts (IDR)
   - Derivatives: Single Stock Futures, Single Stock Options, Index futures (SENSEX, NIFTY), Index Options, Interest Rate Futures, Currency futures
   - Exchange Traded Funds (ETF)
   - Warrants

8. **Resource Mobilization through International Markets**
   - Global Depository Receipt (GDR)
   - American Depository Receipt (ADR)
   - Listing on the London Alternative Investment Market (AIM), NASDAQ, NYSE
9. **Landmark Studies and Report of Committees on Capital Markets**
10. **Economics of Commodities Marketing**
    (a) Economic Rationale for Commodities Trading Place and store value
    (b) Perishables and non-perishables
    (c) Tangibles and Intangibles (Weather , Freight)
    (d) How resources can be optimized through price hedges
11. **Commodities Market Operations**
    - Origin of Commodity Market in India
    - Products, Participants and Functions
    - Evolution of Commodity Exchanges; Regulatory Framework
    - Structure Of Commodity exchanges, membership, Risk Management, Clearing and Settlement System, Commodities Traded on Stock Exchanges Platform-NCDEX, MCX SX
    - Instruments available for Trading
    - Using commodity exchanges for Hedging, Speculation and Arbitrage
12. **Introduction to Money Market**
    - Nature & Deployment of Surplus Funds and Raising of Short-term funds, Characteristics of Money Market
    - Regulatory framework of RBI, FIMMDA (Fixed Income, Money Market and Derivatives Association) and Foreign Exchange Dealers Association of India (FEDAI) Call Money Market-Players, Utility, Money market Instruments: Commercial Paper, Certificates of Deposits, Bills of Exchange, Treasury Bills (T-Bills), Bill Discounting, Factoring, Letter of Credit, Money Market Mutual Funds, Fixed Maturity Plans

LIST OF RECOMMENDED BOOKS

MODULE 3

PAPER 9.2 : CAPITAL, COMMODITY AND MONEY MARKET

The students may refer to the given books and websites for further knowledge and study of the subject :

READINGS

1.	M.Y. Khan	: Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi 110 002.
2.	Taxmann	: SEBI Manual
3.	Shashi K Gupta Neeti Gupta Nishja Aggarwal	: Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Ram Road, 24, Daryaganj, New Delhi -110002
4.	Indian Institute of Banking & Finance	: Securities Markets and Products; Taxmann Publications (P) Ltd., 21/35, West Punjabi Bagh, New delhi-110026
5.	Dr. S Gurusamy	: Capital Markets, Tata McGraw Hill Education Private Limited, 7 West Patel Nagar, New Delhi-110008
6.	Niti Nandini Chatnani	: Commodity Markets, Tata McGraw Hill Education Private Limited, 7 West Patel Nagar, New Delhi-110008
7.	Bharat Kulkarni	: Commodity Markets and Derivatives, Excel Books, A-45, Naraina, Phase I, New Delhi-1100028
8.	Taxmann	: Sumit Agrawal & Robin Baby's Commentary on SEBI Act

REFERENCES

Website :

www.sebi.gov.in

www.nse-india.com

www.bseindia.com

www.rbi.org.in

www.mca.gov.in

www.iica.in

www.corporateprofessionals.com

JOURNALS

1.	SEBI and Corporate Laws	: Taxmann, 59/32, New Rohtak Road, New Delhi-110 005.
2.	Corporate Law Adviser	: Corporate Law Adviser, Post Bag No. 3, Vasant Vihar, New Delhi-110052.
3.	SEBI Monthly Bulletin	

SEBI Annual Report	:	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 LESSONS

Study Lesson No.	Topic
1.	Economic Framework of Capital Market
2.	Legal Framework
3.	Framework of Market Infrastructure Institutions
4.	Financial Intermediaries Framework
5.	Primary Market
6.	Secondary Market
7.	Capital Market Investment Institutions
8.	Capital Market Instruments
9.	Resource Mobilization through International Markets
10.	Economics of Commodities Marketing
11.	Commodities Market Operations
12.	Money Market
13.	Insider Trading
14.	Substantial Acquisition of Shares and Takeovers
	REPORT OF THE COMMITTEES ON CAPITAL MARKET
	PRACTICE TEST PAPER

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Lesson 1
Economic Framework of Capital Market

LESSON OUTLINE

– Introduction
– Constituents of Financial System
– Financial Assets
– Financial Intermediaries
– Financial Markets
– Classification of Financial Markets
– Capital Market
– Functions of Capital Market
– Role of Capital Market in Resource Allocation
– Capital Formation
– Stages of Capital Formation
– Role of Capital Market in Capital Formation
– LESSON ROUND UP
– SELF TEST QUESTIONS

LEARNING OBJECTIVES

The financial system plays a key role in the economy by stimulating economic growth, influencing economic performance of the factors, affecting economic welfare. This is achieved by financial infrastructure, in which entities with funds allocate funds to those who have potentially more productive ways to invest. A financial system facilitates more efficient transfer of funds. As one party to the transaction may possess superior information than the other, it can lead to the information asymmetry problem and inefficient allocation of financial resources. By overcoming asymmetry problem the financial system facilitates a balance between those with funds to invest and those needing funds.

The aim of this lesson is to enable the students to know the economic framework of financial system in India, how Capital Market plays an important role in resource allocation and capital formation, reduction in transaction cost and such other related matters.

INTRODUCTION

The economic development of any country depends upon the existence of a well organized financial system. It is the financial system which supplies the necessary financial inputs for the production of goods and services which in turn promotes the well being and standard of living of the people of a country. Thus, the 'financial system' is a broader term which brings in its fold the financial markets and the financial institutions which support the system. The major assets traded in the financial system are money and monetary assets. The responsibility of the financial system is to mobilize the savings in the form of money and monetary assets and invest them to productive ventures. An efficient functioning of the financial system facilitates the free flow of funds to more productive activities and thus promotes investment. Thus, the financial system provides the intermediation between savers and investors which in turn promotes faster economic development.

CONSTITUENTS OF THE FINANCIAL SYSTEM

The three main constituents of the financial system are:

1. Financial Assets
2. Financial Intermediaries
3. Financial markets

FINANCIAL ASSETS

An asset is something that provides its owner with expected future benefits. Financial assets are assets, such as stocks or bonds, whose benefit to the owner depends on the issuer of the asset meeting certain obligations. These obligations are called financial liabilities. Every financial asset has a corresponding financial liability; it's this financial liability that gives the financial asset its value.

Classification of Financial Assets

Financial assets can be classified differently under different circumstances, *viz*. :

A. (i) Marketable assets and (ii) Non-marketable assets

B. (i) Money/cash assets, (ii) Debt assets and (iii) Stock assets

A. (i) Marketable Assets : Marketable assets are those which can be easily transferred from one person to another without much procedural hindrance, e.g., Equity shares of listed companies, Bonds of PSUs, Government Securities.

(ii) Non-marketable Assets : Non-marketable assets are those assets which cannot be transferred easily, e.g., FDRs, PF, Pension Funds, NSC, Insurance policy, *etc*.

B. (i) Cash Assets : Cash assets are those assets that can readily be converted in to cash. These assets often retain high levels of liquidity and may be used to ensure the financial ability of a company or individual to conduct its daily operations, e.g., cash, money market funds, commercial papers.

(ii) Debt Asset : Debt assets are issued by a variety of organizations for the purpose of raising their debt capital. There are different ways of raising debt capital, e.g., issue of debentures, raising of term loans, working capital advances, *etc*.

(iii) Stock Asset : Stock assets are issued by the business organizations for the purpose of raising their fixed capital. There are two types of stocks namely equity and preference.

FINANCIAL INTERMEDIARIES

The term 'financial intermediaries' include all kinds of organizations which intermediate and facilitate financial transactions of both individuals as well as corporate customers. Thus, it refers to all kinds of FIs and investing institutions which facilitate financial transactions in the financial markets. They may be in the organized sector or in the unorganized sector and may be further classified into two types :

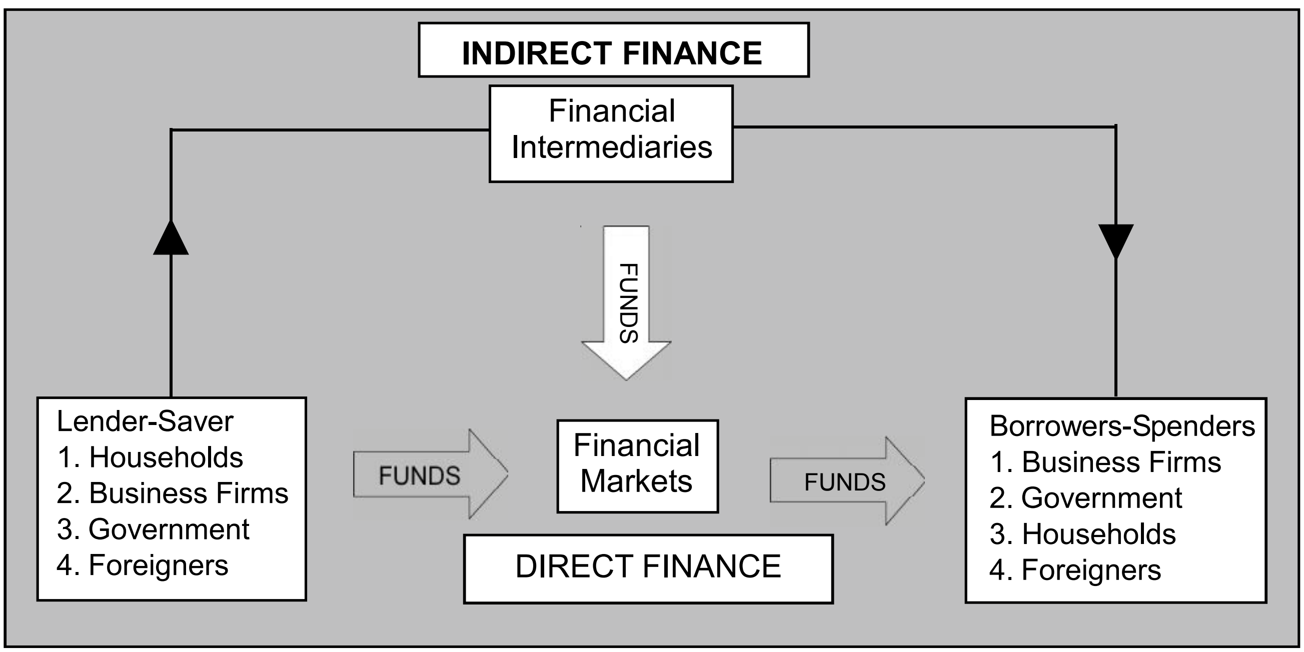
(i) Capital Market Intermediaries: These intermediaries mainly provide long term funds to individuals and corporate customers. They consist of Term Lending Institutions like Financial Corporations and Investment Institutions like Life Insurance Corporation of India (LIC).

(ii) Money Market Intermediaries: Money market intermediaries supply only short term funds to individuals and corporate customers. They consist of commercial banks, cooperative bank, *etc*.

FINANCIAL MARKETS

A financial market is a market where financial assets and financial liabilities are bought and sold. Financial Markets perform the essential economic function of channeling funds from savers who have an excess of funds to spenders who have a shortage of funds. This function is shown schematically in the figure below:

Flow of funds through the financial system:-



Financial markets can perform this basic function either through direct finance in which borrowers borrow funds directly from lenders by selling them securities or through indirect finance, which involves a financial intermediary who stands between the lender-savers and borrower-spenders and helps transfer funds from one to the other. This channelising of funds improves the economic welfare of everyone in the society because it allows funds to move from people who have no productive investment opportunities to those who have such opportunities, thereby contributing towards increased efficiency in the economy.

CLASSIFICATION OF FINANCIAL MARKETS

The financial markets in India can be classified as follows :

(a) **Unorganized Markets :** In unorganized markets, there are a number of money lenders, indigenous bankers, traders, *etc.* who lend money to the public. Indigenous bankers also collect deposits from the public. There are also private finance companies, chit funds *etc*. whose activities are not controlled by the RBI. The RBI has already taken some steps to bring this unorganized sector under the organized fold.

(b) **Organized Markets :** In the organized markets, there are standardized rules and regulations governing their financial dealings. There is also a high degree of institutionalization and instrumentalization. These markets are subject to strict supervision and control by the RBI and other regulatory bodies. These organized markets can be further classified into two types. They are:

(i) Capital Market and

(ii) Money Market.

(i) Capital Market

The capital market is a market for financial assets which have a long or indefinite maturity period. Generally, it deals with long term securities which have a maturity period of more than one year. Capital market may be further classified into three categories, namely :

1. Industrial Securities Market

2. Government Securities Market and

3. Long-term Loans Market.

1. Industrial Securities Market

As the very name suggests, it is a market for industrial securities, namely : (i) equity shares (ii) Preference shares and (iii) Debentures or bonds. It is a market where industrial concerns raise their capital or debt by issuing appropriate instruments. It can be further classified into two categories. These are :

(a) Primary market or New Issue Market,

(b) Secondary market or Stock Exchange.

2. Government Securities Market

It is otherwise called the Gilt-Edged Securities Market. It is a market where government securities are traded. In India there are many kinds of Government securities – short term and long term. Long-term securities are traded in this market while short term securities are traded in the money market. The secondary market for these securities is very narrow since most of the institutional investors tend to retain these securities until their maturity.

3. Long-term Loans Market

Development banks and commercial banks play a significant role in this market by supplying long term loans to corporate customers. Long term loans market may further be classified into – (i) Term loans, (ii) Mortgages and (iii) Financial Guarantees markets.

(ii) Money Market

Money market is a very important segment of a financial system. It is a market for dealings in monetary assets of short-term nature. Short-term funds up to one year and financial assets that are close substitutes for money are dealt in the money market. Money market instruments have the characteristics of liquidity (quick conversion into money), minimum transaction cost and no loss in value. Excess funds are deployed in the money market, which in turn is availed of to meet temporary shortages of cash and other obligations. Money market provides access to providers and users of short-term funds to fulfill their investment and borrowing requirements respectively at an efficient market clearing price. It performs the crucial role of providing an equilibrating mechanism to even out short-term liquidity, surpluses and deficits and in the process, facilitates the conduct of monetary policy. The money market is one of the primary mechanism through which the Central Bank influences liquidity and the general level of interest rates in an economy. The Bank's interventions to influence liquidity serve as a signaling-device for other segments of the financial system.

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

Features of Money Market

The money market is a wholesale market where the volume of the transactions is very large and is settled on a daily basis. Trading in the money market is conducted over the telephone, followed by written confirmation through e-mails, texts from the borrowers and lenders.

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

1. A balancing mechanism for short-term surpluses and deficiencies.
2. A focal point of Central Bank intervention for influencing liquidity in the economy, and
3. A reasonable access to the users of short-term funds to meet their requirements at realistic/reasonable price or cost.

CAPITAL MARKET

Capital Market may be defined as a market for borrowing and lending long-term capital funds required by the business enterprises. Capital Market is the market for financial assets that have long or indefinite maturity period. Capital Market offers an ideal source of external finance. It refers to all the facilities and the institutional arrangements for borrowing and lending medium-term and long-term funds. Like any market, the Capital Market is also composed of whose who demand funds (borrowers) and those who supply funds (lenders).

Transfer of resources from those with idle resources to the others who have a productive need for them is perhaps most efficiently achieved through the Capital Markets. Stated formally, Capital Markets provide channels for reallocation of savings to investments and entrepreneurship and thereby decouple these two activities. As a result, the savers and investors are not constrained by their individual abilities, but by the economy's ability to invest and save respectively, which inevitably enhances the savings and investment in the economy. Savings are linked to investments by a variety of intermediaries through a range of complex financial products called "securities".

There are a set of economic units who demand securities in lieu of funds and others who supply securities for funds. These demand for and supply of securities and funds determine, under competitive market conditions in both goods and Securities Market, the prices of securities which reflect the present value of future prospects of the issuer, adjusted for risks and also prices of funds.

It is not that the users and suppliers of funds meet each other and exchange funds for securities. It is difficult to accomplish such double coincidence of wants. The amount of funds supplied by the supplier may not be the amount needed by the user. Similarly, the risk, liquidity and maturity characteristics of the securities issued by the issuer may not match preference of the supplier. In such cases, they incur substantial search costs to find each other. Search costs are minimised by the intermediaries who match and bring the suppliers and users of funds together. These intermediaries may act as agents to match the needs of users and suppliers of funds for a commission, help suppliers and users in creation and sale of securities for a fee or buy the securities issued by users and in turn, sell their own securities to suppliers to book profit.

The Capital Market, thus, has essentially three categories of participants, namely

(i) the issuers of securities,

(ii) investors in securities and

(iii) the intermediaries.

The issuers and investors are the consumers of services rendered by the intermediaries while the investors are consumers (they subscribe for and trade in securities) of securities issued by issuers. In pursuit of providing a product to meet the needs of each investor and issuer, the intermediaries churn out more and more complicated products. They educate and guide them in their dealings and bring them together. Those who receive funds in exchange for securities and those who receive securities in exchange for funds often need the reassurance that it is safe to do so. This reassurance is provided by the law and by custom, often enforced by the regulator. The regulator develops fair market practices and regulates the conduct of issuers of securities and the intermediaries so as to protect the interests of suppliers of funds. The regulator ensures a high standard of service from intermediaries and supply of quality securities and non-manipulated demand for them in the market.

The market does not work in a vacuum; it requires services of a large variety of intermediaries. The disintermediation in the Capital Market is in fact an intermediation with a difference; it is a risk-less intermediation, where the ultimate risks are borne by the savers and not the intermediaries.

The Capital Market has two interdependent and inseparable segments, the new issues (primary market) and the stock (secondary) market.

PRIMARY MARKET

The Primary Market provides the channel for sale of new securities. Primary Market provides opportunity to issuers of securities, government as well as corporates, to raise resources to meet their requirements of investment and/or discharge some obligation.

They may issue the securities at its face value, or at a discount/premium and these securities may take a variety of form such as equity, debt, *etc*. They may issue the securities in domestic market as well as international market.

The Primary Market issuance is done either through public issues or private placement. A public issue does not limit any entity from investing, while in private placement, the issuance is done to some selected persons only.

There are two major types of issuers who issue securities. The corporate entities issue mainly debt and equity instruments (shares, debentures, *etc*.), while the government (central as well as state governments) issue debt securities only (dated securities, treasury bills). The price signals, which subsume all information about the issuer and his business including associated risk, generated in the secondary market, help the Primary Market in allocation of funds.

SECONDARY MARKET

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 market as well as debt market.

The Secondary Market enables the participants who hold securities to adjust their holdings in response to changes in their assessment of risk and return. They also sell securities for cash to meet their liquidity needs. The Secondary Market has further two components, namely the over-the-counter (OTC) market and the exchange-traded market. OTC is different from the market place provided by the Over The Counter Exchange of India

Limited. OTC markets are essentially informal markets where trades are negotiated. Most of the trading in government securities is in the OTC market. All the spot trades where securities are traded for immediate delivery and payment take place in the OTC market. The exchanges do not provide facility for spot trades in a strict sense. Closest to spot market is the cash market where settlement takes place after some time. Nearly 100% of the trades settled by delivery are settled in demat form. A variant of Secondary Market is the Forward Market, where securities are traded for future delivery and payment. Pure forward is outside the formal market. The versions of forward market in formal market are futures and options. In this futures market, standardised securities are traded for future delivery and settlement. These futures can be on a basket of securities like an index or an individual security. In case of Options, securities are traded for conditional future delivery. There are two types of options–a put option permits the owner to sell a security to the writer of option at a predetermined price while a call option permits the owner to purchase a security from the writer of the option at a predetermined price. These options can also be on individual stocks or basket of stocks like index.

The past few years in many ways have been remarkable for the Capital Market in India. It has grown exponentially as measured in terms of amount raised from the market, number of stock exchanges and other intermediaries, the number of listed stocks, market capitalisation, trading volumes and turnover on stock exchanges, and investor population. Along with this growth, the profiles of the investors, issuers and intermediaries have changed significantly. The market has witnessed fundamental institutional changes resulting in drastic reduction in transaction costs and significant improvements in efficiency, transparency and safety.

What is Transaction Cost?

Transaction cost for a market is important for several reasons. It is a key parameter to measure the impact of modernization of market infrastructure, institutionalisation of the market and market regulation. Besides, transaction cost directly impacts the profits of investors and affects the return on their investments. Investors therefore, seek continuous reduction in transaction cost. Reduction in transaction cost induces investors to trade more frequently resulting in higher volumes.

Transaction cost can be classified into two categories :

(A) Explicit costs

(B) Implicit costs

(A) Explicit costs are observable and measurable. They can be easily measured and are directly borne by the investors. These costs include :

   (i) Brokerage commission

   (ii) Stamp duty

   (iii) Service tax

   (iv) Custody charges; and

   (v) Regulatory charges

Some of these charges, such as stamp duty and service tax are also levied in few other markets.

(B) The implicit costs include :

   (i) Bid-ask spreads

   (ii) Realised spreads

   (iii) Opportunity cost of delayed execution (timing costs) or non-execution.

There are certain additional components of implicit costs peculiar to the Indian markets, which arise on account of existence of physical securities and the process of registration of securities. The risks associated with physical securities such as bad deliveries and delays in transfer, result in loss of liquidity and add to the opportunity costs for the investors.Transaction costs can also be categorised into:

(1) cost of search and information,

(2) cost of contracting and monitoring,

(3) cost of incentive problems between buyers and sellers of financial assets.

(i) Costs of search and information are defined in the following way:

Search cost fall into categories of explicit cost and implicit cost. Information cost is associated with assessing a financial instrument's investment attributes. In a price efficient market, prices reflect the aggregate information collected by all market participants.

(ii) Cost of contracting and monitoring is related to the cost necessary to resolve information asymmetry problems, when the two parties entering into the transaction possess limited information on each other and seek to ensure that the transaction obligations are fulfilled.

(iii) Cost of incentive problems between buyers and sellers arise, when there are conflicts of interest between the two parties, having different incentives for the transactions involving financial asset.

Transaction cost is one of the most important factor which affects the investors and determines the decision making process. Reduction in transaction costs is one of the phenomena which characterizes an efficient financial market and affects the level of market development. This means that, other things being equal, the investors' preference is to invest in markets which have the least transaction costs as the investor aims to maximize profit by incurring the least possible cost.

FUNCTIONS OF CAPITAL MARKET

The main functions of Capital Market are:

1. Allocation Function
2. Liquidity Function
3. Other Function

1. Allocation Function

Capital Market allows for the channelization of the saving of innumerable investors into various productive avenues of investments. Accordingly, the current savings for a period are allocated amongst the various users and uses. The market attracts new investors who are willing to make new funds available to the businesses. It also allocates and rations funds by a system of incentives and penalties.

2. Liquidity Function

Capital Market provides the means whereby buyers and sellers can exchange securities at mutually agreed prices. This allows better liquidity for the securities that are traded.

3. Other Functions

In addition to the functions of funds allocation and liquidity, Capital Market also renders the following functions:

1. **Indicative Function–** A Capital Market acts as a barometer showing not only the progress of a company, but also of the economy as a whole through share price movements.

2. **Savings & Investment Function–** Capital Market provides the means for quickly converting long-term investment into liquid funds, thereby generating confidence among investors and speeding up the process of saving and investment.

3. **Transfer Function–** Capital Market facilitates the transfer of existing assets – tangible and intangible among individual economic units or groups.

4. **Merger Function–** Capital Market encourages voluntary or coercive take-over mechanism to put the management of inefficient companies into more competent hands.

ROLE OF CAPITAL MARKET IN RESOURCE ALLOCATION

Capital Market plays an important role in mobilising resources, and diverting them towards productive channels. In this way, it facilitates and promotes the process of economic growth in the country as discussed below:

1. Link between Savers and Investors:

The Capital Market functions as a link between savers and investors. It plays an important role in mobilising the savings and diverting them in to productive investments. In this way, Capital Market plays a vital role in transferring the financial resources from surplus and wasteful areas to deficit and productive areas, thus increasing the productivity and prosperity of the country.

2. Encouragement to Saving:

With the development of Capital Market, the banking and non-banking institutions provide facilities, which encourage people to save more. In the less- developed countries, in the absence of a Capital Market, there are very little savings and those who save often invest their savings into unproductive and wasteful directions, *i.e.*, in real estate (like land, building, shops & alike) and conspicuous consumption.

3. Encouragement to Investment:

The Capital Market facilitates lending to the businessmen and the Government and thus encourages investment. It provides facilities through banking and non-banking financial institutions. Various financial assets, *e.g.*, shares, securities, bonds, *etc.*, induce savers to lend to the Government or invest in industry. With the development of financial institutions, capital becomes more mobile, interest rates fall and investment increases.

4. Promotes Economic Growth:

The Capital Market not only reflects the general condition of the economy, but also smoothens and accelerates the process of economic growth. Various institutions in the Capital Market, like non-bank financial intermediaries, allocate the resources rationally in accordance with the developmental needs of the country. The proper allocation of resources result in the expansion of trade and industry in both public and private sector, thus promoting balanced economic growth in the country.

5. Stability in Security Prices:

The Capital Market tends to stabilise the values of stocks and securities and also reduces the fluctuations in the prices to the minimum. The process of stabilisation is facilitated by providing capital to the borrowers at a low interest rate and reducing the speculative and unproductive activities.

6. Benefits to Investors:

The Capital Market helps the investors, *i.e.*, those who have funds to invest in long-term financial assets, in different ways:

(a) It brings together the buyers and sellers of securities and thus ensures the marketability of investments;

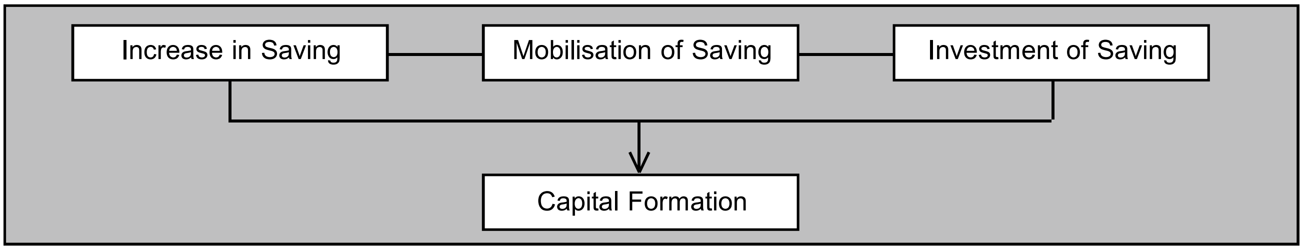
(b) By advertising security prices, the Stock Exchange enables the investors to keep track of their investments and channelise them into most profitable lines;

(c) It safeguards the interests of the investors by compensating them from the Stock Exchange’s Investor Protection Fund in the event of fraud or default.

CAPITAL FORMATION

Capital formation is regarded as a key to economic development. It is on account of the fact that capital formation leads to an increase in the supply of machinery, equipments, plants, and also an increase in human capital. This increases the production and productivity in the economy. This in turn increases employment opportunities and thus the standard of living of people. Thus, capital formation is considered very important.

The chart below indicates the capital formation process.

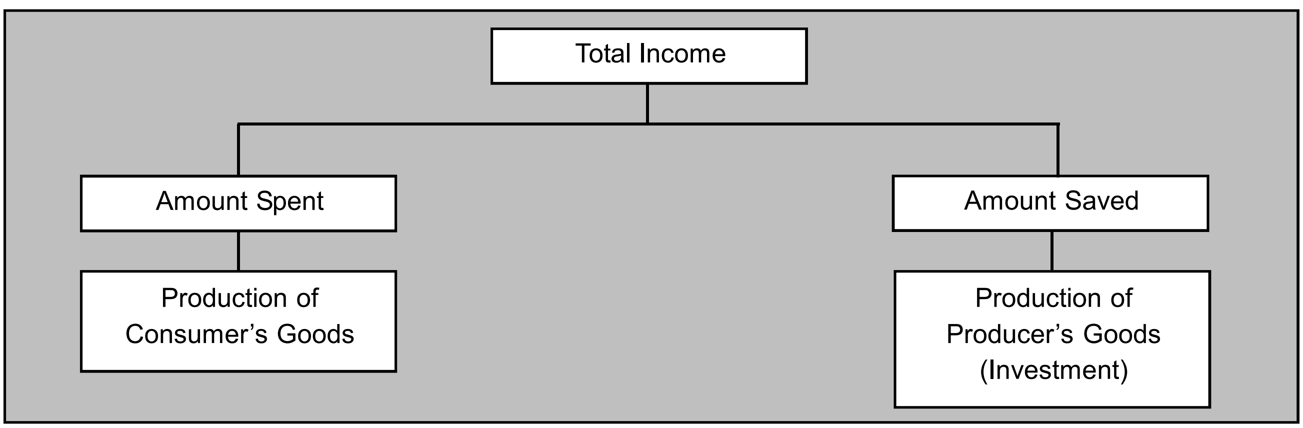


STAGES OF CAPITAL FORMATION

Capital formation process has three stages which are described below:-

1. Increase in Savings

Capital formation depends on saving. According to J.M. Keynes, "Saving is the excess of income over consumption expenditure". To be more precise, saving is a part of income that is not spent on current consumption. If consumers spend their entire income on consumer goods, there could be no accumulation of capital goods. If, on the other hand, consumers decide to save part of their income, country's resources can be devoted to making capital goods. Thus, the production of capital goods depend on saving as shown in the following chart:-



In economics, the term 'Investment' is used to mean the actual production of capital goods. So it can be said that investment depends on saving. Capital accumulation depends on the volume of saving. The volume of saving in turn depends broadly on three factors – Power to save, Will to save and Facilities to save.

2. Mobilization of savings

The second stage of capital formation is the mobilization of available savings. The act of mobilizing savings is done by the financial institutions, such as, commercial banks, finance companies, insurance companies, cooperative societies and so on. These institutions collect deposits from general public, provide security to savings, provide liquidity to savers, and also provide income in the form of interest. Due to this, people like to save through financial institutions. These institutions mobilize the savings collected toward productive investments. Saving and investment are done by different classes of people. Financial institutions act as intermediaries between savers and investors. This leads to the increase in capital formation.

3. Investment of Savings

The third stage of capital formation is the investment of savings. Investment creates capital goods. The act of investment is done by entrepreneurs. Therefore, a large number of bold and skilled entrepreneurs are indispensable for increasing capital formation in the country. Entrepreneurs acquire surplus funds from financial institutions and the Capital Market and make productive investments in various types of industries. Investments create and increase machinery and equipments. This leads to an increase in the national income of the country.

ROLE OF CAPITAL MARKET IN CAPITAL FORMATION

Capital Market has a crucial role in capital formation. For a speedy economic development adequate capital formation is necessary. The significance of Capital Market in economic development is explained below:

1. Mobilisation of Savings and Acceleration of Capital Formation :-

In Capital Market, various types of securities help to mobilise savings from different sectors of population. The twin features of reasonable return and liquidity in stock exchange are definite incentives to the people to invest in securities. This accelerates the capital formation in the country.

2. Raising Long-Term Capital :-

The existence of a stock exchange enables the companies to raise permanent capital. The investors cannot commit their funds for a permanent period but companies require funds permanently. The stock exchange resolves this clash of interests by offering an opportunity to investors to buy or sell their securities, while permanent capital with the company remains unaffected.

3. Promotion of Industrial Growth :-

The stock exchange is a central market through which resources are transferred to the industrial sector of the economy. The existence of such an institution encourages people to invest in productive channels. Thus, it stimulates industrial growth and economic development of the country by mobilising funds for investment in the corporate securities.

4. Ready and Continuous Market :-

The stock exchange provides a central convenient place where buyers and sellers can easily purchase and sell securities. Easy marketability makes investment in securities more liquid as compared to other assets.

5. Technical Assistance :-

An important drawback encountered by entrepreneurs in developing countries is lack of technical assistance. By offering advisory services relating to preparation of feasibility reports, identifying growth potential and training entrepreneurs in project management, the financial intermediaries in Capital Market play an important role.

6. Reliable guide to Performance :-

The Capital Market serves as a reliable guide to the performance and financial position of corporates, and thereby promotes efficiency.

7. Proper channelisation of funds :-

The prevailing market price of a security and relative yield are the guiding factors for the people to channelise their funds in a particular company. This ensures effective utilisation of funds in the public interest.

8. Provision of variety of services :-

The financial institutions functioning in the Capital Market provide a variety of services, such as, grant of long term and medium term loans to entrepreneurs, provision of underwriting facilities, assistance in promotion of companies, participation in equity capital, giving expert advice *etc*.

9. Development of backward areas :-

Capital Markets provide funds for projects in backward areas. This facilitates economic development of backward areas. Long term funds are also provided for development projects in backward and rural areas.

10. Foreign Capital :-

Capital Markets make it possible to generate foreign capital. Indian firms are able to generate capital funds from overseas markets by way of bonds and other securities. Government has liberalised its policy with respect to Foreign Direct Investment (FDI) in the country. This not only brings in foreign capital but also foreign technology which is important for economic development of the country.

11. Easy liquidity :-

With the help of secondary markets, the investors can sell off their holdings and convert them into liquid cash. Commercial banks also allow investors to withdraw their deposits, as and when they are in need of funds.

12. Revival of Sick Units :-

The Commercial and Financial Institutions provide timely financial assistance to viable sick units to overcome their industrial sickness. To help the weak units to overcome their financial industrial sickness banks and FIs may write off a part of their loan.

LESSON SUMMARY

– An efficient functioning of the financial system facilitates the free flow of funds to more productive activities and thus promotes investment. Thus, the financial system provides the intermediation between savers and investors and promotes faster economic development.

– Financial assets are assets, such as stocks or bonds, whose benefit to the owner depends on the issuer of the asset meeting certain obligations.

– Financial assets can be classified differently under different circumstances, e.g., (A) : (i) Marketable assets and (ii) Non-marketable assets ; (B) : (i) Money/cash assets, (ii) Debt assets and (iii) Stock assets.

– The term ‘financial intermediaries’ include all kinds of organizations which intermediate and facilitate financial transactions of both individuals and corporate customers.

– Financial Markets perform the essential economic function of channeling funds from savers who have an excess of funds to spenders who have a shortage of funds.

– Capital Market may be defined as a market for borrowing and lending long-term capital funds required by business enterprises. Capital Market is the market for financial assets that have long or indefinite maturity.

– Capital Market plays an important role in mobilising resources, and diverting them into productive channels. In this way, it facilitates and promotes the process of economic growth in the country.

– Capital formation is regarded as a key to economic development. It is because capital formation leads to an increase in the supply of machinery, equipments, plants, and also an increase in human capital. This increases production and productivity in an economy. This in turn increases employment opportunities and standard of living of people. Thus, capital formation is considered very important.

– Capital formation process has three stages-(i) Increase in savings (ii) Mobilization of savings (iii) Investment of savings.

– Capital Market has a crucial significance to the process of capital formation. For a speedy economic development adequate capital formation is necessary.

– Transaction cost is a key parameter to measure the impact of modernization of market infrastructure, institutionalisation of the market and market regulation. Besides, transaction cost directly reduces the profits of investors and affects the return on their investments.

– Transaction cost can be classified into two categories: (A) Explicit costs (B) Implicit costs.

– Transaction cost is one of the most important factors which affect the investors and determines the decision making process; because the investors need to be compensated for the risk and transaction cost involved in the buying and selling process.

SELF TEST QUESTIONS

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

1. What is financial market? Briefly discuss about various types of Financial Market.
2. Explain the various functions of Capital Market.
3. What do you understand by capital formation? Discuss various stages of capital formation.
4. What is a transaction cost? How does it impact an investor?
5. Discuss the role of Capital Market in Capital Formation.

Lesson 2
Legal Framework

LESSON OUTLINE

- Introduction
- Department of Economic Affairs (DEA)
- Capital Market Division
- Ministry of Corporate Affairs
- Company Law Board
- National Company Law Tribunal (NCLT)
- Reserve Bank of India
- Securities and Exchange Board of India(SEBI)
- Legislations
- Grievance Redressal Mechanism
- Grievance Rederessal Mechanism at Stock Exchanges
- Grievance Rederessal Mechanism at SEBI
- Securities Appellate Tribunal
- Prevention of Money Laundering Act, 2002
- Investigating Agencies in case of PMLA, 2002
- Diretorate of Enforcement
- Central Bureau of Investigation
- Financial Intelligence Unit – India (FIU-IND)
- The Financial Action Task Force (FATF)
- FATF Recommendations 2016
- LESSON ROUND UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

Securities Market is an important mobilizer of resources for the corporate sector. Investors' confidence is the key to a healthy development of Securities Market. It is necessary that comprehensive and adequate legal system exist to regulate the security market to protect investors' interests and rights.

Further, the investor needs protection from various malpractices and unfair trade practices carried out by the corporates and intermediaries. For this purpose, the Government of India has developed a strong legal and regulatory framework that governs and regulates the businesses, corporate transactions and the intermediaries.

Keeping this in view, this lesson will enable the students to have an overview of the legal framework of the Securities Market in India, the agencies involved in regulating the Securities Market, and the investigation agencies involved in initiating proceedings against money laundering and related offences.

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 carried out by the corporate and intermediaries. As the individual investors' community and the investment avenues are on the rise, it is necessary to protect the investors through various legislations. Securities Market, in general, is to be regulated to improve the market operations in fair dealings and provide an easy to access market by corporates and investors.

Successive Corporate scams also have prompted Governments around the world, including India, to develop a strong legal and regulatory framework to governs and regulates business and corporate transactions. Some of the central issues encountered while regulating the working of corporations, include the complete structure of rules and regulations, roles and responsibilities and jurisdiction of regulating institutions and also co-ordination among the regulatory bodies.

At present, following agencies and bodies have a significant regulatory influence, directly or indirectly, over the Securities Markets in India. These are:

– Department of Economic Affairs (DEA) which is responsible for the economic management of the country and is the an of the Government of India that is concerned with the orderly functioning of the financial markets as a whole.

– Ministry of Corporate Affairs (MCA) which is at the apex of the three tier structure that has the responsibility for the registration and oversight of incorporated entities which fall under the regulatory purview of the Companies Act.

– The Company Law Board (CLB) which is a quasi judicial body that exercises some of the quasi judicial as well as some judicial powers under the Act whichever previously exercised by the High Court and the Central Government. At present NCLT and NCLAT has also been established under section 408 of Companies Act, 2013 (w.e.f. June 1, 2016) to adjudicate issues relating to companies in India.

– The Reserve Bank of India (RBI) which is primarily responsible, *inter alia*, for the supervision of banks and Money Markets.

– Securities and Exchange Board of India (SEBI) which is responsible for the regulation of Capital Markets and various participants and activities therein; and

Of all the above, the agency which is directly charged with the mandate of supervision of the Capital Market in India is SEBI. The role and function of each agency has been discussed below:

DEPARTMENT OF ECONOMIC AFFAIRS (DEA)

The DEA is the nodal agency of the Union Government with the mandate to formulate and monitor the country's economic policies and programmes that have a bearing on domestic and international aspects of economic management. Apart from forming the Union Budget every year, it has other important functions like:

(i) Formulation and monitoring of macro-economic policies, including issues relating to fiscal policy and public finance, inflation, public debt management, and the functioning of Capital Market, including stock exchanges. In this context, it looks at the ways and means to raise internal resources through taxation, market borrowings, and mobilization of small savings.

(ii) Monitoring and raising of external resources through multilateral and bilateral development assistance, sovereign borrowings abroad, foreign investments, and monitoring foreign exchange resources, including balance of payments.

(iii) Production of bank notes and coins of various denominations, postal stationery, postal stamps, cadre management, career planning, and training of the Indian Economic Service (IES) officers.

Capital Market Division

In India, the Capital Markets are regulated by the Capital Markets division of the DEA, Ministry of Finance. The Capital Markets Division of DEA comprises of various sections. The sections along with the respective works handled by them are:

(i) Primary Market (PM)

- Primary Market Related Intermediaries & Participants
- SEBI Board Meeting (primary responsibility)
- SEBI Act
- Related Rules and Regulations
- Corporate Debt Market Development
- Collective Investment Schemes (CIS) including Mutual Funds
- Sectoral Charge of Ministry of Corporate Affairs
- Budget related matters
- National Institute of Securities Market (NISM)

(ii) Secondary Market (SM)

- Securities Contracts (Regulations) Act, 1956
- Depositories Act, 1996
- Related Rules and Regulations
- Taxes and Stamp Duties in Securities Markets
- Database relating to Securities Markets
- Monitoring of Stock Market Movements / Financial Markets
- Related Intermediaries & Participants like Depositories, Stock Exchanges, Clearing Corporations, Governance of such institutions
- Self Regulatory Organisations
- SME Exchange
- SEBI Board Meeting (secondary responsibility)

(iii) External Markets (EM)

- International Financial Market
- Mumbai International Financial Center
- FEMA and Rules & Regulations
- FATF Cell (Financial Action Task Force)

- Liaison / Branch Offices
- High Level Coordination Committee (HLCC) on Financial Markets
- Sectoral (Legal Affairs, Legislative Department and Parliamentary Affairs) Charge
- Foreign Travels of State Govt/UT functionaries

(iv) External Commercial Borrowings (ECB)

- ECB/FCCB (Foreign Convertible Currency Bond)
- American Depository Receipts (ADR)/ Global Depository Receipts (GDR)
- Foreign Institutional investment (FII)

The principal subjects dealt with in the Capital Market Division are the following:

- Policy matters relating to the Securities Markets, related intermediaries and participants;
- Policy matters relating to the regulation and development of the Securities Markets and investor protection ;
- The main Acts/Rules being administered by Capital Markets Division are:-
  - Depositories Act, 1996 and Rules made thereunder
  - Securities Contracts (Regulation) Act, 1956 and rules made thereunder
  - Securities and Exchange Board of India Act, 1992 and rules made thereunder
- Rules made under the above Acts
  - Securities and Exchange Board of India (Terms and Conditions of Services of Chairman and Members) Rules, 1992
  - Securities Appellate Tribunal (Services, Allowance and other Terms and Conditions of Presiding Officers and other Members) Rules, 2003
  - Foreign Exchange Management Act (FEMA), 1999
  - Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002.

Ministry of Corporate Affairs

The Ministry of Corporate Affairs is primarily concerned with administration of the Companies Act, 2013, other allied Acts and rules & regulations framed there-under mainly for regulating the functioning of the corporate sector in accordance with law. It exercises supervision over the three professional bodies, namely, Institute of Chartered Accountants of India (ICAI), Institute of Company Secretaries of India (ICSI) and the Institute of Cost Accountants of India (ICAI) which are constituted under three separate Acts of the Parliament for proper and orderly growth of the professions concerned. The Ministry of Corporate Affairs also has the responsibility of carrying out the functions of the Central Government relating to administration of Partnership Act, 1932, the Companies (Donations to National Funds) Act, 1951 and Societies Registration Act, 1980.

Company Law Board

The Company Law Board (‘CLB’ in short) addresses the investor grievances & if needed it can proceed against a company *suo motu* also. The CLB is a quasi-judicial body, set up by the Central Government u/s 10E of the Companies Act, 1956 exercising equitable jurisdiction, which was earlier being exercised by the High Court and the Central Government. The Board has powers to regulate its own procedures. The Company Law Board has framed “Company Law Board Regulations 1991” prescribing the procedure for filing the applications/petitions before it. The Central Government has also prescribed the fees for making applications/petitions before the Company Law Board, under the “Company Law Board, (Fees on applications and Petitions) Rules 1991”.

National Company Law Tribunal

Companies Act, 2013 provides for constitution of National Company Law Tribunal and the Appellate Tribunal, as Special Courts for adjudicating cases related to companies. As per Section 407 to 417 of Companies Act, 2013. The Ministry of Corporate Affairs (MCA) on 1st June, 2016 notified the constitution of NCLT and NCALT.

Earlier, MCA had issued an order on 6 June, 2014 which clarifies that until a date is notified by the central government under sub-section (1) of section 434 of the Companies Act, 2013 (18 of 2013),the company law board constituted in pursuance of sub-section (1) of section 10E of the Companies Act, 1956 (1 of 1956) shall exercise the jurisdiction, powers, authority and functions of the tribunal under sub-section (2) of section 74 of the said act.

Reserve Bank of India

The Reserve Bank of India (RBI) was established on 1.4.1935, in accordance with the provisions of the RBI Act, 1934. The main functions of RBI are :

(i) operating monetary policy with the aim of maintaining economic and financial stability and ensuring adequate financial resources for development purposes;

(ii) meeting the currency requirement of the public;

(iii) promotion of an efficient financial system;

(iv) foreign exchange reserve management;

(v) the conduct of banking and financial operations of the government.

The Reserve Bank has systematically focussed on developing and regulating the financial markets in view of the cross-linkages with other sectors of the economy. Further, a healthy, robust and vibrant financial market is crucial for stronger monetary policy transmission. To enable the smooth functioning of the market and to contain systemic risks that can adversely impact the real economy, the Reserve Bank continues to play a strategic role.

RBI controls the monetary policy of India by controlling cash liquidity in the country. Frequent alteration of the values of financial tools like Cash Reserve Ratio (CRR), Repo Rate, Reverse Repo Rate, and Statutory Liquidity Ratio (SLR), restricts the cash flow within the country. As an anti-inflationary measure, RBI limits huge foreign capital inflows to stabilize the Rupee value. RBI regulates the foreign exchange inflow and outflow, by the Foreign Exchange Management Act, 1999. All money transfer out of India is subject to limits defined by the RBI. To maintain the exchange rate of Indian Rupee versus foreign currencies like the US Dollar, Euro, Pound sterling, and Japanese yen, RBI buys and sells foreign currencies. The Reserve Bank of India has the power to influence the volume of credit created by banks in India, which means that it is the controller of credit. Carrying out open market operations or changing the Bank rate helps RBI to achieve this. Through quantitative and qualitative measures, it controls the credit operations of other banks. The gold trade is also regulated by the Reserve Bank of India.

Securities and Exchange Board of India (SEBI)

SEBI was brought into existence by the Securities and Exchange Board of India Act, 1992 which came into effect on January 30, 1992. The preamble to the Act describes the purpose of the Act in broad terms as “an act to provide for the establishment of a Board 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 Securities and Exchange Board of India (SEBI) is the regulator charged with the responsibility to ensure orderly functioning of the Securities Market in India, protect the interests of investors and ensure development of the Securities Market. Since the establishment of SEBI in 1992, the Indian Securities Market has grown enormously in terms of volumes, new products and financial services.

SEBI has full autonomy and authority to regulate and develop the Capital Market. The government has framed rules under the Securities Contracts (Regulation) Act, 1956, the SEBI Act, 1992 and the Depositories Act, 1996. The SEBI has framed regulations under the SEBI Act and the Depositories Act for registration and regulation of all market intermediaries, for prevention of unfair trade practices, and insider trading. SEBI issue notifications, guidelines and circulars which need to be complied with by market participants. All the rules and regulations are administered by the SEBI.

LEGISLATIONS

The four main legislations governing the Securities Market are: (a) the SEBI Act, 1992 which establishes SEBI to protect the interest of investors and to develop and regulate Securities Market; (b) the Companies Act, 2013, which sets out a code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges; and (d) the Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities.

(a) SEBI Act, 1992: The provisions of the SEBI Act define its role in more specific terms. These broadly relate to (i) Regulating the business in stock exchanges and any other Securities Markets ; (ii) Registration and regulation of a range of financial intermediaries and trade participants ; (iii) Prohibiting practices that are considered to be unhealthy for development of the Securities Market, such as, insider trading and fraudulent and unfair trade practices, for promoting and regulating self regulatory organizations ; (iv) Promoting investors' education and training of intermediaries of Securities Markets; (v) Inspection and calling for information from various regulated entities referred to in (ii) above ; (vi) Conducting research ; (viii) Collecting fees or other charges for carrying out the purposes of this section and ; (ix) Performing such other functions as may be prescribed.

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

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

(d) Companies Act, 2013: The Companies Act, 2013 has replaced the Companies Act, 1956. The new Companies Act, 2013 envisages to strengthen the existing regulatory framework on Corporate Governance. It deals with the issue, allotment and transfer of securities and various aspects relating to Corporate Management. It provides for standard of disclosure in public issue of capital, particularly in the field of company management and projects, information about other listed companies under the same management and management perception of risk factors. It also regulates underwriting, the use of premium and discounts on issues, right and bonus issues, payment of interest and dividends, supply of annual report and other information.

GRIEVANCE REDRESSAL MECHANISM

The Capital Market can grow only when investors find it safe for them to invest and they are assured that the rules governing the market are fair and just for all the players. For gaining the confidence of investors in the Capital Market there should be a series of systematic measures which would build their confidence in the systems and processes and protect the interest of investors. An effective mechanism for resolutions of disputes and grievances is required to be put in place.

Grievance Redressal Mechanism at Stock Exchange

Investors who are not satisfied with the response to their grievances received from the brokers/Depository Participants/listed companies, can lodge their grievances with the Stock Exchanges or Depositories. In case of an unsatisfactory redressal, the Stock Exchange has designated Investor Grievance Redressal Committees (IGRCs), or Regional Investor Complaints Resolution Committees (RICRC). This forum acts as a mediator to resolve the claims, disputes and differences between entities and complainants. Stock Exchanges provide a standard format to the complainant for referring the matter to IGRC/RICRC. The committee calls for the parties and acts as a nodal point to resolve the grievances. If the grievance is still not resolved, an investor can file an arbitration claim under the Rules, Bye laws and Regulations of the respective Stock Exchange/Depository. If the investor has an account with the broker or a depository participant (DP), he/she can choose arbitration to settle the disputes. The investor generally cannot pursue an issue through arbitration if it is barred by limitation period 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.

Investor Protection Fund

Investor Protection Fund (IPF) or Customer Protection Fund (CPF) is a fund set up by the Stock Exchanges to meet the legitimate investment claims of the clients of the defaulting members that are not of speculative nature. SEBI has prescribed guidelines for utilisation of IPF at the Stock Exchanges. The Stock Exchanges have been permitted to fix suitable compensation limits, in consultation with the IPF/CPF Trust. It has been provided that the amount of compensation available against a single claim of an investor arising out of default by a member broker of a Stock Exchange shall not be less than ₹ 1 lakh in case of major Stock Exchanges and ₹ 50,000/- in case of other Stock Exchanges.

Grievance Redressal Mechanism at SEBI

SEBI has a dedicated department *viz.*, Office of Investor Assistance and Education (OIAE) to receive investor grievances and to provide assistance to investors by way of education. Investors who are not satisfied with the response to their grievances received from the Stock Exchanges/Depositories can lodge their grievances with SEBI. Grievances pertaining to stock brokers and depository participants are taken up with respective stock exchange and depository for redressal and monitored by SEBI through periodic reports obtained from them. Grievances pertaining to other intermediaries are taken up with them directly for redressal and are continuously monitored by SEBI. Grievances against listed companies are taken up with the respective listed company and are continuously monitored. The company is required to respond in prescribed format in the form of Action Taken Report (ATR). Upon the receipt of ATR, the status of grievances is updated. Where the response of the company is insufficient / inadequate, follow up action is initiated. If the progress of redressal of investor grievances by an entity, is not satisfactory, appropriate enforcement actions (adjudication, direction, prosecution, *etc.*) are initiated against such entity.

SEBI has a web based centralized grievance redress system called SCORES which enables the investors to lodge and follow up their complaints and track the status of redressal of such complaints online from the website SCORES (http://scores.gov.in) 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.

Investor Protection and Education Fund

To protect the interest of investors and shareholders, SEBI has set up an Investor Protection and Education

Fund. SEBI has also notified regulations for administration of the fund which is used solely for the purpose of educating the investor, to conduct the awareness programmes and for other incidental matters. These regulations are called the SEBI (Investor Protection and Education Fund) Regulations, 2009. The following amounts shall be credited to the Fund:

(a) contribution as may be made by SEBI to the Fund;

(b) grants and donations given to the Fund by the Central Government, State Government or any other entity approved by SEBI for this purpose;

(c) proceeds in accordance with the sub-clause (ii) of clause(e) of sub-regulation (12) and the sub- regulation (13)of regulation 28 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997;

(d) security deposits, if any, held by stock exchanges in respect of public issues and rights issues, in the event of de-recognition of such stock exchanges;

(e) amounts in the Investor Protection Fund and Investor Services Fund of a stock exchange, in the event of de-recognition of such stock exchange;

(f) interest or other income received out of any investments made from the Fund;

(g) such other amount as SEBI may specify in the interest of investors.

SECURITIES APPELLATE TRIBUNAL

Securities Appellate Tribunal (SAT) is a statutory body established under the provisions of Section 15K of the SEBI Act, 1992 to hear and dispose of appeals against orders passed by SEBI or by an adjudicating officer under the Act and to exercise jurisdiction, powers and authority conferred on the Tribunal by or under SEBI Act or any other law for the time being in force.

Any Securities Market intermediary/person aggrieved by an order of an adjudicating officer/SEBI has a right to appeal to Securities Appellate Tribunal (SAT). The appeal must be filed within a period of 45 days from the date of receipt of the order by the adjudicating officer/SEBI. The SAT can entertain an appeal after the expiry of 45 days for sufficient cause to be shown. It can confirm/modify/set aside the order appealed against within six months from the date of receipt of appeal.

In order to enable the SAT to dispose off appeals expeditiously, it is not bound by the procedure laid down by the Criminal Procedure Code, 1973 (CrPC); instead it is guided by the principle of natural justice. It has the powers to regulate its own procedure including the place of sitting. For the purpose of discharging its functions, the SAT has the same powers as are vested in a civil court under the civil procedure code while trying a suit in respect of : (a) summoning and enforcing the attendance of any person and examining him on oath; (b) requiring the delivery and production of documents; (c) receiving evidence on affidavits; (d) issuing commission for the examination of witness/documents; (e) reviewing the decisions; (f) dismissing an application for default or deciding it *ex-parte*; (g) setting aside any order of dismissal of any application for default or any order passed by it *ex-parte* and (h) any other mater which may be prescribed.

Any proceeding before the SAT is deemed to be a judicial proceeding under the Indian Penal Code and the SAT is deemed to be a civil court under the Code of Criminal Procedure.

No civil court has jurisdiction over the adjudicating officers and the SAT. The only remedy available to an aggrieved party against the decision/order of the SAT is an appeal within 60 days from the date of communication to the decision or order of the Securities Appellate Tribunal on any question of fact or law arising out of such order to the Supreme Court of India. 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.

PREVENTION OF MONEY LAUNDERING ACT, 2002

The Prevention of Money Laundering Act (PMLA), 2002 was enacted in January, 2003. The Act along with the Rules framed thereunder have come into force with effect from 1st July, 2005.

Section 3 of PMLA defines the offence of Money Laundering as "whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money-laundering". It prescribes obligation of banking companies, financial institutions and intermediaries for verification and maintenance of records of the identity of all its clients and also of all transactions and for furnishing information of such transactions in prescribed form to the Financial Intelligence Unit-India (FIU-IND). It empowers the Director of FIU-IND to impose fine on banking company, financial institution or intermediary if they or any of its officers fail to comply with the provisions of the Act as indicated above.

PMLA empowers certain officers of the Directorate of Enforcement to carry out investigations in cases involving offence of money laundering and also to attach the property involved in money laundering. PMLA envisages setting up of an Adjudicating Authority to exercise jurisdiction, power and authority conferred on it, essentially to confirm attachment or order confiscation of attached properties. It also envisages setting up of an Appellate Tribunal to hear appeals against the order of the Adjudicating Authority and the authorities like Director FIU-IND.

PMLA envisages designation of one or more Courts of Sessions as a Special Court or Special Courts to try the offences punishable under PMLA and offences with which the accused may, under the Code of Criminal Procedure 1973, be charged at the same trial. PMLA allows the Central Government to enter into an agreement with Government of a country outside India for enforcing the provisions of the PMLA, exchange of information for the prevention of any offence under PMLA or under the corresponding law in force in that country or investigation of cases relating to any offence under PMLA.

Objective

The PML Act seeks to combat money laundering in India and has three main objectives:

- To prevent and control money laundering
- To confiscate and seize the property obtained from the laundered money; and
- To deal with any other issue connected with money laundering in India.

Punishment for Money-Laundering

Section 4 of the Prevention of Money Laundering Act, 2002 specifies punishment for money laundering as under:

> "Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine which may extend to five lakh rupees.
>
> Provided that where the proceeds of crime involved in money-laundering relates to any offence specified under paragraph 2 of Part A of the Schedule, the provisions of this section shall have effect as if for the words "which may extend to seven years", the words "which may extend to ten years" had been substituted."

Obligations of Banking Companies, Financial Institutions and Intermediaries of Securities Market

Section 12 of the Prevention of Money Laundering Act, 2002 lays down following obligations on banking companies, financial institutions and intermediaries.

Every banking company, financial institution and intermediary shall –

(a) maintain a record of all transactions, the nature and value of which may be prescribed, whether such transactions comprise of a single transaction or a series of transactions integrally connected to each other, and where such series of transactions take place within a month;

(b) furnish information of transactions referred to in clause (a) to the Director within such time as may be prescribed;

(c) verify and maintain the records of the identity of all its clients, in such a manner as may be prescribed.

Provided that where the principal officer of a banking company or financial institution or intermediary, as the case may be, has reason to believe that a single transaction or series of transactions integrally connected to each other have been valued below the prescribed value so as to defeat the provisions of this section, such officer shall furnish information in respect of such transactions to the Director within the prescribed time.

The records referred above is required to be maintained for a period of ten years from the date of transactions between the clients and the banking company or financial institution or intermediary, as the case may be.

The records referred to in clause (c) shall be maintained for a period of ten years from the date of cessation of transactions between the clients and the banking company or financial institution or intermediary, as the case may be.

Intermediary under PMLA includes following persons registered under Section 12 of SEBI Act:-

(i) Stock brokers

(ii) Sub-brokers

(iii) Share transfer agents

(iv) Bankers to an issue

(v) Trustees to trust deed

(vi) Registrars to issue

(vii) Merchant bankers

(viii) Underwriters

(ix) Portfolio Managers

(x) Investment advisers

(xi) Depositories and Depository Participants

(xii) Custodian of securities

(xiii) Foreign institutional investors

(xiv) Credit rating agencies

(xv) Venture capital funds

(xvi) Collective investment schemes including mutual funds

Cash Transaction Reports

The Prevention of Money-laundering Act, 2002, and rule thereunder require every banking company, financial institution and intermediary, to furnish to FIU-IND information relating to -

A. All cash transactions of the value of more than rupees ten lakhs or its equivalent in foreign currency;

B. All series of cash transactions integrally connected to each other which have been valued below rupees ten lakhs or its equivalent in foreign currency where such series of transactions have taken place within a month;

Suspicious Transaction Reports

Every banking company, financial institution and intermediary shall furnish to FIU-IND information of all suspicious transactions whether or not made in cash.

> Suspicions Transaction means a transaction including an attempted transaction, whether or not made in cash which, to a person acting in good faith –
>
> (a) gives rise to a reasonable ground of suspicion that it may involve proceeds of an offence specified in the Schedule to the Act, regardless of the value involved; or
>
> (b) appears to be made in circumstances of unusual or unjustified complexity; or
>
> (c) appears to have no economic rationale or bonafide purpose; or
>
> (d) gives rise to a reasonable ground of suspicion that it may involve financing of the activities relating to terrorism.

Broad categories of reason for suspicion and examples of suspicious transactions for a banking company are indicated as under:

Identity of client

- False identification documents
- Identification documents which could not be verified within reasonable time
- Accounts opened with names very close to other established business entities

Background of client

- Suspicious background or links with known criminals

Multiple accounts

- Large number of accounts having either a common account holder, introducer, or Authorised Signatory.

Signatory with no rationale

- Unexplained transfers between multiple accounts with no rationale

Activity in accounts

- Unusual activity compared with past transactions
- Sudden activity in dormant accounts
- Activity inconsistent with what would be expected from declared business

Nature of transactions

- Unusual or unjustified complexity

– No economic rationale or bonafide purpose

– Frequent purchases of drafts or other negotiable instruments with cash

– Nature of transactions inconsistent with what would be expected from declared business

Value of transactions

– Value just under the reporting threshold amount in an apparent attempt to avoid reporting

– Value inconsistent with the client's apparent financial standing

Broad categories of reason for suspicion and examples of suspicious transactions for an intermediary are indicated as under:

Identity of Client

– False identification documents

– Identification documents which could not be verified within reasonable time

– Non-face to face client

– Doubt over the real beneficiary of the account

– Accounts opened with names very close to other established business entities

Suspicious Background

– Suspicious background or links with known criminals

Multiple Accounts

– Large number of accounts having either a common account holder, introducer, or Authorised Signatory and alike.

Signatory with no rationale

– Unexplained transfers between multiple accounts with no rationale

Activity in Accounts

– Unusual activity compared to past transactions

– Use of different accounts by client alternatively

– Sudden activity in dormant accounts

– Activity inconsistent with what would be expected from declared business

– Account used for circular trading

Nature of Transactions

– Unusual or unjustified complexity

– No economic rationale or bonafide purpose

– Source of funds are doubtful

– Appears to be case of insider trading

– Investment proceeds transferred to a third party

– Transactions reflect likely market manipulations

– Suspicious off market transactions

Value of Transactions

– Value just under the reporting threshold amount in an apparent attempt to avoid reporting

– Large sums being transferred from overseas for making payments

– Inconsistent with the clients apparent financial standing

– Inconsistency in the payment pattern by client

– Block deal which is not at market price or prices appear to be artificially inflated/deflated.

Agreements with foreign countries

Section 56 of the Prevention of Money Laundering Act, 2002 provides for agreements with foreign countries to facilitate exchange of information with them.

– The Central Government may enter into an agreement with the Government of any country outside India for-

(i) enforcing the provisions of this Act;

(ii) exchange of information for the prevention of any offence under this Act or under the corresponding law in force in that country or investigation of cases relating to any offence under this Act.

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

– The Central Government may, by notification in the Official Gazette, direct that the application of this Act in relation to a contracting State with which reciprocal arrangements have been made, shall be subject to such conditions, exceptions or qualifications as are specified in the said notification.

As per the PMLA, the officers of the Directorate of Enforcement have been given powers to investigate cases of Money Laundering. The enforcement agency has extensive powers to discharge its duties under the Act. The officers have also been authorised to initiate proceedings for attachment of property and to launch prosecution in the designated Special Court. Financial Intelligence Unit-India (FIU-IND) is the authority to implement the provisions of the Act. The application of Anti-Money Laundering measures by market intermediaries has been emphasized by International Regulatory agencies as a key element in combating money laundering. Financial Action Task Force (FATF) is the agency who evaluates the member countries and certify whether they are compliant or not. India has been confirmed as one of the countries that are is compliance with AML regulations, during December 2010. Apart from the FIU and FATF, Central Bureau of Investigation(CBI) is also empowered to investigate cases relating to Money Laundering.

INVESTIGATING AGENCIES IN CASE OF PMLA, 2002

The following investigating agencies are involved in case of PMLA, 2002

Directorate of Enforcement

The Directorate of Enforcement, with its Headquarters at New Delhi is headed by the Director of Enforcement. In case of money laundering investigation can be initiated only by authorities designated by Central Government such as Directorate of Enforcement. These authorities can carry out interim measures such as the survey, search, seizure and arrest of the accused. Section 13 of the Prevention of Money Laundering Act, 2002, confers power on the Director (appointed by the Central Government and entrusted with powers of a civil court) to ensure compliance and to call for records and make appropriate inquiries when necessary.

Functions

The main functions of the Directorate are as under :

1. Investigate Cases of contraventions of the provisions of Foreign Exchange Management Act, 1999 (FEMA). Such cases of contraventions of FEMA are dealt with by way of adjudication by designated authorities of Enforcement Directorate (ED) and penalties such case of upto three times the sum involved can be imposed.
2. Investigate Cases of money laundering under the provisions of Prevention of Money Laundering Act, 2002 (PMLA) and to take actions of attachment and confiscation of property if the same is determined to be the proceeds of crime derived from a Scheduled Offence under PMLA, and to prosecute the persons involved in the offence of money laundering. There are 156 offences under 28 statutes which are categorized as Scheduled Offences under PMLA.
3. Adjudicate Show Cause Notices issued under the repealed Foreign Exchange Regulation Act, 1973 (FERA) upto 31.5.2002 for the alleged contraventions of the Act which may result in imposition of penalties. Pursue prosecutions launched under FERA in the concerned courts.
4. Sponsor cases of preventive detention under Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 (COFEPOSA) in regard to contraventions of FEMA.
5. Render cooperation to foreign countries in matters relating to money laundering and restitution of assets under the provisions of PMLA and to seek cooperation in such matters.

Central Bureau of Investigation

The investigations of the economic offences by the CBI are carried out through a separate division in it, called the Economic Offences Wing.

CBI derives its powers of investigation from Delhi Special Police Establishment Act, 1946 (DSPE) and investigates cases notified U/S 3 of the DSPE Act, 1946. Since Law and Order is a State subject and basic jurisdiction to investigate the offences lies with the State Police, the CBI *suo moto* investigates cases against employees of Central Government/Public Sector Undertakings of the Government of India in the Union Territories only. Investigation in respect of offences committed in the States can be carried out only with the consent of concerned State U/S 6 of the DSPE Act, 1946.

As regards economic offences, CBI is empowered to investigate offences which are also notified U/S 3 of the DSPE Act in the Union Territories and such offences can be investigated in the State with the consent of the State Government as required U/S 6 of the DSPE Act.

Therefore, in terms of Economic Offences, CBI can investigate : –

(i) Cases of fraud, cheating, embezzlement and the like relating to companies in which large funds are involved and some other cases when committed by organized gangs or professionals having ramifications in several States.

(ii) Cases having inter-state and international ramifications and involving several official agencies where it is considered necessary that a single investigating agency like CBI should be in charge of investigation.

Financial Intelligence Unit – India (FIU-IND)

FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the Finance Minister of India. Financial Intelligence Unit – India (FIU-IND) was set by the Government of India *vide* O.M. dated 18th November 2004 as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions. FIU-IND is also responsible for coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering and related crimes.

Functions of FIU-IND

The main function of FIU-IND is to receive cash/suspicious transaction reports, analyse them and, as appropriate, disseminate valuable financial information to intelligence/enforcement agencies and regulatory authorities . The functions of FIU-IND are:

1. Collection of Information: Act as the central reception point for receiving Cash Transaction reports (CTRs) and Suspicious Transaction Reports (STRs) from various reporting entities.

2. Analysis of Information: Analyze received information in order to uncover patterns of transactions suggesting suspicion of money laundering and related crimes.

3. Sharing of Information: Share information with national intelligence/law enforcement agencies, national regulatory authorities and foreign Financial Intelligence Units.

4. Act as Central Repository: Establish and maintain national database on cash transactions and suspicious transactions on the basis of reports received from reporting entities.

5. Coordination: Coordinate and strengthen collection and sharing of financial intelligence through an effective national, regional and global network to combat money laundering and related crimes.

6. Research and Analysis: Monitor and identify strategic key areas on money laundering trends, typologies and developments.

The Financial Action Task Force (FATF)

Financial Action Task Force (FATF) was established in July 1989 by a Group of Seven (G-7) Summit in Paris, initially to examine and develop measures to combat money laundering. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The FATF is therefore a “policy-making body” which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas.

The FATF has developed a series of Recommendations that are recognised as the international standard for combating money laundering and the financing of terrorism and proliferation of weapons of mass destruction. They form the basis for a co-ordinated response to these threats to the integrity of the financial system and help ensure a level playing field. First issued in 1990, the FATF Recommendations were revised in 1996, 2001, 2003, 2012 and most recently in 2016 to ensure that they remain up to date and relevant, and they are intended to be of universal application.

The FATF monitors the progress of its members in implementing necessary measures, reviews money laundering and terrorist financing techniques and counter-measures, and promotes the adoption and implementation of appropriate measures globally. In collaboration with other international stakeholders, the FATF works to identify national-level vulnerabilities with the aim of protecting the international financial system from any misuse.

FATF Recommendations 2016

The FATF Recommendations are the basis on which all countries should meet the shared objective of tackling money laundering, terrorist financing and the financing of proliferation. The FATF calls upon all countries to effectively implement these measures within their national systems.

A – AML/CFT POLICIES AND COORDINATION

1 - Assessing risks & applying a risk-based approach

2 - National cooperation and coordination

B – MONEY LAUNDERING AND CONFISCATION

3 - Money laundering offence

4 - Confiscation and provisional measures

C – TERRORIST FINANCING AND FINANCING OF PROLIFERATION

5 - Terrorist financing offence

6 - Targeted financial sanctions related to terrorism & terrorist financing

7 - Targeted financial sanctions related to proliferation

8 - Non-profit organisations

D – PREVENTIVE MEASURES

9 - Financial institution secrecy laws

Customer due diligence and record keeping

10 - Customer due diligence

11 - Record keeping

Additional measures for specific customers and activities

12 - Politically exposed persons

13 - Correspondent banking

14 - Money or value transfer services

15 - New technologies

16 - Wire transfers

Reliance, Controls and Financial Groups

17 - Reliance on third parties

18 - Internal controls and foreign branches and subsidiaries

19 - Higher-risk countries

Reporting of suspicious transactions

20 - Reporting of suspicious transactions

21 - Tipping-off and confidentiality

Designated non-financial Businesses and Professions (DNFBPs)

22 - DNFBPs: Customer due diligence

23 - DNFBPs: Other measures

E – TRANSPARENCY AND BENEFICIAL OWNERSHIP OF LEGAL PERSONS AND ARRANGEMENTS

24 - Transparency and beneficial ownership of legal persons

25 - Transparency and beneficial ownership of legal arrangements

F – POWERS AND RESPONSIBILITIES OF COMPETENT AUTHORITIES AND OTHER INSTITUTIONAL MEASURES

Regulation and Supervision

26 - Regulation and supervision of financial institutions

27 - Powers of supervisors

28 - Regulation and supervision of DNFBPs

Operational and Law Enforcement

29 - Financial intelligence units

30 - Responsibilities of law enforcement and investigative authorities

31 - Powers of law enforcement and investigative authorities

32 - Cash couriers

General Requirements

33 - Statistics

34 - Guidance and feedback

Sanctions

35 - Sanctions

G – INTERNATIONAL COOPERATION

36 - International instruments

37 - Mutual legal assistance

38 - Mutual legal assistance: freezing and confiscation

39 - Extradition

40 - Other forms of international cooperation

LESSON ROUND UP

– 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.

– The Department of Economic Affairs is the nodal agency of the Union Government to formulate and monitor the country's economic policies and programmes that have a bearing on domestic and international aspects of economic management.

– The Ministry of Corporate Affairs is primarily concerned with administration of the Companies Act, 2013, other allied Acts and Rules & Regulations framed thereunder mainly for regulating the functioning of the corporate sector in accordance with law.

– The CLB is a quasi-judicial body, exercising equitable jurisdiction, which was earlier being exercised by the High Court or the Central Government.

– RBI regulates the foreign exchange inflow and outflow, under the Foreign Exchange Management Act, 1999. All money transfers out of India are subject to limits defined by the RBI.

– The Securities and Exchange Board of India (SEBI) is the regulator charged with the mandate to ensure orderly functioning of the Securities Market in India, protect the interests of investors and ensure development of the Securities Market.

– The four main legislations governing the Securities Market are: (a) the SEBI Act, 1992 (b) the Companies

Act, 2013 (c) the Securities Contracts (Regulation) Act, 1956 (d) the Depositories Act, 1996.

- The Stock Exchange has designated Investor Grievance Redressal Committees (IGRCs), or Regional Investor Complaints Resolution Committees (RICRC) which acts as a mediator to resolve the claims, disputes and differences between entities and complainants.
- Investor Protection Fund (IPF) or Customer Protection Fund (CPF) is a fund set up by the Stock Exchanges to meet the legitimate investment claims of the clients of the defaulting members that are not of speculative nature.
- SEBI has a dedicated department, *i.e.,* Office of Investor Assistance and Education (OIAE) to receive investor grievances and to provide assistance to investors by way of education. Investors who are not satisfied with the response to their grievances received from the Stock Exchanges/Depositories can lodge their grievances with SEBI.
- To protect the interest of investors and shareholders, SEBI has set up an Investor Protection and Education Fund.
- Any Securities Market intermediary/person aggrieved by an order of an adjudicating officer/SEBI has a right to appeal to Securities Appellate Tribunal (SAT).
- The Prevention of Money Laundering Act (PMLA), 2002 was enacted in January, 2003.
- Section 3 of the PMLA defines the offence of Money Laundering as "whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money-laundering".
- PMLA empowers certain officers of the Directorate of Enforcement to carry out investigations in cases involving offence of money laundering and also to attach the property involved in money laundering.
- CBI derives its powers of investigation from Delhi Special Police Establishment Act (DSPE) and investigates cases notified U/S 3 of the DSPE Act, 1946.
- Financial Intelligence Unit – India (FIU-IND) was set by the Government of India as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions.
- Financial Action Task Force (FATF) was established in July 1989 by a Group of Seven (G-7) Summit in Paris, initially to examine and develop measures to combat money laundering. The FATF recommendations are regularly revised to be apt at change. Recently they are revised in 2016.
- The FATF Recommendations are the basis on which all countries should meet the shared objective of tackling money laundering, terrorist financing and the financing of proliferation.

SELF TEST QUESTIONS

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

1. Briefly explain about the legislations governing Securities Market in India.
2. Discuss about the Grievance Redressal Mechanism at Stock Exchanges.
3. Explain the procedure relating to filing an appeal with SAT against an order passed by an adjudicating officer or SEBI ?
4. What are the Obligations of Banking Companies, Financial Institutions and Intermediaries of Securities Market under the Prevention of Money Laundering Act, 2002?
5. Describe the various functions of Financial Intelligence Unit – India (FIU-IND).

Lesson 3
Framework of Market Infrastructure Institutions

LESSON OUTLINE

- Introduction
- Securities Contract (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012
- Recognition of Stock Exchanges and Clearing Corporations
- Networth Requirements
- Ownership of Stock Exchanges
- Ownership of Clearing Corporations
- Governance of Stock Exchanges and Clearing Corporations
- Listing of Securities
- Procedural Norms
- Depositories Act, 1996
- Securities Contracts (Regulation) Act, 1956
- LESSON ROUND UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

Stock Exchanges and other institutions like Depositories and Clearing Corporations, which form a vital part of the market infrastructure, are systemically important for the country's financial development and serve as the part of the infrastructure necessary for the Securities Market. SEBI has prescribed various Act and Regulations which have been modified from time to time so as to respond to the needs of the market and in keeping with financial and technological advancement world over.

The main objective of this lesson is to enable the students to understand the Regulatory Framework governing the Stock Exchanges, Clearing Corporations and Depositories in India.

FRAMEWORK OF MARKET INFRASTRUCTURE INSTITUTIONS

Introduction

Stock Exchanges in India have a long history of more than 175 years. Stock Exchanges have witnessed some drastic changes in terms of in their ownership and governance structure over these time, from being a purely closed club of trading members to full demutualization, and from an organization resembling more a self regulatory organization to a SEBI regulated entity. Changes have been brought in from time to time in the management and functioning of the stock exchanges to serve the overarching objective of market development, financial inclusion, transparency, developing and operating and risk free trading system. Along with stock exchanges, other institutions (*i.e.,* depositories and clearing corporations) which are as much a vital part of the market infrastructure for achieving the above objectives also developed. These institutions (i.e., stock exchanges, depositories and clearing corporations) are important for the country's financial development and serve as the infrastructure necessary for the securities market. These institutions are collectively referred to as Market Infrastructure Institutions (MIIs). SEBI has prescribed various Acts and Regulations from time to time for insruing the smooth functioning of these MIIs. These Acts and Regulations have been modified from time to time so as to respond to the needs of the market and in keeping with financial and technological advancement world over.

SECURITIES CONTRACT (REGULATION) (STOCK EXCHANGES AND CLEARING CORPORATIONS) REGULATIONS, 2012

SEBI notified the Securities Contract (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 ("SECC Regulations") on June 20, 2012 to regulate the mechansims of recognition, ownership and governance in Stock Exchanges and Clearing Corporations and matters connected therewith or incidental thereto.

These Regulations provide for recognition, ownership, governance and listing provisions with respect to Stock Exchanges as well as Clearing Corporations. The important provisions of the new Regulations are discussed here under:

Recognition of Stock Exchanges and Clearing Corporations

As per the provisions of these Regulations, all Stock Exchanges and Clearing Corporations are required to apply for recognition by the SEBI. The Stock Exchanges which have been recognized under the Act as on the date of commencement of these Regulations shall be deemed to have been recognized under these Regulations and all the provisions shall be applicable on them. The existing Clearing Corporations will continue for a period of 3 months from the date of applicability of these Regulations until an application made for the recognition is disposed of. The Regulations provide for the manner of making application, fees, documents required and consideration for grant of recognition by SEBI. The Regulations also provides for the period of recognition, regulatory fees as well as provisions with respect to renewal and withdrawal of recognition.

Networth Requirements

Stock Exchanges and Clearing Corporations are required to maintain minimum networth requirement of ₹ 100 crores at all times. The existing recognized Stock Exchanges and Clearing Corporations are required to fulfill the networth requirement within a maximum period of 3 years from the date of commencement of these Regulations. The limit is not to apply to an applicant performing clearing functions of a recognized stock exchange on the date of commencement of these regulations. It is further provided that the recognized Stock Exchange or the recognized Clearing Corporation shall not distribute profit in manner to its shareholders until specified networth limit is met. The manner of calculation of networth is also prescribed which vary in case of Stock Exchange and Clearing Corporations.

Ownership of Stock Exchanges

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

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

Others requirements

Apart from the above mentioned requirement, following other requirements are also prescribed with :

- No Clearing Corporation shall hold any right, stake or interest in any recognized Stock Exchange.
- Any person who directly or indirectly and either individually or with PAC acquires 2% or more in equity capital would require to apply for approval of SEBI within 15 days of such acquisition. If the approval is not granted the shares so acquired shall be forthwith divested. Shareholders of existing recognized Exchange holding more than 2% equity may apply for approval within 90 days of commencement of these Regulations.
- Stock exchange, Depository, Banking company, Insurance company, Public financial Institution allowed to hold upto 15% equity capital, cannot acquire either directly or indirectly and either individually or with PAC any holding over and above 5% without the prior approval from SEBI.
- Every shareholder of the recognized Stock Exchange is required to be a Fit & Proper person.

Ownership of Clearing Corporations

The provisions with respect to ownership and shareholding of recognized Clearing Corporations are similar to the aforesaid provisions as applicable to recognized Stock Exchanges, except for the following:

- 51% or more equity share capital to be held by one or more recognized Stock Exchanges.
- A single Stock Exchange cannot hold more than 15% of equity share capital in one Clearing Corporation.

Governance of Stock Exchanges and Clearing Corporations

The provisions with respect to management and governance of recognized Stock Exchanges as well as Clearing Corporations are also provided in the Regulations, broadly covering the following:

- Composition of Governing Board.
- Guidelines for election of Chairperson as well as number of public interest directors, appointment of Shareholder Director, *etc.* on the Governing Board.
- Conditions for appointment of Directors and the Managing Director.
- Code of conduct for Directors and Key Managerial Personnel.
- Compensation and Tenure for Key Managerial Personnel.
- Segregation of regulatory department from other departments.
- Constitution of Oversight committee.
- To address conflicts of interest in respect of member regulation, listing functions and trading and surveillance function.
- Constitution of Advisory Committee.

  To advice governing board on non regulatory and operational matters including product design, technology, charges and levies.
- Constitution of Risk Management committee (in case of clearing corporations).
- To formulate and implement a comprehensive detail risk management policy.
- Appointment of compliance officer.
- Transfer of Profits.
- Transfer of penalties.
- Disclosure and Corporate Governance norms.

Listing of Securities

As per the provisions of the Regulations, a recognized stock exchange can apply for the listing of its securities on any recognized stock exchange other than itself if:

- It complies with the provisions of these regulations.
- It has completed 3 years of continuous trading operations immediately preceding the date of application of listing.
- It has the approval of the board.

Though as per the provisions of these Regulations, the securities of a recognized Clearing Corporation shall not be listed on a stock exchange.

The Regulations also requires securities of both the recognized Stock Exchanges as well as Clearing Corporations to be held in dematerialized form.

PROCEDURAL NORMS

To facilitate the implementation of the SECC Regulations and provide guidelines to Stock Exchanges and Clearing Corporations for their operations in accordance with the terms of SECC Regulations, SEBI has issued procedural norms on recognition, ownership and governance for Stock Exchanges and Clearing Corporations dated December 13, 2012.

The Procedural Norms are divided into four (4) parts as Parts A to D which are discussed (in brief) as follow:

Part A: Recognition

For the purpose of granting an in principle approval in terms of regulation 7(5) of the SECC Regulations, SEBI is entitled to consider *inter alia* the following information in relation to an application made under regulation 4 of the SECC Regulations:

- Business feasibility plan for the next five years;
- Net worth certificate/ financial books and bank account details;
- Detailed write-up on each of its functions;
- Details of authorized officials along with specimen signatures of the authorized signatories;
- Proposed organizational structure;
- Necessary undertakings;
- Manpower planning;
- Background and necessary information (as specified herein) to establish that its shareholders/promoters are fit and proper persons, Information regarding its Office set-up, Appointment of Managing Director after following due process;

Paragraph 2 of the Procedural Norms provides that a Clearing Corporation shall make bye-laws providing *inter alia* for the following:

- The timings for pay-in and pay-out of funds and securities;
- Rules for clearing and settlement;
- Risk management mechanism;
- Process of netting, novation and guarantee for settlement of trades;
- Norms for contribution into and utilization of the Fund in terms of regulation 39 of SECC Regulations;
- Rights and obligations of the clearing members *vis-a-vis* the clearing Corporation, other clearing members, the trading members and clients of such trading members;
- Criteria for admission and regulation of clearing members;
- Default handling mechanism;
- Committees as mentioned in paragraph 7 of the Procedural Norms;
- Any other matter as may be specified by SEBI.

Part B : Action Plan for achieving Networth

- In terms of regulation 14 of SECC Regulations a recognized stock exchange is required to have a net worth of ₹ 100 crore. However, in case of a stock exchange having a net worth of less than ₹ 100 crore such stock exchange is required to submit a plan duly approved by its shareholders to achieve such net worth in accordance with the terms of regulation 14 of the SECC Regulations. This plan has to be submitted within a period of ninety days from the date of issue of the Procedural Norms.
- A Clearing Corporation which has made an application for recognition in terms of Regulation 3 of SECC Regulations and has a networth of less than ₹ 300 crore shall submit its plan duly approved by its shareholders to SEBI for achieving its networth withhin 90 days from the date of issue of the Procedural Norms.

Ownership

- In terms of Regulation 17(2) of the SECC Regulations, except a person who is resident in India, no one is allowed to hold or acquire more than 5% of the paid up equity capital in a stock exchange.

- However, a stock exchange, depository, banking company, insurance company and a public financial institution may acquire or hold up to 15% of the paid up equity capital in a stock exchange.
- Despite the SECC Regulations providing a threshold of 5% for the shareholding, the Procedural Norms state that a shareholder holding more than 2% of the paid up equity capital in a stock exchange is required to obtained SEBI's prior approval.
- Under paragraph 5 of the Procedural Norms, the stock exchange/clearing corporation is required to put in place a monitoring mechanism to ensure compliance with the shareholding requirements at all times. The stock exchange/clearing corporation is also required to:
- Disseminate information on its website regarding the number of shares available in non-public, FII and FDI category. The same shall also be disseminated by the stock exchange where shares of such stock exchange/clearing corporation are listed;
- Check the shareholding pattern of the stock exchange/clearing corporation from time to time to ensure compliance with the SECC Regulations;
- Upon breach of shareholding limits, same shall be intimated to SEBI within seven days.

Part C: Governance

- Paragraph 6.2.1 of the Procedural Norms states that for the purpose of appointment of CEO/Managing Director/Executive Director the Stock Exchange/Clearing Corporation shall constitute a committee which shall oversee the appointment process. In this regard, the managing director shall be selected through open advertisement in all editions of at least one national daily from amongst persons qualified in the fields of capital markets/ finance/ management and possessing sufficient experience.
- Under paragraph 6.3.1 of the Procedural Norms the Board of the Stock Exchange/Clearing Corporation may forward a minimum of two names for each vacancy of public interest directors. In terms of paragraph 6.3.3 chairperson of the Stock Exchange/Clearing Corporation shall be appointed with the prior approval of SEBI. In terms of paragraph 6.3.4 public interest directors are not permitted to simultaneously hold positions on the board of other Stock Exchanges/Clearing Corporations or their subsidiaries.
- Paragraph 6.4 deals with shareholder directors. Names of persons nominated for appointment as shareholder directors shall be sent to SEBI after approval of such names from the Board of the Stock Exchange/Clearing Corporations and Shareholders' approval of the Stock Exchange/Clearing Corporation.
- The Board shall appoint trading members/ clearing members to the advisory committee after being satisfied that they are fit and proper persons in terms of regulation 20 of the SECC Regulations. The Board shall also appoint a compliance officer in terms of regulation 32 of the SECC Regulation. The Board shall ensure that all key management persons are fit and proper as per regulation 20 of SECC Regulations.
- Paragraph 7 requires the formation of various statutory committees. Stock exchanges are required to have committees such as Investor Grievance Redressal Committee, Defaulters' Committee, Investor Services Committee, Advisory Committee, Ethics Committee, Arbitration Committee, and Independent Oversight Committee of the Governing Board for Trading and Surveillance Function, *etc.* and the Clearing Corporation to have Advisory Committee, Risk Management Committee, and Ethics Committee.
- Paragraph 8 provides for Norms for Compensation Policy. Regulation 27 of SECC Regulations mandates that the Compensation Policy for Key Management Personnel of Stock Exchange/Clearing Corporation shall be in accordance with the norms specified by SEBI.
- Paragraph 9 of the Procedural Norms mandates the segregation of regulatory departments from other

departments in Stock Exchanges. Some of the key regulatory departments are surveillance, listing, member registration, compliance, inspection, enforcement, investor protection, *etc.* Similarly, such a separation is mandated for clearing corporations. Some of the key regulatory departments in clearing corporations are risk management, member registration, compliance, inspection, enforcement, default, investor protection, *etc.*

Part D of the Procedural Norms deals with Miscellany subjects including procedural aspects such as amendments to the bye laws of Stock Exchanges/Clearing Corporations, internal manual for conflict resolution, disclosure of securities transactions by directors and parties related thereto, other clarifications, *etc.*

THE DEPOSITORIES ACT, 1996

The Depositories Act, 1996 provides for the establishment of both single as well as multiple depositories. Any body to be eligible for providing depository services must be formed and registered as a company under the Companies Act, 2013 and must seek registration with SEBI and obtain a Certificate of Commencement of Business from SEBI on fulfilment of the prescribed conditions.

Objectives

The depositories legislation as per the Statement of objects and reasons appended to the Depositories Act, 1996 aims at providing for:

– A legal basis for establishment of depositories to conduct the task of maintenance of ownership records of securities and effect changes in ownership records through book entry;

– Demateralisation 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. The investor has the choice of holding physical securities or opt for a depository based ownership record.

However, in case of a fresh issue of securities all securities issued have to be in the 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 in the depository mode and if in depository mode, which depository or participant, would be entirely with the investor.

Fungibility

Section 9 states that securities in depositories shall be in fungible form.

The Act envisages that all securities held in depository shall be fungible *i.e.* all certificates of the same security shall become interchangeable in the sense that investor loses the right to obtain the exact certificate he surrenders at the time of entry into depository. It is like withdrawing money from the bank without bothering about the distinctive numbers of the currency notes.

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 entries 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 remaining portion in physical form. Sections 89 and 186 of the 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 be subjected to all the liabilities in respect of his securities held by a depository.

Register of beneficial owner

Every depository is required to maintain a register and an index of beneficial owners in the manner provided in the Companies Act, 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 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 and such depository is required to make entries in its records accordingly. Any entry in the records of a depository should be an evidence of a pledge or hypothecation.

Pledge and Hypothecation

If the lender (pledgee) has a unilateral right (without reference to borrower) to appropriate the securities to his account if the borrower (pledgor) defaults or otherwise, the transaction is called a pledge. If the lender needs concurrence of the borrower (pledgor) for appropriating securities to his account, the transaction is called hypothecation. The Depositories Act, 1996 permits the creation of pledge and hypothecation against the securities. Securities held in a depository account can be pledged or hypothecated against a loan, credit, or such other facility availed by the beneficial owner of such securities. For this purpose, both the parties to the agreement, i.e., the pledgor and the pledgee must have a beneficiary account with Depository. However, both parties need not have their depository account with the same DP. The nature of control on the securities offered as collateral determines whether the transaction is a pledge or hypothecation.

Procedure for Pledge/Hypothecation

The pledgor initiates the creation of pledge/hypothecation through its DP and the pledgee instructs its DP to confirm the creation of the pledge. The pledge/hypothecation so created can either be closed on repayment of loan or invoked if there is a default. After the pledgor has repaid the loan to the pledgee, the pledgor initiates the closure of pledge/hypothecation through its DP and the pledgee instructs its DP to confirm the closure of the pledge/hypothecation. If the pledgor defaults in discharging his obligation under the agreement, the pledgee may invoke the pledge/ hypothecation. This has to be done after taking necessary steps under the terms of the agreement with the pledgor and the Bye-Laws of Depository and rules and regulations framed by SEBI.

Furnishing of information and records by depository and issuer

Every depository is required to 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 of depository. Every issuer should 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 Depositories Act provides that if a beneficial owner seeks to opt out of a depository in respect of any security he should inform the depository accordingly. After the receipt of intimation the depository should make appropriate entries in its records and also inform the issuer. Every issuer may, within thirty days of the receipt of intimation from the depository and on fulfilment of such conditions and on payment of such fees as may be specified by the regulations, issue a 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 a right to recover the same from such participant.

ENQUIRY AND INSPECTION

Power of SEBI

Section 18 of the Depositories Act provides that SEBI, in public interest or in the interest of investors, may by order in writing call upon any issuer, depository, participant or beneficial owner to furnish in writing such information relating to the securities held in a depository as it may require; or authorise any person to make an enquiry or inspection in relation to the affairs of the issuer, beneficial owner, depository or participant, who shall submit a report of such enquiry or inspection to it within such period as may be specified in the order.

Sub-section (2) to Section 18 provides that every director, manager, partner, secretary, officer or employee of the depository or issuer or the participant or beneficial owner shall on demand produce before the person making the enquiry or inspection all information or such records and other documents in his custody having a bearing on the subject matter of such enquiry or inspection.

If after making or causing to be made an enquiry or inspection, SEBI is satisfied that it is necessary in the interest of investors, or orderly development of securities market; or to prevent the affairs of any depository or participant being conducted in the manner detrimental to the interests of investors or securities market, SEBI may issue such directions to any depository or participant or any person associated with the securities market; or to any issuer as may be appropriate in the interest of investors or the securities market.

Power of SEBI to give directions

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

The power to issue directions under Section 19 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.

PENALTY

Penalty for failure to furnish information/return etc.

Section 19A provides that any person, who is required under Depositories Act or any rules or regulations or bye¬laws made thereunder –

(a) to furnish any information, document, books, returns or report to SEBI, fails to furnish the same within the time specified therefore fails to furnish the same within specified time;

(b) to file any return or furnish any information, books or other documents within the time specified therefore in the regulations or bye-laws, fails to file return or furnish the same within the time specified therefore;

(c) to maintain books of account or records, fails to maintain the same;

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

Penalty for failure to enter into agreement

Section 19B provides that if a depository or participant or any issuer or its agent or any person, who is a registered intermediary with SEBI and is required under this Act or any rules or regulations made thereunder, to enter into an agreement, fails to enter into such agreement, such intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less for every such failure.

Penalty for failure to redress investors' grievances

Section 19C lays down that if any depository or participant or any issuer or its agent or any person, who is a registered intermediary with SEBI, after having been called upon by the SEBI in writing, to redress the grievances of the investors, fails to redress such grievances within the time specified, such depository or participant or issuer or its agents or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for delay in dematerialisation or issue of certificate of securities

Section 19D stipulates that if any issuer or its agent or any person, who is a registered intermediary, fails to dematerialise or issue the certificate of securities on opting out of a depository by the investors, within the time specified under this Act or regulations or bye-laws made there under or abets in delaying the process of dematerialisation or issue the certificate of securities on opting out of a depository of securities, such intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure to reconcile records

Section 19E provides that if a depository or participant or any issuer or its agent or any person, who is a registered intermediary, fails to reconcile the records of dematerialised securities with all the securities issued by the issuer as specified in the regulations, such depository or participant or issuer or its agent or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure to comply with directions issued by SEBI

Section 19F requires that if any person fails to comply with the directions issued by SEBI under section 19, within the time specified by it, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for contravention where no separate penalty has been provided

Section 19G provides that whoever fails to comply with any provision of this Act, the rules or the regulations or bye-laws made or directions issued by SEBI thereunder for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.

Thing You May Know

Every intermediary in the Capital Market is required to be registered with SEBI under Seciton 12 of the SEBI Act, 1992.

Power to adjudicate

Section 19H provides that for the purpose of adjudging, SEBI shall appoint any officer not below the rank of a Division Chief of SEBI to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty. While holding an inquiry, the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document, which in the opinion of the adjudicating officer, may be useful for or relevant to the subject matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in this Act, he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.

Factors to be taken into account by Adjudicating Officer

Accroding to Section 19 I, while adjudging the quantum of penalty, the adjudicating officer shall have due regard to the following factors, namely–(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default; (b) the amount of loss caused to an investor or group of investors as a result of the default; (c) the repetitive nature of the default.

Settlement of Administrative Civil Proceedings

Section 19-IA stipulates that any person, against whom any proceedings have been initiated or may be initiated under section 19, section 19H, as the case may be, can file an application in writing to SEBI proposing for settlement of the proceedings initiated or to be initiated for the alleged defaults.

Sub-section 2 authorises 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 be determined by SEBI in accordance with the regulations made under the SEBI Act, 1992.

The settlement procedure will be as provided in SEBI Act, 1992. (Sub-section 3)

No appeal shall lie under section 23A against any order passed by SEBI or the adjudicating officer, as the case may be, under this section. (Sub-section 4)

Recovery of amounts

1. 19-IB provides that if a person fails to pay the penalty imposed by the adjudicating officer or fails to comply with a direction of disgorgement order issued under Section 19 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.

and for this purpose, the provisions of section 221 to 227, 228A, 229, 231, 232, the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962, as in force from time to time, in so far as may be, apply with necessary modifications as if the said provisions and the rules thereunder were the provisions of this Act and referred to the amount due under this Act instead of income-tax under the Income-tax Act, 1961.

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

2. The Recovery Officer shall be empowered to seek the assistance of the local district administration while exercising the powers.

3. The recovery of amounts by a Recovery Officer under this Section pursuant to noncompliance with any direction issued by SEBI under section 19, 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 under this Act

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 XVIID 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 23A of this Act.

Crediting of penalties to consolidated fund of India

Section 19J provides that all sums realised by way of penalties under this Act shall be credited to the Consolidated Fund of India.

OFFENCES

Section 20 provides that without prejudice to any award of penalty by the adjudicating officer under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations or bye-laws made 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.

Offences by companies

Section 21 requires, that where an offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. The proviso to the section also provides that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence. Where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Cognizance of offences by Courts

According to Section 22, a court shall not 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 SEBI or by any concerned.

Composition of certain offences

Section 22A provides that notwithstandig anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.

Power to grant immunity

Section 22B empowers the Central Government to grant immunity, on recommendation by 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 there under, has made a full and true disclosure in respect of alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder and 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 and the recommendation of SEBI is not binding upon the Central Government in this case.

The immunity granted to a person may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had no such immunity been granted.

SPECIAL COURT

Establishment of Special Courts

Section 22 C provides that 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.

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. 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 22D says that all offences under this Act committed prior to the date of commencement of the Securities Laws (Amendment) Ordinance, 2013 or on or after the date of such commencement, 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 22E authorises the High Court to 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 22F stipulates 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.

The person conducting prosecution should have been in practice as an Advocate for not less than seven years or should have held a post, for a period of not less than seven years, under the Union or a State requiring special knowledge of law.

Transitional provisions

Under Section 22G, 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, nothing contained in this section shall affect the powers of the High Court, under section 407 of the Code to transfer any case or class of cases taken cognizance of by a Court of Session under this Section.

APPEALS

Section 23 deals with appeal to Central Government. Any person aggrieved by an order of SEBI made under this Act, or the regulations made thereunder may prefer an appeal to the Central Government within such time as may be prescribed.

No appeal shall be admitted if it is preferred after the expiry of the period prescribed therefor. However, an appeal may be admitted after the expiry of the period prescribed therefor 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 such form and shall be accompanied by a copy of the order appealed against and by such fees as may be prescribed. The procedure for disposing of an appeal shall be such as may be prescribed. However, before disposing of an appeal, the appellant shall be given a reasonable opportunity of being heard.

Appeal to Securities Appellate Tribunal

Section 23A provides that, any person aggrieved by an order of SEBI under this Act or the regulation made thereunder or an order made by an adjudicating officer under this Act may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter. Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made by SEBI is received by the person and it shall be in such form and be accompanied by such fee as may be prescribed.

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

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

The Securities Appellate Tribunal shall send a copy of every order made by it to SEBI and parties to the appeal. The appeal filed before the Securities Appellate Tribunal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

The provisions of Limitations Act, 1963, will apply to an appeal made to a Securities Appellate Tribunal.

Procedure and powers of Securities Appellate Tribunal

Section 23B provides that the Securities Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules, the Securities Appellate Tribunal shall have powers to regulate their own procedure including the places at which they shall have their sittings. The Securities Appellate Tribunal shall have, for the purpose of discharging their functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely –

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

(b) requiring the discovery and production of documents;

(c) receiving evidence on affidavits;

(d) issuing commissions for the examination of witnesses or documents;

(e) reviewing its decisions;

(f) dismissing an application for default or deciding it *ex parte;*

(g) setting aside any order of dismissal of any application for default or any order passed by it *ex parte*; and

(h) any other matter which may be prescribed.

Every proceeding before the Securities Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code and the Securities Appellate Tribunal shall be deemed to be a civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Appeal to Supreme Court

Section 23F provides that any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of law arising out of such order. However, the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Right to legal representation

Section 23C stipulates that the appellant may either appear in person or authorise one or more Chartered Accountants or Company Secretaries or Cost Accountants, in practice or Legal Practitioners or any of its officers to present his/its case before the Securities Appellate Tribunal.

Civil Court not to have Jurisdiction

According to Section 23E, a Civil Court shall not have jurisdiction to entertain any suit or proceeding in respect of any matter which a Securities Appellate Tribunal is empowered by or under this Act to determine and no injunction can be granted by any court or other authority in respect of any action taken or to be taken, in pursuance of any power conferred by or under this Act.

Areas on which rules may be framed by the Central Government

The Central Government under Section 24, may frame Rules to provide, *inter alia*, for:

– the manner of inquiry under Section 19H(1).

– the time within which an appeal may be preferred from the orders of SEBI under Section 23(1).

– the form in which an appeal may be preferred and the fees payable in respect of such appeal.

– the procedure for disposing of an appeal.

– the form in which an appeal may be filed before the Securities Appellate Tribunal under Section 23A and the fees payable in respect of such appeal.

SECURITIES CONTRACTS (REGULATION) ACT, 1956

The SCRA, 1956 provides for direct and indirect control of virtually all aspects of the securities trading including the running of stock exchanges which aims to prevent undesirable transactions in securities. It gives the Central Government regulatory jurisdiction over (a) Stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. 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 Regulation Rules 1956. Power to recognize a Stock Exchange vests with the Central Government. However, Central Government has delegated this powers to SEBI vide its notification No. F. No.1/57/SE/93 dated 13.9.1994.

Application for recognition of stock exchanges

Section 3 of the Act requires that, any stock exchange, which is desirous of being recognised for the purposes of this Act, may make an application in the prescribed manner to the Central Government.

Every application must 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 authorised representatives and clerks.

Grant of recognition to stock exchanges

Section 4 lays down that if the Central Government is satisfied, after making such inquiry as may be necessary in this behalf and after obtaining such further information, if any, as it may require,—

(a) that the rules and bye-laws of a stock exchange applying for registration are in conformity with such conditions as may be prescribed with a view to ensure fair dealing and to protect investors;

(b) that the stock exchange is willing to comply with any other conditions (including conditions as to the number of members) which the Central Government, after consultation with the governing body of the stock exchange and having regard to the area served by the stock exchange and its standing and the nature of the securities dealt with by it, may impose for the purpose of carrying out the objects of this Act; and

(c) that it would be in the interest of the trade and also in the public interest to grant recognition to the stock exchange; it may grant recognition to the stock exchange subject to the conditions imposed upon it as aforesaid and in such form as may be prescribed.

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

(i) the qualifications for membership of stock exchanges;

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

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

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

Every grant of recognition to a stock exchange under section 4 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 situate, and such recognition shall have effect as from the date of its publication in the Gazette of India.

An application for the grant of recognition shall not be refused except after giving an opportunity to the stock exchange concerned to be heard in the matter; and the reasons for such refusal shall be communicated to the stock exchange in writing. No rules of a recognised stock exchange shall be amended except with the approval of the Central Government.

Withdrawal of recognition

Section 5 stipulates that if the Central Government is of opinion that the recognition granted to a stock exchange under the provisions of SCR Act 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, no such withdrawal shall affect the validity of any contract entered into or made before the date of the notification, and the Central Government may, after consultation with the stock exchange, make such provision as it deems fit in the notification of withdrawal or in any subsequent notification similarly published for the due performance of any contracts outstanding on that date.

Where the recognised stock exchange has not been corporatised or demutualised or it fails to submit the scheme within the specified time therefor or the scheme has been rejected by SEBI the recognition granted to such stock exchange under section 4, shall, notwithstanding anything to the contrary contained in this Act, stand withdrawn and the Central Government shall publish, by notification in the Official Gazette, such withdrawal of recognition.

Further, no such withdrawal shall 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.

Power of Central Government to call for periodical returns or direct inquiries to be made

Section 6 provides that every recognised stock exchange shall furnish to SEBI such periodical returns relating to its affairs as may be prescribed.

Every recognised stock exchange and every member thereof shall maintain and preserve for such periods not exceeding five years such books of account, 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 at all reasonable times by SEBI.

If SEBI is satisfied that it is in the interest of the trade or in the public interest so to do, it may, by order in writing,—

(a) call upon a recognised stock exchange or any member thereof to furnish in writing such information or explanation relating to the affairs of the stock exchange or of the member in relation to the stock exchange as SEBI may require; or

(b) appoint one or more persons to make an inquiry in the prescribed manner in relation to the affairs of the governing body of a stock exchange or the affairs of any of the members of the stock exchange in relation to the stock exchange and submit a report of the result of such inquiry to SEBI within such time as may be specified in the order or, in the case of an inquiry in relation to the affairs of any of the members of a stock exchange, direct the governing body to make the inquiry and submit its report and he shall be bound to produce before the authority making the inquiry all such books of account, and other documents in his custody or power relating to or having a bearing on the subject-matter of such inquiry and also to furnish the authorities within such time as may be specified with any such statement or information relating thereto as may be required of him.

Annual reports to be furnished to Central Government by stock exchanges

Section 7 provides that every recognised stock exchange shall furnish the Central Government with a copy of the annual report, and such annual report shall contain such particulars as may be prescribed.

Power of recognised stock exchange to make rules restricting voting rights, etc

According to Section 7A 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;

(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) above.

No rules of a recognised stock exchange made or amended in relation to any matter referred to in clauses (a) to (d) of sub-section (1) shall have effect until they have been approved by the Central Government and published by that Government in the Official Gazette and, in approving the rules so made or amended, the Central Government may make such modifications therein as it thinks fit, and on such publication, the rules as approved by the Central Government shall be deemed to have been validly made, notwithstanding anything to the contrary contained in the Companies Act, 2013. The powers have been delegated concurrently to SEBI also in this regard.

Power of Central Government to direct rules to be made or to 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. It also provides that if 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 therefore direct 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 specified in section 3 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 made under this Act 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.

Clearing Corporation

Section 8A stipulates 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;

(c) 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 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 byelaws submitted to it and approve the transfer of the duties and functions of a clearing house to a clearing corporation.

Power of SEBI to make or amend bye-laws of recognised stock exchanges

Section 10 requires that 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 amendment has been carried out to the bye-laws so made or amended it 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 situate, 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.

Notwithstanding anything contained in this section, where the governing body of a recognised stock exchange objects to any bye-laws made or amended under this section 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 anywhere any bye-laws so made or amended are revised as a result of any action taken under this section, the byelaws 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 the SEBI is satisfied in any case that in the interest of the trade or in the public interest any bye-laws should be made, amended or revised immediately, it may, by order in writing specifying the reasons therefor, dispense with the condition of previous publication.

Power of Central Government to supersede governing body of a recognised stock exchange

Section 11 provides that without prejudice to any other powers vested in the Central Government under this Act, where the Central Government is of opinion that the governing body of any recognised stock exchange should be superseded, then, notwithstanding anything contained in any other law for the time being in force, the Central Government may serve on the governing body a written notice that the Central Government is considering the supersession 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 under this section, the following consequences shall ensue, namely:—

(a) the members of the governing body which has been superseded shall, as from the date of the notification of supersession, cease to hold office as such members;

(b) the person or persons appointed may exercise and perform all the powers and duties of the governing body which has been superseded;

(c) all such property of the recognised stock exchange as the person or persons appointed may, by order in writing, specify in this behalf as being necessary for the purpose of enabling him or them to carry on the business of the stock exchange, shall vest in such person or persons.

Notwithstanding anything to the contrary contained in any law or the rules or bye-laws of the recognised stock exchange the governing body of which is superseded, the person or persons appointed shall hold office for such period as may be specified in the notification published and the Central Government may from time to time, by like notification, vary such period.

The Central Government may at any time before the determination of the period of office of any person or persons appointed under this section call upon the recognised stock exchange to re-constitute the governing body in accordance with its rules and on such re-constitution all the property of the recognised stock exchange which has vested in, or was in the possession of, the person or persons appointed shall re-vest or vest, as the case may be, in the governing body so re-constituted.

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

Power to suspend business of recognised stock exchanges

According to Section 12, if in the opinion of the Central Government an emergency has arisen and for the purpose of meeting the emergency the Central Government considers it expedient so to do, it may, by notification in the Official Gazette, for reasons to be set out therein, direct a recognised stock exchange to suspend such of its business for such period not exceeding seven days and subject to such conditions as may be specified in the notification, and, if, in the opinion of the Central Government, the interest of the trade or the public interest requires that the period should be extended, may, by like notification extend the said period from time to time.

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.

Penalty

Section 23G deals with penalty for failure to furnish periodical returns, *etc.* by a recognised stock exchange**.** If a recognised stock exchange fails or neglects to furnish its periodical returns to SEBI or fails or neglects to make or amend its rules or bye-laws as directed by SEBI or fails to comply with directions issued by SEBI, such recognised stock exchange shall be liable to a penalty which may extend to twenty-five crore rupees.

Section 23H deals with penalty for contravention where no separate penalty has been provided. Whoever fails to comply with any provision of this Act, the rules or articles or bye- laws or the regulations of the recognised stock exchange or directions issued by SEBI for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.

LESSON ROUND UP

– Stock Exchanges, Clearing Corporations and Depositories are systemically important for the country's financial development and serve as the infrastructure necessary for the securities market. These institutions are collectively referred to as Market Infrastructure Institutions (MIIs).

– SEBI has prescribed various Acts and Regulations from time to time for the smooth functioning of these MIIs.

– SEBI notified the Securities Contract (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 ("SECC Regulations") on June 20, 2012 to regulate recognition, ownership and governance in stock exchanges and clearing corporations and matters connected therewith or incidental thereto.

– These Regulations provide for recognition, ownership, governance and listing provisions with respect to Stock Exchanges as well as Clearing Corporations.

– To facilitate the implementation of the SECC Regulations and provide guidelines to stock exchanges and clearing corporations for their operations in accordance with the terms of SECC Regulations, SEBI has issued procedural norms on recognition, ownership and governance for stock exchanges and clearing corporations dated December 13, 2012.

– The Depositories Act, 1996 provides for the establishment of single or multiple depositories. Any body to be eligible for providing depository services must be formed and registered as a company under the Companies Act, 2013 and must seek registration with SEBI and obtain a Certificate of Commencement of Business from SEBI on fulfillment of the prescribed conditions.

– Section 23 provides that any person aggrieved by an order of SEBI made under Depositories Act, or the regulations made thereunder may prefer an appeal to the Central Government within such time as may be prescribed.

– The SCRA, 1956 provides for direct and indirect control of virtually all aspects of the securities trading including the running of stock exchanges which aims to prevent undesirable transaction in securities.

– Section 3 of the SCRA, 1956 requires that, any stock exchange, which is desirous of being recognised for the purposes of this Act, may make an application in the prescribed manner to the Central Government.

– Section 23G deals with penalty for failure to furnish periodical returns, *etc.* by a recognised stock exchange. If a recognised stock exchange fails or neglects to furnish periodical returns to SEBI or fails or neglects to make or amend its rules or bye-laws as directed by SEBI or fails to comply with directions issued by SEBI, such recognised stock exchange shall be liable to a penalty which may extend to twenty-five crore rupees.

SELF TEST QUESTIONS

1. Describe the provisions relating to maintenance of networth by a Stock Exchange and Clearing Corporations under SECC Regulations.
2. What do you understand by Pledge and Hypothecation of Securities? Explain the procedure for pledge or Hypotecation of Securities which is in demat account.
3. Briefly explain the provision relating to Appeal to be made under the Depositories Act, 1996.

Lesson 4
Financial Intermediaries Framework

LESSON OUTLINE

- Introduction
- SEBI (Merchant Bankers) Regulations, 1992
- SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993
- SEBI (Underwriters) Regulations, 1993
- SEBI (Bankers to an Issue) Regulations, 1994
- SEBI (Debenture Trustees) Regulations, 1993
- SEBI (Stock Brokers and Sub Brokers) Regulations, 1992
- SEBI (Portfolio Managers) Regulations, 1993
- SEBI (Custodian of Securities) Regulations, 1996
- SEBI (Investment Advisers) Regulations, 2013
- SEBI (Credit Rating Agencies) Regulations, 1999
- Guideline for Market Maker
- SEBI (Depositories and Participant) Regulations, 1996
- Designated Depository Participants
- LESSON ROUND UP
- 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 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.

The main objective of this lesson is to give the detailed framework of the Market Intermediaries as prescribed by SEBI.

INTRODUCTION

The Market Regulator, SEBI, regulates various intermediaries in the primary and secondary markets through its Regulations framed for these 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 to comply. These Regulations also empower SEBI to inspect the functioning of these intermediaries and to collect fees from them and to impose penalties on the 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 advisors and such other intermediaries who may be associated with securities market in any manner whatsoever.

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.

PRIMARY MARKET INTERMEDIARIES

The following market intermediaries are involved in the Primary Market:

– Merchant Bankers/Lead Managers

– Registrars and Share Transfer Agents

– Underwriters

– Bankers to issue

– Debenture Trustees

MERCHANT BANKER

'Merchant Banker' means any person engaged in the business of issue management by making arrangements regarding selling, buying or subscribing to securities or acting as manager/consultant/advisor or rendering corporate advisory services in relation to such issue management.

SEBI (MERCHANT BANKERS) REGULATIONS, 1992

The activities of the merchant bankers in the Indian capital market are regulated by SEBI (Merchant Bankers) Regulations, 1992. Regulation 3 of SEBI (Merchant Bankers) Regulations, 1992 lays down that an application by a person desiring to become merchant banker shall be made to SEBI in the prescribed Form (A) seeking grant of a certificate of initial registration alongwith a non-refundable application fee as specified in Schedule II of the Regulations.

The aforesaid application shall be made for any one of the following categories of the merchant banker namely:–

(a) Category I, that is –

   (i) to carry on any activity of the issue management, which will, *inter alia,* consist of preparation of prospectus and other information relating to the issue, determining financial structure, tie up of financiers and final allotment and refund of the subscriptions; and

   (ii) to act as adviser, consultant, manager, underwriter, portfolio manager;

(b) Category II, that is to act as adviser, consultant, co-manager, underwriter, portfolio manager;

(c) Category III, that is to act as underwriter, adviser, consultant to an issue;

(d) Category IV, that is to act only as adviser or consultant to an issue.

Regulation 4 and 5 deal with the methodology for application and furnishing of information, clarification and personal representation by the applicant. Incomplete or non-conforming applications shall be rejected after giving an opportunity to remove the deficiencies within a time specified by SEBI.

Regulation 6 lists out the following considerations for being taken into account by SEBI for grant of certificate of registration :

(a) the applicant shall be a body corporate other than a non-banking financial company as defined under clause (f) of section 45-I of the RBI Act, 1934;

Provided that the merchant banker who has been granted registration by the RBI to act as a primary or satellite dealer may carry on such activity subject to the condition that it shall not accept or hold public deposit;

(b) the applicant has in his employment a minimum of two persons who have the experience to conduct the business of the merchant banker;

(c) a person directly or indirectly connected with the applicant has not been granted registration by SEBI;

Here the expression "directly or indirectly connected" means any person being an associate, subsidiary or interconnected or group company of the applicant in case of the applicant being a body corporate.

(d) the applicant fulfills the capital adequacy requirement;

(e) the applicant, his partner, director or principal officer is not involved in any litigation connected with the securities market which has an adverse bearing on the business of the applicant;

(f) the applicant, his director, partner or principal officer has not at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence;

(g) the applicant has the professional qualification from an institution recognised by the Government, in finance, law or business management;

(h) the applicant is a fit and proper person;

(i) grant of certificate to the applicant is in the interest of investors.

Capital Adequacy

Regulation 7 prescribes that the capital adequacy requirement shall be a networth of not less than five crore rupees.

'Networth' means the sum of paid-up capital and free reserves of the applicant at the time of making application.

Regulations 8, 9A and 10 deal with procedure for registration, renewal of certificate, conditions of registration and procedure where registration is not granted.

Regulation 11 stipulate that on refusal of registration by SEBI, the applicant shall cease to carry on any activity as a merchant banker from the date of receipt of SEBI's refusal letter.

Regulation 12 provides for payment of fees and consequences of failure to pay annual fees. It provides that SEBI may suspend the registration certificate if merchant banker fails to pay the fees.

General Obligations and Responsibilities of Merchant Banker

Chapter III of the Regulations containing Regulations 13 to 28 deals with general obligations and responsibilities of Merchant Bankers.

Regulation 13 stipulates that every merchant banker shall abide by the code of conduct which has been specified in Schedule III. The code of conduct as provided in the schedule is as under:

CODE OF CONDUCT FOR MERCHANT BANKERS

1. A merchant banker shall make all efforts to protect the interest of investors.

2. A merchant banker shall maintain high standards of integrity, dignity and fairness in the conduct of its business.

3. A merchant banker shall fulfil its obligations in a prompt, ethical, and professional manner.

4. A merchant banker shall at all times exercise due diligence, ensure proper care and exercise independent professional judgement.

5. A merchant banker shall endeavour to ensure that –

   (a) inquiries from investors are adequately dealt with;

   (b) grievances of investors are redressed in a timely and appropriate manner;

   (c) where a complaint is not remedied promptly, the investor is advised of any further steps which may be available to the investor under the regulatory system.

6. A merchant banker shall ensure that adequate disclosures are made to the investors in a timely manner in accordance with the applicable regulations and guidelines so as to enable them to make a balanced and informed decision.

7. A merchant banker shall endeavour to ensure that the investors are provided with true and adequate information without making any misleading or exaggerated claims or any misrepresentation and are made aware of the attendant risks before taking any investment decision.

8. A merchant banker shall endeavour to ensure that copies of the prospectus, offer document, letter of offer or any other related literature is made available to the investors at the time of issue or the offer.

9. A merchant banker shall not discriminate amongst its clients, save and except on ethical and commercial considerations.

10. A merchant banker shall not make any statement, either oral or written, which would misrepresent the services that the merchant banker is capable of performing for any client or has rendered to any client.

11. A merchant banker shall avoid conflict of interest and make adequate disclosure of its interest.

12. A merchant banker shall put in place a mechanism to resolve any conflict of interest situation that may arise in the conduct of its business or where any conflict of interest arises, shall take reasonable steps to resolve the same in an equitable manner.

13. A merchant banker shall make appropriate disclosure to the client of its possible source or potential areas of conflict of duties and interest while acting as merchant banker which would impair its ability to render fair, objective and unbiased services.

14. A merchant banker shall always endeavour to render the best possible advice to the clients having regard to their needs.

15. A merchant banker shall not divulge to anybody either orally or in writing, directly or indirectly, any confidential information about its clients which has come to its knowledge, without taking prior permission of its clients, except where such disclosures are required to be made in compliance with any law for the time being in force.

16. A merchant banker shall ensure that any change in registration status/any penal action taken by the SEBI or any material change in the merchant banker's financial status, which may adversely affect the interest of clients/ investors, is promptly informed to the clients and any business remaining outstanding is transferred to another registered intermediary in accordance with any instructions of the affected clients.

17. A merchant banker shall not indulge in any unfair competition, such as weaning away the clients on assurance of higher premium or advantageous offer price or which is likely to harm the interest of other merchant bankers or investors or is likely to place such other merchant bankers in a disadvantageous position while competing for or executing any assignment.

18. A merchant banker shall maintain arms length distance between its merchant banking activity and any other activity.

19. A merchant banker shall have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients, investors and other registered entities from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.

20. A merchant banker shall not make any untrue statement or suppress any material fact in any documents, reports or information furnished to the SEBI.

21. A merchant banker shall maintain an appropriate level of knowledge and competence and abide by the provisions of the Act, regulations made thereunder, circulars and guidelines, which may be applicable and relevant to the activities carried on by it. The merchant banker shall also comply with the award of the Ombudsman passed under the SEBI (Ombudsman) Regulations, 2003.

22. A merchant banker shall ensure that the Board is promptly informed about any action, legal proceedings, *etc.*, initiated against it in respect of material breach or non-compliance by it, of any law, rules, regulations, directions of the SEBI or of any other regulatory body.

23. (a) A merchant banker or any of its employees shall not render, directly or indirectly, any investment advice about any security in any publicly accessible media, whether real-time or non-real-time, unless a disclosure of his interest including a long or short position, in the said security has been made, while rendering such advice.

(b) In the event of an employee of the merchant banker rendering such advice, the merchant banker shall ensure that such employee shall also disclose the interest, if any, of himself, his dependent family members and the employer merchant banker, including their long or short position in the said security, while rendering such advice.

24. A merchant banker shall demarcate the responsibilities of the various intermediaries appointed by it clearly so as to avoid any conflict or confusion in their job description.

25. A merchant banker shall provide adequate freedom and powers to its compliance officer for the effective discharge of the compliance officer's duties.

26. A merchant banker shall develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in carrying out their duties. Such a code may extend to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance or resolution of conflict of interests, disclosure of shareholdings and interests, *etc.*

27. A merchant banker shall ensure that good corporate policies and corporate governance are in place.

28. A merchant banker shall ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed (including having relevant professional training or experience).

29. A merchant banker shall ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it in the conduct of its business, in respect of dealings in securities market.

30. A merchant banker shall be responsible for the acts or omissions of its employees and agents in respect of the conduct of its business.

31. A merchant banker shall ensure that the senior management, particularly decsions makers have access to all relevant information about the business on a timely basis.

32. A merchant banker shall not be a party to or instrument for –

(a) creation of false market; or

(b) price rigging or manipulation; or

(c) passing of unpublished price sensitive information in respect of securities which are listed and proposed to be listed in any stock exchange to any person or intermediary in the securities market.

Regulation 13A provides that no merchant banker other than a bank or a public financial institution who has been granted a certificate of registration shall carry on any business other than that of the securities market. However, a merchant banker who has been granted certificate of registration under these regulations may ensure market making in accordance with Chapter XB of SEBI (ICDR) Regulations, 2009.

Regulations 14 to 17 deal with maintenance of books of accounts, records, submission of half-yearly results, rectifying deficiencies pointed out in the auditor's report *etc.*

Responsibilities of Lead Manager

Regulation 20 provides that no lead manager shall agree to manage or be associated with any issue unless his responsibilities relating to the issue mainly those of disclosures, allotment and refund are clearly defined, allocated and determined and a statement specifying such responsibilities is furnished to SEBI at least 1 month before the opening of the issue for subscription, but where there are more than 1 lead merchant banker to the issue the responsibility of each such lead merchant banker shall clearly be demarcated and the statement specifying such responsibilities shall be furnished to SEBI at least 1 month before the opening of the issue for subscription.

Merchant Banker not to Act as such for an Associate

Regulation 21 stipulates that a lead merchant banker shall not associate himself with any issue if a merchant banker not holding a certificate from SEBI is associated with the issue.

Regulation 21A provides that a merchant banker shall not lead manage any issue or be associated with any activity undertaken under any regulations made by SEBI, if he is a promoter or a director or an associate of the issuer of securities or of any person making an offer to sell or purchase securities. However, a merchant banker who is an associate of such issuer or person may be appointed, if he is involved only in the marketing of the issue or offer.

Here, a merchant banker shall be deemed to be an "associate of the issuer or person" if:

(i) either of them controls, directly or indirectly through its subsidiary or holding company, not less than 15% of the voting rights in the other; or

(ii) either of them, directly or indirectly, by itself or in combination with other persons, exercises control over the other; or

(iii) there is a common director, excluding nominee director, amongst the issuer, its subsidiary or holding company and the merchant banker.

Minimum Underwriting Obligation

Regulation 22 lays down that in respect of every issue to be managed, the lead merchant banker holding a certificate under Category I shall accept a minimum underwriting obligation of 5% of the total underwriting commitment or ₹ 25 lakhs whichever is less but if the lead merchant banker is unable to accept the minimum underwriting obligation, that lead merchant banker shall make arrangement for having the issue underwritten to that extent by a merchant banker associated with the issue and shall keep SEBI informed of such arrangement.

In case of issue made in accordance with Chapter XB of SEBI (ICDR) Regulations, 2009, the merchant banker shall itself or jointly with other merchant bankers associated with the issues, underwrite atleast 15% of the issue size.

Prohibition to Acquire Shares

Regulations 26 and 27 deal with this matter.

Regulation 26 lays down that no merchant banker or any of its directors, partners or manager or principal officer shall either on their own account or through their associates or relatives, enter into any transaction in securities of bodies corporate on the basis of unpublished price sensitive information obtained by them during the course of any professional assignment either from the clients or otherwise.

Regulation 27 requires every merchant banker to submit to SEBI complete particulars of any transaction for acquisition of securities of any body corporate whose issue is being managed by that merchant banker, within 15 days from the date of entering into such transaction. In case of any transaction for acquisition of securities made in pursuance of underwriting or market making obligation in accordance with Chapter XB of SEBI (ICDR) Regulations, 2009, the complete particulars of the transaction shall be submitted to SEBI on quarterly basis.

Disclosure to SEBI

Regulation 28 provides that a merchant banker is required to disclose to SEBI, as and when required, the following information, namely:

(i) his responsibilities with regard to the management of the issue;

(ii) any change in the information or particulars previously furnished, which have a bearing on the certificate granted to it;

(iii) the names of the body corporate whose issues he has managed or has been associated with;

(iv) the particulars relating to the breach of the capital adequacy requirement;

(v) relating to his activities as a manager, underwriter, consultant or adviser to an issue, as the case may be.

The merchant banker shall submit a periodic report in such manner as may be specified by SEBI from time to time.

Appointment of Compliance Officer

Regulation 28A requires every merchant banker to appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications guidelines, instructions *etc.* issued by SEBI or Central Government and for redressal of investor grievances. Compliance officer is required to immediately and independently report to SEBI, any non-compliance observed by him and ensure that observations made or deficiencies pointed out by SEBI on/in the draft prospectus or letter of offer as the case may be, do not occur.

Procedure for Inspection

Chapter IV containing Regulations 29 to 34 lays down the procedure for inspection of the merchant banker's offices and records by SEBI.

Regulation 29 empowers SEBI to appoint one or more persons as inspecting authority to undertake inspection of books of accounts, records and documents *etc.* of the merchant banker:

(a) to ensure that such books and records are maintained in the prescribed manner;

(b) the provisions of SEBI Act and the rules and regulations thereunder are complied with;

(c) to investigate into complaints from investors, other merchant bankers or other persons on any matter having a bearing on the activities of the merchant banker; and

(d) to investigate *suo motu* in the interest of the securities business or investors' interest into the working of the merchant banker.

Regulation 30 and 31 authorise SEBI to undertake such inspection with or without notice and the obligations of the merchant bankers in relation to such inspection.

Regulation 32 provides for the submission of an inspection report to SEBI by the inspecting authority on completion of inspection. Regulation 33 requires that SEBI or chairman shall after consideration of inspection or investigation report take such action as SEBI or chairman may deem fit and appropriate including action under Chapter V of the SEBI (Intermediaries) Regulations, 2008.

Regulation 34 permits SEBI to appoint a qualified auditor to investigate into the books of accounts or the affairs of the merchant banker and such auditor shall have the same powers of the inspecting authority referred to above.

Procedure for Action against Merchant Banker in case of Default

Chapter V containing Regulation 35 deals with the procedure for taking action against the merchant banker in case of default. Regulation 35 provides that a merchant banker who contravenes any of the provisions of the Act, rules or regulations, framed thereunder shall be liable for one or more actions specified therein including the action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

REGISTRARS TO AN ISSUE AND SHARE TRANSFER AGENTS

The Registrars to an Issue and Share Transfer Agents constitute an important category of intermediaries in the primary market. They render very useful services in mobilising new capital and facilitating proper records of the details of the investors, so that the basis for allotment could be decided and allotment ensured as per SEBI Regulations.

SEBI (REGISTRARS TO AN ISSUE AND SHARE TRANSFER AGENTS) REGULATIONS, 1993

SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 were notified by SEBI on 31st May, 1993 in exercise of the powers conferred by Section 30 of SEBI Act,1992, with the approval of Central Government.

Chapter I of the Regulations contains preliminary items and Chapter II consisting of Regulations 3 to 12 dealing with procedure for applying for registration as Registrar to an Issue (RTI) and Share Transfer Agents (STA), either as Category-I to carry on both the activities of RTI and STA or Category-II to carry on the activity either as Registrar to an Issue or as a Share Transfer Agent. The application should be complete and conform to the requirements otherwise it will be rejected. But an opportunity will be given to remove the objections as may be indicated by SEBI. In case of failure the application may be rejected.

Criteria for Registration

Regulation 6 lays down that SEBI shall take into account the following matters while considering the applications for registration. It shall assess whether the applicant:

(a) has the necessary infrastructure like adequate office space, equipments and manpower to effectively discharge his activities;

(b) has any past experience in the activities;

(c) any person directly or indirectly connected with him has been granted registration by SEBI under the Act;

(d) Fulfils the capital adequacy requirement;

(e) has been subjected to any disciplinary proceedings under the Act;

(f) any of its director, partner or principal officer is or has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence;

(g) is a fit and proper person.

Regulation 7 stipulates the capital adequacy requirement (networth) for category I as ₹ 50,00,000 and category II as ₹ 25,00,000.

Regulations 8 to 10 lay down the procedure for registration, renewal of certificate, conditions of registration, period of validity of certificate and the procedure where registration is not granted. It is made clear that the applicant will be given due opportunity of being heard before rejection of his application.

Regulation 11 says that in case of refusal to grant or renew a certificate of registration, the concerned person shall cease to carry on any activity as registrar or share transfer agent as the case may be. Regulation 12 prescribes payment of fees and indicates the consequences of failure to pay the fees. In the latter case, SEBI may suspend the certificate with the consequence that the RTI shall cease to carry on his activity from the date of suspension of the certificate.

General Obligations and Responsibilities

Chapter III consisting of Regulations 13 to 15 lays down the general obligations and responsibilities of RTAs.

Specified in Schedule III of these Regulations

Regulation 13A prohibits an RTI from acting as such Registrar in case he or it is an associate of the body corporate issuing the securities. For the purposes of this regulation, Registrar to an Issue or the body corporate, as the case may be, shall be deemed to be an associate of other where –

(i) he or it controls directly or indirectly not less than10% of the voting power of the body corporate or of Registrar to an issue, as the case may be or he or any of his relatives is a director or promoter of the body corporate or of the Registrar to an Issue, as the case may be. The term ‘relative’ shall have the same meaning as assigned to it under Section 2(77) of the Companies Act, 2013.

The RTA has to maintain of three preceeding financial years proper books and records as prescribed in Regulation 14 and preserve the account books and other records for a minimum period of 3 years. Regulation 15A provides that every Registrar to an Issue and Share Transfer Agent shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions *etc.* issued by SEBI or Central Government and for redressal of investor grievances. Compliance officer shall immediately and independently report to SEBI any non-compliance observed by him.

Procedure for Inspection

Chapter IV containing Regulation 16 to 21 deals with procedure for inspection by SEBI appointed inspecting authority to ensure that the books of accounts and documents are maintained as prescribed and that the provisions of SEBI Act and the rules and regulations thereunder are complied with. Investigation may be undertaken on the basis of complaints received from the investors, other registrars or any other intermediaries in respect of RTI.

Regulation 17 lays down the procedure and Regulation 18 indicates the obligations of the RTI in relation to such inspection/investigation.

Regulations 19 and 20 stipulate that the inspecting authority shall on the conclusion of its inspection submit a report to SEBI. SEBI after considering the inspection or investigation report take such action as SEBI or chairman may deem fit and appropriate including action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

Regulation 21 authorises SEBI to appoint an Auditor to investigate into the books of account or the affairs of the RTI and STA. The Auditor shall have the same powers as SEBI appointed inspecting authority.

Liability for Action in case of default

Regulation 22 stipulates the provisions for liability in case of default. A registrar to an Issue who –

(i) fails to comply with any condition subject to which registration has been granted.

(ii) Contravenes any of the provisions of the Act, rules or regulations.

(iii) Contravenes the provisions of the SCRA and the rules made thereunder, provisions of the Depositories Act, 1996 or rules made thereunder, the rules, regulations or bye laws of the stock exchange, shall be dealt with in the manner provided in Chapter V of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

UNDERWRITERS

Underwriters represent one of the key elements among the capital market intermediaries. They facilitate raising of capital by assuring to take up the unsubscribed portion upto a specified limit. Underwriting is an arrangement whereby certain parties assure the issuing company to take up shares, debentures or other securities to a specified extent in case the public subscription does not amount to the expected levels. For this purpose, an arrangement (agreement) will be entered into between the issuing company and the assuring party such as a financial institution, banks, merchant banker, broker or other person.

SEBI (UNDERWRITERS) REGULATIONS, 1993

These regulations were notified by SEBI in exercise of the powers conferred by Section 30 of SEBI Act, 1992 with the approval of Central Government. They came into force from 8th October, 1993.

Chapter I contains preliminary matters including definitions.

Chapter II deals with the procedure for registration of underwriters and it contains Regulations 3 to 12.

Regulation 3 lays down that the applicant seeking the certificate shall apply to SEBI in form A. Every Stock Broker or Merchant Banker holding a valid certificate of registration under section 12 of SEBI Act shall be entitled to act as an underwriter without obtaining a separate certificate under these regulation. Regulation 4 and 5 requires the applicant to furnish further information and clarification to SEBI regarding matters relevant to underwriting. If SEBI on receipt of further information is of the opinion that the information so furnished is not sufficient to decide on the application and seeking further information through correspondence may delay the matter, it may require the applicant or its principal officer to appear before SEBI in order to give an opportunity to the applicant to give further clarifications on the application.

Regulation 5 provides that an application not complete in all respects and not conforming to instructions specified in the form would be rejected. The applicant would be given an opportunity to remove within one month, the objections as may be indicated by SEBI. SEBI may however extend the time by another month in order to enable the applicant to comply with the requirements of SEBI.

Regulation 6 prescribes the following conditions for consideration of the application:

1. the applicant shall have necessary infrastructure like adequate office space, equipments and manpower and past experience in underwriting, employing at least two persons with such experience. No person directly or indirectly connected with the applicant should have been granted registration by SEBI.

SEBI shall take into account whether a previous application for a certificate of any person directly or indirectly connected with the applicant has been rejected by SEBI or any disciplinary action has been taken against such person under the Act or any rules/regulations.

2. the applicant should be a fit and proper person, fulfilling the capital adequacy requirements and no director, partner or principal officer should have been at any time convicted for an offence involving moral turpitude or found guilty of any economic offence.

Regulation 7 prescribes for the following capital adequacy requirement:

1. The networth should not be less than ₹ 20 lakhs.
2. The stock broker who act as a underwriter should have capital adequacy as prescribed by the stock exchange of which he is a member.

Regulations 8 and 8A, 9A, deal with grant of Certificate of initial Registration and permanent Registration, conditions of registration & period of validity of certificate.

Regulations 10 and 11 deal with the procedure where registration is not granted and the effect of refusal to grant Certificate of Permanent Registeration. Regulation 12 prescribes fee payable and consequences of failure to pay the fee.

Obligations and Responsibilities of Underwriters

Chapter III consisting of Regulation 13 to 18 deals with these matters. Every underwriter shall abide by the code of conduct at all times.

Regulations 14 and 15 contain provisions regarding the matters on which every underwriter shall enter into an agreement with the body corporate and his general responsibilities.

The contents of the agreement shall include the period of agreement, the allocation of duties and responsibilities between the underwriter and the client, the amount of underwriting obligations, the period by which the underwriter should subscribe, the amount of commission/brokerage payable, and other details of arrangment for fulfilling the underwriting obligations. The general responsibilities of the underwriter are as follows:

1. The underwriter shall not derive any direct or indirect benefit from underwriting the issue other than the commission or brokerage payable under an agreement for underwriting.
2. The total underwriting obligations under all the agreements shall not exceed 20 times the networth.
3. Every underwriter, in the event of being called upon to subscribe for securities of a body corporate pursuant to an agreement shall subscribe to such securities within 45 days of the receipt of such intimation from such body corporate.

Regulation 16 to 18 relate to maintenance of proper accounts, books and records and their preservation for 5 years and SEBI's power call for and obtain information from the underwriter.

Appointment of Compliance Officer

Regulation 17A requires every underwriter to appoint a compliance officer responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions *etc.* issued by SEBI or the Central Government and for redressal of investors' grievances. The compliance officer is required to report to SEBI immediately and independently of any non-compliance observed by him.

Inspection and Disciplinary Proceedings

Chapter IV containing Regulations 19 to 24 makes provisions on this subject. SEBI is empowered to appoint inspectors to ensure that books of accounts, records *etc.* are maintained properly and the Act along with the rules and regulations are duly complied with. SEBI is also empowered to investigate into complaints recieved from investors, other underwriters *etc.* as well as under their own power to investigate *suo moto* in the interest of securities business and the investors. Regulations 20 and 21 lay down the procedure for inspection and obligations of underwriter during such inspections.

Regulations 22 relates to submission of inspection report to SEBI.

Regulation 23 provides that SEBI or the chairman after the consideration of inspection or investigation report may take action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

Regulation 24 authorise SEBI to appoint a qualified auditor to investigate into the affairs and the accounts of the underwriter with the same powers as applicable in the case of SEBI appointed inspecting authority.

Procedure for Action in Case of Default

Chapter V containing Regulation 25 lays down the procedure for action in case of default. An underwriter who contravenes any of the provisions of the Act, rules or regulations, shall be dealt with in the manner provided under Chapter V of SEBI (Intermediaries) Regulations, 2008.

BANKER TO AN ISSUE

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

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

SEBI (BANKER TO AN ISSUE) REGULATION, 1994

SEBI notified these regulations effective from 14th July, 1994 in exercise of the powers conferred by Section 30 of SEBI Act, 1994 after approval by the Central Government.

Chapter I deal with preliminary matters and definitions.

Chapter II containing Regulations 3 to 11 deals with procedure of registration for Bankers to an Issue with SEBI.

Regulations 3 to 5 prescribe that the application by a scheduled bank for grant of certificate of initial Registration as a banker to an issue should be made to SEBI in Form A conforming to the instructions therein failing which, in case of default may be rejected after giving due opportunity to remove such defects within specified time. SEBI may call for and obtain further information or clarification from the applicant.

Consideration of Application

Regulation 6 prescribes the matters that are considered by SEBI in relation to the application:

(a) the applicant has the necessary infrastructure, communication and data processing facilities and manpower to effectively discharge his activities;

(b) the applicant or any of its directors is not involved in any litigation connected with the securities market and which has an adverse bearing on the business of the applicant or has not been convicted of any economic offence;

(c) the applicant is a scheduled bank;

(d) the applicant is a fit and proper person;

(e) grant of certificate to the applicant is in the interest of investors.

Procedure for Registration

Regulations 7, 7A, 8A deal with the grant of certificate of initial registeration and permanent registeration & conditions of registration. Regulation 9 relates to the procedure where the registration is not granted, leading to the rejection of the application after giving an opportunity to the applicant to be heard. The applicant has a right to appeal for reconsideration and SEBI shall reconsider the application and communicate its decision to the applicant in writing.

Regulation 10 lays down that the applicant whose application is refused by SEBI shall cease to carry on any activity as a banker to an issue from the date on which he receives the communication of refusal.

Regulation 11 imposes the duty on the applicant to pay the fees as prescribed. Non-payment of fees may result in suspension of the registration and the applicant shall cease to carry on the activity as a banker to the issue during the period of suspension.

General Obligations and Responsibilities

Regulation 12 requires every banker to an issue to maintain the following records with respect to:

(a) the number of applications received, the names of the investors, the dates on which the applications were received and the amounts so received from the investors;

(b) the time within which the applications received from the investors were forwarded to the body corporate or registrar to an issue as the case may be;

(c) the dates and amount of the refund monies paid to the investors;

(d) dates, names and amount of dividend/interest warrant paid to the investors.

The Banker to an issue shall intimate to SEBI about the place where these documents are kept and shall preserve them for a minimum period of 3 years.

Regulation 13 requires the banker to inform SEBI as to the number of issues for which he was engaged as banker and certain other additional information regarding the monies received, the refunds made and the dividend/interest warrant paid.

Regulation 14 requires the banker to an issue to enter into an agreement with the body corporate for whom he is acting as an banker to issue with regard to the following matters:

(a) the number of centres at which the application and the application monies of an issue of a body corporate will be collected from the investors;

(b) the time within which the statements regarding the applications and the application monies received from the investors investing in an issue of a body corporate will be forwarded to the registrar to an issue of the body corporate, as the case may be;

(c) the daily statement will be sent by the designated controlling branch of the bankers to the issue to the registrar to an issue indicating the number of body corporate and the amount of application money received.

Regulation 15 requires the banker to an issue to inform SEBI about disciplinary action taken, if any by the RBI against him in relation to issue payment work. If as a result of such action the banker to an issue is prohibited from carrying on the activities, the certificate shall be deemed to have been cancelled or suspended as the case may be.

CODE OF CONDUCT

Regulation 16 prescribes that every banker to an issue shall abide by the Code of Conduct as specified in Schedule III of the Regulations.

Compliance Officer

Regulation 16A provides that every banker to an issue is required to appoint a compliance officer responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions *etc.* issued by SEBI or Central Government. He shall also be entrusted with the responsibility of redressal of investors' grievances. He is required to immediately and independently report to SEBI regarding any non-compliance observed by him.

Procedure for Inspection

Chapter IV containing Regulation 17 to 22 deals with inspection of the Banker to an Issue.

Regulation 17 and 18 authorise SEBI to request RBI to undertake inspection of the books of accounts, records and documents of the banker, to ensure their proper maintenance, and compliance with SEBI Act, Rules and Regulations, to investigate into the complaints received from investors, body corporates or any other person on any matter having a bearing on the activities of the banker as a banker to an issue and to investigate into any other matter referred by SEBI.

Regulation 19 lays down that RBI shall on receipt of a request from SEBI take appropriate steps to undertake inspection of Bankers to an Issue for such purposes as may be required by SEBI.

Regulation 20 requires that the banker shall offer all assistance and co-operation to RBI's inspecting officers to facilitate the inspection.

Regulation 21 stipulates that the RBI shall furnish to SEBI, copy of the inspection report along with copies of other relevant documents in support of the observations made by the inspecting authority.

Action on Inspection or Investigation Report

SEBI or the Chairman after consideration of inspection or investigation report may take such action as the SEBI or its Chairman may deem fit and appropriate including action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

Procedure for Action in Case of Default

Regulation 23 provides that banker to an issue who contravenes any of the provisions of the Act, rules or regulations framed thereunder, shall be dealt with in the manner provided under Chapter V of the SEBI (Intermediaries) Regulations, 2008.

DEBENTURE TRUSTEES

Debenture trustee means a trustee of a trust deed for seeing any issue of debentures of a body corporate.

Debentures, Bonds and other hybrid instruments in most cases unless otherwise specified, carry securities for the investors unlike in the case of equity and preference shares. It is necessary that the company makes proper arrangements to extend assurances and comply with legal requirements in favour of the investors who are entitled to this type of security. Intermediaries such as Trustees who are generally Banks and Financial Institutions render this service to the investors for a fee payable by the company. The issuing company has to complete the process of finalising and executing the trust deed or document and get it registered within the prescribed period and file the charge with the Registrar of Companies (ROC) in respect of the security offered.

SEBI (DEBENTURE TRUSTEES) REGULATIONS, 1993

These regulations were notified by SEBI effective from 29th December, 1993 in exercise of the powers conferred by Section 30 of SEBI Act, 1992 after previous approval of the Central Government.

Chapter I contains preliminary matters and definitions.

Chapter II consisting Regulations 3 to 12 deals with the procedure for initial or permanent registration of debenture trustees.

Regulation 3 stipulates that the application for registeration shall be made in Form A of the Regulation to the SEBI which shall be accompanied by a non-refundable application fees as specified. This is as per the Schedule II of these Regulations to the SEBI. Regulation 4 authorises SEBI to call for and obtain further information from the applicant before granting the registration. The applicant or its principal officer may, if so required, appear before SEBI for personal representation. Regulation 5 stipulates that an application which is incomplete and does not conform to instructions shall be rejected after giving an opportunity to the applicant to remove such objections within time specified.

Regulation 6 lays down that SEBI shall take into account the following matters in considering the application, namely that the applicant:

(1) has the necessary infrastructure like adequate office space, equipments, and manpower to effectively discharge his activities;

(2) has any past experience as a debenture trustee or has in his employment minimum two persons who had the experience in matters which are relevant to a debenture trustee; or

(3) any person, directly or indirectly connected with the applicant has not been granted registration by SEBI under the Act;

(4) has in his employment at least one person who possesses the professional qualification in law from an institution recognised by the Government; or

(5) any of its director or principal officer is or has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence.

(6) is a fit and proper person;

(7) fulfils the capital adequacy requirements specified in Regulation 7A of these Regulations.

Regulation 7 lays down that to be a debenture trustee the applicant shall be a scheduled bank carrying on commercial activity, a public financial institution, an insurance company or a body corporate.

Regulation 7A of the Regulations provide that the capital adequacy requirement of debenture trustee shall not be less than the networth of ₹ 2 crore.

Regulations 8 and 9A deal with the procedure for registration and the renewal thereof, conditions of registration, time period for disposal of application and period of validity of certificate.

Regulation 10 lays down that if an applicant does not fulfil the requirements of Regulation 6 above, it may be rejected after giving reasonable opportunity to the applicant of being heard. The rejection shall be conveyed in writing by SEBI and the applicant may again apply for reconsideration of SEBI. After due reconsideration SEBI shall communicate its bindings in writing to the applicant.

Regulations 11 and 12 deal with effect of refusal to grant certificate of permanent registration by SEBI and non-payment of fees by the applicant. In the absence of a valid certificate the trustee shall cease to act as a debenture trustee.

Responsibilities and Obligations of Debenture Trustees

Chapter III containing Regulations 13 to 18 deals with this subject. Regulation 13 lays down that no debenture trustee who has been granted a certificate by SEBI shall act as debenture trustee unless he enters into a written agreement with the body corporate before the opening of the subscription list for issue of debentures and the agreement *inter alia* contains that debenture trustee has agreed to act as such under the trust deed for securing an issue of debentures for the body corporate and the time limit within which the security for the debentures shall be created.

Regulation 13A stipulates that no debenture trustee shall act as such for any issue of debentures in case:

(a) it is an associate of the body corporate; or

(b) it has lent and the loan is not yet fully repaid or is proposing to lend money to the body corporate.

Regulation 14 provides that every debenture trustee shall amongst other matters accept the trust deed which contains the matters specified in Schedule IV to the Regulations.

Duties of Debenture Trustees

Regulation 15 casts the following duties on the debenture trustees:

(1) call for periodical reports from the body corporate;

(2) take possession of trust property in accordance with the provisions of the trust deed;

(3) enforce security in the interest of the debenture holders;

(4) do such acts as necessary in the event the security becomes enforceable;

(5) carry out such acts as are necessary for the protection of the debenture holders and to do all things necessary in order to resolve the grievances of the debenture holders;

(6) ascertain and specify that:

   (a) in case where the allotment letter has been issued and debenture certificate is to be issued after registration of charge, the debenture certificates have been despatched by the body corporate to the debenture holders within 30 days of the registration of the charge with ROC;

   (b) debenture certificates have been despatched to the debenture holders in accordance with the provisions of the Companies Act;

   (c) interest warrants for interest due on the debentures have been despatched to the debenture holders on or before the due dates;

   (d) debentureholders have been paid the monies due to them on the date of redemption of the debentures;

(7) ensure on a continuous basis that the property charged to the debenture is available and adequate at all time to discharge the interest and principal amounts payable in respect of the debentures and that such property is free from any other encumbrances save and except those which are specifically agreed to by the debenture trustee.

(8) exercise due diligence to ensure compliance by the body corporate, with the provisions of the Companies Act, the listing agreement of the stock exchange or the trust deed;

(9) to take appropriate measures for protecting the interest of the debenture holders as soon as any breach of the trust deed or law comes to his notice;

(10) to ascertain that the debentures have been converted or redeemed in accordance with the provisions and conditions under which they are offered to the debenture holders;

(11) inform SEBI immediately of any breach of trust deed or provision of any law;

(12) appoint a nominee director on the Board of the body corporate in the event of :

(i) two consecutive defaults in payment of interest to the debentures; or

(ii) default in creation of security for debentures; or

(iii) default in redemption of debentures.

(13) communicate to the debenture holders on half yearly basis the compliance of the terms of the issue by the body corporate, defaults, if any, in payment of interest or redemption of debentures and action taken therefore;

(14) The debenture trustee shall –

(a) obtain reports from the leading bank regarding the project.

(b) monitor utilization of funds raised in the issue.

(c) obtain a certificate from the issuer's auditors.

(i) in respect of utilization of funds during the implementation period of the project; and

(ii) in the case of debentures issued for financing working capital at the end of accounting year.

(15) A debenture trustee may call or cause to be called by the body corporate a meeting of all the debenture holders on –

(a) a requisition in writing signed by at least one-tenth of the debentureholders in value for the time being outstanding.

(b) the happening of any event, which constitutes a default or which in the opinion of the debenture trustees affects the interest of the debentureholders.

(16) No debenture trustee should relinquish its assignment in respect of the debenture issue of any body corporate, unless and until another debenture trustee is appointed in its place by the body corporate.

(17) A debenture trustee is required to maintain the networth requirements on a continuous basis. He is under an obligation to inform SEBI immediately in respect of any shortfall in the networth. He is also not entitled to undertake new assignments until it restores the networth to the level of specified requirement within the time specified by SEBI.

(18) Debenture trustee may inspect books of accounts, records, registers of the body corporate and the trust property to the extent necessary for discharging its obligations.

Code of Conduct

Regulation 16 requires that every debenture trustee shall abide by the code of conduct as specified in Schedule III to the Regulations.

Maintenance of Records

Regulations 17 and 18 deal with maintenance of books of accounts, records and documents relating to trusteeship functions for a period of not less than five financial years preceding the current financial year. Every debenture trustee would inform SEBI about the place where the books of accounts records and documents are maintained and furnish various information to SEBI.

Appointment of Compliance Officer

Every debenture trustee is required to appoint a compliance officer responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions *etc.* issued by SEBI or Central Government. He is also responsible for redressal of investor grievances. The Compliance officer is under an obligation to immediately and independently report to SEBI any non-compliance observed by him. He would also report any non-compliance of the requirements specified in the listing agreement with respect to debenture issues and debentureholders, by the body corporate to SEBI.

Information to SEBI

Debenture trustee is required to submit the following information and documents to SEBI, as and when SEBI may require –

(a) The number and nature of the grievances of the debentureholders received and resolved.

(b) Copies of the trust deed.

(c) Non-Payment or delayed payment of interest to debentureholders, if any, in respect of each issue of debentures of a body corporate.

(d) Details of despatch and transfer of debenture certificates giving therein the dates, modes *etc.*

(e) Any other particular or document which is relevant to debenture trustee.

Action on Inspection or Investigation Report

Chapter IV consisting of Regulation 19 to 24 deals with inspection and disciplinary proceedings.

SEBI or the chairman may after consideration of inspection or investigation report take such action as the Board or chairman may deem fit and appropriate including action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

Procedure for Action in Case of Default

Regulation 25 of Chapter V lays down that a debenture trustee would be dealt with in the manner provided under Chapter V of SEBI (Intermediaries) Regulations, 2008, if he fails to comply with the conditions of registration, contravenes the provisions of SEBI Act/Companies Act, Rules and Regulations.

SECONDARY MARKET INTERMEDIARIES

The following market intermediaries are involved in the secondary market:

– Stock brokers

– Sub-brokers

– Portfolio managers

– Custodians

– Investment Advisers

STOCK BROKERS AND SUB-BROKER

Stock broker means a member of a stock exchange. A stock-broker plays a very important role in the secondary market helping both the seller and the buyer of the securities to enter into a transaction.

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

No stock broker or sub-broker shall buy, sell or deal in securities unless he holds a certificate of registration granted by SEBI under the Regulations made by SEBI in relation to them.

SEBI (STOCK BROKERS & SUB-BROKERS) REGULATIONS, 1992

SEBI (Stock Brokers & Sub-Brokers) Regulations, 1992 were notified by SEBI in exercise of the powers conferred by section 30 of SEBI Act, 1992 and came into effect on 23rd October, 1992.

Chapter II of the Regulations contains Regulation 3 to 10 which deal with registration of Stock Brokers. An application by a stock broker for grant of a certificate of registration shall be made in Form A through the Stock exchange or stock exchanges, as the case may be, of which he is admitted as a member. The stock exchange shall forward the application form to SEBI as early as possible but not later than 30 days from the date of its receipt. SEBI may require the applicant to furnish such further information or clarifications regarding the dealings in securities and related matters to consider the application for granting a certificate of registration. The applicant or its principal officer shall, if so required, appear before SEBI for personal representation.

SEBI shall take into account the following aspects before granting a certificate:

(a) whether the stock broker is eligible to be admitted as a member of a stock exchange;

(b) whether he has the necessary infrastructure like adequate office space, equipment and manpower to effectively discharge his activities;

(c) whether he has any past experience in the business of buying, selling or dealing in securities;

(d) whether he was subjected to disciplinary proceedings under the rules, regulations and bye-laws of a stock exchange with respect to his business as a stock broker involving either himself or any of his partners, directors or employees; and

(e) whether he is a fit and proper person.

SEBI, on being satisfied that the stock broker is eligible, shall grant a certificate of registration to him and send an intimation to that effect to the stock exchange or stock exchanges as the case may be. However, subject to the conditions as stipulated by SEBI for registration, a stock broker holding a certificate of registration with respect to membership of a recognised stock exchange having nationwide trading terminals shall be eligible for trading on SME platform established by such stock exchange without obtaining a separate certificate of registration for trading on the SME platform. Regulation 6A lays down the conditions of registration. The stock broker holding a certificate shall at all times abide by the Code of Conduct as specified in Schedule II of the Regulations.

Rejection of Application of Brokers

Regulation 8 stipulates that where an application for grant of a certificate does not fulfil the requirements, as prescribed in the Regulations, SEBI may reject the application after giving a reasonable opportunity of being heard. The refusal to grant the registration certificate shall be communicated by SEBI within 30 days of such refusal to the concerned stock exchange and to the applicant stating therein the grounds on which the application has been rejected. An applicant may, being aggrieved by the decision of SEBI, apply within a period of 30 days from the date of receipt of such intimation, to SEBI for reconsideration of its decision. SEBI shall reconsider an application made and communicate its decision as soon as possible in writing to the applicant and to the concerned stock exchange. The stock broker whose application for grant of a certificate has been refused by SEBI shall not, on and from the date of the receipt of SEBI's communication, buy, sell or deal in securities as a stock broker.

Every applicant eligible for grant of a certificate of registration shall pay such fees and in such manner as specified in Schedule III to the regulations. However, SEBI may on sufficient cause being shown, permit the stock broker to pay such fees at any time before the expiry of 6 months from the date on which such fees become due. Where a stock broker fails to pay the fees as provided, SEBI may suspend the registration certificate, where upon the stock broker shall cease to buy, sell or deal in securities as a stock broker.

Registration of Sub-brokers

Chapter III containing Regulations 11 to 16 deal with registration of sub-brokers. A sub-broker cannot act as such unless he holds a certificate granted by SEBI. Where a sub-broker merely changes his affiliation from one stock broker to another stock broker being a member of the same stock exchange, there is no requirement of obtaining a fresh certificate. Again, there is no need of obtaining a fresh certificate where a registered sub-broker is affiliated to stock broker who is eligible to trade on SME platform.

Regulation 11A lays down that an application by a sub-broker for the grant of certificate shall be made in Form- B. Such application from the sub-broker applicant shall be accompanied by a recommendation letter in Form-C from a stock broker of a recognised stock exchange with whom the former is to be affiliated along with two references including one from his banker. The application form shall be submitted to the stock exchange of which the stock broker with whom he is to be affiliated is a member.

The stock exchange on receipt of an application shall verify the information contained therein and shall also certify that the applicant is eligible for registration as per criteria specified below:

(1) In the case of an individual:

   (a) the applicant is not less than 21 years of age;

   (b) the applicant has not been convicted of any offence involving fraud or dishonesty;

   (c) the applicant has at least passed 12th standard equivalent examination from an Institution recognised by the Government. However, SEBI may relax this criterion on merits having regard to the applicant's experience;

   (d) the applicant is a fit and proper person.

(2) In the case of partnership firm or a body corporate, the partners or directors as the case may be shall comply with the requirements stated above. It is also to be assessed whether the applicant has necessary infrastructure like adequate office space, equipment and manpower to effectively discharge his activities. The applicant should be a person recognised by the stock exchange as a sub-broker affiliated to a member broker of the stock exchange. The stock exchange shall forward the application form of such applicants, alongwith recommendation letter issued by the stock broker with whom he is affiliated alongwith a recognition letter issued by the stock exchange to SEBI within 30 days from the date of its receipt.

SEBI on being satisfied that the sub-broker is eligible, shall grant a certificate in Form-E to the sub-broker and send an intimation to that effect to the stock exchange or exchanges as the case may be. SEBI may grant a certificate of registration to the applicant subject to the terms and conditions as laid down by SEBI in Regulation 12A.

Regulation 12A lays down the conditions for registration. Any registration granted by SEBI shall be subject to the following conditions: –

(a) he shall abide by the rules, regulations and bye-laws of the stock exchange which are applicable to him;

(b) he shall pay fees charged by SEBI;

(c) he shall take adequate steps for redressal of grievances, of the investors within one month of the date of receipt of the complaint and keep SEBI informed about the number, nature and other particulars of the complaints received from such investors; and

(d) he is authorized in writing by a stock-broker being a member of a stock exchange for affiliating himself in buying, selling or dealing in securities.

Where an application for grant of a certificate does not fulfil the requirements mentioned in Regulation 11A, SEBI may reject the application after giving a reasonable opportunity of being heard. The refusal to grant the certificate shall be communicated by SEBI within 30 days of such refusal to the concerned stock exchange and to the applicant in writing stating therein the grounds on which the application has been rejected. An applicant being aggrieved by the decision of SEBI may, within a period of 30 days from the date of receipt of such intimation apply to SEBI for reconsideration of the decision.

SEBI shall reconsider an application made and communicate its decision to the applicant in writing and to the concerned stock exchange as soon as possible.

A person whose application for grant of a certificate has been refused by SEBI shall, on and from the date of communication of refusal cease to carry on any activity as a sub-broker. The sub-broker has the following general obligations:

(a) pay the fees as per Schedule III;

(b) abide by the Code of Conduct specified in Schedule II;

(c) enter into an agreement with the stock broker for specifying the scope of his authority and responsibilities;

(d) comply with the rules, regulations and bye laws of the stock exchange;

(e) not be affiliated to more than one stock broker of one stock exchange.

The sub-broker shall keep and maintain the books and documents specified in the Regulations.

No director of a stock broker can act as a sub-broker to the same stock broker.

The general obligations and responsibilities, procedure for inspection and for taking action in case of default shall be the same for both stock brokers and sub-brokers.

Registration of Trading and Clearing Members

Chapter IIIA consisting of Regulation 16A to 16I deals with registration of trading and clearing members. Regulation 16A on the procedure for application for registration requires that an application for grant of certificate of registration by a trading member of a derivatives exchange or derivatives segment of a stock exchange shall be made in Form-AA of Schedule-I, through the concerned derivatives exchange or derivatives segment of a stock exchange of which he is a member. Similarly, an application for grant of certificate of registration by a clearing member or self clearing member of the clearing corporation or clearing house of a derivatives exchange or derivatives segment of a stock exchange shall be made in Form-AA of Schedule-I, through the concerned clearing corporation or clearing house of which is he a member. However, a trading member who also seeks to act as a clearing member or self clearing member shall make separate applications for each activity. The concerned exchange shall forward the application to SEBI as early as possible but not later than 30 days from the date of its receipt. SEBI may require the applicant or the concerned stock exchange or segment or clearing house or corporation to furnish such other information or clarification regarding the trading and settlement in derivatives and matters connected thereto, to consider the application for grant of a certificate. The applicant or its principal officer, if so required shall appear before SEBI for personal representation.

SEBI shall take into account the following aspects while considering the application, namely –

1 whether the applicant is eligible to be admitted as a trading member or a clearing member as the case may be;

2 whether the applicant has the necessary infrastructure like adequate office space, equipment and man power to effectively undertake his activities; and

3 whether he is/was subjected to disciplinary procedures under the rules, regulations and bye-laws of any stock exchange with respect to his business, involving either himself or any of his partners, directors or employees;

4 whether the applicant has any financial liability which is due and payable to SEBI.

The applicant shall also be required to have a net worth as may be specified from time to time and the approved user and sales personnel of the trading member shall be required to have passed a certification programme approved by SEBI. An applicant who desires to act as a clearing member shall also have a minimum net worth of ₹ 300 lakhs and shall deposit at least a sum of ₹ 50 lakhs or higher amount with a clearing corporation or a clearing house of the derivatives exchange or derivatives segment in the form specified from time to time. An applicant who derives to act as a self clearing member, in addition shall comply with the requirement of minimum networth of ₹ 100 lakhs and shall deposit atleast a sum of ₹ 50 lacs or higher amount with the clearing corporation or clearing house of the derivatives exchange or derivatives segment in the form specified from time to time.

'Net worth' in this context shall mean paid up capital plus free reserves and other securities approved by SEBI from time to time (but does not include fixed assets, pledged securities, value of members card, non allowable securities which are unlisted, bad deliveries, doubtful dates and advances of more than three months and debt/ advances given to the associate persons of the members), pre-paid expenses, losses, intangible assets and 30% value of marketable securities.

Registration Procedure for Trading and Clearing Member

Regulation 16I lays down on that on being satisfied that the applicant is eligible, SEBI shall grant a certificate in Form-DA of Schedule-I to the applicant and send an intimation to that effect to the derivative segment of the stock exchange or derivatives exchange or clearing corporation or clearing house as the case may be. Where an applicant does not fulfil the requirements, SEBI may reject the application after giving a reasonable opportunity to the applicant of being heard. The refusal to grant such certificate shall be communicated by SEBI within 30 days of such refusal to the concerned segment of stock exchange or clearing corporation or clearing house and to the applicant stating therein the grounds on which the application has been rejected. If aggrieved by the decision of SEBI as referred to above, the applicant may apply within a period of 30 days from the date of receipt of such information to SEBI for reconsideration of its decision. SEBI shall reconsider the application and communicate its decision as soon as possible in writing to the applicant and to the concerned segment of stock exchange or clearing house or corporation. If certificate of registration is refused to an applicant he shall not from the date of receipt of SEBI's letter of rejection, deal in or settle the derivatives contracts as a member of the derivatives exchange, segment, clearing corporation or clearing house. Every applicant eligible for grant of certificate as a trading or clearing member or self clearing member, shall pay such fee as may be specified. If the fee is not paid, SEBI may suspend or cancel the registration after giving an opportunity of being heard where upon the trading and clearing member or self-clearing member shall cease to deal in and settle the derivatives contract.

Registration of Trading and Clearing Members of Currency Derivatives Segment

Chapter IIIB containing Regulation 16J to 16R deals with registration of trading, clearing member and self-clearing member of currency derivative segment. Regulation 16J provide that the application for grant of certificate of registration by a trading member of currency derivatives segment of a stock exchange shall be made in Form AB of Schedule I, through the concerned currency derivatives segment of a stock exchange of which he is a member. An application for grant of certificate of registration by a clearing member or self-clearing member of the clearing corporation or clearing house of currency derivatives segment of a stock exchange, shall be made in Form AB of Schedule I, through the concerned clearing corporation or clearing house of which he is a member: However, a trading member who also seeks to act as a clearing member or self-clearing member shall make separate applications for each activity in Form AB of Schedule I. The currency derivatives segment or clearing house or corporation, as the case may be, shall forward the application to the SEBI as early as possible but not later than thirty days from the date of its receipt.

Regulation 16K provides that SEBI may require the applicant or the concerned stock exchange or segment or clearing house or corporation to furnish such other information or clarifications, regarding the trading and settlement in currency derivatives and matters connected thereto, to consider the application for grant of a certificate. The applicant or its principal officer shall, if so required, appear before SEBI for personal representation.

Regulation 16L lays down that SEBI shall take into account for considering the grant of a certificate all matters relating to dealing and settlement in currency derivatives and in particular the following, namely, wheather the applicant

(a) is eligible to be admitted as a trading member or a clearing member or self-clearing member

(b) has the necessary infrastructure like adequate office place, equipment and manpower to effectively undertake his activities;

(c) is subjected to disciplinary proceedings under the rules, regulations and bye-laws of any stock exchange with respect to his business involving either himself or any of his partners, directors or employees;

(d) has any financial liability which is due and payable to the SEBI under these regulations.

An applicant shall also have a net worth of ₹ 1 Crore and shall ensure that its approved user and sales personnel have passed a certification programme approved by SEBI. An applicant who desires to act as a clearing member or self-clearing member shall have a minimum net worth of ₹ 10 crore and shall deposit at least a sum of ₹ 50 lacs or higher amount with the clearing corporation or clearing house of the currency derivatives segment in the form specified from time to time.

Registration Procedure

Regulation 16M requires that on being satisfied that the applicant is eligible, SEBI shall grant a certificate in Form DB of Schedule I, to the applicant and send an intimation to that effect to the currency derivatives segment of the stock exchange or clearing corporation or clearing house, as the case may be. Regulation 16N provides that where an application for the grant of a certificate does not fulfil the requirements SEBI may reject the application of the applicant after giving a reasonable opportunity of being heard. The refusal to grant the certificate of registration shall be communicated by SEBI within 30 days of such refusal to the currency derivatives segment of the stock exchange, or clearing house or corporation and to the applicant stating therein the grounds on which the application has been rejected. An applicant may, if aggrieved by the decision of SEBI as referred to above, the applicant may apply within a period of thirty days from the date of receipt of such information to SEBI for reconsideration of its decision. SEBI shall reconsider an application made and communicate its decision as soon as possible in writing to the applicant and to the currency derivatives segment of the stock exchange or clearing house or corporation.

Regulation 16O lays down that an applicant, whose application for the grant of a certificate of registration has been refused by SEBI shall not on and from the date of receipt of the communication deal in or settle the currency derivatives contracts as a member of the currency derivatives segment of the stock exchange or clearing corporation or clearing house.

Code of Conduct

Regulation 16Q requires that the code of conduct specified for the stock broker as stipulated in Schedule-II shall be applicable *mutatis mutandis* to the trading member, clearing member and self-clearing member and such members shall at all times abide by the same. The trading member shall obtain details of the prospective clients in "know your client" format as specified by SEBI before executing an order on behalf of such client. The trading member shall mandatorily furnish "risk disclosure document" disclosing the risk inherent in trading in derivatives to the prospective clients in the form specified. The trading or clearing member or self-clearing member shall deposit a margin money or any other deposit and shall maintain position or exposure limit as specified by SEBI or the concerned exchange or segment or clearing corporation or clearing house from time to time.

General Obligations and Responsibilities

Regulation 17 and 18 deal with the general obligations and responsibilities of stock brokers. It lays down that every stock broker shall keep and maintain books of accounts, records and documents namely – Register of Transactions (Sauda book); clients' ledger; general ledger; journals; cash book; bank pass book; documents register including particulars of securities received and delivered in physical form and the statement of account and other records relating to receipt and delivery of securities provided by the depository participants in respect of dematerialised securities, members contract books showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other members; counterfoils or duplicates of contract notes issued to clients; written consents of clients in respect of contracts entered into as principals; margin deposit book; registers of accounts of sub-brokers; an agreement with sub-broker specifying scope of authority, and responsibilities of the stock brokers as well as sub-brokers and an client account opening form in the format as specified by SEBI.

Every stock broker shall intimate to SEBI the place where the books of accounts, records and documents are maintained. He shall, after the close of each accounting period, furnish to SEBI if so required, as soon as possible but not later than 6 months from the close of the said period, a copy of the audited balance sheet and profit and loss account for the said accounting period.

If this is not possible, the stock broker shall keep SEBI informed of the same together with the reasons for the delay and the period of time by which such documents would be furnished to SEBI. Every stock broker shall preserve the books of accounts and other records for a minimum period of 5 years. The Stock broker shall not deal with any person as sub-broker unless such person has been granted certificate of registration by SEBI.

Compliance Officer

Regulation 18A requires every stock broker to appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions *etc.* issued by SEBI or Central Government and for redressal of investors' grievances. Compliance officer shall immediately and independently report to SEBI any non-compliance observed by him.

Procedure for Inspection of Stock Brokers' Offices

Regulations 19 to 24 provides for procedure for inspection. It is provided that where it appears necessary to SEBI, it may appoint one or more persons as inspecting authority to undertake inspection of the books of accounts other records and documents of the stock brokers:

(a) to ensure that the books of account and other books are being maintained in the manner required,

(b) that the provisions of the Act, rules and regulations as well as the provisions of the Securities Contracts (Regulation) Act, 1956 and the rules made thereunder are being complied with,

(c) to investigate into the complaints received from investors, other stock brokers, sub-brokers or any other person on any other matter having a bearing on the activities of the stock brokers, and

(d) to investigate *suo motu* in the interest of securities business or investors interest into the affairs of the stock broker.

Before undertaking inspection, SEBI shall give a reasonable notice to the stock broker. However, if SEBI is satisfied that in the interest of the investors or in public interest, no such notice should be given, it may by an order in writing, direct that the inspection be taken up without such notice to the stock broker. On being empowered by SEBI, the inspecting authority shall undertake the inspection and the stock broker concerned shall be bound to discharge his obligations to facilitate and co-operate for the conduct of inspection by the said authority.

It shall be the duty of every director, proprietor, partner, officer and employee of the stock broker who is being inspected, to produce to the inspecting authority such books, accounts and other documents in his custody or control and furnish him with the statements and information relating to the transactions in securities market within such time as the inspecting authority may require.

The stock broker shall allow the inspecting authority to have reasonable access to the premises occupied by such stock broker or by any other person on his behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the stock broker or any other person and also provide copies of documents or other materials which in the opinion of the inspecting authority are relevant. The said authority in the course of inspection shall be entitled to examine or record statements of any member, director, partner, proprietor and employee of the stock broker. It shall be duty of every director, proprietor, partner, officer and employee of stock broker to give the said authority all assistance in connection with the inspection, which the stock broker may be reasonably expected to give.

The inspecting authority shall as soon as possible submit an inspection report to SEBI who shall after consideration of inspection or investigation report take such action as it may deem fits and appropriate including action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

SEBI is also empowered to appoint a qualified auditor to investigate into the books of accounts or the affairs of the stock broker. The auditor so appointed shall have the same powers of the inspecting authority as enumerated above and the obligations of the stock broker as detailed above shall be applicable to the investigation.

Procedure for Action in Case of Default

A stock broker or a sub-broker who contravenes any of the provisions of the Act, rules or regulations framed thereunder shall be liable for any one or more of the following actions –

(i) Monetary penalty under Chapter VIA of the Act.

(ii) Penalties as specified under Chapter V of SEBI (Intermediaries) Regulations, 2008 including suspension or cancellation of certificate of registration as a stock broker or a sub-broker.

(iii) Prosecution under Section 24 of the Act.

Liability for Monetary Penalty

A stock broker or a sub-broker shall be liable for monetary penalty in respect of the following violations, namely –

(i) Failure to file any return or report with SEBI.

(ii) Failure to furnish any information, books or other documents within 15 days of issue of notice by SEBI.

(iii) Failure to maintain books of account or record as per the Act, rules or regulations framed thereunder.

(iv) Failure to redress the grievances of investors within 30 days of receipts of notice from SEBI.

(v) Failure to issue contract notes in the form and manner specified by the Stock Exchange of which such broker is a member.

(vi) Failure to deliver any security or make payment of the amount due to the investor within 48 hours of the settlement of trade unless the client has agreed in writing otherwise.

(vii) Charging of brokerage which is in excess of brokerage specified in the regulations or the bye-laws of the stock exchange.

(viii) Dealing in securities of a body corporate listed on any stock exchange on his own behalf or on behalf of any other person on the basis of any unpublished price sensitive information.

(ix) Procuring or communicating any unpublished price sensitive information except as required in the ordinary course of business or under any law.

(x) Counselling any person to deal in securities of any body corporate on the basis of unpublished price sensitive information.

(xi) Indulging in fraudulent and unfair trade practices relating to securities.

(xii) Failure to maintain client opening form.

(xiii) Failure to segregate his own funds or securities from the client's funds or securities or using the securities or funds of the client for his own purpose or for purpose of any other client.

(xiv) Acting as an unregistered sub-broker or dealing with unregistered sub-brokers.

(xv) Failure to comply with directions issued by SEBI under the Act or the regulations framed thereunder.

(xvi) Failure to exercise due skill, care and diligence.

(xvii) Failure to obtain prior approval of SEBI in case of change in control of stock broker.

(xviii) Failure to satisfy the net worth or capital adequacy norms, if any, specified by SEBI.

(xix) Extending use of trading terminal or any unauthorized person or place.

(xx) Violations for which no separate penalty has been provided under these regulations.

Liability for Action under the Enquiry Proceeding

A stock broker or a sub-broker shall be liable for any action as specified in SEBI (Intermediaries) Regulations, 2008 including suspension or cancellation of his certificate of registration as a stock broker or a sub-broker, as the case may be, if he –

(i) ceases to be a member of a stock exchange; or

(ii) has been declared defaulter by a stock exchange and not re-admitted as a member within a period of six months; or

(iii) surrender his certificate of registration to SEBI; or

(iv) has been found to be not a fit and proper person by SEBI under these or any other regulations; or

(v) has been declared insolvent or order for winding up has been passed in the case of a broker or sub-broker being a company registered under the Companies Act, 1956 (now Companies Act, 2013); or

(vi) or any of the partners or any whole-time director in case a broker or sub-broker is a company registered under the Companies Act, 1956 (now Companies Act, 2013) has been convicted by a court of competent jurisdiction for an offence involving moral turpitude; or

(vii) fails to pay fee as per Schedule III of these regulations; or

(viii) fails to comply with the rules, regulations and bye-laws of the stock exchange of which he is a member; or

(ix) fails to co-operate with the inspecting or investigating authority; or

(x) fails to abide by any award of the Ombudsman or decision of SEBI under the (Ombudsman) Regulations, 2003; or

(xi) fails to pay the penalty imposed by the Adjudicating Officer; or

(xii) indulges in market manipulation of securities or index; or

(xiii) indulges in insider trading in violation of SEBI (Prohibition of Insider Trading) Regulations, 1992; or

(xiv) violates SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003; or

(xv) commits violation of any of the provisions for which monetary penalty or other penalties could be imposed; or

(xvi) fails to comply with the circulars issued by SEBI; or

(xvii) commits violations specified in Regulation 26 which in the opinion of SEBI are of a grievous nature.

Liability for Prosecution

A stock broker or a sub-broker shall be liable for prosecution under Section 24 of the SEBI Act for any of the following violations, namely –

(i) Dealing in securities without obtaining certificate of registration from SEBI as a stock broker or a sub-broker.

(ii) Dealing in securities or providing trading floor or assisting in trading outside the recognized stock exchange in violation of provisions of the Securities Contract (Regulation) Act, 1956 or rules made or notifications issued thereunder.

(iii) Market manipulation of securities or index.

(iv) Indulging in insider trading in violation of SEBI (Prohibition of Insider Trading) Regulations, 1992.

(v) Violating SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003.

(vi) Failure without reasonable cause –

(a) to produce to the investigating authority or any person authorized by him in this behalf, any books, registers, records or other documents which are in his custody or power; or

(b) to appear before the investigating authority personally or to answer any question which is put to him by the investigating authority; or

(c) to sign the notes of any examination taken down by the investigating authority.

(vii) Failure to pay penalty imposed by the adjudicating officer or failure to comply with any of his directions or orders.

A CASE STUDY ON FRAUDULENT DEALINGS

Bishwanath Murlidhar Jhunjhunwala v. SEBI

SEBI noticed a spurt in the volume in the trading of the scrip of Snowcem India Ltd. (SIL), both at NSE and BSE. Though the scrip was not very liquid, it was observed that during June 1999 to August 1999, price of the scrip ranged between ₹55 to ₹127. The Appellant, a stock broker of BSE himself was found to have registered himself as a client with a broker of NSE and placed orders in large quantities in the scrip of SIL to the tune of 2,87,400 shares which amounted to 5.59 percent of the total volume traded at NSE between June 1999 and August 1999. Orders placed by the Appellant were matched with those orders placed by Kosha Investment Ltd. (KIL). Further, the Appellant had not traded in his own account at BSE. The conduct of the Appellant was in violation of Regulation 4(a), (b) and (d) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 in view of which he was prohibited from accessing capital market for a period of 2 years. Upholding the impugned order in its totality, the Hon'ble SAT noted that, "It is a fact that the persons who operate in the market are required to maintain high standards of integrity, promptitude and fairness in the conduct of business dealings.

CERTIFICATION BY PRACTICING COMPANY SECRETARY

1. Internal Audit for Stock Brokers/Trading Members/ Clearing Members

SEBI has authorized the Practicing Company Secretary to carry out complete internal audit of stock brokers/ trading members/clearing members on a half yearly basis. The circular states that stock brokers/trading members/ clearing members shall carry out complete internal audit on a half yearly basis by chartered accountants, company secretaries or cost and management accountants who are in practice and who do not have any conflict of interest. The scope of such audit covers, *inter alia*, the existence, scope and efficiency of the internal control system, compliance with the provisions of the SEBI Act, 1992, Securities Contracts (Regulation) Act 1956, SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992, circulars issued by SEBI, agreements, KYC requirements, Bye Laws of the Exchanges, data security and insurance in respect of the operations of stock brokers/clearing members. The objective of internal audit is –

(i) to ensure that the books of account, records (including telephone records and electronic records) and documents are being maintained in the manner required under SEBI Act, 1992, SCR Act, 1956 and SEBI (Stock brokers and Sub-brokers) Regulations, 1992.

(ii) to ascertain as to whether adequate internal control systems, procedures and safeguards have been established and are being followed by the intermediary to fulfill its obligations within the scope of the audit.

(iii) to ascertain as to whether any circumstances exist which would render the intermediary unfit or ineligible.

(iv) to ascertain whether the provisions of the securities laws and the directions or circulars issued thereunder are being complied with.

(v) to ascertain whether the provision of stock exchange bye-laws, notices, circulars, instructions or orders issued by stock exchanges are being complied with.

(vi) to inquire into the complaints received from investors, clients, other market participants or any other person on any matter having a bearing on the activities of the stock broker.

PORTFOLIO MANAGER

Portfolio manager means any person who pursuant to contract or arrangement with the client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the clients as the case may be. "Discretionary portfolio manager" is defined as one who exercises or may exercise, under a contract relating to portfolio management, any degree of discretion as to the investment or the management of the portfolio of the securities or the funds of the client. "Portfolio" means the total holdings of securities belonging to any person.

A portfolio manager thus, with professional experience and expertise in the field, studies the market and adjusts the investment mix for his client on a continuing basis to ensure safety of investment and reasonable returns therefrom.

SEBI (PORTFOLIO MANAGERS) REGULATIONS, 1993

SEBI issued SEBI (Portfolio Managers) Regulations, 1993 in exercise of the powers conferred by Section 30 of SEBI Act, 1992. These regulations got effective from 7th January, 1993.

Chapter I contains preliminary matters and definitions. Chapter II consisting of Regulations 3 to 12 deal with the procedure for registration of portfolio managers

Regulation 3 provides that a person shall not act a portfolio manager unless he holds a certificate granted by SEBI under these Regulations.

Regulation 3A lays down that an application by a portfolio manager for grant of the certificate shall be made to SEBI in the prescribed form-A and shall be accompanied by a non-refundable application fee, as specified in Clause (1) of Schedule II, to be paid in the manner specified in Part B thereof. Incomplete applications shall be rejected after the applicant is given an opportunity to remove within the time specified such objections on the application as may be indicated by SEBI. Before disposing the application, SEBI may require the applicant to furnish further information or clarification and the applicant or its principal officer who is mainly responsible for the activities as a portfolio manager, shall appear before SEBI to make a personal representation, if required.

Norms for Registration as Portfolio Managers

The requirements to be satisfied by the applicant for getting the certificate of registration as mentioned in Regulation 6 are as follows:

(a) the applicant is a body corporate;

(b) the applicant has the necessary infrastructure like adequate office space, equipments and the manpower to effectively discharge the activities of a portfolio manager;

(c) the principal officer of the applicant has either professional qualifications in finance, law, accountancy or business management from an institution recognised by the Government or a foreign university or an experience of at least 10 years in related activities in the securities market including in a portfolio manager, stock broker or as a fund manager;

(d) the applicant has in its employment minimum of two persons who, between them, have at least five years experience as portfolio manager or stock broker or investment manager or in the areas related to fund management;

(e) any previous application for grant of certificate made by any person directly or indirectly connected with the applicant has been rejected by SEBI;

(f) any disciplinary action has been taken by the SEBI against a person directly or indirectly connected with the applicant under the Act or the Rules or the Regulations made thereunder.

(g) the applicant fulfils the capital adequacy requirements;

(h) the applicant, its director, principal officer or the employee as specified in Clause (d) is involved in any litigation connected with the securities market which has an adverse bearing on the business of the applicant;

(i) the applicant, its director, principal officer or the employee as specified in Clause (d) has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence;

(j) the applicant is a fit and proper person;

(k) grant of certificate to the applicant is in the interests of investors.

Capital Adequacy Requirement

Regulation 7 lays down that portfolio manager must have capital adequacy requirement of not less than networth of two crore rupees. However, the portfolio manager shall fulfill capital adequacy requirement under these regulations, separately and independently, of capital adequacy requirements, if any, for each activity undertaken by it under the relevant regulations. Networth for the present purpose means the aggregate value of paid-up equity capital plus free reserves (excluding reserves created out of revaluation) reduced by the aggregate value of accumulated losses and deferred expenditure not written off, including miscellaneous expenses not written off.

SEBI on being satisfied that the applicant fulfils the requirement specified above shall send an intimation to the applicant. On payment of the requisite fees by the applicant in accordance with Clause 1A of Schedule II of the Regulations, he will be granted a certificate of Registration in Form-B.

Renewal of Certificate

According to Regulation 9, a portfolio manager may make an application for renewal of his registration at least three months before the expiry of the validity of his certificate.

SEBI, in addition to the information furnished in form A along with fees specified in Clause 1 of Schedule II has prescribed for certain additional information to be submitted by the applicant while seeking registration/ renewal as portfolio managers. The applicant has been required to furnish the additional detailed information in the following areas:

1. Memorandum and Articles of Association of the applicant
2. Details of Directors & shareholding pattern
3. Details of Promoters & shareholding pattern
4. Details of applicant registered with SEBI as any other intermediary
5. Details of the Principal Officer
6. Details of Key personnel
7. Details of infrastructure facilities
8. Details of the proposed Schemes
9. Details of facility for safe custody
10. Details of facility for equity research
11. Financial Accounts of the applicant
12. Report from principal bankers
13. List of brokers
14. Details regarding applicant registered with RBI (if any)
15. Details of associated registered intermediaries
16. Declaration by at least two directors
17. Declaration for fit and proper person
18. Director’s Declaration under regulation 6.

The applicant has been advised to note that furnishing of incomplete information would delay the processing of the application. The applicant has also been advised to keep the Board informed of all the consequent changes in the information provided to the board.

Conditions of Registration

Any registration granted or any renewal granted under these regulation shall be subject to the following conditions namely:

(a) where the portfolio manager proposes to change its status or constitution, it shall obtain prior approval of the SEBI for continuing to act as such after the change;

(b) it shall pay the fees for registration or renewal, as the case may be, in the manner provided in these regulations;

(c) it shall take adequate steps for redressal of grievances of the investors within one month of the date of the receipt of the complaint and keep SEBI informed about the number, nature and other particulars of the complaints received;

(d) it shall maintain capital adequacy requirements specified in these regulation at all times during the period of the certificate or renewal thereof;

(e) it shall abide by the regulations made under the Act in respect of the activities carried on by it as portfolio manager.

Period of Validity of Certificate

The certificate of registration granted and its renewal granted under these regulation shall be valid for a period of three years from the date of its issue to the applicant.

Procedure Where Registration is not Granted

Where the applicant does not satisfy the requirement of registration, SEBI may reject the application after giving an opportunity of being heard. The refusal shall be communicated by SEBI within 30 days of such refusal indicating the grounds for rejection. An applicant if aggrieved by SEBI's rejection may apply within a period of 30 days from the date of receipt of rejection letter to SEBI for reconsideration. SEBI shall reconsider the matter and communicate its final decision as soon as possible in writing to the applicant. The applicant shall cease to carry on activity as portfolio manager on receipt of rejection of his application. If the portfolio manager fails to pay the fees as provided in Schedule II, SEBI may suspend the certificate and during the period of suspension the portfolio manager shall not carry on activity as such portfolio manager.

Code of Conduct

Regulation 13 lays down that every portfolio manager shall abide by the code of conduct as specified in Schedule III to the Regulations.

Contract with Clients and Disclosures

Regulation 14 stipulates that the portfolio manager, before taking up an assignment of management of funds or portfolio of securities on behalf of a client, enter into an agreement in writing with such client clearly defining the *inter se* relationship and setting out their mutual rights, liabilities and obligations relating to the management of funds or portfolio of securities containing the details as specified in Schedule IV to the Regulations:

The agreement between the portfolio manager and the client shall, *inter alia*, contain:

(i) the investment objectives and the services to be provided;

(ii) areas of investment and restrictions, if any, imposed by the client with regard to the investment in a particular company or industry;

(iii) type of instruments and proportion of exposure;

(iv) tenure of portfolio investments;

(v) terms for early withdrawal of funds or securities by the clients;

(vi) attendant risks involved in the management of the portfolio;

(vii) period of the contract and provision of early termination, if any;

(viii) amount to be invested subject to the restrictions provided under these regulations;

(ix) procedure of settling client's account including form of repayment on maturity or early termination of contract;

(x) fees payable to the portfolio manager;

(xi) the quantum and manner of fees payable by the client for each activity for which service is rendered by the portfolio manager directly or indirectly (where such service is outsourced);

(xii) custody of securities;

(xiii) in case of a discretionary portfolio manager a condition that the liability of a client shall not exceed his investment with the portfolio manager;

(xiv) the terms of accounts and audit and furnishing of the reports to the clients as per the provisions of these regulations; and

(xv) other terms of portfolio investment subject to these regulations.

The portfolio manager shall provide to the client, the Disclosure Document as specified in Schedule V, along with a certificate in Form C as specified in Schedule I, at least two days prior to entering into an agreement with the client.

(1). The Disclosure Document, shall *inter alia* contain the following –

(i) the quantum and manner of payment of fees payable by the client for each activity for which service is rendered by the portfolio manager directly or indirectly (where such service is outsourced);

(ii) portfolio risks;

(iii) complete disclosures in respect of transactions with related parties as per the accounting standards specified by the Institute of Chartered Accountants of India in this regard;

(iv) the performance of the portfolio manager :

Provided that the performance of a discretionary portfolio manager shall be calculated using weighted average method taking each individual category of investments for the immediately preceding three years and in such cases performance indicators shall also be disclosed;

(v) the audited financial statements of the portfolio manager for the immediately preceding three years.

The contents of the Disclosure Document would be certified by an independent chartered accountant.

The portfolio manager is required to file with SEBI, a copy of the Disclosure Document before it is circulated or issued to any person and every six months thereafter or whenever any material change is effected therein whichever is earlier, along with the certificate in Form C as specified in Schedule I. The portfolio manager shall ensure that the disclosure document is given to clients along with the account opening form atleast 2 days in advance of signing of the agreement. The portfolio manager shall charge an agreed fee from the clients for rendering portfolio management services without guaranteeing or assuring, either directly or indirectly, any return and the fee so charged may be a fixed fee or a return based fee or a combination of both.

The portfolio manager may, subject to the disclosure in terms of the Disclosure Document and specific permission from the client, charge such fees from the client for each activity for which service is rendered by the portfolio manager directly or indirectly (where such service is outsourced).

Responsibilities of a Portfolio Manager

Regulation 15 lays down that the discretionary portfolio manager shall individually and independently manage the funds of each client in accordance with the needs of a client in a manner which does not partake the character of a mutual fund, whereas the non discretionary portfolio manager shall manage the funds in accordance with the directions of the client. The responsibilities of a portfolio manager includes the following :

(a) The portfolio manager shall not accept from the client, funds or securities worth less than twenty five lacs rupees.

(b) The portfolio manager shall act in a fiduciary capacity with regard to the clients funds.

(c) The portfolio manager shall keep the funds of all clients in a separate account to be maintained by it in a Scheduled Commercial Bank.

(d) He shall transact in securities within the limitation placed by the client for dealing in securities under the provisions of RBI Act, 1934.

(e) He shall not derive any direct or indirect benefit out of the clients' funds or securities.

(f) The portfolio manager shall not borrow funds or securities on behalf of the client.

(g) The portfolio manager shall not lend securities held on behalf of client to a third person except as provided under the Regulations.

(h) The portfolio manger shall ensure proper and timely handling of complaints from the clients and take appropriate action immediately.

Investment of Clients Money

Regulation 16 provides that

(1) The money or securities accepted by the portfolio manager shall not be invested or managed by the portfolio manager except in terms of the agreement between the portfolio manager and the client.

(2) Any renewal of portfolio fund on maturity of the initial period shall be deemed as a fresh placement.

(3) The funds or securities can be withdrawn or taken back by the client before the maturity of the contract under the following circumstances, namely –

(a) voluntary or compulsory termination of portfolio management services by the portfolio manager or the client.

(b) suspension or cancellation of the certificate of registration of the portfolio manager by the SEBI.

(c) bankruptcy or liquidation of the portfolio manager.

(4) The portfolio manager shall invest funds of his clients in money market instruments or derivatives or as specified in the contract:

However, leveraging of portfolio shall not be permitted in respect of investment in derivatives. Further the portfolio manager shall not deploy the clients' funds in bill discounting, badla financing or for the purpose of lending or placement with corporate or non-corporate bodies. “Money market instruments” includes commercial paper, trade bill, treasury bills, certificate of deposit and usance bills.

(5) The portfolio manager shall not while dealing with clients' funds indulge in speculative transactions that is, he shall not enter into any transaction for purchase or sale of any security which is periodically or ultimately settled otherwise than by actual delivery or transfer of security except the transactions in derivatives.

(6) The portfolio manager shall, ordinarily purchase or sell securities separately for each client. However, in the event of aggregation of purchases or sales for economy of scale, *inter se* allocation shall be done on a *pro rata* basis and at weighted average price of the day's transactions. The portfolio manager shall not keep any open

position in respect of allocation of sales or purchases effected in a day. Any transaction of purchase or sale including that between the portfolio manager's own accounts and client's accounts or between two clients' accounts shall be at the prevailing market price.

(7) The portfolio manager shall segregate each clients' funds and portfolio of securities and keep them separately from his own funds and securities and be responsible for safekeeping of clients' funds and securities.

(8) The portfolio manager shall not hold the listed securities or unlisted securities belonging to the portfolio account, in its own name on behalf of its clients either by virtue of contract with clients or otherwise. The portfolio managers, may, subject to authorization by the client in writing, participate in securities lending.

Foreign institutional investors and sub accounts registered with SEBI may avail of the services of a portfolio manager.

(9) Every portfolio manager shall appoint a custodian in respect of securities managed or administered by it. However, this regulation shall not apply to a portfolio Manager who has total assets under management of value less than five hundred crore rupees; or who performs purely advisory functions.

Accounting by Portfolio Managers

Regulations 17 to 20 deal with books of accounts, records, accounts and audit.

Regulation 17 lays down that every portfolio manager shall keep and maintain the following books of accounts, records and documents, namely -a) a copy each of balance sheet, profit and loss account and the auditor's account in respect of each accounting period b) a statement of financial position and c) records in support of every investment transaction or recommendation which will indicate the data, facts and opinions leading to that investment decision. Every portfolio manager shall intimate to SEBI where the books of accounts, records or documents are maintained. Every portfolio manager shall after the end of each accounting period furnish to SEBI copies of the balance sheet, profit and loss account and such other documents as are required by the regulations for any other preceeding five accounting years. Regulation 18 provides that portfolio manager should furnish to SEBI half-yearly unaudited financial results when required by SEBI with a view to assist in monitoring the capital adequacy of the portfolio manager.

The portfolio manager shall preserve the books of account and other records and documents mentioned in any of the regulations mentioned under chapter III for a minimum period of five years.

Regulation 20 lays down that the portfolio manager shall maintain separate client-wise accounts. The funds received from the clients, investments or disinvestments and all the credits to the account of the client like interest, dividend, bonus or any other beneficial interest received on the investment and debits for expenses if any shall be properly accounted for and details thereof shall be reflected correctly in the clients accounts. The tax deducted at source as required under the Income Tax Act, 1961 shall be recorded in the portfolio account. The books of account will be audited by a qualified auditor to ensure that portfolio manager has followed proper accounting methods and procedures and that he has performed the duties in accordance with the law. A certificate to this effect shall, if so specified be submitted to SEBI within 6 months of the close of the portfolio managers accounting period.

The portfolio accounts of the portfolio manager shall be audited annually by an independent chartered accountant and a copy of the certificate issued by the chartered accountant shall be given to the client.

The client may appoint a chartered accountant to audit the books and accounts of the portfolio manager relating to his transactions and the portfolio manager shall co-operate with such chartered accountant in course of the audit.

Reports by Portfolio Manager to the Client

Regulation 21 lays down that the portfolio manager and as and when required by the client shall furnish periodically a report to the client as agreed to in the contract but not exceeding a period of 6 months and such report shall contain the following details, namely–

(a) the composition and the value of the portfolio, description of security, number of securities, value of each security held in a portfolio, cash balance and aggregate value of the portfolio as on the date of report.

(b) transactions undertaken during the period of report including date of transaction and details of purchases and sales.

(c) beneficial interest received during that period in respect of interest, dividend, bonus shares, rights shares and debentures.

(d) expenses incurred in managing the portfolio of the client.

(e) details of risk foreseen by the portfolio manager and the risk relating to the securities recommended by the portfolio manager for investment or disinvestment.

Regulation 21(1A) provides that the report may be made available on the website of the portfolio manager with restricted access to each client.

The portfolio manager shall in terms of agreement with the client also furnish to the client documents and information relating only to the management of a portfolio. On termination of the contract, the portfolio manager shall give a detailed statement of accounts to the client and settle the account with the client as agreed in the contract. The client has the right to obtain details of his portfolio from the portfolio managers.

Action on Auditor's Report and Disclosure to SEBI

Every portfolio manager shall within two months from the date of the auditor's report take steps to rectify the deficiencies made out in such report. A portfolio manager shall disclose to SEBI as and when required the information, namely - particulars regarding the management of a portfolio; any change in the information or particulars previously furnished; which have a bearing on the certificate granted to him; the names of the clients whose portfolio he has managed; and particulars relating to the capital adequacy requirement.

Compliance Officer

Regulation 23A provides that every portfolio manager is required to appoint a compliance officer responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions *etc.* issued by SEBI or the Central Government and for redressal of investors' grievances. The compliance officer should independently and immediately report to SEBI for any non-compliance observed by him.

Inspection and Disciplinary Proceedings

Regulations 24 to 29 contain provisions related to inspection and disciplinary proceedings by SEBI.

Regulation 24 empowers SEBI to appoint one or more persons as inspecting authority to undertake the inspection of the books of accounts, records and documents of the portfolio manager to ensure that they are being maintained in the manner required, that the provisions of the Act, Rules and Regulations are being complied with. The inspecting authority shall investigate into the complaints received from the investors, other portfolio managers or any other person on any matter having a bearing on the activities of the portfolio manager and investigate *suo motu* in the interest of securities business or investors interest into the affairs of the portfolio manager.

Obligations of Portfolio Manager

(1) It shall be the duty of every director, proprietor, partner, officer and employee of the portfolio manager who is being inspected, to produce to the inspecting authority such books of accounts and documents in his custody or

control and furnish him with the statements and information relating to these activities within such time as the inspecting authority may require.

(2) The portfolio manager shall allow the inspecting authority to have reasonable access to the premises occupied by the former or by any other person on his behalf and also extend reasonable facility for examining any books, records, documents and computer data in his possession or in the possession of any other person and also provide copies of documents or other material which in the opinion of the inspecting authority are relevant for the purposes of the inspection.

(3) In the course of inspection, the inspecting authority shall be entitled to examine or record statements of any principal officer, director, partner, proprietor and employee of the portfolio manager.

(4) It shall be the duty of each such person to give to the inspecting authority all assistance in connection with the inspection which the portfolio manager may reasonably be expected to give.

The inspecting authority shall submit an inspection report to SEBI as soon as it is possible. SEBI or the chairman shall after consideration of the inspection or investigation report take such action as SEBI or its chairman may deem fit and appropriate including action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

Liability for Action in Case of Default

A portfolio manager who contravenes any of the provisions of the Act, Rules or Regulations framed there under shall be liable for one or more action specified therein including the action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

INTERNAL AUDIT OF PORTFOLIO MANAGER

Every Portfolio manager is required to appoint a Practising Company Secretary or a Practising Chartered Accountant for conducting the internal audit. The Portfolio manager is required to report the compliance of the aforesaid requirement to SEBI while submitting the half yearly report.

The report is to be submitted twice a year, as on 31st of March and 30th of September. The report should reach SEBI within thirty days of the period to which it relates.

No precise period has been prescribed for the PCS to submit his report to the Board of the company. However, it would be advisable for the PCS to give the audit report to the Portfolio Manager sufficiently well in advance to enable the Company to report the compliance of the same to SEBI.

The scope of the internal audit would comprise the checking of compliance of SEBI (Portfolio Managers) Regulations 1993 and circulars notifications or guidelines issued by SEBI and internal procedures followed by the Portfolio Manager.

CUSTODIAN OF SECURITIES

Custodian of securities means any person who carries on or proposes to carry on the business of providing custodial services. The term “custodial services” in relation to securities of a client or gold or gold related instruments held by a mutual fund in accordance with the SEBI (Mutual Funds) Regulations, 1996 means safekeeping of securities or gold or gold related instruments or title deeds of real estate assets and providing services incidental thereto, and includes –

(i) maintaining accounts of securities or gold or gold related instruments or title deeds of real estate assets of a client;

(ii) undertaking activities as a Domestic Depository in terms of the Companies (Issue of Indian Depository Receipts) Rules, 2004.

(iii) collecting the benefits or rights accruing to the client in respect of securities or gold or gold related instruments; or title deeds or real estate assets

(iv) keeping the client informed of the actions taken or to be taken by the issuer of securities, having a bearing on the benefits or rights accruing to the client; and

(v) maintaining and reconciling records of the services referred to in points (i) to (iii).

SEBI (CUSTODIAN OF SECURITIES) REGULATIONS, 1996

In exercise of the powers conferred by section 30 of SEBI Act, 1992 notified the SEBI (Custodian of Securities) Regulations, 1996 on May 16, 1996.

Chapter I contains preliminary matters and Chapter II consisting Regulations 3 to 11 relating to procedure for registeration of custodian.

Application for Grant of Certificate

Regulation 3(1) provides that any person proposing to carry on business as custodian of securities on or after the commencement of these regulations shall make an application to SEBI for grant of a certificate. SEBI may, however in special cases, where it is of the opinion that it is necessary to do so for reasons to be recorded in writing, may extend the period upto a maximum of six months from the date of such commencement.

Any person who fails to make an application for grant of certificate within the period or the extended period specified therein, shall cease to carry on any activity as custodian of securities and shall be subject to the directions of SEBI with regard to the transfer of records, documents or securities relating to his activities as custodian of securities.

Application to Conform to Requirements

An application which is not complete in all respects or which does not conform to the instructions specified therein will be rejected. However before rejecting any such application, SEBI would give the applicant an opportunity to remove the objection, within such time as may be specified.

Furnishing of Information

SEBI may require the applicant to furnish such further information or clarification regarding matters relevant to the activities of a custodian of securities for the purpose of consideration of the application. The applicant or his authorised representative may, if so required, appear before SEBI for personal representation, in connection with the grant of certificate.

Consideration of Application for Grant of Certificate

SEBI, while granting the Certificate shall take into account following matters which are relevant to the activities of a custodian of securities:

(a) the applicant fulfils the capital requirement;

(b) the applicant has the necessary infrastructure, including adequate office space, vaults for safe custody of securities and computer systems capability, required to effectively discharge his activities as custodian of securities;

(c) the applicant has the requisite approvals under any law for the time being in force, in connection with providing custodial services in respect of gold or gold related instruments of a mutual fund, or title deeds of real estate assets held by a real state mutual funds scheme where applicable;

(d) the applicant has in his employment adequate and competent persons who have the experience, capacity and ability of managing the business of the custodian of securities;

(e) the applicant has prepared a complete manual, setting out the systems and procedures to be followed by him for the effective and efficient discharge of his functions and the arms length relationships to be maintained with the other businesses, if any, of the applicant;

(f) the applicant is a person who has been refused a certificate by SEBI or whose certificate has been cancelled by SEBI;

(g) the applicant, his director, his principal officer or any of his employees is involved in any litigation connected with the securities market;

(h) the applicant, his director, his principal officer or any of his employees has at any time been convicted of any offence involving moral turpitude or of any economic offence;

(i) the applicant is a fit and proper person; and

(j) the grant of certificate is in the interest of investors.

Also SEBI shall not consider an application unless the applicant is a body corporate.

Capital Requirement

Regulation 7(1) provides for the capital adequacy requirement. It provides that the applicant must have a net worth of a minimum of rupees fifty crores. The term "net worth" means the paid up capital and the free reserves as on the date of the application. Any applicant is permitted to fulfil his capital adequacy requirements within one month of the receipt of certificate.

Procedure and Grant of Certificate

Regulation 8(1) provides that after considering the application, if SEBI is satisfied that all particulars sought have been furnished and the applicant is eligible for the grant of a certificate, it will send an intimation of the same to the applicant.

On receipt of an intimation the applicant shall pay to SEBI specified registration fee. SEBI shall thereafter grant a certificate to the applicant on receipt of the registration fee. It has been provided that SEBI may restrict the certificate of registration to provide custodial services either in respect of securities or in respect of gold or gold related instruments of a client or title deeds of real estate assets held by a real estate mutual fund scheme.

A custodial of securities holding a certificate of registration may provide custodial services in respect of gold or gold related instruments of a mutual fund and in respect of title deeds of real estate assets held by a real estate mutual fund scheme, only after taking prior approval of the SEBI.

Conditions of Certificate

The certificate granted to the custodian of securities may be subject to the following conditions, namely:

(a) it shall not commence any activities as custodian of securities unless it fulfils the capital requirement;

(b) it shall abide by the provisions of the Act and these regulations in the discharge of its functions as custodian of securities;

(c) it shall enter into a valid agreement with its client for the purpose of providing custodial services;

(d) it shall pay annual fees as specified in these regulations;

(e) if any information previously submitted by it to SEBI is found by it to be false or misleading in any material particular, or if there is any change in such information, it shall forthwith inform SEBI in writing; and

(f) besides providing custodial services, it shall not carry on any activity other than activities relating to rendering of financial services.

Period of Validity

Regulation 9A of the Regulations provide that every certificate granted under these regulation shall be valid for a period of three years from the date of grant.

Renewal of Certificate

Regulation 9B provides that a custodian of securities, desirous of having its certificate renewed shall make an application to SEBI for renewal of the certificate in Form A, not less than three months before the expiry of its period of validity under Regulation 9A. The application for renewal of certificate shall be dealt with, as far as may be, as if it were an application for the grant of a fresh certificate and shall be accompanied with the application fee as specified in Schedule II.

Procedure where Certificate is not Granted

Regulation 10(1) lays down that after considering an application for grant of certificate, if SEBI is satisfied that a certificate should not be granted, SEBI may reject the application after giving the applicant a reasonable opportunity of being heard.

The decision of SEBI rejecting the application shall be communicated within thirty days of such decision to the applicant in writing, stating therein the grounds on which the application has been rejected. An applicant, aggrieved by the decision of SEBI may within a period of thirty days from the date of receipt of communication apply to SEBI for re-consideration of its decision.

SEBI shall, as soon as possible, in the light of the submissions made in the application for re-consideration and after giving the applicant a reasonable opportunity of being heard, convey its decision in writing to the applicant.

Effect of Refusal to Grant Certificate

Any custodian of securities whose application for grant of certificate has been rejected by SEBI shall, on and from the date of the receipt of the communication ceases to carry on any activity as custodian of securities and shall be subject to the directions of SEBI with regard to the transfer of records, documents or securities that may be in its custody or control relating to its activity as custodian of securities.

Code of conduct

Every custodian of securities shall abide by the Code of Conduct as specified in the Third Schedule to the Regulations.

Segregation of Activities

Regulation 13 provides that where a custodian of securities is carrying on any activity besides that of acting as custodian of securities, then the activities relating to his business as custodian of securities shall be separate and segregated from all other activities and its officers and employees engaged in providing custodial services shall not be engaged in any other activity carried on by him.

Mechanism for Monitoring Review

Regulation 14(1) provides that every custodian of securities shall have adequate mechanisms for the purposes of reviewing, monitoring and evaluating the custodian’s controls, systems, procedures and safeguards. The custodian of securities shall cause to be inspected annually the mechanism by an expert and forward the inspection report to SEBI within three months from the date of inspection.

Prohibition of Assignment

No custodian of securities shall assign or delegate its functions as a custodian of securities to any other person unless such person is a custodian of securities.

However, a custodian of securities may engage the services of a person not being a custodian, for the purpose of physical safekeeping of gold belonging to its client being a mutual fund having a gold exchange traded fund scheme, subject to the following conditions:

(a) the custodian shall remain responsible in all respects to its client for safekeeping of the gold kept with such other person, including any associated risks;

(b) all books, documents and other records relating to the gold so kept with the other person shall be maintained in the premises of the custodian or if they are not so maintained, they shall be made available therein, if so required by SEBI;

(c) the custodian of securities shall continue to fulfil all duties to the clients relating to the gold so kept with the other person, except for its physical safekeeping.

Separate Custody Account

Every custodian of securities is required to open a separate custody account for each client, in the name of the client whose securities are in its custody and ensure that the assets of one client would not be mixed with those of another client.

Agreement with the Client

Every custodian of securities is required to enter into an agreement with each client on whose behalf it is acting as custodian of securities and every such agreement shall provide for the following matters, namely:

(a) the circumstances under which the custodian of securities will accept or release securities, assets or documents from the custody account;

(b) the circumstances under which the custodian of securities will accept or release monies from the custody account.

(c) the circumstances under which the custodian of securities will receive rights or entitlements on the securities of the client;

(d) the circumstances and the manner of registration of securities in respect of each client;

(e) details of the insurance, if any, to be provided for by the custodian of securities.

Internal Controls

Every custodian of securities is required to have adequate internal controls to prevent any manipulation of records and documents, including audits for securities and rights or entitlements arising from the securities held by it on behalf of its client. Every custodian of securities would take appropriate safekeeping measures to ensure that such securities, assets or documents are protected from theft and natural hazard.

Maintenance of Records and Documents

Regulation 19(1) provides that every custodian of securities is required to maintain the following records and documents, containing details of:

(a) securities, assets or documents received and released on behalf of each client;

(b) monies received and released on behalf of each client;

(c) rights or entitlements of each client arising from the securities held on behalf of the client;

(d) registration of securities in respect of each client;

(e) ledger for each client;

(f) instructions received from and sent to clients; and records of all reports submitted to SEBI.

The Custodian of securities would intimate to SEBI the place where the records and documents are maintained and custodian of securities shall preserve the records and documents maintained for a minimum period of five years.

Appointment of Compliance Officer

Regulation 19A(1) provides that every custodian of securities would appoint a compliance officer responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions *etc.* issued by SEBI or the Central Government. He is under an obligation for redressal of investors' grievances.

The compliance officer is required to immediately and independently report to SEBI any non-compliance observed by him.

Information to SEBI

SEBI may, at any time, call for any information from a custodian of securities with respect to any matter relating to its activity as custodian of securities. Where any information is called for by SEBI, it shall be the duty of the custodian of securities to furnish such information, within such reasonable period as SEBI may specify.

Inspection and Audit

SEBI may appoint one or more persons as inspecting officer to undertake inspection of the books of accounts, records and documents of the custodian of securities for any of the following purposes, namely:

(a) to ensure that the books of account, records and documents are being maintained by the custodian of securities in the manner specified in these regulations;

(b) to investigate into complaints received from investors, clients or any other person, on any matter having a bearing on the activities of the custodian of securities;

(c) to ascertain whether the provisions of the Act and these regulations are being complied with by the custodian of securities; and

(d) to investigate *suo moto* into the affairs of the custodian of securities, in the interest of the securities market or in the interest of investors.

Obligations of Custodian

It is the duty of the custodian of securities whose affairs are being inspected, and of every director, officer and employee thereof, to produce to the inspecting officer such books, securities, accounts, records and other documents in its custody or control and furnish him with such statements and information relating to his activities of the custodian of securities, as the inspecting officer may require, within such reasonable period as the inspecting officer may specify.

The custodian of securities is required to allow the inspecting officer to have reasonable access to the premises occupied by such custodian or by any other person on his behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the custodian of securities or such other person and also provide copies of documents or other materials which, in the opinion of the inspecting officer are relevant for the purposes of the inspection.

The inspecting officer, in the course of inspection, is entitled to examine or to record the statements of any director, officer or employee of the custodian of securities. It is the duty of every director, officer or employee of the custodian of securities to give to the inspecting officer all assistance in connection with the inspection, which the inspecting officer may reasonably require.

Liability for Action in Case of Default

A custodian of securities who contravenes any of the provisions of the Act, the rules framed there under or these regulations or fails to furnish any information relating to his activity as custodian of securities as required by SEBI or furnishes to SEBI information which is false and misleading in any material particular or does not submit periodic returns or reports as required by SEBI or does not co-operate in any enquiry or inspection conducted by SEBI or fails to update its systems and procedures as recommended by SEBI or fails to resolve the complaints of clients or fails to give a satisfactory reply to SEBI in this behalf or is guilty of misconduct or makes a breach of the Code of Conduct specified in the Third Schedule or fails to pay annual fees, shall be dealt with in the manner provided under Chapter V of SEBI (Intermediaries) Regulations, 2008.

INVESTMENT ADVISER

"Investment Adviser" means any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called.

"Investment advice" means advice relating to investing in, purchasing, selling or otherwise dealing in securities or investment products, and advice on investment portfolio containing securities or investment products, whether written, oral or through any other means of communication for the benefit of the client and shall include financial planning.

However, investment advice given through newspaper, magazines, any electronic or broadcasting or telecommunications medium, which is widely available to the public shall not be considered as investment advice for the purpose of these regulations;

SEBI (INVESTMENT ADVISERS) REGULATIONS, 2013

In exercise of the powers conferred by sub-section (1) of Section 30 read with clause (b) of sub-section (2) of Section 11 of SEBI Act, 1992, SEBI framed these regulations.

Registration of Investment Advisers

Regulation 3 deals with the application for grant of certificate by SEBI. A person shall not act as an investment adviser or hold itself out as an investment adviser unless he has obtained a certificate of registration from SEBI.

An application for grant of certificate of registration shall be made in the prescribed form and shall be accompanied with a non-refundable application fee to be paid in the manner specified in these regulations.

Exemption from registration

Regulation 4 provides that certain persons are exempted from the requirement of registration under Regulation 3 subject to the fulfilment of the conditions stipulated therefore, –

(a) Any person who gives general comments in good faith in regard to trends in the financial or securities market or the economic situation where such comments do not specify any particular securities or investment product;

(b) Any insurance agent or insurance broker who offers investment advice solely in insurance products and is registered with Insurance Regulatory and Development Authority for such activity;

(c) Any pension advisor who offers investment advice solely on pension products and is registered with Pension Fund Regulatory and Development Authority for such activity;

(d) Any distributor of mutual funds, who is a member of a self regulatory organisation recognised by SEBI or is registered with an association of asset management companies of mutual funds, providing any investment advice to its clients incidental to its primary activity;

(e) Any advocate, solicitor or law firm, who provides investment advice to their clients, incidental to their legal practise;

(f) Any member of Institute of Chartered Accountants of India, Institute of Company Secretaries of India, Institute of Cost and Works Accountants of India, Actuarial Society of India or any other professional body as may be specified by SEBI, who provides investment advice to their clients, incidental to his professional service;

(g) Any stock broker or sub-broker registered under SEBI (Stock Broker and Sub-Broker) Regulations, 1992, portfolio manager registered under SEBI (Portfolio Managers) Regulations, 1993 or merchant banker registered under SEBI (Merchant Bankers) Regulations, 1992, who provides any investment advice to its clients incidental to their primary activity:

However, such intermediaries shall comply with the general obligation(s) and responsibilities as specified in Chapter III of these regulations. Further the existing portfolio manager offering only investment advisory services may apply for registration under these regulations after expiry of his current certificate of registration as a portfolio manager;

(h) Any fund manager, by whatever name called of a mutual fund, alternative investment fund or any other intermediary or entity registered with SEBI;

(i) Any person who provides investment advice exclusively to clients based out of India: However, persons providing investment advice to Non-Resident Indian or Person of Indian Origin shall fall within the purview of these regulations;

(j) Any representative and partner of an investment adviser which is registered under these regulations. However, such representative and partner shall comply with these regulations;

(k) Any other person as may be specified by SEBI.

Qualification & Certification

– Investment Advisers are required to hold a professional qualification or a post-graduate degree or post graduate diploma in finance, accountancy, business management, commerce, economics, capital market, banking, insurance or actuarial science, from a university or an institution recognised by the Central Government or any State Government or a recognised foreign university or institution or association. Alternatively, advisers having a graduate degree in any discipline with experience of at least five years in activities relating to advice in financial products financial advisory or securities or fund or asset or portfolio management are also qualified to be apply.

– Investment Advisers, their partners and their representatives should have a certification on financial planning or fund or asset or portfolio management or investment advisory services from NISM or from any other organization or institution including Financial Planning Standards Board India (FPSB) or stock exchange in India provided that such certification is accredited by NISM.

– Existing investment advisers and their representatives seeking registration under these regulations will have to obtain certification within two years from the date of commencement of advisor regulations. Investment advisers whose existing certificates which are due for expiry need to also obtain the above mentioned certification to continue their practice.

Capital adequacy

SEBI has also laid down capital adequacy requirements for corporate and individual distributors. Corporate distributors will require a minimum net worth of ₹ 25 lakh while individuals and partnership firms will require to posses tangible assets worth at least ₹ 1 lakh.

Registration

After complying with the investment advisers regulations, Investment advisers would need to register with SEBI by paying a non-refundable application fee of ₹ 5,000. Individual advisors will have to shell out a registration fee of ₹ 10,000 while a corporate will have to cough up ₹ 1 lakh in addition to the application fee. This certificate will be valid for a period of five years.

General Obligations and Responsibilities

Regulation 15 deals with the general obligation of Investment Advisers which are as follow:

- An investment adviser shall act in a fiduciary capacity towards its clients and shall disclose all conflict of interests as and when they arise.
- An investment adviser shall not receive any consideration by way of remuneration or compensation or in any other form from any person other than the client being advised, in respect of the underlying products or securities for which advice is provided.
- An investment adviser shall maintain an arms-length relationship between its activities as an investment adviser and other activities.
- An investment adviser which is also engaged in activities other than investment advisory services shall ensure that its investment advisory services are clearly segregated from all its other activities.
- An investment adviser shall ensure that in case of any conflict of interest of the investment advisory activities with other activities, such conflict of interest shall be disclosed to the client.
- An investment adviser shall not divulge any confidential information about its client, which has come to its knowledge, without taking prior permission of its clients, except where such disclosures are required to be made in compliance with any law for the time being in force.
- An investment advisor shall not enter into transactions on its own account which is contrary to its advice given to clients for a period of fifteen days from the day of such advice.

However, during the period of such fifteen days, if the investment adviser is of the opinion that the situation has changed, then it may enter into such a transaction on its own account after giving such revised assessment to the client at least 24 hours in advance of entering into such transaction.

- An investment advisor shall follow Know Your Client procedure as specified by SEBI from time to time.
- An investment adviser shall abide by Code of Conduct as specified in Third Schedule.
- An investment adviser shall not act on its own account, knowingly to sell securities or investment products to or purchase securities or investment product from a client.
- In case of change in control of the investment adviser, prior approval from SEBI shall be taken.
- Investment advisers shall furnish to SEBI information and reports as may be specified by SEBI from time to time.
- It shall be the responsibility of the Investment Adviser to ensure that its representatives and partners, as applicable, comply with the certification and qualification requirements under these Regulation at all times.

Maintenance of records

Regulation 19 provides that an investment adviser shall maintain the following records,

(a) Know Your Client records of the client;

(b) Risk profiling and risk assessment of the client;

(c) Suitability assessment of the advice being provided;

(d) Copies of agreements with clients, if any;

(e) Investment advice provided, whether written or oral;

(f) Rationale for arriving at investment advice, duly signed and dated;

(g) A register or record containing list of the clients, the date of advice, nature of the advice, the products/ securities in which advice was rendered and fee, if any charged for such advice.

All records shall be maintained either in physical or electronic form and preserved for a minimum period of five years. However, where records are required to be duly signed and are maintained in electronic form, such records shall be digitally signed.

Liability for action in case of default

An investment adviser who –

(a) contravenes any of the provisions of the Act or any regulations or circulars issued thereunder;

(b) fails to furnish any information relating to its activity as an investment adviser as required by SEBI;

(c) furnishes to SEBI information which is false or misleading in any material particular;

(d) does not submit periodic returns or reports as required by SEBI;

(e) does not co-operate in any enquiry, inspection or investigation conducted by the SEBI;

(f) fails to resolve the complaints of investors or fails to give a satisfactory reply to SEBI in this behalf,

shall be dealt with in the manner provided under the Securities and Exchange Board of India (Intermediaries) Regulations, 2008

Audit of Investment Adviser

According to Regulation 19(3) an investment adviser shall conduct yearly audit in respect of compliance with these regulations from a member of Institute of Chartered Accountant of India or Institute of Company Secretaries of India.

SEBI (CREDIT RATING AGENCIES) REGULATIONS, 1999

SEBI regulations for Credit Rating Agencies (CRAs) cover rating of securities only and not rating of fixed deposits, foreign exchange, country ratings, real estates *etc.* CRAs can be promoted by public financial institutions, scheduled commercial banks, foreign banks operating in India, foreign credit rating agencies recognised in the country of their incorporation, having at least five years experience in rating, or any company or a body corporate having continuous net worth of minimum ₹100 crore for the previous five years. CRAs would be required to have a minimum net worth of ₹ 5 crore. A CRA cannot rate a security issued by its promoter. No Chairman, Director or Employee of the promoters shall be Chairman, Director or Employee of CRA or its rating committee. A CRA cannot rate securities issued by any borrower, subsidiary, an associate promoter of CRA, if there are common Chairman, Directors and Employees between the CRA or its rating committee and these entities. A CRA cannot rate a security issued by its associate or subsidiary if the CRA or its rating committee has a Chairman, Director or Employee who is also a Chairman, Director or Employee of any such entity. CRAs would have to carry out periodic reviews of the ratings given during the lifetime of the rated instrument. For ensuring that corporates provide correct/ adequate information to CRAs, a clause would be incorporated in the listing agreement of the stock exchanges requiring the companies to co-operate with the rating agencies in giving correct and adequate information. Issuers coming out with a public/rights issue of debt securities would be required to incorporate an undertaking in the offer document promising necessary co-operation with the rating agency in providing true and adequate information.

Registration of Credit Rating Agencies

(1) Any person proposing to commence any activity as a credit rating agency should make an application to SEBI for the grant of a certificate of registration for the purpose.

(2) Any person, who before the said date carrying on any activity as a credit rating agency, should make an application to SEBI for the grant of a certificate within a period of three months from such date. However, SEBI may, where it is of the opinion that it is necessary to do so, for reasons to be recorded in writing, extend the said period upto a maximum of six months from such date.

(3) An application for the grant of a certificate should be made to SEBI accompanied by a non-refundable specified application fee.

(4) Any person who fails to make an application for the grant of a certificate within the period specified in that sub-regulation, ceases to carry on rating activity.

Promoter of Credit Rating Agency

SEBI should not consider an application unless the applicant is promoted by a person belonging to any of the following categories, namely:

(i) a public financial institution;

(ii) a scheduled commercial bank;

(iii) a foreign bank operating in India with the approval of the Reserve Bank of India;

(iv) a foreign credit rating agency recognized under Indian Law and having at least five years experience in rating securities;

(v) any company or a body corporate, having continuous net worth of minimum rupees one hundred crores as per its audited annual accounts for the previous five years in relation to the date on which application to SEBI is made seeking registration.

Eligibility Criteria

SEBI shall not consider an application for the grant of a certificate unless the applicant satisfies the following conditions, namely:

(a) the applicant is set up and registered as a company under the Companies Act, 2013;

(b) the applicant has, in its Memorandum of Association, specified rating activity as one of its main objects;

(c) the applicant has a minimum net worth of ₹ 5 crores. However a credit rating agency existing at the commencement of these regulations, with a net worth of less than ₹ 5 crores, shall be deemed to have satisfied this condition, if it increases its net worth to the said minimum within a period of three years of such commencement.

(d) the applicant has adequate infrastructure, to enable it to provide rating services in accordance with the provisions of the Act and these regulations;

(e) the applicant and the promoters of the applicant, have professional competence, financial soundness and general reputation of fairness and integrity in business transactions, to the satisfaction of SEBI;

(f) neither the applicant, nor its promoter, nor any director of the applicant or its promoter, is involved in any legal proceeding connected with the securities market, which may have an adverse impact on the interests of the investors;

(g) neither the applicant, nor its promoters, nor any director, or its promoter has at any time in the past been convicted of any offence involving moral turpitude or any economic offence;

(h) the applicant has, in its employment, persons having adequate professional and other relevant experience to the satisfaction of the SEBI;

(i) neither the applicant, nor any person directly or indirectly connected with the applicant has in the past been –

   (i) refused by SEBI a certificate under these regulations or

   (ii) subjected to any proceedings for a contravention of the Act or of any rules or regulations made under the Act.

(j) the applicant, in all other respects, is a fit and proper person for the grant of a certificate;

(k) grant of certificate to the applicant is in the interest of investors and the securities market.

Application to Conform to the Requirements

Any application for a certificate, which is not complete in all respects or does not conform to the requirement or instructions as specified should be rejected by SEBI. However before rejecting any application, the applicant should be given an opportunity to remove, within thirty days of the date of receipt of relevant communication, from SEBI such objections as may be indicated by SEBI. It has been further provided that SEBI may on sufficient reason being shown, extend the time for removal of objections by such further time, not exceeding thirty days to enable the applicant to remove such objections.

Furnishing of Information, Clarification and Personal Representation

SEBI may require the applicant to furnish such further information or clarification as it considers necessary, for the purpose of processing of the application. SEBI if so desires, may ask the applicant or its authorised representative to appear before it for personal representation in connection with the grant of a certificate.

Grant of Certificate

SEBI grants a certificate after getting satisfied that the applicant is eligible for the grant of a certificate of registration. The grant of certificate of registration should be subject to the payment of the specified registration fee in the manner prescribed.

Conditions of Certificate

The certificate granted is subject to the condition that the credit rating agency complies with the provisions of the Act, the regulations made thereunder and the guidelines, directives, circulars and instructions issued by SEBI from time to time on the subject of credit rating. The credit rating agency should forthwith inform SEBI in writing where any information or particulars furnished to SEBI by a credit rating agency is found to be false or misleading in any material particular; or has undergone change subsequently to its furnishing at the time of the application for a certificate. The period of validity of certificate of a registeration shall be three years.

Procedure where Certificate is not granted

SEBI may reject the application if after considering the application it is of the opinion that a certificate should not be granted or renewed, after giving the applicant a reasonable opportunity of being heard. The decision of SEBI not to grant or not to renew the certificate should be communicated by SEBI to the applicant within a period of thirty days of such decision, stating the grounds of the decision. Any applicant aggrieved by the decision of SEBI rejecting his application may, within a period of thirty days from the date of receipt by him of the communication apply to SEBI in writing for re-consideration of such decision. Where an application for re-consideration is made, SEBI should consider the application and communicate to the applicant its decision in writing, as soon as may be.

Effect of Refusal to Grant Certificate

An applicant whose application for the grant of a certificate has been rejected should not undertake any rating activity. An applicant, whose application for the grant of a certificate has been rejected by SEBI, should on and from the date of the receipt of the communication cease to carry on any rating activity. If SEBI is satisfied that it is in the interest of the investors, it may permit the credit rating agency to complete the rating assignments already entered into by it, during the pendency of the application or period of validity of the certificate. SEBI in order to protect the interest of investors may issue directions with regard to the transfer of records, documents or reports relating to the activities of a credit rating agency, whose application for the grant or renewal of a certificate has been rejected and for this purpose also determines the terms and conditions of such appointment.

Code of Conduct

Every credit rating agency is required to abide by the following terms of the Code of Conduct as per SEBI Regulations:

(1) A credit rating agency in the conduct of its business should observe high standards of integrity, dignity and fairness in all its dealings with its clients.

(2) A credit rating agency should fulfil its obligations in an ethical manner.

(3) A credit rating agency should render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgement. It shall wherever necessary, disclose to the clients, possible sources of conflict of duties and interests, while providing unbiased services.

(4) The credit rating agency should avoid any conflict of interest of any member of its rating committee participating in the rating analysis. Any potential conflict of interest shall be disclosed to the client.

(5) A credit rating agency should not indulge in unfair competition nor they wean away client of any other rating agency on assurance of higher rating.

(6) A credit rating agency should not make any exaggerated statement, whether oral or written, to the client either about its qualification or its capability to render certain services or its achievements in regard to services rendered to other clients.

(7) A credit rating agency should always endeavour to ensure that all professional dealings are effected in a prompt and efficient manner.

(8) A credit rating agency should not divulge to other clients, press or any other party any confidential information about its client, which has come to its knowledge, without making disclosure to the concerned person of the rated company/client.

(9) A credit rating agency should not make untrue statement or suppress any material fact in any documents, reports, papers or information furnished to SEBI or to public or to stock exchange.

(10) A credit rating agency should not generally and particularly in respect of issue of securities rated by, it be a party –

(a) to creation of false market

(b) passing of price sensitive information to brokers, members of the stock exchanges, other players in the capital market or to any other person or take any other action which is unethical or unfair to the investors.

(11) A credit rating agency should maintain an arm's length relationship between its credit rating activity and any other activity. A credit rating agency or any of his employees should not render directly or indirectly any investment advice about any security in the publicly accessible media, whether real-time or non-real time, unless a disclosure of his interest including long or short position in the said security has been made, while rendering such advice. In case an employee of the credit rating agency is rendering such advice, he should also disclose the interest of his dependent family members and the employer including their long or short in the said security, while rendering such advice.

(12) A credit rating agency is required to abide by the provisions of the Act, regulations and circulars which may be applicable and relevant to the activities carried on by the credit rating agency.

Agreement with the Client

Every credit rating agency is required to enter into a written agreement with each client whose securities it proposes to rate, and every such agreement should include the following provisions, namely:

(a) the rights and liabilities of each party in respect of the rating of securities shall be defined;

(b) the fee to be charged by the credit rating agency shall be specified;

(c) the client shall agree to a periodic review of the rating by the credit rating agency during the tenure of the rated instrument and to co-operate with the credit rating agency in order to enable the latter to arrive at, and maintain, a true and accurate rating of the clients' securities and shall in particular provide to the latter, true, adequate and timely information for the purpose;

(d) the credit rating agency shall disclose to the client the rating assigned to the securities of the latter through regular methods of dissemination, irrespective of whether the rating is or is not accepted by the client;

(e) the client shall agree to disclose the rating assigned to the client's listed securities by any credit rating agency during the last three years and any rating given in respect of the client's securities by any other credit rating agency, which has not been accepted by the client in the offer document;

(f) the client shall agree to obtain a rating for any issue of debt securities in accordance with the relevant regulations

Monitoring of Ratings

Credit rating agency should during the lifetime of securities rated by it continuously monitor the rating of such securities. It should also disseminate information regarding newly assigned ratings, and changes in earlier rating promptly through press releases and websites, and, in the case of securities issued by listed companies, such information should also be provided simultaneously to the concerned stock exchanges where the said securities are listed.

Procedure for Review of Rating

Every credit rating agency should carry out a periodic review of all published ratings during the lifetime of the securities. If the client does not co-operate with the credit rating agency so as to enable the credit rating agency to comply with its obligations, the credit rating agency should carry out the review on the basis of the best available information.

However, it has been provided that if owing to such lack of co-operation, a rating has been based on the best available information, the credit rating agency should disclose to the investors the fact that the rating is so based. A credit rating agency should not withdraw a rating so long as the obligations under the security rated by it are outstanding, except where the company whose security is rated is wound up or merged or amalgamated with another company.

Internal Procedures to be Framed

Credit rating agency should frame appropriate procedures and systems for monitoring the trading of securities by its employees in the securities of its clients, in order to prevent contravention of SEBI (Insider Trading) Regulations, 1992; SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 2003; and other laws relevant to trading of securities.

Disclosure of Rating Definitions

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

Submission of Information

In case any information is called for by SEBI from a credit rating agency including any report relating to its activities, the credit rating agency is required to furnish such information to SEBI within a period specified or if no such period is specified, then within a reasonable time. It should also furnish to SEBI, copies of its balance sheet and profit and loss account at the close of each accounting period,

Every credit rating agency is required to comply with such guidelines, directives, circulars and instructions as issued by SEBI from time to time.

Appointment of Compliance Officer

It is under an obligation to appoint a compliance officer who will be responsible for monitoring the compliance of the Act, Rules and Regulations, notifications, guidelines, instructions *etc.* issued by SEBI or the Central Government. The compliance officer should immediately and independently report to SEBI any non-compliance observed by him.

Maintenance of Books of Accounts Records, *etc.*

Credit rating agency should keep and maintain, for a minimum period of five years, the following books of accounts, records and documents, namely:

(i) copy of its balance sheet, as on the end of each accounting period;

(ii) a copy of its profit and loss account for each accounting period;

(iii) a copy of the auditor's report on its accounts for each accounting period.

(iv) a copy of the agreement entered into, with each client;

(v) information supplied by each of the clients;

(vi) correspondence with each client;

(vii) ratings assigned to various securities including upgradation and down gradation (if any) of the ratings so assigned;

(viii) rating notes considered by the rating committee;

(ix) record of decisions of the rating committee;

(x) letter assigning rating;

(xi) particulars of fees charged for rating and such other records as SEBI may specify from time to time.

Credit rating agency is required to intimate to SEBI, the place where the books of account, records and documents required to be maintained under these regulations are being maintained.

Steps on Auditor's Report

Credit rating agency should within two months from the date of the auditor's report, take steps to rectify the deficiencies if any, made out in the auditor's report, insofar as they relate to the activity of rating of securities.

Confidentiality

Every credit rating agency shall treat, as confidential, information supplied to it by the client and no credit rating agency shall disclose the same to any other person, except where such disclosure is required under any law.

Rating Process

Credit rating agency should specify the rating process and file a copy of the same with SEBI for its record and also file with SEBI any modifications or additions made therein from time to time. It should in all cases follow a proper rating process. Credit rating agency is required to have professional rating committees, comprising of members who are adequately qualified and equipped with the knowledge to assign a rating. All rating decisions, including the decisions regarding changes in rating, should be taken by the rating committee. Credit rating agency should be staffed by analysts qualified to carry out a rating assignment. Credit rating agency should inform SEBI about new rating instruments or symbols introduced by it. Credit rating agency, while rating a security should exercise due diligence in order to ensure that the rating given by the credit rating agency is fair and appropriate. A credit rating agency should not rate securities issued by it. Rating definition, as well as the structure for a particular rating product, should not be changed by a credit rating agency, without prior information to SEBI. A credit rating agency should disclose to the concerned stock exchange through press release and websites for general investors, the rating assigned to the securities of a client, after periodic review, including changes in rating, if any.

Restrictions on Rating of Securities Issued by Promoter and Certain Entities, Connected with A Promoter, or Rating Agency

Credit rating agency shall not rate a security issued by its promoter:

(1) No credit rating agency should rate a security issued by an entity,

- (a) which is a borrower of its promoter or
- (b) a subsidiary of its promoter or
  - (i) an associate of its promoter, if there are common Chairman, Directors between credit rating agency and these entities,
  - (ii) there are common employees,
  - (iii) there are common Chairman, Directors, Employees on the rating committee.
- (2) No credit rating agency should rate a security issued by its associate or subsidiary, if the credit rating agency or its rating committee has a Chairman, director or employee who is also a Chairman, director or employee of any such entity.

However, these conditions do not apply to securities whose rating has been already done by a credit rating agency before the commencement of these regulations, and such securities may, subject to the provisions of the other Chapters of these regulations, continue to be rated, without the need to comply with the restrictions imposed by the regulations.

Procedure for Inspection and Investigation

SEBI can appoint one or more persons as inspecting officers, to undertake inspection or investigation of the books of account, records and documents of the credit rating agencies, for any of the purposes specified in the regulations. The purposes referred to in the regulations should be to ascertain whether the books of account, records and documents are being maintained properly, to ascertain whether the provisions of the Act and these regulations are being complied with, to investigate into complaints received from investors, clients or any other person on any matter having a bearing on activities of the credit rating agency and in the interest of the securities market or in the interest of investors. The inspections ordered by SEBI should not ordinarily get into an examination of the appropriateness of the assigned ratings on the merits. Inspections to judge the appropriateness of the ratings may be ordered by SEBI, only in cases of complaints which are serious in nature to be carried out either by the officers of SEBI or independent experts with relevant experience or combination of both.

Notice of Inspection or Investigation

SEBI shall give ten days written notice to the credit rating agency before ordering an inspection or investigation. SEBI in the interest of the investors may by an order in writing, direct that the inspection or investigation of the affairs of the credit rating agency to be taken up without such notice. During the course of an inspection or investigation, the credit rating agency against whom the inspection or investigation is being carried out shall be bound to discharge all its obligations as provided in the regulations.

Obligations of Credit Rating Agency

It shall be the duty of credit rating agency whose affairs are being inspected or investigated, and of every director, officer or employee thereof, to produce to the inspecting or investigating officer such books, accounts and other documents in its or his custody or control and furnish him with such statements and information relating to its rating activities, as the inspecting officer may require within such reasonable period as may be specified by the officer. The credit rating agency should allow the inspecting officer to have reasonable access to the premises occupied by such credit rating agency or by any other person on its behalf and extend to the inspecting officer reasonable facility for examining any books, records, documents and computer data in the possession of the credit rating agency and to provide copies of documents or other materials which, in the opinion of the inspecting officer, are relevant for the purposes of the inspection or investigation, as the case may be. The inspecting officer, in the course of inspection or investigation, shall entitled to examine, or record the statements, of any officer, director or employee of the credit rating agency for the purposes connected with the inspection or investigation. Every director, officer or employee of the credit rating agency is bound to render to the inspecting officer all assistance in connection with the inspection or investigation which the inspecting officer may reasonably require.

The inspecting officer should as soon as possible, on completion of the inspection or investigation, submit a report to SEBI. However if directed to do so by SEBI, he may submit an interim report. SEBI after considering the inspection report or the interim report referred to in the regulation communicate the findings of the inspecting officer to the credit rating agency and give it a reasonable opportunity of being heard in the matter. SEBI may call upon the credit rating agency on receipt of the explanation, if any, to take such measures as it may deem fit in the interest of the securities market and for due compliance with the provisions of the Act and the regulations.

Action in case of Default

A credit rating agency which –

(a) fails to comply with any condition subject to which a certificate has been granted;

(b) contravenes any of the provisions of the Act or these regulations or any other regulations made under the Act; shall be dealt with in the manner provided under Chapter V of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

MARKET MAKER

"Market-Maker" means a trading member of the Stock Exchange registered as such as per the Rules and Bye-laws of the Stock Exchange. A market-maker is responsible for enhancing the demand supply situation in securities such as stocks and futures & options.

Market-making means infusing liquidity in securities that are not frequently traded on stock exchanges.

GUIDELINES FOR MARKET MAKER

SEBI issued 'Guidelines for Market Makers on Small and Medium Enterprise (SME) Exchange/separate platform of existing Exchange having nationwide terminal'. As per the circular, market making has been made mandatory in respect of all scrips listed and traded on SME Exchange.

Registration of the Market Maker

Any member of the Exchange would be eligible to act as Market Maker provided the criteria laid down by the exchange are met. The member brokers desirous of acting as Market Maker in the exchange shall apply to the concerned stock exchange for registration as Market Makers unless already registered as a Market Maker.

The Obligations and Responsibilities of Market Makers

The Market Maker shall fulfil the following conditions to provide depth and continuity on the exchange:

(a) The Market Maker shall be required to provide a 2-way quote for 75% of the time in a day. The same shall be monitored by the stock exchange. Further, the Market Maker shall inform the exchange in advance for each and every black out period when the quotes are not being offered by the Market Maker.

(b) The minimum depth of the quote shall be ₹1,00,000. However, the investors with holdings of value less than ₹ 1,00,000 shall be allowed to offer their holding to the Market Maker in that scrip provided that he sells his entire holding in that scrip in one lot along with a declaration to the effect to the selling broker.

(c) Execution of the order at the quoted price and quantity must be guaranteed by the Market Maker, for the quotes given by him.

(d) There would not be more than five Market Makers for a scrip. These would be selected on the basis of objective criteria to be evolved by the Exchange which would include capital adequacy, networth, infrastructure, minimum volume of business *etc.*

(e) The Market Maker may compete with other Market Makers for better quotes to the investors;

(f) Once registered as a Market Maker, he has to start providing quotes from the day of the listing / the day when designated as the Market Maker for the respective scrip and shall be subject to the guidelines laid down for market making by the exchange.

(g) Once registered as a Market Maker, he has to act in that capacity for a period as mutually decided between the Merchant Banker and the market maker.

(h) Further, the Market Maker shall be allowed to deregister by giving one month notice to the exchange, subject to (g) above.

Dissemination of Information

The exchange should disseminate the list of Market Makers for the respective scrip to the public.

Number of Shares per Market Maker

The number of companies in whose shares a Market Maker would make market should be linked to his capital adequacy as decided by the exchange.

Risk Containment Measures and Monitoring for Market Makers

All applicable margins should be levied and collected without any waiver/exemption.

Capital Adequacy

The exchanges would prescribe the capital adequacy requirement for its members to commensurate with the number of companies which Market Maker proposes to make market. Further, the stock exchange may lay down additional criteria also for Market Makers as risk containment measures. The same shall be monitored by the stock exchange

Monitoring

All the requirements with regard to market making shall be monitored by the stock exchange and any violation of these requirements would be liable to punitive action to be taken by the Disciplinary Action Committee (DAC) of the Exchange, which may also include monitory penalty apart from the trade restriction as decided by the DAC under intimation to the Merchant Banker.

Price Band and Spreads

The exchanges shall prescribe the maximum spread between bid and ask price. The exchange, may at its discretion also prescribe the price bands for the same. Further, in case of new issue the spread shall also be specified in the offer document with the prior approval of the exchange.

SEBI (DEPOSITORIES AND PARTICIPANTS) REGULATIONS, 1996

SEBI had issued SEBI (Depositories and Participants) Regulations, 1996 on 16th May, 1996 which apply to depositories and its participants.

These regulations also contain provisions for operations and functioning of depositories, form for application and certificates used and schedule of fees for participants, *etc.* It also contains provisions for registration of depository and depository participants, rights and obligations of various users and constituents, inspection and procedure for action in case of default.

Entities desiring to become depository participants must apply to the depository and are required to be recommended to SEBI by the depository. If approved and registered by SEBI, the depository participant can be admitted on the depository. The depository has to formulate its own set of criteria for selection of participants. Every participant holding a certificate is required at all times to abide by the specified Code of Conduct.

The regulations require the depository to list out, through its Bye-laws, the securities which are eligible to be admitted to the depository for dematerialization. Equity shares, debentures, warrants, bonds, units of mutual funds, *etc.* are part of the list of eligible securities. The depository is empowered to set its own criteria for selection of securities and make securities eligible to be maintained in the form of electronic holdings on the depository. Further, the regulations stipulate that agreements should be entered into by the following entities:

– depository and every participant

– participant and every client

– depository, issuer company and the Registrar

The draft of these agreements are to be included in the Bye-laws and to be approved by SEBI. The depository is required to ensure that sufficient safeguards are in place to protect the data available with it and with the participants. To reduce risk in operations, the regulations stipulate that adequate insurance cover be provided by the depository and by the depository participants as well.

The regulations also require for reconciliation to be carried out on a daily basis. Further, the depository and the registrar will also reconcile balances on a daily and a periodic basis.

Rights and Obligations of Depositories and its Constituents

These Regulations deal with rights and obligations of depositories and every depository has to state in its bye-laws the securities eligible for dematerialisation which include shares, scrips, stock, bonds, debentures stock, *etc.*, and include units of mutual funds, rights under collective investment schemes and venture capital funds, commercial paper, certificate of deposit, securitised debt, money market instruments and even unlisted securities.

Every depository is required to enter into an agreement with the issuer in respect of securities disclosed as eligible to be held in demat form. No agreement is required to be entered into where the depository itself is an issuer of securities.

The depository is also required to enter into a tripartite agreement with the issuer, its transfer agent and itself where company has appointed a transfer agent. Every depository is required to maintain continuous connectivity with issuers, registrars and transfer agents, participants and clearing house or clearing corporations. Depositories should take adequate measures including insurance to protect the interest of the beneficial owners.

Every depository is required to maintain the following records and documents namely:

- records of securities dematerialised and rematerialised;
- the names of the transferor, transferee, and the dates of transfer of securities;
- a register and an index of beneficial owners;
- details of holding of the securities of the beneficial owners as at the end of the each day;
- records of instruction(s) received from and sent to participants, issuers' agents and beneficial owners;
- records of approval, notice, entry and cancellation of pledge or hypothecation, as the case may be;
- details of participants;
- details of securities declared to be eligible for dematerialisation in the depository; and
- such other records as may be specified by SEBI for carrying on the activities as a depository.

Every depository has to intimate SEBI the place where the records and documents are maintained. Subject to the provisions of any other law, the depository shall preserve records and documents for a minimum period of five years. Participants are required to enter into an agreement with beneficial owners. It is required that separate accounts are to be opened by every participant in the name of each of the beneficial owner and the securities of each beneficial owners are to be segregated and shall not be mixed up with the securities of other beneficial owners or with the participant's own securities. The participants are obliged to reconcile the records with every depository on a daily basis.

Participants are required to maintain the following records for a period of five years:

- records of all the transactions entered into with a depository and with a beneficial owner;
- details of securities dematerialised, rematerialised on behalf of beneficial owners with whom it has entered into an agreement;
- records of instructions received from beneficial owners and statements of account provided to beneficial owners; and
- records of approval, notice, entry and cancellation of pledge or hypothecation as the case may be.

GOVERNANCE OF DEPOSITORY

Governing Board, Disclosures and Corporate Governance

- Regulations deal with the composition of Governing Board of a Depository –
  - The governing board of every depository is required to include:
    - (a) shareholder directors;
    - (b) public interest directors; and
    - (c) managing director.
- Any employee of a depository may be appointed on the governing board in addition to the managing director, and such director shall be deemed to be a shareholder director.
- The chairperson shall be elected by the governing board from amongst the public interest directors subject to prior approval of SEBI.
- The number of public interest directors shall not be less than the number of shareholder directors in a depository.
- The managing director shall be an *ex-officio* director on the governing board and shall not be included in either the category of public interest directors or shareholder directors.

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

Investor Protection Fund

Every depository is required to establish and maintain an Investor Protection Fund for the protection of interest of beneficial owners. Every depository should credit twenty five per cent of its profits every year to the Investor Protection Fund.

AUDIT UNDER SEBI (DEPOSITORIES AND PARTICIPANTS) REGULATIONS, 1996

Regulation 55A of SEBI (Depositories and Participants) Regulations, 1996 provides that every issuer shall submit an audit report on a quarterly basis to the concerned stock exchanges audited by a **Practicing Company Secretary** or a qualified Chartered Accountant, for the purposes of reconciliation of the total issued capital, listed capital and capital held by depositories in dematerialized form, the details of changes in share capital during the quarter and the in-principle approval obtained by the issuer from all the stock exchanges where it is listed in respect of such further issued capital.

The audit report is required to give the updated status of the register of members of the issuer and confirm that the securities have been dematerialized as per requests received 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 (CDS) have allowed Company Secretaries in Whole-time Practice to undertake internal audit of the operations of Depository Participants (DPs).

NSDL has vide its circular No. NSDL/SG/II/010/99 dated 26th March 1999 notified amendment of its Bye Law 10.3.1 of Chapter 10 as follows:

> 10.3.1 "Every Participant shall ensure that an internal audit in respect of the operations of the Depository is conducted at intervals of not more than three months by a qualified Chartered Accountant or a Company Secretary holding a certificate of Practice and a copy of the internal audit report shall be furnished to the Depository."

CDSL has vide its letter dated September 28, 1999 notified amendment of its Bye Law 16.3.1 as follows:

> 16.3.1 "Every Participant shall ensure that an internal audit shall be conducted in respect of the participant's operations relating to CDS by a qualified Chartered Accountant in accordance with the provisions of the Chartered Accountants Act, 1949 or by a Company Secretary in practice in accordance with the provisions of the Company Secretaries Act, 1980, at such intervals as may be specified by CDS from time to time. A copy of Internal Audit report shall be furnished to CDS."

CONCURRENT AUDIT

National Securities Depository Limited vide its Circular No. NSDL/POLICY/2006/0021 dated June 24, 2006 provided 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 of the Depository Participant. Depository Participants have been 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 preprinted serial numbers.

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

(II) Verification of DIS

The procedure followed by the Participants with respect to:

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

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

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

(d) Two step verification for a transaction for more than ₹ 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.

Designated Depository Participant (DDP)

"Designated depository participant" means a person who has been approved by SEBI under Chapter III of SEBI (Foreign Portfolio Investors) Regulations, 2014. A person shall not act as designated depository participant unless it has obtained the approval of SEBI.

Eligibility criteria for DDP

SEBI shall grant an approval to a person to act as DDP subject to satisfaction of, *inter alia,* the following conditions:

(a) The applicant is a participant and custodian registered with the SEBI;

(b) The applicant is an Authorized Dealer Category-1 bank authorized by the Reserve Bank of India;

(c) The applicant has multinational presence either through its branches or through agency relationships with intermediaries regulated in their respective home jurisdictions;

(d) The applicant has systems and procedures to comply with the requirements of FATF Standards, Prevention of Money Laundering Act, 2002, and the rules and circulars prescribed thereunder.

(e) A Certificate of Registration granted to a DDP shall be permanent unless suspended or cancelled by SEBI or surrendered by the DDP.

On 7 January 2014, SEBI notified the SEBI (Foreign Portfolio Investors) Regulations, 2014 (FPI Regulations). Subsequently, the SEBI has also vide a Circular dated 8 January 2013 issued operating guidelines for Designated Depository Participants (DDP) who would grant registration to Foreign Portfolio Investors (FPI). Designated Depository Participants (DDPs) are authorised to grant registration to FPIs on behalf of the SEBI. The application for grant of registration is to be made to the DDP in a prescribed form alongwith the specified fees.

Apart from this, all the securities market Intermediaries are also required to comply with the Anti-Money Laundering Guidelines SEBI (Self Regulatory Organisations) Regulations, 2004 , SEBI (Intermediaries) Regulations, 2008 and SEBI {KYC(Know Your Client) Registration agency(KRA)}, Regulations, 2011 which have already been elaborated at the executive level.

SEBI (RESEARCH ANALYST) REGULATIONS, 2014

In exercise of its powers conferred under section 30 of the SEBI Act, 1992, SEBI has on 01.09.2014 notified SEBI (Research Analyst) Regulations, 2014. Some of the important regulations contained in it are as follows:

a. **Application For Grant Of Certificate**.- Regulation 3(1) provides that any person shall not act as a research analyst or research entity or hold itself out as a research analyst unless he has obtained a certificate of registration from SEBI under these regulations. The Regulation further provides that any person acting as research analyst or research entity before the commencement of these regulations may continue to do so for a period of six months from such commencement or, if it has made an application for a certificate of registration within the period of six months, till the disposal of such application.

   Further that an investment adviser, credit rating agency, asset management company or fund manager, who issues research report or circulates/distributes research report to the public or its director or employee who makes public appearance, shall not be required to seek registration under regulation 3, subject to compliance of Chapter III of these regulations.

An application for grant of certificate of registration shall be made in Form A as specified in the First Schedule to these regulations and shall be accompanied by a non-refundable application fee to be paid in the manner specified in Second Schedule.

b. **Issuance of research report by a person located outside India.-** Regulation 4 provides that any person located outside India engaged in issuance of research report or research analysis in respect of securities listed or proposed to be listed on a stock exchange shall enter into an agreement with a research analyst or research entity registered under these regulations.

   Regulation 5 further provides that SEBI may require the applicant to furnish further information or clarification for the purpose of consideration of the application. The applicant or his authorised representative, if so required, shall appear before SEBI for personal representation.

c. **Consideration Of Application And Eligibility Criteria**.- Regulation 6 lays down that SEBI shall take into account all matters which are relevant to the grant of certificate of registration. SEBI shall assess whether:

   (i) the applicant is an individual or a body corporate or limited liability partnership firm;

   (ii) in case the applicant is an individual, he is appropriately qualified and certified;

   (iii) in case the applicant is a body corporate, the individuals employed as research analyst are qualified and certified;

   (iv) in case the applicant is a partnership firm or a limited liability partnership, partners engaged in issuance of research report or research analysis are qualified and certified;

   (v) in case the applicant is a research entity, the individuals employed as research analyst are qualified and certified;

   (vi) the applicant fulfills the capital adequacy requirements;

   (vii) the applicant, individuals employed as research analyst and partners of the applicant, if any, are fit and proper persons;

   (viii) the applicant has the necessary infrastructure to effectively discharge the activities of research analyst;

   (ix) the applicant or any person directly or indirectly connected with the applicant has in the past been refused certificate by SEBI and if so, the grounds for such refusal;

   (x) any disciplinary action has been taken by SEBI or any other regulatory authority against the applicant or any person directly or indirectly connected to the applicant under the respective Act, rules or regulations made thereunder.

d. **Qualification And Certification Requirement**.- Regulation 7 provides that an individual registered as research analyst, individuals employed as research analyst and partners of a research analyst, if any, engaged in preparation and/or publication of research report or research analysis shall have the following minimum qualifications:

   (i) A professional qualification or post-graduate degree or post graduate diploma in finance, accountancy, business management, commerce, economics, capital market, financial services or markets provided by:

      (I) a university which is recognized by University Grants Commission or by any other commission/council/board/body established under an Act of Parliament in India for the purpose; or

      (II) an institute/association affiliated with such university; or

(III) an institute/ association/university established by the central government or state government; or

(IV) autonomous institute falling under administrative control of Government of India; or

(ii) professional qualification or post-graduate degree or post graduate diploma which is accredited by All Indian Council for Technical Education, National Assessment and Accreditation Council or National Board of Accreditation or any other council/board/body set up under an Act of Parliament in India for the purpose; or

(iii) a graduate in any discipline with an experience of at least five years in activities relating to financial products or markets or securities or fund or asset or portfolio management.

An individual registered as research analyst under these regulations, individuals employed as research analyst and partners of a research analyst, shall have, at all times, a NISM certification for research analysts as specified by SEBI or other certification recognized by SEBI from time to time.

Research analyst or research entity already engaged in issuance of research report or research analysis seeking registration under these regulations shall ensure that it or the individuals employed by it as research analyst and/or its partners obtain such certification within two years from the date of commencement of these regulations.

(e) Capital Adequacy.- Regulation 8 prescribes the capital adequacy requirement:

(i) of research analyst who is body corporate or limited liability partnership firm shall have a net worth of not less than twenty five lakh rupees.

(ii) of research analyst who is individual or partnership firm shall have net tangible assets of value not less than one lakh rupees.

All existing research analysts shall comply with the capital adequacy requirement within one year from the date of commencement of these regulations.

(f) Grant of Certificate of Registration.- Regulation 9 stipulates that SEBI on being satisfied that the applicant is eligible, shall grant a certificate of registration in Form B under First Schedule after receipt of the payment of registration fees as specified in Second schedule and send intimation to the applicant in this regard. The certificate of registration granted shall be valid for a period of five years from the date of its issue.

(g) Renewal of Certificate.- Regulation 11 provides that the research analyst, desirous of having its certificate renewed shall make an application to SEBI for renewal of the certificate, not less than three months before the expiry of the period of validity. The application for renewal shall be dealt with in the same manner as if it were an application made under regulation 3 for grant of certificate.

(h) Procedure Where Registration Is Refused.- Regulation 12 (1) lays down that after considering an application, if SEBI is of the opinion that a certificate should not be granted to the applicant, it may reject the application after giving the applicant a reasonable opportunity of being heard. The decision of SEBI rejecting the application shall be communicated to the applicant within thirty days of such decision. Where an application for a certificate is rejected by SEBI, the applicant shall forthwith cease to act as a research analyst.

(i) Conditions Of Certificate.- Regulation 13 provides that the certificate granted under regulation 9 shall, inter alia, be subject to the following conditions:

(i) the research analyst shall abide by the provisions of the Act and these regulations;

(ii) the research analyst shall forthwith inform SEBI in writing, if any information or particulars previously submitted to SEBI are found to be false or misleading in any material particular or if there is any material change in the information already submitted;

(iii) research analyst registered under these regulations shall use the term research analyst in all correspondences with its clients.

(j) **Recognition Of Body Or Body Corporate For Regulation Of Research Analysts**.- Regulation 14 provides that SEBI may recognize any body or body corporate for the purpose of regulating research analysts. SEBI may, at the time of recognition of such body or body corporate, delegate administration, supervision and regulation of research analysts to such body or body corporate on such terms and conditions as may be specified by SEBI. SEBI may also specify that any person shall not act as research analyst unless he is a member of a recognized body or body corporate.

(k) **Establishing Internal Policies And Procedures**.- Regulation 15 provides that research analyst or research entity shall have written internal policies and control procedures governing the dealing and trading by any research analyst for:

(i) addressing actual or potential conflict of interest arising from such dealings or trading of securities of subject company;

(ii) promoting objective and reliable research that reflects the unbiased view of research analyst; and

(iii) preventing the use of research report or research analysis to manipulate the securities market.

Research analyst or research entity shall have in place appropriate mechanisms to ensure independence of its research activities from its other business activities.

(l) **Limitations on Trading By Research Analysts**.- Regulation 16 lays down the following limitations on trading by research analyst:

(i) Personal trading activities of the individuals employed as research analyst by research entity shall be monitored, recorded and where ever necessary, shall be subject to a formal approval process.

(ii) Independent research analysts, individuals employed as research analyst by research entity or their associates shall not deal or trade in securities that the research analyst recommends or follows within thirty days before and five days after the publication of a research report.

(iii) Independent research analysts, individuals employed as research analysts by research entity or their associates shall not deal or trade directly or indirectly in securities that he reviews in a manner contrary to his given recommendation.

(iv) Independent research analysts, individuals employed as research analysts by research entity or their associate shall not purchase or receive securities of the issuer before the issuer's initial public offering, if the issuer is principally engaged in the same types of business as companies that the research analyst follows or recommends.

(v) Provisions of sub-regulations (2) to (4) shall apply mutatis mutandis to a research entity unless it has segregated its research activities from all other activities and maintained an arms-length relationship between such activities.

(vi) Notwithstanding anything contained in sub-regulations (2) to (4), such restrictions to trade or deal in securities may not apply in case of significant news or event concerning the subject company or based upon an unanticipated significant change in the personal financial circumstances of the research analyst, subject to prior written approval as per the terms specified in the approved internal policies and procedures.

(m) Compensation of Research Analysts.- The Regulation 17 provides for compensation for research analysts:

(i) Research entity shall not pay any bonus, salary or other form of compensation to any individual employed as research analyst that is determined or based on any specific merchant banking or investment banking or brokerage services transaction.

(ii) The compensation of all individuals employed as research analyst shall be reviewed, documented and approved annually by board of directors/committee appointed by board of directors of the research entity, which does not consist of representation from its merchant banking or investment banking or brokerage services divisions.

(iii) The board of directors/committee appointed by board of directors of the research entity approving or reviewing the compensation of individual employed as research analyst shall not take into account such individual's contribution to the research entity's investment banking or merchant banking or brokerage services business.

(iv) An individual employed as research analyst by research entity shall not be subject to the supervision or control of any employee of the merchant banking or investment banking or brokerage services divisions of that research entity.

(n) Limitations On Publication Of Research Report, Public Appearance And Conduct Of Business, *etc.*- Regulation 18 provides the following limitations on publication of research report, public appearance and conduct of business:

(i) Research analyst or research entity shall not publish or distribute research report or research analysis or make public appearance regarding a subject company for which he has acted as a manager or co-manager at any time falling within a period of:

(I) Forty days immediately following the day on which the securities are priced if the offering is an initial public offering; or

(II) Ten days immediately following the day on which the securities are priced if the offering is a further public offering. Research analyst or research entity may publish or distribute research report or research analysis or make public appearance within such forty day and ten day periods, subject to prior written approval of legal or compliance personnel as specified in the internal policies and procedures.

(ii) A research entity, who has agreed to participate or is participating as an underwriter of an issuer's initial public offering shall not publish or distribute a research report or make public appearance regarding that issuer before expiry of twenty five days from the date of the offering.

(iii) Research analyst or research entity who has acted as a manager or co-manager of public offering of securities of a company shall not publish or distribute a research report or make a public appearance concerning that company within fifteen days prior to date of entering into and fifteen days after the expiration/waiver/termination of a lock-up agreement or any other agreement that the research analyst or research entity has entered into with a subject company that restricts or prohibits the sale of securities held by the subject company after the completion of public offering of securities.

Research analyst or research entity may publish or distribute research report or research analysis or make public appearance regarding that company within such fifteen days subject to prior written approval of legal or compliance personnel as specified in the internal policies and procedures.

(iv) Research analyst or individuals employed as research analyst by research entity shall not participate in business activities designed to solicit investment banking or merchant banking or brokerage services business, such as sales pitches and deal road shows.

(v) Research analyst or individuals employed as research analyst by research entity shall not engage in any communication with a current or prospective client in the presence of personnel from investment banking or merchant banking or brokerage services divisions or company management about an investment banking services transaction.

(vi) Investment banking or merchant banking or brokerage services division's personnel of research entity shall not direct the individuals employed as research analyst to engage in sales or marketing related to an investment banking or merchant banking or brokerage services and shall not direct the research analyst to engage in any communication with a current or prospective client about such division's transaction.

However, sub-regulations (4) to (6) shall not prohibit research analyst or research entity from engaging in investor education activities including publication of pre-deal research and briefing the views of the research analyst on the transaction to the sales or marketing personnel.

(vii) Research analyst or research entity shall have adequate documentary basis, supported by research, for preparing a research report.

(viii) Research analyst or research entity shall not provide any promise or assurance of favourable review in its research report to a company or industry or sector or group of companies or business group as consideration to commence or influence a business relationship or for the receipt of compensation or other benefits.

(ix) Research analyst or research entity shall not issue a research report that is not consistent with the views of the individuals employed as research analyst regarding a subject company.

(x) Research entity shall ensure that the individuals employed as research analyst are separate from other employees who are performing sales trading, dealing, corporate finance advisory or any other activity that may affect the independence of its research report.

However, the individual employed as research analyst by research entity can receive feedback from sales or trading personnel of brokerage division to ascertain the impact of research report.

(o) Disclosures In Research Reports.- Regulation 19 stipulates that a research analyst or research entity shall disclose all material information about itself including its business activity, disciplinary history, the terms and conditions on which it offers research report, details of associates and such other information as is necessary to take an investment decision, including the following:

(i) Research analyst or research entity shall disclose the following in research report and in public appearance with regard to ownership and material conflicts of interest:

(I) whether the research analyst or research entity or his associate or his relative has any financial interest in the subject company and the nature of such financial interest;

(II) whether the research analyst or research entity or its associates or relatives, have actual/ beneficial ownership of 1 per cent or more securities of the subject company, at the end of the month immediately preceding the date of publication of the research report or date of the public appearance;

(III) whether the research analyst or research entity or his associate or his relative, has any other material conflict of interest at the time of publication of the research report or at the time of public appearance;

(ii) Research analyst or research entity shall disclose the following in research report with regard to receipt of compensation:

(I) whether it or its associates have received any compensation from the subject company in the past twelve months;

(II) whether it or its associates have managed or co-managed public offering of securities for the subject company in the past twelve months;

(III) whether it or its associates have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months;

(IV) whether it or its associates have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months;

(V) whether it or its associates have received any compensation or other benefits from the subject company or third party in connection with the research report.

(iii) Research analyst or research entity shall disclose the following in public appearance with regard to receipt of compensation:

(I) whether it or its associates have received any compensation from the subject company in the past twelve months;

(II) whether the subject company is or was a client during twelve months preceding the date of distribution of the research report and the types of services provided.

However, research analyst or research entity shall not be required to make a disclosure to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking or merchant banking or brokerage services transactions of the subject company.

(iv) whether the research analyst has served as an officer, director or employee of the subject company;

(v) whether the research analyst or research entity has been engaged in market making activity for the subject company;

(vi) Research analyst or research entity shall provide all other disclosures in research report and public appearance as specified by SEBI under any other regulations.

(p) Regulation 20 - Contents Of Research Report.- Regulation 20 stipulates the following contents of research report:

(i) Research analyst or research entity shall take steps to ensure that facts in its research reports are based on reliable information and shall define the terms used in making recommendations, and these terms shall be consistently used.

(ii) Research analyst or research entity that employs a rating system must clearly define the meaning of each such rating including the time horizon and benchmarks on which a rating is based.

(iii) If a research report contains either a rating or price target for subject company's securities and the research analyst or research entity has assigned a rating or price target to the securities for at least one year, such research report shall also provide the graph of daily closing price of such securities for the period assigned or for a three-year period, whichever is shorter.

(q) Distribution Of Research Reports.- Regulation 22 provides the following distribution of Research Report:

(i) A research report shall not be made available selectively to internal trading personnel or a particular client or class of clients in advance of other clients who are entitled to receive the research report.

(ii) Research analyst or research entity who distributes any third party research report shall review the third party research report for any untrue statement of material fact or any false or misleading information.

(iii) Research analyst or research entity who distributes any third party research report shall disclose any material conflict of interest of such third party research provider or he shall provide a web address that directs a recipient to the relevant disclosures.

(iv) Provisions of sub-regulations (2) and (3) shall not apply to a research analyst or research entity if he has no direct or indirect business or contractual relationship with such third party research provider.

(r) Additional Disclosures by Proxy Adviser.- Regulations 23 provide that all the provisions of Chapter II, III, IV, V and VI shall apply mutatis mutandis to the proxy adviser. The employees of proxy advisors engaged in providing proxy advisory services shall be required to have a minimum qualification of being a graduate in any discipline. Further that certification requirement for employees of proxy advisors engaged in providing proxy advisory services shall be as specified by SEBI. The time period for compliance with capital adequacy for proxy advisors shall be three years. The proxy adviser shall additionally disclose the following:

(i) the extent of research involved in a particular recommendation and the extent and/or effectiveness of its controls and procedures in ensuring the accuracy of issuer data;

(ii) policies and procedures for interacting with issuers, informing issuers about the recommendation and review of recommendations;

Proxy adviser shall maintain the record of his voting recommendations and furnish the same to SEBI on request. In case of any inconsistency or difficulty in respect of applicability of provisions of these regulations to proxy advisers, SEBI may issue such clarifications or exemptions as may be deemed appropriate.

(s) General Responsibility.- Regulation 24 provides the following responsibility of research analyst or research entity:

(i) Research analyst or research entity shall maintain an arms-length relationship between its research activity and other activities.

(ii) Research analyst or research entity shall abide by Code of Conduct as specified in Third Schedule.

(iii) In case of change in control of the research analyst or research entity, prior approval from SEBI shall be taken.

(iv) Research analyst or research entity shall furnish to SEBI information and reports as may be specified by SEBI from time to time.

(v) It shall be the responsibility of the research analyst or research entity to ensure that its employees or partners, as may be applicable, comply with the certification and qualification requirements at all times.

(t) Maintenance of Records.- Regulation 25(1) lays down that the research analyst or research entity shall maintain the following records:

(i) research report duly signed and dated;

(ii) research recommendation provided;

(iii) rationale for arriving at research recommendation;

(iv) record of public appearance.

All records shall be maintained either in physical or electronic form and preserved for a minimum period of five years. Where records are required to be duly signed and are maintained in electronic form, such records shall be digitally signed. Research analyst or research entity shall conduct annual audit in respect of compliance with these regulations from a member of Institute of Chartered Accountants of India or Institute of Company Secretaries of India.

(u) **Appointment of Compliance Officer.-** Regulation 26 provides that every research analyst or research entity which is a body corporate or limited liability partnership firm shall appoint a compliance officer who shall be responsible for monitoring the compliance of the provisions.

(v) Liability For Action In Case of Default.- Regulation 32 stipulates the provisions for liability for action in case of default. A Research analyst or research entity who:

(i) contravenes any of the provisions of the Act or any regulations or circulars issued thereunder;

(ii) fails to furnish any information relating to its activity as a research analyst as required by SEBI;

(iii) furnishes to SEBI information which is false or misleading in any material particular;

(iv) does not submit periodic returns or reports as required by SEBI;

(v) does not co-operate in any enquiry, inspection or investigation conducted by SEBI;

(vi) fails to resolve the complaints or fails to give a satisfactory reply to SEBI in this behalf, shall be dealt with in the manner provided under the Act or SEBI (Intermediaries) Regulations, 2008.

SINGLE REGISTRATION FOR DEPOSITORY PARTICIPANTS

In exercise of its powers conferred under Section 11(1) of SEBI Act, 1992 and Regulation 73 of the SEBI (Depositories and Participant) Regulations, 1996, SEBI issued a circular on 30th December, 2015 providing for Single Registration for Depository Participants.

The circular brings in an amendment as per which the existing requirement of obtaining certificate of initial registration to act as a participant and subsequently permanent registration to continue to act as a participant for each depository has been done. Henceforth, one certificate of initial registration and subsequently permanent registration through any depository shall be required after commencement of the Securities and Exchange Board of India (Depositories and Participants) (Amendment) Regulations, 2014.

For the purpose of single registration, the following guidelines are issued:

- If a new entity desires to act as a participant in any of the depository, the entity shall apply to SEBI for certificate of initial registration through the concerned depository in the manner prescribed in the DP Regulations.
- If an entity has been granted a certificate of registration to act as a participant through one depository and wishes to act as a participant with the other depository, it shall directly apply to the concerned depository for approval in the manner as prescribed in the DP Regulations.
- The concerned depository, on receipt of the application, may grant approval to the entity after exercising due diligence and on being satisfied about the compliance of all relevant eligibility requirements including the following:

(a) The applicant, its directors, proprietor, partners and associates shall be fit and proper.

(b) The applicant has taken satisfactory corrective steps to rectify the deficiencies or irregularities observed in the past inspections or in case of actions initiated/ taken by SEBI/ depository(s) or other regulators.

(c) Recovery of all pending fees/ dues payable to SEBI and depository; and

(d) Payment of registration fees as prescribed in the DP Regulations.

The depositories shall report to SEBI about the approval as stated above on a monthly basis.

- The participant shall apply to SEBI for permanent registration through any of the depositories in which it is acting as a participant as per the DP Regulations.
- The depositories shall coordinate and share information with each other, about their participants.

SARAL ACCOUNT OPENING FORM FOR RESIDENT INDIVIDUALS

SEBI *vide* circular dated March 04, 2015 provided for SARAL account opening for resident individuals. An individual investors can open a trading account and demat account by filling up a simplified Account Opening Form (‘AOF‘) termed as ‘SARAL AOF‘ and will also have the option to obtain other facilities, whenever they require, on furnishing of additional information as per prescribed regulations/circulars.

For these set of individual investors, the requirement of submission of ‘proof of address‘ is as follows:

- Individual investor may submit only one documentary proof of address (either residence/correspondence or permanent) while opening a trading account and / or demat account or while undergoing updation.
- In case the proof of address furnished by the said investor is not the address where the investor is currently residing, the intermediary may take a declaration of the residence/correspondence address on which all correspondence will be made by the intermediary with the investor. No proof is required to be submitted for such correspondence/residence address.
- In the event of change of address due to relocation or any other reason, investor may intimate the new address for correspondence to the intermediary within two weeks of such a change. The residence/ correspondence address and any such change thereof may be verified by the intermediary through positive confirmation‘ such as (i) acknowledgment of receipt Welcome Kit/ dispatch of contract notes / any periodical statement, etc. (ii) telephonic conversation; (iii) visits, *etc.*

INVESTOR PROTECTION FUND OF DEPOSITORIES

Regulation 53C provides that every depository shall establish and maintain an Investor Protection Fund (IPF) for the protection of interest of beneficial owners. However, this Fund shall not be used by the depository for the purpose of indemnifying the beneficial owner under section 16 of the Depositories Act, 1996. Every depository shall credit five per cent or such percentage as may be specified by SEBI, of its profits from depository operations every year to the Investor Protection Fund.

(i) Utilization of the IPF.- The IPF may be utilized for the following purposes with a focus on depository related services:

– Promotion of investor education and investor awareness programmes through seminars, lectures, workshops, publications (print and electronic media), training programmes etc. aimed at enhancing securities market literacy and promoting retail participation in securities market.

– To aid, assist, subsidise, support, promote and foster research activities for promotion/ development of the securities market.

– To utilize the fund for supporting initiatives of Depository Participants for promotion of investor education and investor awareness programmes.

– To utilize the fund in any other manner as may be prescribed/ permitted by SEBI in the interest of investors.

Depositories shall frame their internal guidelines on utilisation of the funds in accordance with the aforementioned objectives and post approval of their board of directors, submit the same within 30 days to SEBI. Depositories shall also keep SEBI informed of any subsequent changes in internal guidelines with regard to utilization of IPF.

(ii) Constitution and Management of the IPF.- The IPF shall be administered by way of a Trust created for the purpose:

– The IPF Trust shall consist of atleast:

a) one Public Interest Director (PID) of the depository,

b) one person of eminence from an academic institution from the field of finance / an expert in the field of investor education/a representative from the registered investor associations, recognized by SEBI and managing director of the depository.

– The depository shall provide the secretariat for the IPF Trust.

– The depository shall ensure that the funds in the IPF are kept in a separate account designated for this purpose and that the IPF is immune from any liabilities of the depository.

(iii) Contribution to the IPF.- The following contributions shall be made by the depository to the IPF:

– 5% of their profits from depository operations every year.

– All fines and penalties recovered from DPs and other users including clearing member pool account penalty as specified in SEBI circular no. SMDRP/Policy/Cir-05/2001 dated February 01, 2001.

– Interest or Income received out of any investments made from the IPF.

– Funds lying to the credit of IPR (Investor Protection Reserve) / BOPF (Beneficial Owners Protection Fund) of the depository or any other such fund / reserve of the depository shall be transferred to IPF.

– Any other sums as may be prescribed by SEBI from time to time.

(iii) Investments of Fund –

– Funds of the trust shall be invested in instruments such as Central Government securities, fixed deposits of scheduled banks and any such instruments which are allowed as per the investment policy approved by the board of the depository.

– The investment policy shall be devised with an objective of capital protection along with highest degree of safety and least market risk.

– The balance available in the IPF as at the end of the month and the amount utilised during the month including the manner of utilization, shall be reported in the monthly development report of the depository.

LESSON ROUND UP

– 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.

– Regulation 3 of SEBI (Merchant Bankers) Regulations, 1992 lays down that an application by a person desiring to become merchant banker shall be made to SEBI in the prescribed form seeking grant of a certificate of initial registration alongwith a non-refundable application fee as specified in Schedule II of the Regulations.

– The Registrars to an Issue and Share Transfer Agents constitute an important category of intermediaries in the primary market.

– 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.

– Banker to an Issue means a scheduled bank carrying on all or any of the following activities:
  - Acceptance of application and application monies;
  - Acceptance of allotment or call monies;
  - Refund of application monies;
  - Payment of dividend or interest warrants.
– Regulation 25 of Chapter V of SEBI (Debenture Trustees) Regulations, 1993 lays down that a debenture trustee would be dealt with in the manner provided under Chapter V of SEBI (Intermediaries) Regulations, 2008, if he fails to comply with the conditions of registration, contravenes the provisions of SEBI Act/ Companies Act, Rules and Regulations.
– SEBI has authorized the Practicing Company Secretaries to carry out complete internal audit of stock brokers/ trading members/clearing members on a half yearly basis.
– Every Portfolio Manager is required to appoint a Practising Company Secretaries or a Practising Chartered Accountants for conducting the internal audit.
– Any person proposing to carry on business as custodian of securities on or after the commencement of these regulations shall make an application to SEBI for grant of a certificate.
– “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.
– SEBI regulations for Credit Rating Agencies (CRAs) cover rating of securities only and not rating of fixed deposits, foreign exchange, country ratings, real estates *etc.*
– “Market-Maker” means a trading member of the Stock Exchange registered as such as per the Rules and Bye-laws of the Stock Exchange.
– SEBI (Depositories and Participants) Regulations, 1996, contain provisions for operations and functioning of depositories, form for application and certificates used and schedule of fees for participants, *etc.*
– DDP means a person who has been approved by SEBI under Chapter III of SEBI (Foreign Portfolio Investor) Regulations, 2014. A person shall not act as a designated depositary participant unless it has obtained the approval of SEBI.

SELF TEST QUESTIONS

1. Briefly discuss the general obligations and responsibilities of the merchant banker and due diligence certificate issued by the merchant banker.
2. Explain the code of conduct prescribed by SEBI for Investment Advisers.
3. Explain general obligations of Credit Rating Agencies under Chapter III of SEBI (Credit Rating Agencies) Regulations, 1999.
4. Enumerate the provisions relating to Reconciliation of Share Capital Audit under SEBI (Depositories and Participants) Regulations, 1996.
5. What do you understand by a ‘Designated Depository Participant’ (DDP)? Describe the eligibility criteria required to be fulfilled to become a DDP.

Lesson 5
Primary Market

LESSON OUTLINE

- Introduction
- Types of Issue
- Offer for Sale
- Difference between Offer for Sale (OFS) process and IPOs/FPOs
- SEBI Guidelines on Offer for Sale of shares by promoters through the Stock Exchange Mechanism
- Different form of prospectus
- Filing of offer Document
- Lead manager
- Pre-issue management
- Post-issue management
- Underwriting
- Due Diligence
- Due Diligence in IPO/FPO
- Basis of Allotment
- Book Building
- Alternate Method of book Building
- Green Shoe Option Facility
- Pre-issue activities
- Rights Issue
- Bonus Issue
- Preferential Issue
- Qualified Institutional Placement
- Institutional Placement Programme
- Listing Agreement
- LESSON ROUND UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

One of the important segments in the financial system is the primary market which is seen as an excellent avenue for companies to raise huge amount of money as the investment directly made to the issuer by tapping a cross section of investors and using different fund raising methods. Public issue of securities whether it is being in the form of rights issue, bonus issue or through Qualified Institutional Placement (QIP)or Institutional Placement Programme (IPP), it has to comply with the SEBI (ICDR) Regulations, 2009.

The main objective of this lesson is to give a detailed view of provisions relating to SEBI (ICDR) Regulations, 2009 pertaining to different types of public issue of securities. Apart from this, this lesson will also provides an understanding as to how the basis of allotment is finalised, book building process, Green Shoe Option, Due diligence carried out in IPO/FPO and the time based and event based compliances required under Listing Agreement, *etc*.

INTRODUCTION

Primary Market is a Market for new issues or financial claims. Hence, it is also called new issue market. Primary Market deals with those securities which are issued to the public for the first time. Primary Market provides an opportunity to issuers of securities, Government as well as corporates, to raise financial resources to meet their requirements of investment and/or discharge some obligation. The issuers create and issue fresh securities in exchange for funds through public issues and/or as private placement. When equity shares are exclusively offered to the existing shareholders it is called 'Rights Issue' and when it is issued to selected mature and sophisticated institutional investors as opposed to general public it is called 'Private Placement Issues'. Issuers may issue the securities at its face value, or at a discount/premium and these securities may take a variety of forms such as equity, debt or some hybrid instruments.

Types of Issue

Public Issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus. For raising capital from the public by the issue of shares, a public company has to comply with the provisions of the Companies Act, 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 new investors for becoming part of shareholders' family of the issuer it is called a public issue. Public issue can be further classified into Initial public offer (IPO) and Further public offer (FPO). The significant features of each type of public issue are illustrated below:

(i) **Initial public offer (IPO):** When an unlisted company makes either a fresh issue of securities or offers its existing securities for sale or both for the first time to the public, it is called an IPO. This paves way for listing and trading of the issuer's securities in the Stock Exchanges.

(ii) **Further public offer (FPO)** : When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, it is called a FPO.

(b) **Right issue (RI):** When an issue of securities is made by an issuer to its shareholders existing as on a particular date fixed by the issuer (i.e. record date), it is called a Rights Issue. The rights are offered in a particular ratio to the number of securities held as on the record date.

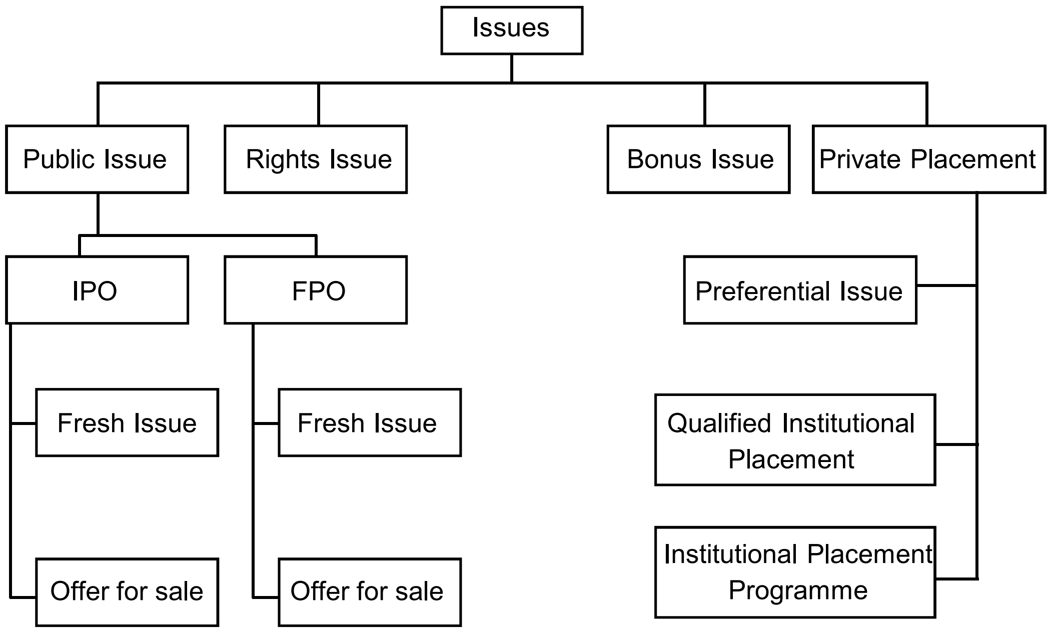
(c) **Bonus issue:** When an issuer makes an issue of securities to its existing shareholders as on a record date, without any consideration from them, it is called a bonus issue. The shares are issued out of the Company's free reserve or share premium account in a particular ratio to the number of securities held on a record date.

(d) **Private placement:** When an issuer makes an issue of securities to a select group of persons not exceeding 49, and which is neither a rights issue nor a public issue, it is called a private placement. Private placement of shares or convertible securities by listed issuer can be of two types:

(i) **Preferential allotment:** When a listed issuer issues shares or convertible securities, to a select group of persons in terms of provisions of Chapter VII of SEBI (ICDR) Regulations, it is called a preferential allotment. The issuer is required to comply with various provisions which inter alia include pricing, disclosures in the notice, lock in etc., in addition to the requirements specified in the Companies Act.

(ii) **Qualified institutions placement (QIP)**: When a listed issuer issues equity shares or securities convertible in to equity shares to Qualified Institutions Buyers only in terms of provisions of Chapter VIII of SEBI (ICDR) Regulations, it is called a QIP.

(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.



OFFER FOR SALE

Offer for Sale (OFS) is another form of share sale, which is very much similar to Further Public Offer (FPO). OFS mechanism facilitates the promoters of an already listed company to sell or dilute their existing shareholdings through an exchange based bidding platform.

Except the promoters of the company, all market participants like individuals, mutual funds, foreign institutional investors (FIIs), insurance companies, corporates, other Qualified Institutional Bidders (QIBs), HUFs *etc.* can bid/participate in the OFS process or buy the shares. The promoters of the company can only participate as the sellers in the process.

OFS PROCESS

The following is the process of an offer for sale:

(i) The sellers are required to deposit the offered shares with the exchange before 11.00 a.m. on T–1 day, where ‘T’ is the day of OFS.

(ii) Once the OFS starts, one can participate in the process himself using online trading accounts by placing bids under the ‘OFS’ section of their respective broking websites.

(iii) Investors, who do not have online trading accounts, can place their bids by directing the dealer of their broking company to do it on their behalf. The investor can modify or cancel their bids during the offer timings except in the last 60 minutes *i.e.* till 2:30 p.m.

(iv) The exchange will announce the “Indicative Price” only during the last 60 minutes of the OFS. Indicative Price is the volume weighted average price of all the valid/confirmed bids. e.g. There are total 1000 shares in an offer for sale with ₹ 200 as the floor price. If the investors bid for 200 shares at ₹ 210 and 800 shares at ₹ 200, the indicative price for the offer would be [(200*210)+(800*200)]/1000 = ₹ 202.

(v) No leverage is provided to the investors against the stock margin available in the trading accounts and thus, they are required to deposit 100% of the order value in cash to bid for it. Also, the funds allocated for OFS cannot be utilised for other investment purposes or against any other obligation of the trading member.

(vi) Once the bidding gets over, allotment price is fixed and allocation is done. The successful bidders will be allotted shares directly into their demat account on T+1 basis the very next day. In case of partial allotment or no allotment, the refunds will be made on the same day itself. This makes the OFS process really fast, just like buying shares of the company from the open market.

(vii) During the offer timings or once the offer gets completed, the investor can monitor the quantity and price of bids received *etc.* from the website of the Stock Exchange.

Difference between Offer for Sale (OFS) process and IPOs/FPOs

(i) Physical Application: Unlike IPOs/FPOs, no physical application forms are issued to apply for shares in the OFS process. OFS process is completely platform based.

(ii) Time Period: While IPOs/FPOs remain open for 3-4 days, OFS gets over in a single trading day as the markets gets closed for trading at 3:30 p.m.

(iii) Price Band: Under IPOs/FPOs, there is a price band in which the investors need to bid for the shares or simply give their consent to buy the shares at the "Cut-Off" price. With OFS, there is a "Floor Price". As the name suggests, it is the minimum price at which the investor can bid for the shares under OFS. An investor will not be able to place an order below the floor price as it will not be accepted by the system.

Though it is not mandatory to disclose the floor price before the issue opens, the promoters usually disclose it prior to the share sale in almost all of the issues. Alternatively, the promoters can submit the floor price in a sealed envelope to the exchange which will be disclosed post closure of the offer. In case the floor price is not disclosed to the public, the investors can place their bids at any price they want.

(iv) Charges: Investors are not required to pay any kind of charges over and above the 'Fixed Price' in an IPO or FPO. But, the OFS process involves certain transaction charges including the brokerage, Securities Transaction Tax (STT) and other charges, which the investors normally pay when they buy shares of a company in the cash market.

On the OFS day, normal trading in the shares of the company will continue even when the bidding process is 'ON'. The investors have the option to either buy the shares of the company in the normal market or place their bids for the shares on sale in the OFS. The investors can place only 'Limit' orders under the OFS facility as 'Market' orders are not allowed.

SEBI GUIDELINES ON OFFER FOR SALE (OFS) OF SHARES BY PROMOTERS THROUGH THE STOCK EXCHANGE MECHANISM

SEBI has detailed guidelines on how the offer-for-sale should be followed which is discussed below:

1. Eligibility

(a) Exchanges

The facility of offer for sale of shares shall be available on Bombay Stock Exchange (BSE) and National Stock Exchange (NSE).

(b) Sellers

(i) All promoter(s)/ promoter group entities of such companies that are eligible for trading and are required to increase public shareholding to meet the minimum public shareholding requirements in terms of Rule 19(2)(b) and 19A of Securities Contracts (Regulation) Rules, 1957 (SCRR), read with clause 40A (ii) (c) of Listing Agreement.

(ii) All promoters/promoter group entities of top 100 companies by market capitalisation in any of the last four completed quarters, market capitalisation being calculated as average market capitalisation in a quarter.

For (i) and (ii) above, the promoter/promoter group entities should not have purchased and/or sold the shares of the company in the 12 weeks period prior to the offer and they should undertake not to purchase and/or sell shares of the company in the 12 weeks period after the offer. However, within the cooling off period of +12 weeks, the promoter(s)/promoter group entities can offer their shares only through OFS/ Institutional Placement Programme (IPP) with a gap of 2 weeks between successive offers. The above shall also be applicable on promoter(s) /promoter group entities who have already offered their shares through OFS/IPP.

(c) Buyers

All investors registered with the brokers of the aforementioned stock exchanges other than the promoter(s)/ promoter group entities.

2. Definitions

"Single Clearing Price" is the price at which the shares are allocated to the successful bidders in a proportionate basis methodology.

"Multiple Clearing Prices" are the prices at which the shares are allocated to the successful bidders in a price priority methodology.

"Indicative Price" is the volume weighted average price of all the valid/confirm bids.

"Floor Price" is the minimum price at which the seller intends to sell the shares.

3. Size of Offer for sale of shares

The size of the offer shall be a minimum of ₹ 25 crores. However, size of offer can be less than ₹25 crores so as to achieve minimum public shareholding in a single tranche.

4. Advertisement and offer expenses

(a) Advertisements about the offer for sale of shares through stock exchange(s) , if any, shall be made after the announcement/ notice of the offer for sale of shares to the stock exchanges in accordance with para 5 (b) below and its contents shall be restricted to the contents of the notice as given to the stock exchange under Para 5 (b).

(b) All expenses relating to offer for sale of shares through stock exchange(s) shall be borne by the seller(s).

5. Operational Requirements

(a) Appointment of Broker

The Seller(s) will appoint broker(s) for this purpose. The Seller's broker(s) may also undertake transactions on behalf of eligible buyers.

(b) Contents of the announcement/ Notice of the Offer for sale of shares

Seller(s) shall announce the intention of sale of shares at least on the day prior to the offer for sale, along with the following information:

(i) Name of the seller(s) (promoter/ promoter group) and the name of the company whose shares are proposed to be sold.

(ii) Name of the Exchange(s) where the orders shall be placed. In case orders are to be placed on both BSE and NSE, one of them shall be declared as the Designated Stock Exchange (DSE).

(iii) Date and time of the opening and closing of the offer.

(iv) Allocation methodology *i.e.* either on a price priority (multiple clearing prices) basis or on a proportionate basis at a single clearing price.

(v) Number of shares being offered for sale.

(vi) The maximum number of shares that the seller may choose to sell over and above the offer made at point (v) above. The name of the broker(s) on behalf of the seller(s).

(vii) The date and time of the declaration of floor price, if the seller(s) chooses to announce it to the market. Alternatively, a declaration to the effect that the floor price will be submitted to the DSE in a sealed envelope that shall be disclosed post closure of the offer.

(viii) Conditions, if any, for withdrawal or cancellation of the offer.

(c) Floor price

(i) In case the seller chooses to disclose the floor price, the seller(s) shall declare it after the close of trading hours and before the close of business hours of the exchanges on T-1 day else the seller(s) shall give the floor price in a sealed envelope to DSE before the opening of the offer. (T day being the day of the offer for sale)

(ii) The floor price if not declared to the market, shall not be disclosed to anybody, including the selling broker(s).

(iii) Sealed envelope shall be opened by the DSE after the closure of the offer for sale and the floor price suitably disseminated to the market.

(d) Timelines

(i) The duration of the offer for sale shall be as per the trading hours of the secondary market and shall not exceed one trading day.

(ii) Orders shall be placed during trading hours.

(iii) In case of institutional trades, the custodians shall conclude the confirmation of bids with the available funds not latter than the end of the half an hour post close session.

(e) Order Placement

(i) A separate window for the purpose of sale of shares through OFS shall be created. The following orders shall be valid in the OFS window:

A. Orders with 100% of margin paid upfront by institutional investors and non-institutional investors. Such orders can be modified or canceled at any time during the trading hours.

B. Such orders cannot be modified or cancelled during the last 60 minutes of the duration of offer.

(ii) Cumulative order/bid quantity shall be made available online to the market throughout the trading session at specific intervals. The indicative price shall be disclosed by the exchange only during the last 60 minutes of the duration of the offer for sale.

(iii) If the security has a price band in the normal segment, the same shall not apply for the orders placed in the offer for sale. Stock specific tick size as per the extant practice in normal trading session shall be made applicable for this window.

(iv) In case of shares under offer for sale, the trading in the normal market shall also continue. However, in case of market closure due to the incidence of breach of 'Market wide index based circuit filter', the offer for sale shall also be halted.

(v) Only limit orders/ bids shall be permitted.

(vi) Multiple orders from a single buyer shall be permitted.

(vii) In case floor price is disclosed, orders/ bids below floor price shall not be accepted.

6. Risk Management

(a) Clearing Corporation shall collect 100% of order value in cash from non-institutional investors at the order of level for every buy order/bid. In case of institutional investors, they shall have an option to pay either 25% of the order value or 100% of the order value in cash at the order level for every buy order/ bid to the clearing corporation/clearing house. The funds collected shall neither be utilized against any other obligation of the trading member nor co-mingled with other segments.

(b) Modification/cancellation of order/bids will be allowed only for bids for which 100% upfront margin has been received. In case of order/bid modification or cancellation, such funds shall be released/ collected on a real time basis by clearing corporation.

(c) The seller(s) shall deposit the entire quantity of shares offered for sale including the additional shares disclosed at Para 5(b)(vi) as pay-in with the clearing corporation/clearing house of DSE prior to the commencement of the offer. No other margin shall be charged on the seller(s).

7. Allocation

(a) Minimum of 25% of the shares offered shall be reserved for mutual funds and insurance companies, subject to allocation methodology. Any unsubscribed portion thereof shall be available to the other bidders.

(b) The orders shall be cumulated by the DSE immediately on close of the offer. Based on the methodology for allocation to be followed as disclosed in the notice, the DSE shall draw up the allocation. *i.e.* either on a price priority (multiple prices) basis or on a proportionate basis at a single clearing price.

(c) No allocation will be made in case of order/ bid is below floor price.

(d) No single bidder other than mutual funds and insurance companies shall be allocated more than 25% of the size of offer for sale.

(e) The allocation details shall be shared by the DSE with the other exchange after the allocation is crystallized.

8. (i) Settlement

(a) The allocation and the obligations resulting thereof shall be intimated to the brokers on T day.

(b) Settlement shall take place on trade for trade basis and shall be completed on T+1 day. There shall be no netting of settlement at brokers end.

(c) Funds collected from the bidders who have not been allocated shares shall be released after the download of the obligation.

(d) On T+1 day, to the extent of obligation determined, the clearing Corporation/ Clearing house of DSE shall transfer such number of shares to the clearing corporation/clearing house of the other stock exchange, without consideration of money. Excess shares, if any, shall be returned to seller broker(s).The direct credit of shares shall be given to the demat account of the successful bidder provided such manner of credit is indicated by the broker/bidder.

(ii) Handling of default in pay-in

(a) In case of default in pay-in by any investor, 10% of the order value shall be charged as penalty from the investor and collected from the broker. This amount shall be credited to the Investor Protection Fund of the stock exchange. Tha balance amount shall be returned to the bidder.

(b) The price at which allotments have been made based on the allocation on T day shall not be revised as a result of any default in pay-in.

(c) Issuer shall have the option to cancel in full or conclude the offer.

(d) Allotment details after settlement shall also be disseminated by the exchange.

(e) Allocation details after settlement shall be consolidated by the DSE and excess shares, if any, shall be returned by the respective Clearing Corporation/ Clearing house to the seller(s) broker(s).

(f) Settlement Guarantee Fund shall not be available for OFS through stock exchange mechanism.

9. Issuance of Contract Notes

The brokers shall be required to issue contracts note to its clients based on the allotment price and quantity in terms of conditions specified by the exchange.

10. Withdrawal of offer

The offer for sale may be withdrawn prior to its proposed opening. In such a case there will be a cooling off period of 10 trading days from the date of withdrawal before an offer is made once again. The stock exchange(s) shall suitably disseminate details of such withdrawal.

11. Cancellation of offer

Cancellation of offer shall not be permitted during the bidding period. If the seller(s) fails to get sufficient demand at or above the floor price, he may choose to either conclude the offer or cancel it in full. The seller may also choose to conclude the offer or cancel it in full, in case of defaults in settlement obligation.

UNDERSTANDING THE GUIDELINE STEP WISE

Step 1 – The seller (promoter) appoints a broker for the offer-for-sale.

Step 2 – The seller announces his intention to sell shares at least one trading day before the offer-for-sale opens.

It will have the details of seller, designated stock exchange, date and time of offer open and close. It also has details of number of shares offered, allocation methodology, maximum offer size over and above offer-for-sale size, name of seller's broker(s). Finally, it should have details on the date and time of declaration of floor price.

Step 3 – The seller shall declare the floor price after trading hours and before close of business hours to the designated stock exchange a day before the offer-for-sale date (Trade date minus one day). This is applicable if the seller chooses to declare the floor price.

Otherwise, the floor price is given in a sealed envelope to the stock exchange and not disclosed to anybody, including the selling broker.

The stock exchange disseminates it to the market after the offer-for-sale closes.

The offer duration will coincide with trading hours in the secondary market (9 a.m. to 3.30 p.m.). Order processing and funds pay-in shall occur only during trading hours on the exchange platform.

For institutional trades, custodians are expected to conclude bid confirmation with available funds latest by half an hour post the session.

Orders can be placed in a separate window created by the exchange. Order modification is allowed only for bids with 100 per cent upfront margins. Orders cannot be modified in the last 60 minutes of the offer-for-sale.

Information on bid quantity shall be made available by the exchanges at specified time intervals. Exchanges shall disclose the indicative price only during the last 60 minutes of the offer-for-sale.

Price band for the scrip in the normal segment would not be applicable to the offer-for-sale. However, standard tick sizes would apply. Tick size is the minimum price by which share prices can move up or down.

Though normal market trading for scrips under the offer-for-sale would continue, it would be halted if the scrip hits the circuit in the normal market.

Only limit orders are permitted and buyers are allowed to place multiple orders. Orders below floor price (if disclosed) would not be accepted.

Step 4 – All non-institutional investors have to bring in 100 per cent upfront margin. Institutions are allowed to pay either 25 per cent or 100 per cent as upfront margin. The seller has to deposit the entire quantity of shares under the offer to the clearing corporation as pay–in before the offer-for-sale starts.

Step 5 – One fourth of shares of OFS is reserved for mutual funds and insurance companies. The stock exchange allocates shares either on price priority (in case of multiple clearing prices) or proportionate basis (in case of single clearing price).

Orders below floor price are not taken up for allocation. No single bidder other than mutual funds and insurance companies would be allocated over 25 per cent.

Step 6 – The allocation and obligations are intimated to brokers on the trade date (T). Trades are settled on the T+1 date. The clearing corporation will transfer shares into the demat accounts of successful bidders.

Step 7 – Bidders will forfeit 10 per cent of their bid value to the investor protection fund if they default on the pay-in amount. Allotment price on the T day would not change due to any default pay-in.

Issuer has the option to conclude the offer or cancel it in full. The settlement guarantee fund is not available for this facility through stock exchange mechanism.

Step 8 - Brokers would issue contract notes to their clients based on the allotment price and quantity.

DIFFERENT FORM OF PROSPECTUS

A company is required to issue a prospectus each time it accesses the capital market. The different forms of prospectus are discussed below:

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.

Draft Offer Documents

"Draft Offer document" means the offer document in draft stage. The draft offer documents are filed with SEBI, atleast 30 days prior to the filing of the Offer Document with ROC/SEs. SEBI may specifies changes, if any, in the Draft Offer Document and the Issuer or the Lead Merchant banker shall carry out such changes in the draft offer document before filing the Offer Document with ROC/SEs. The Draft Offer document is available on the SEBI website for public comments for a period of 21 days from the filing of the Draft Offer Document with SEBI.

RHP (Red Herring Prospectus)

" Red Herring Prospectus" is a prospectus, which does not have details of either price or number of shares being offered, or the amount of issue. This means that in case price is not disclosed, the number of shares and the upper and lower price bands are disclosed. On the other hand, an issuer can state the issue size and the number of shares are determined later. An RHP for an FPO can be filed with the ROC without the price band and the issuer, in such a case will notify the floor price or a price band by way of an advertisement one day prior to the opening of the issue. In the case of book-built issues, it is a process of price discovery and the price cannot be determined until the bidding process is completed. Hence, such details are not shown in the Red Herring prospectus filed with ROC in terms of the provisions of the Companies Act. Only on completion of the bidding process, the details of the final price are included in the offer document. The offer document filed thereafter with ROC is called a prospectus.

Shelf Prospectus

Shelf prospectus means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus. Section 31 of the Companies Act, 2013 enable public financial institutions, public sector banks, and scheduled banks, whose main object is to make loans to, or subscribe for securities of private industrial enterprises engaged in infrastructure financing to issue shelf prospectus. Section 31 lays down that-

- Any public financial institution, public sector bank or scheduled bank whose main object is financing shall file a shelf prospectus.
- A company filing a shelf prospectus with the Registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within a period of validity of such shelf prospectus.
- A company filing a shelf prospectus shall be required to file an information memorandum on all material facts relating to new charges created, changes in the financial position as have occurred between the first offer of securities, previous offer of securities and the succeeding offer of securities within such time as may be prescribed by the Central Government, prior to making of a second or subsequent offer of securities under the shelf prospectus.
- An information memorandum shall be issued to the public along with shelf prospectus filed at the stage of the first offer of securities and such prospectus shall be valid for a period of one year from the date of opening of the first issue of securities under that prospectus:

Provided that where an update of information memorandum is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus.

Filing of Offer Document

An issuer company cannot make any public issue of securities, unless a draft offer document has been filed with SEBI through a Merchant Banker, at least 30 days prior to registering the prospectus with the Registrar of Companies (ROC) or filing the letter of offer with the designated stock exchange.

However, if SEBI specifies changes or issues observations on the draft Prospectus within 30 days from the date of receipt of the draft Prospectus by SEBI the issuer company or the Lead Manager to the Issue shall carry out such changes in the draft Prospectus or comply with the observations issued by SEBI before filing the Prospectus with ROC.

SEBI may specify changes or issue observations, if any, on the draft prospectus within 30 days from the later of the date of receipt of the draft offer document or the date of receipt of satisfactory reply from the lead merchant bankers. Where SEBI has sought any clarification or additional information from them or the date of receipt of clarification or information from any regulator or agency, where SEBI has sought any clarification or information from such regulator or agency or the date of receipt of a copy of in-principal approval letter issued by the recognized stock exchanges.

The lead merchant banker should while filing the offer document with SEBI, file a copy of such document with the recognized stock exchanges where the specified securities are proposed to be listed and a soft copy of the offer document should also be furnished to SEBI.

LEAD MANAGER

The public issue of corporate securities involves marketing of capital issues of new and existing companies, additional issues of existing companies including rights issue and dilution of shares by letter of offer,. The public issues are managed by the involvement of various agencies *i.e.* underwriters, brokers, bankers, advertising agency, printers, auditors, legal advisers, registrar to the issue and merchant bankers providing specialized services to make the issue of the success. However merchant banker is the agency at the apex level than that plan, co-ordinate and control the entire issue activity and direct different agencies to contribute to the successful marketing of securities.

Merchant bankers are independent financial institution appointed by the company going public. Companies appoint more than one lead manager to manage IPO's. They are known as Book Running Lead Manager and Co Book Running Lead Managers. Their main responsibilities are to initiate the IPO processing, help company in road shows, creating draft offer document and get it approve by SEBI and stock exchanges and helping company to list shares at stock market. The procedure of the managing a public issue by a merchant banker is divided into two phases, *viz*;

- Pre-issue management
- Post-issue management

Pre-Issue Management

Steps required to be taken to manage pre-issue activity is as follows:-

(1) Obtaining stock exchange approvals to memorandum and articles of associations.

(2) Taking action as per SEBI Regulations

(3) Finalizing the appointments of the following agencies:

- Co-manager/Advisers to the issue
- Underwriters to the issue
- Brokers to the issue
- Bankers to the issue and refund Banker
- Advertising agency
- Printers and Registrar to the issue

(4) Advise the company to appoint auditors, legal advisers

(5) Drafting of prospectus

(6) Obtaining approvals of draft prospectus from the company's legal advisers, underwriting financial institutions/ Banks

(7) Obtaining consent from parties and agencies acting for the issue to be enclosed with the prospectus.

(8) Approval of prospectus from SEBI.

(9) Filing of the prospectus with Registrar of Companies.

(10) Making an application for enlistment with Stock Exchange along, with copy of the prospectus.

(11) Publicity of the issue with advertisement and conferences.

(12) Open subscription list.

Post-issue Management

Steps involved in post-issue management are:-

(1) To verify and confirm that the issue is subscribed to the extent of 90% including devolvement from underwriters in case of under subscription.

(2) To supervise and co-ordinate the allotment procedure of registrar to the issue as per prescribed Stock Exchange guidelines.

(3) To ensure issue of refund order, allotment letters / certificates within the prescribed time limit after the closure of subscription list.

(4) To report periodically to SEBI about the progress in the matters related to allotment and refunds.

(5) To ensure the listing of securities at Stock Exchanges.

(6) To attend the investors grievances regarding the public issue.

Co-ordination with Intermediaries

– The Post-issue lead merchant banker shall maintain close co-ordination with the Registrars to the Issue and arrange to depute its officers to the offices of various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from collecting bank branches, and/or self certified syndicate banks processing of the applications including application form for applications supported by blocked amount and other matters till the basis of allotment is finalised, despatch of security certificates and refund orders are completed and securities are listed.

– Any act of omission or commission on the part of any of the intermediaries noticed during such visits shall be duly reported to SEBI.

– In case there is a development on underwriters, the merchant banker is required to ensure that the notice for development containing the obligation of the issuer is issued within a period of 10 days from the date of closure of the issue.

– In case of undersubscribed issues, the merchant bank is required to furnish information in respect of underwriters who have failed to meet their underwriting development to SEBI in the format specified in these regulations.

– The post-issue merchant banker is required to confirm to the bankers to the issue by way of copies of listing and trading approval that all formalities in connection with the issue have been completed and that the banker is free to release the money to the issuer or refund it in case of failure of the issue.

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, 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 development and the same shall be incorporated in the inter-se allocation of responsibilities accompanying the due diligence certificate submitted by the Lead Merchant Banker to the SEBI.

Due Diligence

Due diligence is a detailed investigation of the affairs of a business. As such, it spans investigation into all relevant aspects of the past, present and predictable future of the business of a target company. Due diligence is a process of a thorough and objective examination that is undertaken before corporate entities enter into major transactions such as mergers and acquisitions, issuing new stock or other securities, project finance, securitization, *etc.*

One of the key objectives of due diligence is to minimize and to the maximum extent practicable, the possibility of there being unknown liabilities or risks. The exercise is multi-dimensional and involves investigation into the business, tax, financial, accounting and legal aspects of an issuer. The aim of due diligence is to identify problems within the business, particularly any issues which may give rise to unexpected liabilities in the future.

Due Diligence in IPO/FPO

When the due diligence is carried out as part of the steps leading to an IPO, the exercise takes on added meaning and encompasses a wider scope, as it identifies the areas or the issues where the company exhibits weaknesses and the due diligence process becomes a tool, which shows the company the way to optimize its potential and thereby increasing its value to potential investors. Pre-IPO due diligence process will result in a gap analysis between the present status of the company and the company that should be floated *i.e.*, a gap is an expectations gap created as a result of how the market expects a listed company to conduct its affairs. In this scenario, once these gaps have been highlighted the due diligence exercise should not stop there but should include advice given by the advisors to the company on the processes and activities which are required to fill the gaps identified. In an IPO the due diligence exercise is a broader, fuller exercise which apart from identifying the weaknesses also looks at resolving them with the purpose of increasing the value of the company.

The due diligence process aspires to achieve the following:

- to assess the reasonableness of historical and projected earnings and cash flows;
- to identify key vulnerabilities, risk and opportunities;
- to gain an intimate understanding of the company and the market in which the company operates such that the company's management can anticipate and manage change;
- to set in motion the planning for the post-IPO operations.

It will result in a critical analysis of the control, accounting and reporting systems of the company and a critical appraisal of key personnel. It will identify the value drivers of the company thus enabling the directors to understand where the value is and to focus their efforts on increasing that value.

Due diligence spans the entire public issue process. The steps involved in due diligence are given broadly below:

1. Decision on public issue
2. Business due diligence
3. Legal and Financial Due Diligence
4. Disclosures in Prospectus
5. Marketing to Investors
6. Post issue compliance

Key areas to be focused:

(a) the financial statements – to ensure their accuracy;

(b) the assets – confirm their value, condition existence and legal title;

(c) the employees – identification and evaluation of the key movers and shakers;

(d) the sales strategy – analyzing the policies and procedures in place and assessing what works and what does not;

(e) the marketing – what is driving the business and is it effective?

(f) the industry in which the company operates – understand trends and new technologies;

(g) the competition – identify the threats;

(h) the systems – how efficient are they? Are upgrades required?

(i) legal and corporate and tax issues – is the shareholding structure robust? Are there any tax issues which need to be resolved?

(j) company contracts and leases – identify what the risks and obligations are;

(k) suppliers – are they expected to remain around?

Illustrative list of documents/information to be examined during due-diligence process:

(i) Basic documents

Review of basic corporate documents like:

- Memorandum and Articles of Association of the Company
- Copies of Incorporation Certificate/Commencement of Business Certificate/ Change of Name certificate (if applicable)

– Registered office address of the company

– History/businesses of the company

– Special rights available to any persons through shareholder or other Agreements.

(ii) Promoters/Personnel

1. Promoters' bio-data with special reference to qualification and experience. Track record of the promoters in the capital market – public issue by other group companies, violation of securities laws.
2. Directors' & Key Personnel – details bio-data including father's name, address, occupation, year-wise experience. Background of the Directors – including examining the list of willful defaulters periodically prepared by RBI.
3. Constitution of Audit Committee, remuneration Committee *etc.*, Terms of reference of these committees.
4. Organization Chart.
5. Key Personnel/Employees/Directors left in the last two years with reasons.
6. Break-up of Employees – whether any agreement are entered into with employee – If so, copy of agreement.
7. Details of Pay scales/Bonus (including performance)/PF/Gratuity *etc.*
8. Employment of contract labour – no. of workers, copy of contract.

(iii) Financials

1. Projections of combined operations (existing + proposed) for 5 years including the following:
   – Income details including prices
   – Cash flow and Balance Sheet
   – Capacity utilization details
   – Interest calculation – Assn. of rate/Repayment schedule
   – Depreciation – Book & I.T.
   – Tax
   – Tax *etc.*
   – Assumptions w.r.t. cost items
   – Commencement of commercial production (Year to be mentioned)
   – IT depreciation table for past OR (in case projections have to be prepared)
   – Latest provisional accounts with all schedules
   – Latest income Tax Depreciation calculation
   – Input-Output ration (consumption norms) for each segment alongwith prices and input prices
   – Services-wise capacity & Capacity utilization projects for the next 5 years
   – Working Capital norms
   – Basis for working out various expenses
   – Month from which the commercial production will commence for the new project
   – IT depreciation table for past.

2. Bankers to the Company – name & addresses.
3. Details of Banks Loan, Term Loan, Promissory notes, Hundis, Credit Agreements, Lease, Hire Purchase, Guarantees or any other evidences of indebtedness, Copies of Sanction letters, Original amount, Interest rate, Amount outstanding, Repayment schedule.
4. Details of default/reschedulements, if any – copy of correspondence with lenders.
5. Accounts for last 3 years and latest unaudited accounts.
6. Associate/Group Companies' concerns accounts for last 3 years. Also give: Profile of the concerns.
7. Audited Balance Sheet, P&L Account for last 3 years of the promoter company (*i.e.* if promoter is a Co.)
8. In case any liabilities are not disclosed in the Balance Sheet, details thereof, or any secret reserves.
9. Age-wise analysis of stocks, debtors, creditors and loans & advances given
10. Terms of various loans & advances given
11. If names of any associates/related units are present in the debtors or parties to whom loans & advances have been given
12. Details of contingents liabilities including guarantees given by Co./directors
13. Trends in profit ratios.

(iv) Project Information

1. Project Feasibility report
2. Reports/documents prepared by independent research agencies in respect of the state of the industry and demand and supply for the company's products
3. Break-up of Cost of Project:
   – Land – Locational site & map, area, copy of documents *i.e.* Sale/lese Deed for land, Soil Test Report, Order for converting land into Industrial land *etc.*
   – Building – Details break-up from Architect, Approval details from Municipality *etc.* and Valuation Report from a chartered engg. (for existing building and suitability of site)
   – Equipments – Invoices/Quotations of main items. (Indicate Imported mach. Separately)
   – Margin Money for Working Capital – Margin Money for Working Capital (calculation)
   – Preliminary & Pre-operative expenses – break-up
   – Provision for contingencies – break-up
4. Schedule of Implementation.
5. Status of Project as on a recent date – Amount spent & sources
6. Promoter's contribution till date (supported by Auditor's certificate if possible)
7. Current & proposed Shareholding pattern
8. Sanctions received by the issuer from bankers/institutions for debt financing in the project
9. Notes on the following: Technical process, utilities (power, water, transport, effluent treatment), location, land building, Plant & Machinery).
   (a) Manpower

(i) Break-up of employees – whether any agreements are entered into with employee – If so, copy of agreement

(ii) Details of Pay scales/bonus (including performance bonus)/PF/ Gratuity *etc.*

(iii) Employment of contract labour – no. of workers, copy of contract.

(b) Quality Control facilities, Research & Development.

10. Market (Demand/supply with sources alongwith copies),
11. Marketing & Distribution (network *etc.*) & relevant documents wherever applicable.
12. Arrangements and strategy of the company for marketing its products
13. Discussions with important customers, suppliers, Joint Venture partners, collaborators of the company.

(v) General Information

1. Details on Litigation, Disputes, overdue, statuary dues, other Material development and tax status of Company & promoters.
2. Copies of IT returns of the Company along with copies of Assessment orders for last three years.
3. Copies of IT/Wealth tax returns of the promoters along with copies of Assessment orders for last three years.
4. Copy of documents for Collaborations/Marketing Tie-ups/Other Tie-ups if any.
5. NOC/Approval/Sanctions from SEB/SPCB or copy of application.
6. Copy of SIA Registration/SSI Regn./EOU License/LOI or License.
7. Incentives if any – such as subsidy, Sales tax loans/exemption/concession/ power subsidy (Copy of Booklet or notification).
8. List of existing plant & machinery with cost & age & type of ownership (lease *etc.*)
9. R&D (if any) cost for the project for the last three years. (Sources of any outside R&D funds including any joint venture agreements)
10. Summary of Bad Debts experience for the last five years.
11. Approvals from company's Board of Directors/Shareholders to issue securities to the public.
12. Copies of documents filed with Registrar of Companies.
13. Names of stock exchanges where shares of the Co. are listed.
14. Stock Market quotation of share, wherever applicable, as on recent date.
15. Special legislation applicable, if any, and compliance thereof (e.g. NBFCs *etc.*)

(vi) Third Parties

1. Brochure on collaborators, copy of Government approval for collaboration.
2. Copy of Agreement with Consultants, Copy of Government approval in case of foreign consultants.
3. Copies of important Agreements/Contracts of any sort with all the parties concerned with the company.
4. Copy of FIPB/RBI approvals (NRI/Foreign participant *etc.*), wherever applicable.
5. Details of Patents, Trademarks, Copyrights, Licenses *etc.*, if any.
6. List of major customers/clients (attach copies of main pending orders).

7. Competitors & Market shares for Company's products (with sources, wherever possible).
8. Sales arrangements, terms & conditions.
9. Main suppliers – terms & conditions.

Pre-issue-Due Diligence Certificates

According to SEBI (ICDR) Regulations, 2009, the lead merchant baker is required to submit due diligence certificate with SEBI at the time of:-

- Filing of draft offer document with SEBI.
- At the time of registering prospectus with ROC.
- Immediately before opening of the issue.
- After the opening of the issue and before its closure before it closes for subscription.

Post issue diligence

- The lead merchant banker shall exercise due diligence and satisfy himself about all the aspects of the issue including the veracity and adequacy of disclosure in the offer documents.
- The lead merchant banker shall call upon the issuer, its promoters or directors or in case of an offer for sale , the selling shareholders, to fulfil their obligations as disclosed by them in the offer document and as required in terms of these regulations.
- The post –issue merchant banker shall continue to be responsible for post issue activities till the subscribers have received the securities certificates, credit to their demat account or refund of application moneys and the listing agreement is entered into by the issuer with the stock exchanges and listing/ trading permission is obtained.

BASIS OF ALLOTMENT

After the closure of the issue, for e.g a book built public issue, the bids received are aggregated under different categories i.e Qualified Institutional Buyers (QIBs), Non-Institutional Buyers (NIBs), Retail, *etc.* The oversubscription ratios are then calculated for each of the categories as against the shares reserved for each of the categories in the offer document. Within each of these categories, the bids are then segregated into different buckets based on the number of shares applied for. The oversubscription ratio is then applied to the number of shares applied for and the number of shares to be allotted for applicants in each of the buckets is determined. Then, the number of successful allottees is determined. This process is followed in case of proportionate allotment. Thus allotment to each investor is done based on proportionate basis in both book built and fixed price public issue.

Example-Allocation to retail Investor

CARE IPO had total 71,99,700 equity shares on offer in the IPO, at an issue price of ₹ 750 per share. 35% of the offer was available for allocation to the retail individual bidders in accordance with the SEBI Regulations, which makes it 25,19,895 equity shares.

When the investors apply for a company's shares in an IPO, there is a bid 'lot' system. With CARE IPO, the bid lot size was in multiples of 20 shares and the retail investors had the option to apply for a maximum of 13 lots (260 shares) and a minimum of 1 lot (20 shares). So, the minimum investment in the CARE IPO was ₹ 15,000 and ₹ 1,95,000 as the maximum.

Retail investors have been allotted only 20 shares irrespective of their application size *i.e.* whether they applied for 20 shares or 260 shares or any number of shares in between, they got only 20 shares allotted in the ratio of 101:256 *i.e.* only 101 applicants got these 20 shares out of 256 applicants.

Actually, a total of 3,19,350 retail individual applicants applied for it, in varying number of bid lots *i.e.* between 1 to 13 bid lots and only 1,25,994 applicants got the shares allotted in the ratio of 101:256.

Allocation to Retail Individual Bidders (after technical rejection)

No. of Shares Applied	No.of Applications Received	% of Total	Total No. of Equity Shares Applied	% of Total	No. of Equity Shares Allocated	Ratio of Allottees to Applicants	Total No. of Equity Shares Allocated
20	245680	76.93	4913600	32.58	20	101:256	1938580
40	15853	4.96	634120	4.20	20	101:256	125100
60	9199	2.88	551940	3.66	20	101:256	72580
80	4505	1.41	360400	2.39	20	101:256	35540
100	5832	1.83	583200	3.87	20	101:256	46020
120	7892	2.47	947040	6.28	20	101:256	62280
140	3831	1.20	536340	3.56	20	101:256	30220
160	1223	0.38	195680	1.30	20	101:256	9660
180	657	0.21	118260	0.78	20	101:256	5180
200	2324	0.73	464800	3.08	20	101:256	18340
220	480	0.15	105600	0.70	20	101:256	3780
240	843	0.26	202320	1.34	20	101:256	6660
260	21031	6.59	5468060	36.26	20	101:256	165940
Total	319350	100	15081360	100	N.A.	N.A.	2519880

In the table above, there were 2,45,680 applicants who applied for 20 shares with each of their applications. Out of these 2,45,680 applicants, 96,929 applicants have been allotted 20 shares each or total of 19,38,580 shares.

2,45,680 * 101/256 = 96,929 * 20 shares = 19,38,580

Similarly, 15,853 * 101/256 = 6,255 * 20 shares = 1,25,100

9,199 * 101/256 = 3,629 * 20 shares = 72,580 and so on.

BOOK BUILDING

Book Building means a process undertaken to elicit demand and to assess the price for determination of the quantum or value of specified securities or Indian Depository Receipts, as the case may be.

The book building process in India is very transparent. All investors including small investors can see on an hourly basis where the book is being built before applying. According to this method, share prices are determines on the basis of real demand for the shares at various price levels in the market.

1. An issuer company may, subject to the requirements specified make an issue of securities to the public through a prospectus through 100% of the net offer to the public through book building process.

2. Reservation to the extent of percentage specified in these Regulations can be made only to the following categories:

(a) employees and in case of a new issuer, persons who are in permanent and full time employment of the promoting companies excluding the promoter and the relative of promoter of such companies

(b) 'shareholders of the listed promoting companies in the case of a new company and shareholders of listed group companies in the case of an existing company' on a 'competitive basis' or on a 'firm allotment basis' excluding promoters. However, if the promoting companies are designated financial institutions or state or central financial institutions, the shareholder of such promoting companies shall be excluded for this purpose.

(c) persons who, on the date of filing of the draft offer document with SEBI, have business association, as depositors, bondholders and subscribers to services, with the issuer making an initial public offering.

However, no reservation can be made for the issue management team, syndicate members, their promoters, directors and employees and for the group/associate companies of issue management team and syndicate members and their promoters, directors and employees.

3. The issuer company is required to enter into an agreement with one or more of the Stock Exchange(s) which have the requisite system of on-line offer of securities. The agreement would cover inter-alia, the rights, duties, responsibilities and obligations of the company and stock exchange (s) inter se. The agreement may also provide for a dispute resolution mechanism between the company and the stock exchange.

   The company may also apply for listing of its securities on an exchange other than the exchange through which it offers its securities to public through the on-line system.

4. The Lead Merchant Banker shall act as the Lead Book Runner.In case the issuer company appoints more than one merchant banker,the names of all such merchant bankers who have submitted the due diligence certificate to SEBI, may be mentioned on the front cover page of the prospectus. A disclosure to the effect that " the investors may contact any of such merchant bankers, for any complaint pertaining to the issue" is required to be made in the prospectus, after the "risk factors.

5. The lead book runner/issuer may designate, in any manner, the other Merchant Bankers if the inter-se allocation of responsibilities amongst the merchant bankers is disclosed in the prospectus on the page giving the details of the issue management team and a co-ordinator has been appointed amongst the lead book runners, for the purpose of co-ordination with SEBI. However the names of only those merchant bankers who have signed the inter-se allocation of responsibilities would be mentioned in the offer document on the page where the details of the issue management team is given.

6. The primary responsibility of building the book is of the Lead Book Runner. The Book Runner(s) may appoint those intermediaries who are registered with SEBI and who are permitted to carry on activity as an 'Underwriter' as syndicate members. The Book Runner(s)/syndicate members shall appoint brokers of the exchange, who are registered with SEBI, for the purpose of accepting bids, applications and placing orders with the company and ensure that the brokers so appointed are financially capable of honouring their commitments arising out of defaults of their clients/investors, if any. However, in case of Application Supported by Blocked Amount, Self Certified Syndicate Banks shall accept and upload the details of such application in electronic bidding system of the stock exchange.

7. The brokers, and self certified syndicate banks accepting applications and application monies, are considered as 'bidding/collection centres'. The broker/s so appointed, shall collect the money from his/their client for every order placed by him/them and in case the client/investors fails to pay for shares allocated as per the Regulations, the broker shall pay such amount.

8. In case of Applications Supported by Blocked Amount, the Self Certified Syndicate Banks shall follow the procedure specified by SEBI in this regard. The company shall pay to the broker/s/ Self Certified Syndicate Banks a commission/fee for the services rendered by him/them. The exchange shall ensure that the broker does not levy a service fee on his clients/investors in lieu of his services.

   The draft prospectus containing all the disclosures except that of price and the number of securities to be offered to the public shall be filed by the Lead Merchant Banker with SEBI. The total size of the issue shall be mentioned in the draft prospectus

9. The red herring prospectus shall disclose, either the floor price of the securities offered through it or a price band along with the range within which the price can move, if any.

   However, the issuer may not disclose the floor price or price band in the red herring prospectus if the same is disclosed in case of an initial public offer, at least two working days before the opening of the bid and in case of a further public offer, at least one working day before the opening of the bid, by way of an announcement in all the newspapers in which the pre-issue advertisement was released by the issuer or the merchant banker;

   Further, the announcement shall contain the relevant financial ratios, computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the offer document.

   Where the issuer opts not to make the disclosure of the price band or floor price in the red-herring prospectus in terms of the foregoing proviso, the following shall be additionally disclosed in the red-herring prospectus:

   (a) a statement that the floor price or price band, as the case may be, shall be disclosed atleast two working days (in case of an initial public offer) and atleast one working day (in case of a further public offer) before the opening of the bid;

   (b) a statement that the investors may be guided in the meantime by the secondary market prices in case of public offer;

   (c) names and editions of the newspapers where the announcement of the floor price or price band would be made;

   (d) names of websites (with address), journals or other media in which the said announcement will be made.

   Where the issuer decides to opts for price band instead of floor price, the lead book runner shall ensure compliance with the following conditions:

   (a) The cap of the price band should not be more than 20% of the floor of the band; *i.e.*, cap of the price band shall be less than or equal to 120% of the floor of the price band.

   (b) The price band can be revised during the bidding period in which case the maximum revision on either side shall not exceed 20% i.e floor of price band can move up or down to the extent of 20% of floor of the price band disclosed in the red herring prospectus and the cap of the revised price band will be fixed in accordance with Clause (a) above;

   (c) Any revision in the price band shall be widely disseminated by informing the stock exchanges, by issuing press release and also indicating the change on the relevant website and the terminals of the syndicate members.

(d) In case the price band is revised, the bidding period shall be extended for a further period of three days, subject to the total bidding period not exceeding ten working days.

(e) The manner in which the shortfall, if any, in the project financing, arising on account of lowering of price band to the extent of 20% will be met shall be disclosed in the red herring prospectus. It shall also be disclosed that the allotment shall not be made unless the financing is tied up.

10. In case of appointment of more than one Lead Merchant Banker or Book Runner for book building, the rights, obligations and responsibilities of each should be delineated. In case of an under subscription in an issue, the shortfall shall have to be made good by the Book Runner(s) to the issue and the same shall be incorporated in the inter se allocation of responsibility as provided in the Regulations.

11. The issuer company shall circulate the application forms to the Brokers.

12. The pre-issue obligations and disclosure requirements shall be applicable to issue of securities through book building unless stated otherwise in these regulations.

13. The Book Runner(s) and the issuer company shall determine the issue price based on the bids received through the 'Syndicate Members' and 'Self Certified Syndicate Banks'.

14. Retail individual investors may bid at "cut off" price instead of their writing the specific bid prices in the bid forms.

15. On determination of the price, the number of securities to be offered shall be determined *i.e.* issue size divided by the price which has been determined.

16. Once the final price (cut-off price) is determined all those bidders whose bids have been found to be successful shall become entitle for allotment of securities.

17. No incentive, whether in cash or kind, shall be paid to the investors who have become entitled for allotment of securities.

18. The broker may collect an amount to the extent of 100% of the application money as margin money from the clients/investors before he places an order on their behalf. The margin collected shall be uniform across all categories of investors.

19. Bids for securities beyond the investment limit prescribed under relevant laws shall not be accepted by the syndicate members/brokers from any category of clients/investors.

20. The lead book runner may reject a bid placed by a Qualified Institutional Buyer for reasons to be recorded in writing provided that such rejection shall be made at the time of acceptance of the bid and the reasons therefor shall be disclosed to the bidders. Necessary disclosures in this regard shall also be made in the offer document.

21. On determination of the entitlement, the information regarding the same *i.e.* the number of securities which the investor becomes entitled shall be intimated immediately to the investors.

22. The final prospectus containing all disclosures as per SEBI ICDR Regulations including the price and the number of securities proposed to be issued shall be filed with the Registrar of Companies.

23. Arrangement shall be made by the issuer for collection of the applications by appointing mandatory collection centres as per these Regulations.

24. The bidding terminals shall contain a online graphical display of demand and bid prices updated at periodic intervals not exceeding 30 minutes. The book running lead manager shall ensure the availability of adequate infrastructure with syndicate members for data entry of the bids in a timely manner.

25. The investors who had not participated in the bidding process or have not received intimation of entitlement of securities may also make an application.

Example

Let's take an example.

Number of shares issued by the company = 100.

Price band = ₹ 30 - ₹ 40.

Now let's check what individuals have bid for.

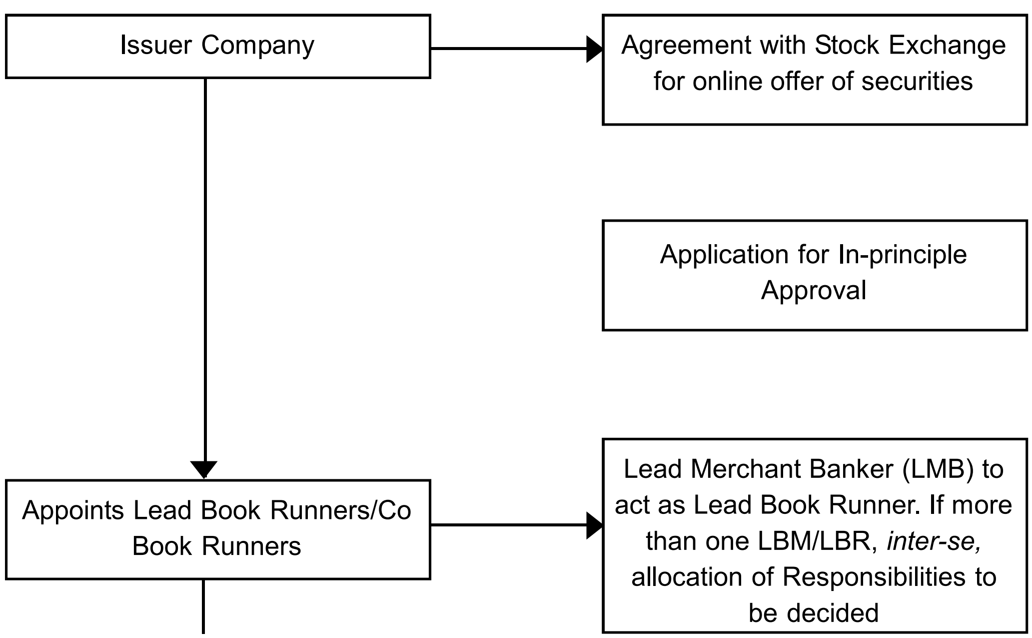
Bid	Number of shares	Price per share
1	20	₹ 40
2	10	₹ 38
3	20	₹ 37
4	30	₹ 36
5	20	₹ 35
6	20	₹ 33
7	20	₹ 30

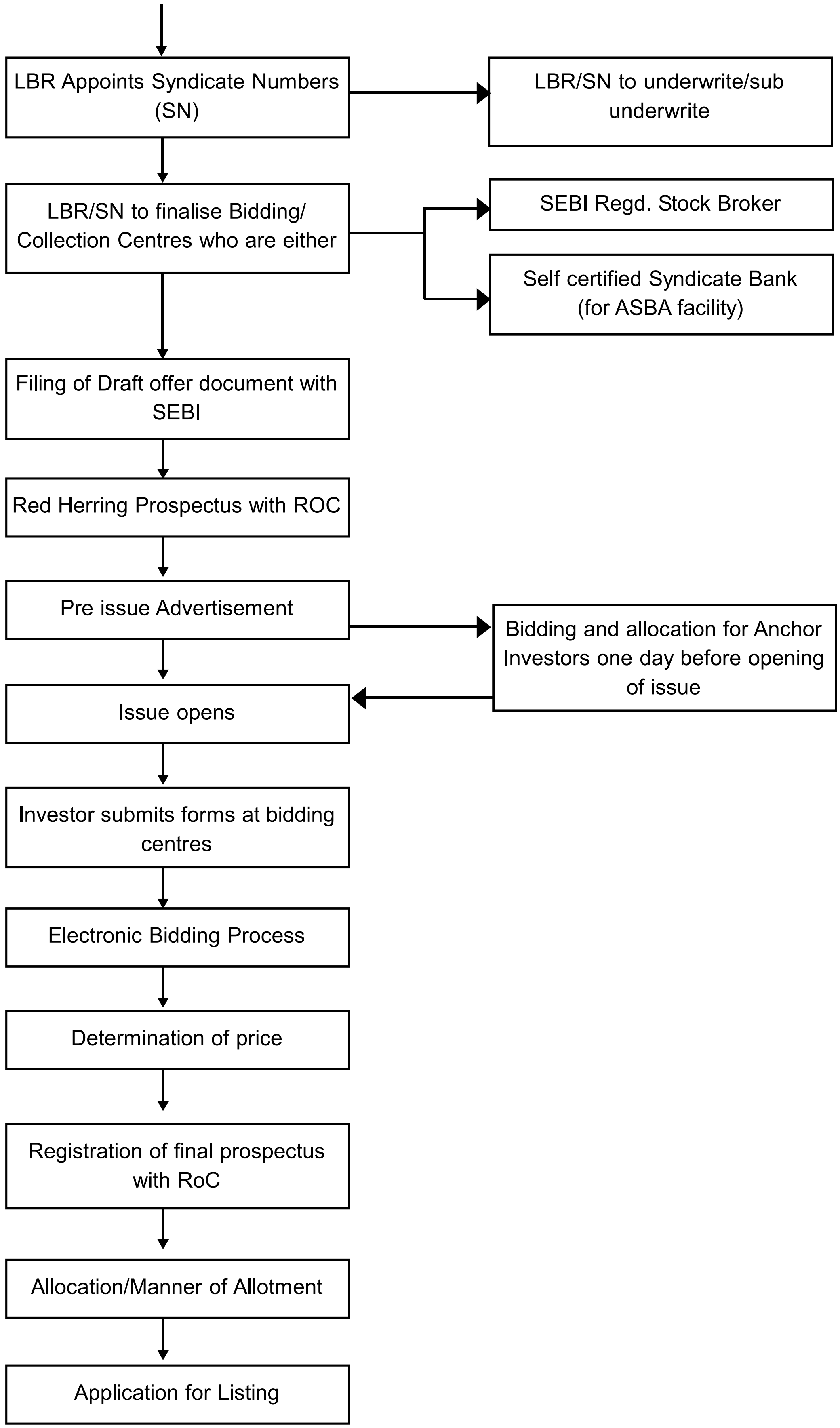
The shares will be sold at the Bid 5 price of 20 shares for ₹ 35.

Because Bidders 1 to 5 are willing to pay at least ₹ 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 = ₹ 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 ₹ 35, the 10 shares will cost ₹ 350 (10 x ₹ 35). The balance ₹ 50 will be refunded to the investor.

BOOK BUILDING PROCESS THROUGH A FLOWCHART




LBR Appoints Syndicate Numbers (SN)
LBR/SN to underwrite/sub underwrite
LBR/SN to finalise Bidding/ Collection Centres who are either
SEBI Regd. Stock Broker
Self certified Syndicate Bank (for ASBA facility)
Filing of Draft offer document with SEBI
Red Herring Prospectus with ROC
Pre issue Advertisement
Bidding and allocation for Anchor Investors one day before opening of issue
Issue opens
Investor submits forms at bidding centres
Electronic Bidding Process
Determination of price
Registration of final prospectus with RoC
Allocation/Manner of Allotment
Application for Listing

ADDITIONAL DISCLOSURES IN CASE OF BOOK BUILDING

Apart from meeting the disclosure requirements as specified in SEBI ICDR Regulations, the following disclosures shall be suitably made:

(i) The particulars of syndicate members, brokers, self certified syndicate banks, registrars, bankers to the issue, *etc.*

(ii) The following statement shall be given under the 'basis for issue price':

"The issue price has been determined by the Issuer in consultation with the Book Runner(s), on the basis of assessment of market demand for the offered securities by way of Book-building."

(iii) The following accounting ratios shall be given under the basis for issue price for each of the accounting periods for which the financial information is given:

1. EPS, pre-issue, for the last three years (as adjusted for changes in capital).
2. P/E pre-issue
3. Average return on net-worth in the last three years.
4. Net-Asset value per share based on last balance sheet.
5. Comparison of all the accounting ratios of the issuer company as mentioned above with the industry average and with the accounting ratios of the peer group (i.e companies of comparable size in the same industry. (Indicate the source from which industry average and accounting ratios of the peer group has been taken)
6. The accounting ratios disclosed in the offer document shall be calculated after giving effect to the consequent increase of capital on account of compulsory conversions outstanding, as well as on the assumption that the options outstanding, if any, to subscribe for additional capital shall be exercised)

(iv) The proposed manner of allocation among respective categories of investors, in the event of under subscription.

Procedure for Bidding

The process of bidding should be in compliance of the following requirements:

(a) Bidding process shall be only through an electronically linked transparent bidding facility provided by recognised stock exchange(s).

(b) The lead book runner shall ensure the availability of adequate infrastructure with syndicate members for data entry of the bids in a timely manner.

(c) The syndicate members shall be present at the bidding centres so that at least one electronically linked computer terminal at all the bidding centres is available for the purpose of bidding.

(d) During the period the issue is open to the public for bidding, the applicants may approach the stock brokers of the stock exchange/s through which the securities are offered under on-line system or Self Certified Syndicate Banks, as the case may be, to place an order for bidding for the specified securities.

(e) Every stock broker shall accept orders from all clients/investors who place orders through him and every Self Certified Syndicate Bank shall accept Applications Supported by Blocked Amount from ASBA investors.

(f) Applicants who are qualified institutional buyers shall place their bids only through the stock brokers who shall have the right to vet the bids;

(g) The bidding terminals shall contain an online graphical display of demand and bid prices updated at periodic intervals, not exceeding thirty minutes.

(h) At the end of each day of the bidding period, the demand including allocation made to anchor investors, shall be shown graphically on the bidding terminals of syndicate members and websites of recognised stock exchanges offering electronically linked transparent bidding facility, for information of public.

(i) The retail individual investors may either withdraw or revise their bids until finalization of allotment.

(j) The issuer may decide to close the bidding by qualified institutional buyers one day prior to the closure of the issue subject to the following conditions:

(i) bidding shall be kept open for a minimum of three days for all categories of applicants;

(ii) disclosures are made in the red herring prospectus regarding the issuer's decision to close the bidding by Qualified Institutional Buyers one day prior to closure of issue.

(k) The Qualified Institutional Buyers and the non-institutional investors shall neither withdraw nor lower the size of their bids at any stage .

(l) The identity of Qualified Institutional Buyers making the bidding shall not be made public.

(m) The stock exchanges shall continue to display on their website, the data pertaining to book built issues in an uniform format, inter alia giving category-wise details of bids received, for a period of at least three days after closure of bids.

Alternate Method of Book Building

In case of further public offers, the issuer may opt for an alternate method of book building, subject to the following:

(a) Issuer shall follow the procedure laid down in Part A of Schedule XI of SEBI (ICDR) Regulations, 2009.

(b) The issuer may mention the floor price in the red herring prospectus or if the floor price is not mentioned in the red herring prospectus, the issuer shall announce the floor price at least one working day before opening of the bid in all the newspapers in which the pre-issue advertisement was released.

(c) Qualified Institutional Buyers shall bid at any price above the floor price.

(d) The bidder who bids at the highest price shall be allotted the number of securities that he has bided for and then the bidder who has bided at the second highest price and so on, until all the specified securities on offer are exhausted.

(e) Allotment shall be on price priority basis for qualified institutional buyers.

(f) Allotment to retail individual investors, non-institutional investors and employees of the issuer shall be made proportionately .

(g) Where, however the number of specified securities bided for at a price is more than available quantity, then allotment shall be done on proportionate basis.

(h) Retail individual investors, non-institutional investors and employees shall be allotted specified securities at the floor price.

(i) The issuer may:-

(A) place a cap either in terms of number of specified securities or percentage of issued capital of the issuer that may be allotted to a single bidder;

(B) decide whether a bidder be allowed to revise the bid upwards or downwards in terms of price and/ or quantity;

(C) decide whether a bidder be allowed single or multiple bids.

GREEN SHOE OPTION FACILITY

"Green Shoe Option" means an option of allocating shares in excess of the shares included in the public issue and operating a post-listing price stabilizing mechanism in accordance with the provisions of Regulation 45 of SEBI (ICDR) Regulations, 2009.

GSO in the system of IPO using book-building method was recognised by SEBI in India through its new guidelines on 14th August 2003 (vide SEBI/ CFD/DIL/DIP/ Circular No. 11). ICICI bank was the first to use Green Shoe Option in its public issue through book building mechanism in India.

A company desirous of availing this option, should in the resolution of the general meeting authorising the public issue, seek authorisation also for the possibility of allotment of further shares to the 'Stabilising Agent' (SA) at the end of the stabilisation period. The company should appoint one of the merchant bankers or book runners, amongst the issue management team, as the "stabilising agent" (SA), who will be responsible for the price stabilisation process, if required. The SA shall enter into an agreement with the issuer company, prior to filing of offer document with SEBI, clearly stating all the terms and conditions relating to this option including fees charged/expenses to be incurred by SA for this purpose.

The SA should also enter into an agreement with the promoter(s) or pre-issue shareholders who will lend their shares under the provisions of this scheme, specifying the maximum number of shares that may be borrowed from the promoters or the shareholders, which shall not be in excess of 15% of the total issue size.

The details of the agreements mentioned above should be disclosed in the draft prospectus, the draft Red Herring prospectus, Red Herring prospectus and the final prospectus. The agreements should also be included as material documents for public inspection. The lead merchant banker or the Lead Book Runner, in consultation with the SA, shall determine the amount of shares to be over-allotted with the public issue, subject to the maximum number specified above.

The draft prospectus, draft Red Herring prospectus, the Red Herring prospectus and the final prospectus should contain the following additional disclosures:

(a) Name of the SA.

(b) The maximum number of shares (as also the percentage vis-a-vis the proposed issue size) proposed to be over-allotted by the company.

(c) The period, for which the company proposes to avail of the stabilisation mechanism.

(d) The maximum increase in the capital of the company and the shareholding pattern post issue, in case the company is required to allot further shares to the extent of over-allotment in the issue.

(e) The maximum amount of funds to be received by the company in case of further allotment and the use of these additional funds, in final document to be filed with ROC.

(f) Details of the agreement/arrangement entered into by SA with the promoters to borrow shares from the latter which inter alia shall include name of the promoters, their existing shareholding, number and percentage of shares to be lent by them and other important terms and conditions including the rights and obligations of each party.

(g) The final prospectus shall additionally disclose the exact number of shares to be allotted pursuant to the public issue, stating separately therein the number of shares to be borrowed from the promoters and over-allotted by the SA, and the percentage of such shares in relation to the total issue size.

In case of an initial public offer by a unlisted company, the promoters and pre-issue shareholders and in case of public issue by a listed company, the promoters and pre-issue shareholders holding more than 5% shares, may lend the shares subject to the provisions of this scheme. The SA should borrow shares from the promoters or the pre-issue shareholders of the issuer company or both, to the extent of the proposed over-allotment. However, the shares so referred shall be in dematerialized form only.

The allocation of these shares should be on pro rata basis to all the applicants.

The stabilisation mechanism should be available for the period disclosed by the company in the prospectus, which shall not exceed 30 days from the date when trading permission was given by the exchange(s).

The SA should open a special account with a bank to be called the "Special Account for GSO proceeds of……… company" (hereinafter referred to as the GSO Bank Account) and a special account for securities with a depository participant to be called the "Special Account of GSO shares of……….. company" (hereinafter referred to as the GSO Demat Account).

The money received from the applicants against the over-allotment in the green shoe option should be kept in the GSO Bank Account, distinct from the issue account and shall be used for the purpose of buying shares from the market, during the stabilisation period.

The shares bought from the market by the SA, if any during the stabilisation period, should be credited to the GSO Demat Account.

The shares bought from the market and lying in the GSO Demat Account should be returned to the promoters immediately, in any case not later than 2 working days after the close of the stabilisation period.

The prime responsibility of the SA should be to stabilise post listing price of the shares. To this end, the SA should determine the timing of buying the shares, the quantity to be bought, the price at which the shares are to be bought *etc.*

On expiry of the stabilisation period, in case the SA does not buy shares to the extent of shares over-allotted by the company from the market, the issuer company shall allot shares to the extent of the shortfall in dematerialized form to the GSO Demat Account, within five days of the closure of the stabilisation period. These shares shall be returned to the promoters by the SA in lieu of the shares borrowed from them and the GSO Demat Account shall be closed thereafter. The company shall make a final listing application in respect of these shares to all the exchanges where the shares allotted in the public issue are listed. The provisions relating to preferential issues shall not be applicable to such allotment.

The shares returned to the promoters as above, as the case may be, shall be subject to the remaining lock-in-period as provided in lock-in or pre-issue share capital of an unlisted company.

The SA shall remit an amount equal to (further shares allotted by the issuer company to the GSO Demat Account) (issue price) to the issuer company from the GSO Bank Account. The amount left in this account, if any, after this remittance and deduction of expenses incurred by the SA for the stabilisation mechanism, shall be transferred to the investor protection fund(s) established by SEBI. The GSO Bank Account shall be closed soon thereafter.

The SA should submit a report to the stock exchange(s) on a daily basis during the stabilisation period. The SA should also submit a final report to SEBI in the format specified in Schedule XII. This report shall be signed by the SA and the company. This report shall be accompanied with a depository statement for the "GSO Demat Account" for the stabilisation period, indicating the flow of the shares into and from the account. The report shall also be accompanied by an undertaking given by the SA and countersigned by the depository(ies) regarding confirmation of lock-in on the shares returned to the promoters in lieu of the shares borrowed from them for the purpose of the stabilisation.

The SA shall maintain a register in respect of each issue having the green shoe option in which he acts as a SA. The register shall contain the following details of:

– in respect of each transaction effected in the course of the stabilising action, the price, date and time.

– the details of the promoters from whom the shares are borrowed and the number of shares borrowed from each; and

– details of allotments made.

The register must be retained for a period of at least three years from the date of the end of the stabilising period. For the aforesaid, over allotment shall mean an allotment or allocation of shares in excess of the size of a public issue, made by the SA out of shares borrowed from the promoters or the pre-issue shareholders or both, in pursuance of green shoe option exercised by the company in accordance with the provisions of the scheme.

ILLUSTRATION

Consider a company planning an IPO of say, 100,000 shares, at a book-built price of ₹ 100/-, resulting in an IPO size of ₹ 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.* ₹100,00,000–100,000 shares at the rate of R100 each, are remitted to the Issuer Company, while the proceeds from the Green Shoe Shares (₹ 15,00,000/-, being 15,000 shares x ₹ 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 ₹ 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;

– ituation #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 (₹ 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 ₹ 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.

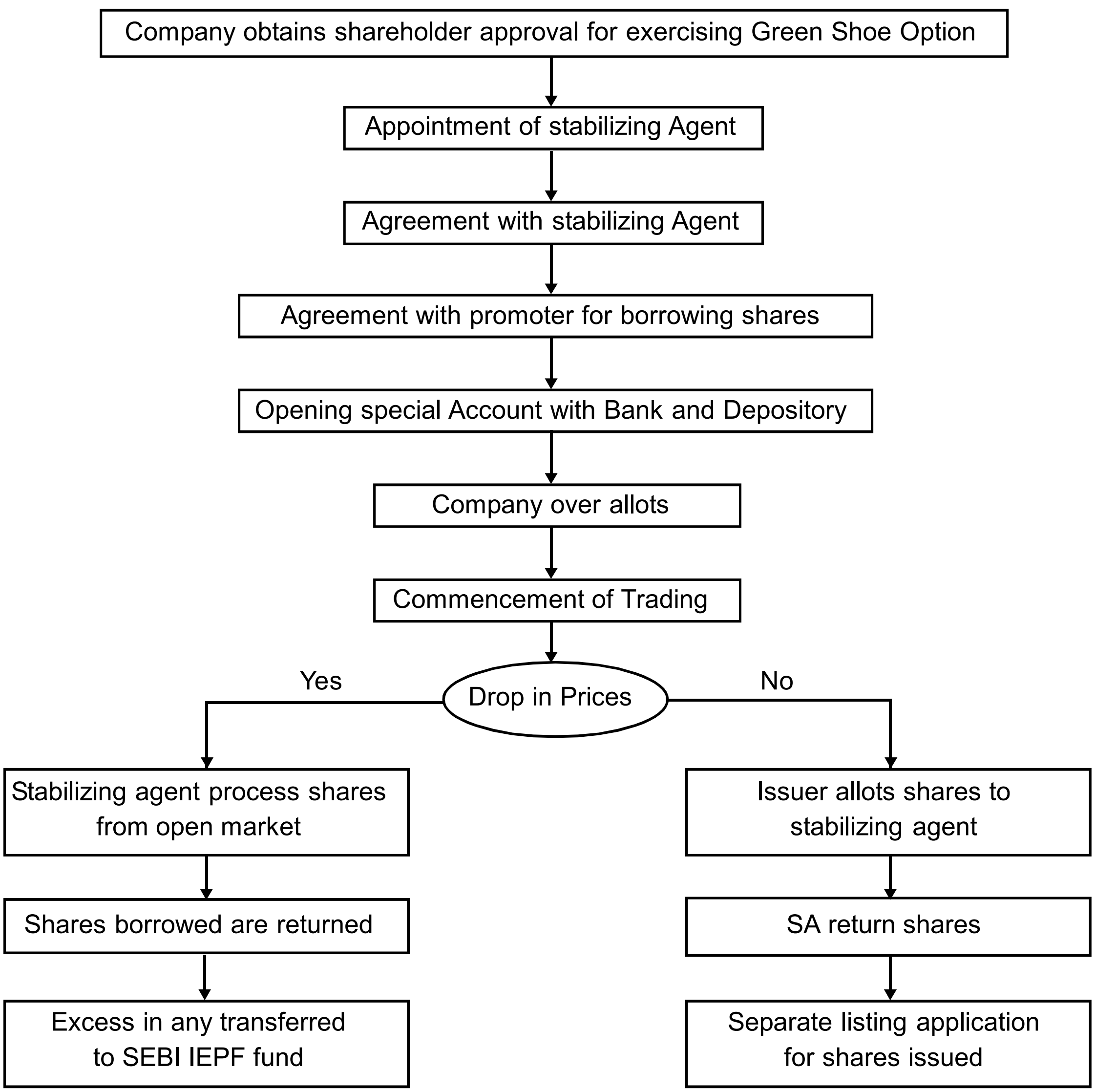
Situation #3 – where some of the Green Shoe Shares are bought back, say 10,000 shares: This situation could arise in an event where the share prices witness a drop in the initial stages of the price stabilisation period, but recover towards the latter stages. In this situation, the stabilising agent 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



PRE-ISSUE ACTIVITIES

1. Signing of MoU: Signing of MoU between the client company and the merchant banker-issue management activities marks the award of the contract.

2. Obtaining appraisal note: An appraisal note containing he details of the proposed capital outlay of the project and the sources of funding is either prepared in-house or is obtained from external appraising agencies *viz*., financial institutions/banks *etc.* A project may be funded either by borrowing money from outside agencies or by injecting capital.

3. Optimum capital structure: The level of capital that would maximize the shareholders value and minimize the overall cost of capital has to be determined. This has to be done considering the nature and size of the project. Equity funding is preferable especially when the project is capital intensive.

4. Convening meeting: A meeting of the board of directors of the issuing company is convened. This is followed by an EGM of its members. The purpose of these meetings is to decide the various aspects related to the issue of securities. An application to RBI, seeking its permission is made, where capital issue of shares is to be offered to NRIs/OCBs or FIIs.

5. Appointment financial Intermediary: Financial intermediaries such as Underwriters, Registrars, *etc.* have to be appointed. Necessary contracts need to be made with the underwriter to ensure due subscription to offer. Similar contracts when entered into with the Registrars to an issue, will help in share allotment related work, appointment of bankers to an issue for handling the collection of applications at various centers, printers for bulk printing of Issue related stationery, legal advisors and advertising agency. Simultaneously consents from various experts such as auditors, solicitors, legal advisors etc has to be obtained under Section 26 of the Companies Act, 2013.

6. Preparing documents: As part of the issue management procedure the documents to be prepared are initial applications of submission to those stock exchanges where the issuing company intends to get its securities listed. MoU with the registrar, with bankers to the issue, with advisors to the issue and co-managers to the issue, agreement for purchase of properties *etc.* This has to be sent for inclusion in the prospectus.

7. Due diligence certificate: The lead manager issue a due diligence certificate which certifies that the company has scrupulously followed all legal requirements has exercised utmost care while preparing the offer document and has made a true fair and adequate disclosures in the draft offer document

8. Submission of offer document: The draft offer document along with the due diligence certificate is filed with SEBI. The SEBI in turn makes necessary corrections in the offer document and returns the same with relevant observations, if any within 21 days from the receipt of the offer document.

9. Finalization of collection centers: In order to collect the issue application forms from the prospective investors to lead manager finalizes the collection centers.

10. Filing with RoC: The offer document completed in all respects after incorporating SEBI observation is filed with Registrar of Companies (RoC) to obtain acknowledgement.

11. Launching the issue: The process of marketing the issue starts once legal formalities are completed and statutory permission for issue of capital is obtained. The lead manager has to arrange for the distribution of public issue stationary to various collecting banks, brokers, investors *etc.* The issue is opened for public immediately after obtaining the observation letter from SEBI. Conducting press conferences, brokers' meets, issuing advertisements in various newspapers and mobilizing brokers and sub-brokers marks the launching of a public issue. The announcement regarding opening of issue is also required to be made through advertising in newspapers, 10 days before the opening of the public issue.

12. Promoters' contribution: A certificate to the effect that the required contribution of the promoters has been raised before opening the issue, has to be obtained from a Chartered Accountant, and duly filed with SEBI.

13. Issue closure: An announcement regarding the closure of the issue should be made in the newspaper.

RIGHTS ISSUE

Rights issue as identified in the SEBI ICDR Regulations is an issue of capital under Section 62 of the Companies Act, 2013 to be offered to the existing shareholders of the company through a letter of offer. This regulation is not applicable to the rights issue where the aggregate value of securities offered does not exceed ₹ 50 lakhs.

- A listed issuer company can not make any rights issue of securities, where the aggregate value of such securities, including premium, if any, exceeds ₹ 50 lakhs unless a draft letter of offer has been filed with SEBI, through a Merchant Banker, at least 30 days prior to the filing of the letter of offer with the Designated Stock Exchange (DSE).

  However, in case of the rights issue where the aggregate value of the securities offered is less than ₹50 Lakhs, the company shall prepare the letter of offer in accordance with the disclosure requirements specified in SEBI ICDR and file the same with SEBI for its information and for being put on the SEBI website.

- An issuer company can not make any public issue of securities, unless a letter of offer has been filed with SEBI through a Merchant Banker, at least 30 days prior to the filing of the Prospectus with the Registrar of Companies (ROC).

  However, if SEBI specifies changes or issues observations on letter of offer within 30 days from the date of receipt of the draft Prospectus by SEBI the issuer company or the Lead Manager to the Issue shall carry out such changes or comply with the observations issued by SEBI before filing the letter of offer with ROC.

- SEBI may specify changes or issue observations, if any, on the letter of offer only after receipt of copy of in-principle approval from all the stock exchanges on which the issuer company intends to list the securities proposed to be offered through the letter of offer.

- A Company can not make a rights issue of equity share or any security convertible at later date into equity share, unless all the existing partly paid-up shares have been fully paid or forfeited.

- A company can not make a rights issue of securities unless firm arrangements of finance through verifiable means towards 75% of the stated means of finance, excluding the amount to be raised through proposed Public/Rights issue, or through identifiable internal accruals have been made.

- A listed company whose equity shares are listed on a stock exchange, may freely price its equity shares and any security convertible into equity at a later date, offered through a rights issue.

- In case of a rights issue, issue price or price band may not be disclosed in the draft letter of offer filed with SEBI. The issue price may be determined anytime before fixation of the record date, in consultation with the Designated Stock Exchange

- In case of rights issue the promoters shall disclose their existing shareholding and the extent to which they are participating in the proposed issue, in the offer document.

- A company cannot make an issue of security through a public or rights issue unless a Memorandum of Understanding has been entered into between a lead merchant banker and the issuer company specifying their mutual rights, liabilities and obligations relating to the issue.

- In case a rights issue is managed by more than one Merchant Banker the rights, obligations and responsibilities of each merchant banker shall be demarcated as specified in Chapter VI.

– In the case of rights issues, lead merchant banker shall ensure that the abridged letters of offer are dispatched to all shareholders at least three days before the date of opening of the issue.

  However, if a specific request for letter of offer is received from any shareholder, the Lead Merchant Banker shall ensure that the letter of offer is made available to such shareholder.

– A disclosure to the effect that the securities offered through this rights issue shall be made fully paid up or may be forfeited within 12 months from the date of allotment of securities in the manner specified in SEBI ICDR Regulations.

– A Company can not make any further issue of capital during the period commencing from the submission of offer document to SEBI on behalf of the company for rights issues, till the securities referred to in the said offer document have been listed or application moneys refunded on account of non-listing or under subscription *etc.* unless full disclosures regarding the total capital to be raised from such further issues are made in the draft offer document.

– A Company can not issue any shares by way of rights unless it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments ,if any, in proportion to the convertible part.

– The share so reserved for the holders of fully or partially compulsorily convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms at which the equity shares offered in the rights issue were issued may be issued at the time of conversion(s) of such debentures on the same terms on which the rights issue was made.

– The Lead Merchant Banker shall ensure that in case of a rights issue, an advertisement giving the date of completion of despatch of letters of offer, shall be released in at least in an English National Daily with wide circulation, one Hindi National Paper and a Regional language daily circulated at the place where registered office of the issuer company is situated at least 3 days before the date of opening of the issue

– An issuer company shall not withdraw rights issue after announcement of record date in relation to such issue.

– In cases where the issuer has withdrawn the rights issue after announcing the record date, the issuer company shall not make an application for listing of any securities of the company for a minimum period of 12 months from the record date.

  However, shares resulting from the conversion of PCDs/ FCDs/ Warrants issued prior to the announcing of the record date in relation to rights issue may be granted listing by the concerned Stock exchange

– Rights issues shall be kept open for at least 15 days and not more than 30 days.

– The quantum of issue whether through a rights or a public issue, shall not exceed the amount specified in the prospectus/ letter of offer.

  However, an oversubscription to the extent of 10% of the net offer to public is permissible for the purpose of rounding off to the nearer multiple of 100 while finalising the allotment.

– If the issuer company does not receive the minimum subscription of ninety per cent. of the issue (including devolvement of underwriters where applicable), the entire subscription shall be refunded to the applicants within fifteen days from the date of closure of the issue.

– If there is delay after the company becomes liable to pay the subscription amount (*i.e.* fifteen days after closure of the issue), the issuer company will pay interest to the subscriber at the rate of 15% per annum for the period of delay.

– The time period for finalization of basis of allotment in the rights issues is 15 days from the date of closure of the issue.

– The issuer company may utilise the funds collected in the rights issue only after the basis of allotment is finalized.

STEPS INVOLVED IN ISSUE OF RIGHTS SHARES

The various steps involved for issue of rights share are enumerated below:

1. Check whether the rights issue is within the authorised share capital of the company. If not, steps should be taken to increase the authorised share capital.

2. In case of a listed company, notify the stock exchange concerned the date of Board Meeting at which the rights issue is proposed to be considered at least 2 days in advance of the meeting.

3. Rights issue shall be kept open for at least 15 days and not more than 30 days.

4. Convene the Board meeting and place before it the proposal for rights issue.

5. The Board should decide on the following matters:

   (i) Quantum of issue and the proportion of rights shares.

   (ii) Alteration of share capital, if necessary, and offering shares to persons other than existing holders of shares in terms of Section 62 of the Companies Act, 2013.

   (iii) Fixation of record date.

   (iv) Appointment of merchant bankers and underwriters (if necessary).

   (v) Approval of draft letter of offer or authorisation of managing director/ company secretary to finalise the letter of offer in consultation with the managers to the issue, the stock exchange and SEBI.

6. Immediately after the Board Meeting notify the concerned Stock Exchanges about particulars of Board's decision.

7. If it is proposed to offer shares to persons other than the shareholders of the company, a General Meeting has to be convened and a resolution is to be passed for the purpose in terms of Section 62 of the Companies Act, 2013.

8. Forward 6 sets of letter of offer to concerned Stock Exchange(s).

9. Despatch letters of offer to shareholders by registered post.

10. Check that an advertisement giving date of completion of despatch of letter of offer has been released in at least an English National Daily, one Hindi National Paper and a Regional Language Daily where registered office of the issuer company is situated.

11. Check that the advertisement contains the list of centres where shareholders or persons entitled to rights may obtain duplicate copies of composite application forms in case they do not receive original application form alongwith the prescribed format on which application may be made.

12. The applications of shareholders who apply both on plain paper and also in a composite application form are liable to be rejected.

13. Make arrangement with bankers for acceptance of share application forms.

14. Prepare a scheme of allotment in consultation with Stock Exchange.

15. Convene Board Meeting and make allotment of shares.

16. Make an application to the Stock Exchange(s) where the company's shares are listed for permission of listing of new shares.

BONUS ISSUE

A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares. The issue of bonus shares by a company is a common feature. When a company is prosperous and accumulates large distributable profits, it converts these accumulated profits into capital and divides the capital among the existing members in proportion to their entitlements. Members do not have to pay any amount for such shares. They are given free. The bonus shares allotted to the members do not represent taxable income in their hands. [*Commissioner of Income Tax, Madras* v. *A.A.V. Ramchandra Chettiar* (1964) 1 Mad CJ 281]. Issue of bonus shares is a bare machinery for capitalizing undistributed profits. The vesting of the rights in the bonus shares takes place when the shares are actually allotted and not from any earlier date.

Advantages of Issuing Bonus Shares

1. Fund flow is not affected adversely.
2. Market value of the Company's shares comes down to their nominal value by issue of bonus shares.
3. Market value of the members' shareholdings increases with the increase in number of shares in the company.
4. Bonus shares is not an income. Hence it is not a taxable income.
5. Paid-up share capital increases with the issue of bonus shares.

Pursuant to the provisions of Section 52 of the Companies Act, 2013, securities premium account can be used in paying up unissued shares of the company to be issued to its members as fully-paid bonus shares. Other free reserves created from out of the profits actually earned during earlier years like general reserve, capital redemption reserve account [Section 55(4)], devolvement rebate reserve *etc.* can be utilised by company for issue of fully paid bonus shares to its members.

There are no guidelines on issuing bonus shares by private or unlisted companies. However, SEBI has notified Regulations for Bonus Issue which are contained in Chapter IX of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 with regard to bonus issues by listed companies.

When a company has accumulated free reserves and is desirous of bridging the gap between the capital and fixed assets, it issues bonus shares to its equity shareholders. Such an issue would not place any fresh funds in the hands of the company. On the contrary, after a bonus issue it would become necessary for the company to earn more to effectively service the increased capital. The shareholder will, however, be benefitted by way of increased return on investment and increased number of shares in their hands.

The following conditions must be satisfied before issuing bonus shares:

(a) Bonus Issue must be authorised by the articles of the company. Such a provision is generally there in articles of almost all the companies as they adopt Table A of Schedule 1 of the Companies Act, 2013, Regulation 96 of ICDR Regulations, 2009.

(b) Bonus Issue must be sanctioned by shareholders in general meeting on recommendation of the Board of directors of the company.

(c) Regulations issued by SEBI must be complied with.

(d) Authorised Capital must be increased where necessary.

SEBI Regulations Pertaining to Bonus Issue

1. Rights of FCD/PCD holders

The proposed bonus issue should not dilute the value or rights of the fully or partly convertible debentures.

A company shall not make a bonus issue of equity shares unless it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments ,if any, in proportion to the convertible part thereof.

The equity shares so reserved for the holders of fully or partly compulsorily convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion at which the bonus shares were issued.

2. Out of Free Reserves

The bonus issue is to be made out of free reserves built out of the genuine profits or securities premium collected in cash only.

3.Revaluation Reserves

The reserves created by revaluation of fixed assets should not be capitalised. These reserves are in fact capital reserves. However, if the assets are subsequently sold and the profits are realised, such profits could be utilised for capitalisation purposes. In fact the Government has in the past approved issue of bonus shares out of capital reserves representing realised capital profits.

4. Bonus Issue not to be in lieu of Dividend

Bonus issue should not be made in lieu of dividend.

5. Fully Paid Shares

If there are any partly paid-up shares outstanding on the date of allotment, these shares should be made fully paid-up before the bonus issue is made.

6. No Default in respect of Fixed Deposits/Debentures

The company should not have defaulted in the payment of any interest or principal in respect of its fixed deposits, debt securities issued by it.

7. Statutory Dues of the Employees

The company should not have defaulted in the payment of its statutory dues to the employees such as contribution to provident fund, gratuity, bonus.

8. Implementation of Proposal within fifteen days

A company which announces bonus should implement bonus issue within fifteen days issue after the approval of board of directors and does not require shareholders' approval for capitalisation of profits or reserves for making bonus issue as per the Articles of Association and shall not have the option of changing the decision.

However, where the company is required to seek shareholders' approval for capitalisation of profits or reserves for making bonus issue as per the Articles of Association, the bonus issue should be implemented within two months from the date of the meeting of the board of directors wherein the decision to announce bonus was taken subject to shareholders' approval.

9. Provision in Articles of Association

The Articles of Association of the Company should provide for capitalisation of reserves and if not a General Body Meeting of the company is to be held and a special resolution making provisions in the Articles of Association for capitalisation should be passed.

10. Authorised Capital

If consequent upon the issue of bonus shares, the subscribed and paid-up capital of the company exceed the authorised share capital, a General Meeting of the company should be held to pass necessary resolution for increasing the authorised capital.

Steps involved in Issue of Bonus Shares

A company issuing bonus shares should ensure that the issue is in conformity with the Regulations for bonus issue laid down by SEBI (ICDR) Regulations, 2009.

The procedure for issue of bonus shares by a listed company is enumerated below:

1. Ensure that if conversion of FCDs/PCDs is pending, similar benefit has been extended to the holders of such FCDs/PCDs, through reservation of shares in proportion of such convertible part of FCDs/PCDs. The shares so reserved may be issued at the time of conversion(s) of such debentures on the same terms on which the bonus issue was made.
2. Ensure that bonus issue has been made out of free reserves built out of the genuine profits or securities premium collected in cash only.
3. Ensure that reserves created by revaluation of fixed assets are not capitalised.
4. Ensure that the company has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it or in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus *etc.*
5. Ensure that the bonus issue is not made in lieu of dividend.
6. There should be a provision in the articles of association of the company permitting issue of bonus shares; if not, steps should be taken to alter the articles suitably.
7. The share capital as increased by the proposed bonus issue should be well within the authorised capital of the company; if not, necessary steps have to be taken to increase the authorised capital.
8. Finalise the proposal and fix the date for the Board Meeting for considering the proposal and for authorising the taking up of incidental and attendant matters.
9. If there are any partly paid-up shares, ensure that these are made fully paid-up before the bonus issue is recommended by the Board of directors.
10. The date of the Board Meeting at which the proposal for bonus issue is proposed to be considered should be notified to the Stock Exchange(s) where the company's shares are listed.
11. Hold the Board Meeting and get the proposal approved by the Board.
12. The resolution to be passed at the General Meeting should also be approved by the Board in its meeting. The intention of the Board regarding the rate of dividend to be declared in the year after the bonus issue should be indicated in the resolution for bonus issue to be passed by members in general meeting.
13. Immediately after the Board meeting intimate the Stock Exchange(s) regarding the outcome of the Meeting.
14. Ensure that the company has announced bonus issue after the approval of Board of Directors and did not

require shareholders' approval for capitalization of profits or reserves for making bonus issue as per the Article of Association, had implemented bonus issue within fifteen days from the date of approval of the issue by the board of directors of the company and must not have the option of changing the decision.

However, where the company was required to seek shareholders' approval for capitalization of profits or reserves for making bonus issue as per the Article of Association, the bonus issue has implemented within two months from the date of the meeting of the Board of Directors where in the decision to announce bonus was taken subject to shareholders' approval.

15. Arrangements for convening the general meeting should then be made keeping in view the requirements of the Companies Act, with regard to length of notice, explanatory statement *etc.* Also three copies of the notice should be sent to the Stock Exchange(s) concerned.
16. Hold the general meeting and get the resolution for issue of bonus shares passed by the members. A copy of the proceedings of the meeting is to be forwarded to the concerned Stock Exchange(s).
17. In consultation with the Regional Stock Exchange fix the date for closure of register of members or record date and get the same approved by the Board of directors. Issue a general notice under Section 91 of Companies Act, 2013 in respect of the fixation of the record date in two newspapers one in English language and other in the language of the region in which the Registered Office of the company is situated.
18. Give 7 days notice to the Stock Exchange(s) concerned before the date of book closure/record date.
19. After the record date process the transfers received and prepare a list of members entitled to bonus shares on the basis of the register of members as updated. This list of allottees is to be approved by the Board or any Committee thereof. The list usually serves as allotment list and on this basis the allotment is to be made to the eligible members.
20. File return of allotment with the Registrar of Companies within 30 days of allotment (Section 39 of the Companies Act, 2013). Also intimate Stock Exchange(s) concerned regarding the allotments made.
21. Ensure that the allotment is made within fifteen days of the date on which the Board of directors approved the bonus issue.
22. Submit an application to the Stock Exchange(s) concerned for listing the bonus shares allotted.

PREFERENTIAL ISSUE

Preferential issue means issuance of equity shares to promoter group or selected investors. It covers allotment of fully convertible debentures, partly convertible debentures or any other financial instruments that could be converted into equity shares at a later date. The investors could be institutional investors, private equity investors, high net-worth individuals, or companies.

Preferential issue is one of the key sources of funding for companies. It has its own advantages and disadvantages. One of the biggest advantages of a preferential issue is that the company can raise money quickly and cheaply compared with other means of raising money, say IPO or issue of shares on a rights basis.

On the other hand, preferential issues and private placement is only for selected class of investors and not for the retail investors. It is like a wholesale market, where institutions with financial clout are allowed to participate. This deprives investment opportunity to the retail investors.

SEBI ICDR Regulations, 2009 Pertaining to Preferential Issue

1. Applicability

The preferential issue of equity shares/Fully Convertible Debentures (FCDs)/ Partly Convertible Debentures

(PCDs) or any other financial instruments which would be converted into or exchanged with equity shares at a later date, by listed companies whose equity share capital is listed on any stock exchange, to any select group of persons under Section 62 of the Companies Act, 2013 on private placement basis is governed by these Regulations.

2. Pricing of the issue

(i) Where the equity shares of the company have been listed on a stock exchange for a period of twenty six weeks or more as on the relevant date, the issue of equity shares on preferential basis is being made at a price not less than higher of the following:

(a) The average of the weekly high and low of the closing prices of the related equity shares quoted on the stock exchange during the twenty six weeks preceding the relevant date;

OR

(b) The average of the weekly high and low of the closing prices of the related equity shares quoted on a stock exchange during the two weeks preceding the relevant date.

(ii) Where the equity shares of a company have been listed on a stock exchange for a period of less than twenty six weeks as on the relevant date, the issue of shares on preferential basis has been made at a price not less than the higher of the following:

(a) The price at which shares were issued by the company in its IPO or the value per share arrived at in a scheme of arrangement under Section 230 to 232 of the Companies Act, 2013, pursuant to which shares of the company were listed , as the case may be;

OR

(b) The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the period shares have been listed preceding the relevant date;

OR

(c) The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date."

Where the price of the equity shares is determined in terms of provision (ii), such price shall be recomputed by the issuer on completion of twenty six weeks from the date of listing on a recognized stock exchange with reference to the average of weekly high and low of the closing prices of the related equity shares quoted on the recognized stock exchange during these twenty six weeks and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.

An issue of shares on preferential basis to Qualified Institutional Buyers not exceeding five in numbers all be made at a price not less than the average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

Relevant date means the date thirty days prior to the date on which the meeting of general body of shareholders is held, in terms of Section 62 of the Companies Act, 2013.

3. Upfront Payment on warrants

(i) A an amount equivalent to at least twenty five per cent of price of shares fixed should be paid on the date of their allotment.

(ii) This amount would be adjusted against the price payable subsequently on acquisition of shares by exercising an option for the purpose.

(iii) If the option to acquire shares is not exercised, the amount so paid would stand forfeited.

4. Disclosures

The explanatory statement to the notice for the general meeting contains the details about the objects of the issue through preferential offer, intention of promoters/directors/key management persons to subscribe to the offer, shareholding pattern before and after the offer, proposed time within which the allotment shall be complete, identity of the proposed allottees and the percentage of post-preferential issue capital that may be held by them.

5. Tenure of Convertible Securities

The tenure of the convertible securities of the issuer does not exceed beyond 18 months from the date of their allotment.

6. Lock-in-period

(i) The specified securities allotted on a preferential basis to the promoter or promoter group and the equity shares allotted to such promoter or promoter group pursuant to exercise of options attached to warrants issued on preferential basis are subjected to lock in period of three years from the date of their allotment.

However, not more than 20% of the total capital of the company, should be locked in for a period of three years from the date of allotment.

Further the equity shares allotted in excess of twenty percent pursuant to exercise of options attached to warrants issued on preferential basis to promoter/promoter group of the issuer, should be locked-in for a period of one year from the date of their allotment

(ii) The specified securities allotted on preferential basis and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to any person other than the promoter/ promoter group of the issuer should be locked in for a period of one year from the date of their allotment.

(iii) Shares acquired by conversion of the convertible instruments other than warrants should be locked in for a period as reduced by the extent the convertible instrument other than warrants have already been locked in.

(iv) The lock-in period in respect of shares issued on preferential basis pursuant to a scheme approved under Corporate Debt Restructuring framework of Reserve Bank of India, shall commence from the date of allotment and has been continued for a period of one year and in case of allotment of partly paid up shares the lock-in period shall commence from the date of allotment and continue for a period of one year from the date when shares become fully paid up.

(v) No listed company shall make preferential issue of equity shares/ warrants/ convertible instruments to any person unless the entire shareholding of such persons in the company, if any, is held by him in dematerialized form.

(vi) The entire pre preferential allotment shareholding of such allottees shall be under lock-in from the relevant date upto a period of six months from the date of preferential allotment.

(vii) The shares/ warrants/ convertible instruments shall be issued on preferential basis, the shareholders who have sold their shares during the six months period prior to the relevant date shall not be eligible for allotment of shares on preferential basis.

7. Allotment Pursuant to Shareholders Resolutions

(i) Allotment pursuant to any resolution passed at a meeting of shareholders of a company granting consent for preferential issues of any financial instrument shall be completed within a period of fifteen days from the date of passing of the resolution.

However, where any application for exemption for the allotment on preferential basis is pending on account of pendency of any approval of such allotment by any regulatory authority or the Central Government; the allotment shall be completed within 15 days from the date of such approval.

However, SEBI has granted relaxation to the issuer in terms of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, the preferential allotment of shares, fully convertible debentures and partly convertible debentures, shall be made by it within such time as may be specified by SEBI in its order granting relaxation.

(ii) The equity shares and securities convertible into equity shares at a later date, allotted in terms of the above said resolution shall be made fully paid up at the time of their allotment

However payment in case of warrants shall be made in terms of these Regulations.

(iii) Nothing contained in the above mentioned shall apply in case of allotment of shares and securities convertible into equity shares at a later date on preferential basis pursuant to a scheme of Corporate Debt Restructuring framework specified by the Reserve Bank of India.

(iv) If allotment of instruments and dispatch of certificates is not completed within fifteen days from the date of such resolution, a fresh consent of the shareholders shall be obtained.

8. Compliance Certificate

(i) A certificate is obtained from the statutory auditors of Issuer Company certifying that the preferential issue of instruments is being made in accordance with the requirements of SEBI Regulations.

(ii) The auditor certificate shall be placed before the meeting of shareholders convened to consider the proposed issue.

9. Submission of Valuation Report

In case of preferential allotment of shares to promoters, their relatives, associates and related entities, for consideration other than cash, valuation of assets in consideration for which the shares are proposed to be issued, shall be done by an independent qualified valuer. The valuation report has been submitted to the exchanges on which shares of issuer company are listed.

10. Use of Issue Proceeds

The details of all monies utilised out of the preferential issue proceeds should be disclosed under an appropriate head in the balance sheet of the company indicating the purpose for which such monies have been utilised. The details of unutilised monies should also be disclosed under a separate head in the balance sheet of the company indicating the form in which such utilised monies have been invested.

11. Other Requirements

- A special resolution is required to be passed by its shareholders.
- All the equity shares if any, held by the proposed allottees in the issuer are in dematerialise form.
- An issuer cannot make preferential issue of securities to any person who has sold any equity shares of the issuer during the six months proceeding the relevant date.
- A listed company shall not make any preferential issue of specified securities unless it is in compliance with the conditions for continuous listing.
- A listed company shall not make any preferential allotment of specified securities unless it has obtained the Permanent Account Number of the proposed allottees.

Non-Applicability

(1) These regulations are not applicable in case of the following:

(a) pursuant to conversion of loan or option attached to convertible debt instruments in terms Sections 62 of the Companies Act, 2013.

(b) pursuant to a scheme approved by a High Court under Section 230 to 232 of the Companies Act, 2013.

(c) in terms of the rehabilitation scheme approved by the Board of Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985.

(2) Pricing and lock-in provisions of ICDR Regulations shall not apply to equity shares allotted to any financial institution within the meaning of sub-clauses (ia) and (ii) of Clause (h) of Section 2 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993.

(3) Disclosure and pricing relating to a preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, where SEBI has granted relaxation to the issuer in terms of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, if adequate disclosures about the plan and process proposed to be followed for identifying the allottees are given in the explanatory statement to notice for the general meeting of shareholders.

(4) Criteria relating to Lock-in and selling of equity shares during six months preceding the preferential issue shall not apply to preferential issue of specified securities where the proposed allottee is a Mutual Fund registered with SEBI or Insurance Company registered with Insurance Regulatory and Development Authority.

QUALIFIED INSTITUTIONS PLACEMENT

A Qualified Institutions Placement means allotment of eligible securities by a listed issuer to qualified institutional buyers on private placement basis in terms of SEBI (ICDR) Regulations. This QIP is different from offer of securities to qualified institutional buyers in an IPO.

Qualified Institutional Buyer

(i) A mutual fund, venture capital fund and foreign venture capital investor registered with SEBI;

(ii) A foreign institutional investor and sub-account (other than a sub-account which is a foreign corporate or foreign individual), registered with SEBI;

(iii) A public financial institution as defined in 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 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 Department of Posts, India.

Eligible securities for the purpose of QIP

Eligible Securities include equity shares, non-convertible debt instruments along with warrants and convertible securities other than warrants.

Relevant date

In case of allotment of equity shares, the date of the meeting in which the board of directors or the committee of directors duly authorised by the board of directors of the issuer decides to open the proposed issue .In case of allotment of eligible convertible securities, either the date as mentioned above or the date on which the holders of such convertible securities become entitled to apply for the equity shares.

Conditions for making QIP

A listed issuer can make qualified institutions placement subject to the following conditions:

– A special resolution approving the issue is required to be passed by its shareholders.

– Prior to the date of issuance of notice to its shareholders for convening the meeting to pass the special resolution, the equity shares of the same class, which are proposed to be allotted through QIP, are listed on a recognised stock exchange having nation wide trading terminal for a period of at least one year.

– If an issuer, being a transferee company in a scheme of merger, de-merger, amalgamation or arrangement sanctioned by a High Court under sections 230 to 232 of the Companies Act, 2013, makes QIP, the period for which the equity shares of the same class of the transferor company were listed on a stock exchange having nation wide trading terminals are also eligible to be considered for the purpose of computation of the period of one year.

– It is in compliance with the requirement of minimum public shareholding specified in the listing agreement with the stock exchange.

– In the special resolution, it shall be, among other relevant matters, the resolution must specify the relevant date and the also specify that the allotment is proposed to be made through QIP.

Intermediaries involved in QIP and their roles

A Qualified Institutions Placement is required to be managed by merchant banker(s) who will exercise due diligence.

While seeking in-principle approval for listing of the eligible securities issued under qualified institutions placement, the merchant banker furnishes to each stock exchange on which the same class of equity shares of the issuer are listed, a due diligence certificate regarding compliance of ICDR regulations and stating that the eligible securities are being issued under qualified institutions placement.

Placement document

'Placement Document' means document prepared by Merchant Banker for the purpose of Qualified Institutions Placement and contains all the relevant and material disclosures to enable QIBs to make an informed decision.

Disclosures required to be made in Placement Document

– The qualified institutions placement is required to be made on the basis of a placement document which contains all material information, including those specified in ICDR Regulations.

– The placement document needs to be serially numbered and copies are required to be circulated only to select Investors.

– The issuer, while seeking in-principle approval from the recognised stock exchange is require to furnish a copy of the placement document, a certificate confirming compliance with the provisions ICDR Regulations along with any other documents required by the stock exchange.

– The placement document is required to a be placed on the website of the issuer and concerned stock exchange with a disclaimer to the effect that it is in connection with a Qualified Institutions Placement and that no offer is being made to the public or to any other category of investors.

Time period for filing the copy of placement document with SEBI

A copy of the placement document is required to be filed with SEBI for its record within thirty days of the allotment of eligible securities.

Pricing

The Qualified Institutions Placement is required to be made at a price not less than the average of the weekly high and low of the closing prices of the equity shares of the same class listed on the stock exchange during the two weeks preceding the relevant date.

If the eligible securities are convertible into or exchangeable with equity shares the issuer is require to determine the price of such equity shares allotted pursuant to such conversion or exchange taking the relevant date as decided and disclosed by it while passing the special resolution.

Issue of partly paid-up securities

An issuer can not allot partly paid up eligible securities. In case of allotment of equity shares on exercise of options attached to warrants, such equity shares shall be fully paid up. However, on allotment of non convertible debt instruments along with warrants, the allottees can pay the full consideration or part thereof payable with respect to warrants, at the time of allotment of such warrants.

The prices determined for Qualified Institutions Placement are subject to appropriate adjustments in certain cases. If the issuer :

– makes an issue of equity shares by way of capitalization of profits or reserves, other than by way of a dividend on shares.

– makes a rights issue of equity shares.

– consolidates its outstanding equity shares into a smaller number of shares.

– divides its outstanding equity shares including by way of stock split.

– re-classifies any of its equity shares into other securities of the issuer.

– is involved in such other similar events or circumstances, which in the opinion of the concerned stock exchange, requires adjustments.

Here stock exchange means any of the recognised stock exchanges in which the equity shares of the same class of the issuer are listed and in which the highest trading volume in such equity shares has been recorded during the two weeks immediately preceding the relevant date.

Restrictions on allotment

– Minimum 10% of eligible securities is required to be allotted to mutual funds. In case the mutual funds do not subscribe to said minimum percentage or any part thereof, such minimum portion or part thereof can be allotted to other qualified institutional buyers.

– An allotment can not be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to promoters of the issuer.

– A qualified institutional buyer who does not hold any shares ‘in the issuer and who has acquired the said rights in the capacity of a lender can not be deemed to be a person related to promoters.

– In a qualified institutions placement of non-convertible debt instrument along with warrants, an investor can subscribe to the combined offering of-non- convertible debt instruments with warrants or to the individual securities, that is, either non- convertible debt instruments or warrants.

Here a Qualified Institutional Buyer who has any of the following rights is deemed to be a person related to the promoters of the issuer:

(a) rights under a shareholders' agreement or voting agreement entered into with promoters or persons related to the promoters.

(b) veto rights or

(c) right to appoint any nominee director on the board of the issuer.

> ***Do you know?***
>
> The applicants in Qualified Institutions Placement can not withdraw their bids after the closure of the issue.

Minimum numbers of allottees

– If the size of the issue is less than of equal to 250 crore rupees minimum two allottees for each placement and where the issue size is greater than 250 rupees minimum of five allottees required.

– A single allottee can not be allotted more than 50% of the issue size.

– The qualified institutional buyers belonging to the same group or who are under same control are deemed to be a single allottee.

Validity of the special resolution

An allotment pursuant to the special resolution approving the proposed QIP is required to be completed within a period of twelve months from the date of passing of the resolution.

The issuer can not make subsequent Qualified Institutions Placement until expiry of six months from the date of the prior qualified institutions placement made pursuant to one or more special resolutions.

> ***Do you know ?***
>
> Allotment to QIBs is to be made with in 12 months of passing Special Resolution approving such allotment.

Restriction on amount raised

The aggregate of the proposed QIP and all previous QIPs made by the issuer in the same financial year should not exceed five times the net worth of the issuer as per the audited balance sheet of the previous financial year.

Tenure

The tenure of the convertible or exchangeable eligible securities issued through qualified institutions placement should not be more than sixty months from the date of allotment.

Transferability of Securities

The eligible securities allotted can not be sold by the allottee for a period of one year from the date of allotment, except on a recognised stock exchange.

INSTITUTIONAL PLACEMENT PROGRAMME

"Institutional Placement Programme" means a further public offer of eligible securities by an eligible seller, in which the offer, allocation and allotment of such securities is made only to Qualified Institutional Buyers in terms of Chapter VIII A of SEBI ICDR Regulations, 2009.

SEBI vide its notification dated January 30, 2012 has amended the Issue of Capital and Disclosure Requirements Regulations, 2009 whereby Chapter VIII-A - Institutional Placement Programme (IPP) has been inserted.

The provisions of this Chapter shall apply to issuance of fresh shares and or offer for sale of shares in a listed issuer for the purpose of achieving minimum public shareholding in terms of Rule 19(2)(b) and 19A of the Securities Contracts (Regulation) Rules, 1957.

Conditions for Institutional Placement Programme

- An institutional placement programme may be made only after a special resolution approving the institutional placement programme has been passed by the shareholders of the issuer in terms of section 62 of the Companies Act, 2013.
- No partly paid-up securities shall be offered.
- The issuer shall obtain an in-principle approval from the stock exchange(s).

Appointment of Merchant Banker

An institutional placement programme shall be managed by merchant banker(s) registered with SEBI who shall exercise due diligence.

Offer Document

- The institutional placement programme shall be made on the basis of the offer document which shall contain all material information.
- The issuer shall, simultaneously while registering the offer document with the Registrar of Companies, file a copy thereof with SEBI and with the stock exchange(s) through the lead merchant banker.
- The issuer shall file the soft copy of the offer document with SEBI, along with the fee.
- The offer document shall also be placed on the website of the concerned stock exchange and of the issuer clearly stating that it is in connection with institutional placement programme and that the offer is being made only to the Qualified Institutional Buyers.
- The merchant banker shall submit to SEBI a due diligence certificate, stating that the eligible securities are being issued under institutional placement programme and that the issuer complies with requirements of this Chapter.

Pricing and Allocation/allotment

- The eligible seller shall announce a floor price or price band at least one day prior to the opening of institutional placement programme.
- The eligible seller shall have the option to make allocation/allotment as per any of the following methods -
  - proportionate basis;
  - price priority basis; or
  - criteria as mentioned in the offer document.
- The method chosen shall be disclosed in the offer document.
- Allocation/allotment shall be overseen by stock exchange before final allotment.

Restrictions

- The promoter or promoter group who are offering their eligible securities should not have purchased and/ or sold the eligible securities of the company in the twelve weeks period prior to the offer and they should undertake not to purchase and / or sell eligible securities of the company in the twelve weeks period after the offer. However, such promoter or promoter group may , within the twelve weeks period offer eligible securities held by them through institutional placement programme or offer for sale through stock exchange mechanism subject to the condition that there shall be a gap of minimum two weeks between the two successive offer(s) and /or programme(s)
- Allocation/allotment under the institutional placement programme shall be made subject to the following conditions:
  - Minimum of twenty five per cent of eligible securities shall be allotted to mutual funds and insurance companies. However, if the mutual funds and insurance companies do not subscribe to said minimum percentage or any part thereof, such minimum portion or part thereof may be allotted to other qualified institutional buyers;
  - No allocation/allotment shall be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to promoters of the issuer. However, a qualified institutional buyer who does not hold any shares in the issuer and who has acquired the rights in the capacity of a lender shall not be deemed to be a person related to promoters.
  - The issuer shall accept bids using ASBA facility only.
  - The bids made by the applicants in institutional placement programme shall not be revised downwards or withdrawn.

Restrictions on size of the offer

- The aggregate of all the tranches of institutional placement programme made by the eligible seller shall not result in increase in public shareholding by more than ten per cent or such lesser per cent as is required to reach minimum public shareholding.
- Where the issue has been oversubscribed, an allotment of not more than ten percent of the offer size shall be made by the eligible seller.

Period of Subscription and display of demand

- The issue shall be kept open for a minimum of one day or maximum of two days.
- The aggregate demand schedule shall be displayed by stock exchange(s) without disclosing the price.

Withdrawal of offer

The eligible seller shall have the right to withdraw the offer in case it is not fully subscribed.

Transferability of eligible securities

The eligible securities allotted under institutional placement programme shall not be sold by the allottee for a period of one year from the date of allocation/allotment, except on a recognised stock exchange.

LISTING AGREEMENT

Listing means admission of securities to dealings on a recognised stock exchange. The securities may be of any public limited company, Central or State Government, quasi governmental and other financial institutions/ corporations, municipalities, *etc.*

Benefits of listing

The following benefits accrue to a company whose securities are listed on the stock exchange–

(1) Public image of the company is enhanced.

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

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

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

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

Listing Agreement

Listing Agreement means a document which a company signs when being listed on the Stock Exchange, in which the company promises to abide by stock exchange regulations, bye laws.

Laws governing Listing

– Securities Contracts (Regulation) Act, 1956

– Securities Contracts (Regulation) Rules, 1957

– Companies Act, 2013

– Guidelines issued by SEBI and

– Rules, Bye-laws and Regulations of respective Stock Exchange.

– Listing Agreement

Event based and time based Compliance under Listing Agreement

EVENT BASED COMPLIANCES

Sl. No.	Clause No. of Listing Agreement	Particulars of Compliance	Advance Notice/Intimation
1.	13	Intimation of particulars of the securities affected due to the prohibitory orders restraining the company from transfer.	Promptly notify the Exchange
2.	16	Date of closure of transfer books/ record date. Notice of Corporate action like mergers, demergers, split and bonus sahres	7 working days advance notice required,. Atleast 7 working days notice is required.
3.	19 (a)	Prior Intimation of Board Meeting having agenda of Buy back, dividend, Rights Issue, Bonus Shares, issue of Convertible debentures.	2 working days advance notice required.
4.	19 (e)	Intimation of Board meeting regarding the FPO to be made through fix price route.	Atleast 48 hours in advance of the board meeting.
5.	20	Intimation by phone, fax, telegram, e-mail, details	Within 15 minutes of

		of dividend/cash bonuses, buy back of securities, the total turnover, gross profit/ loss, provision for depreciation, tax provisions and net profits for the year (with comparison with the previous year) and the amounts appropriated from reserves, capital profits, accumulated profits of past years or other special source to provide wholly or partly for the dividend even if this calls for qualification that such information is provisional or subject to audit.	conclusion of Board Meeting.
6.	22	Intimate by phone, fax, telegram, e-mail, short particulars of increase in share capital, alteration in capital, re-issue of forfeited shares *etc.*	Within 15 minutes of conclusion of Board Meeting.
7.	24 (d)	SEBI acknowledgement card/ observations received on draft prospectus, certificate from lead merchant banker ensuring positive compliance with SEBI ICDR regulations 2009.	Immediately on the receipt of acknowledgement card from SEBI.
8.	24 (f)/24 (i)	File copy of Scheme/Petition proposed to be filed before any Court under section 230/232 & 66 of Companies Act, 2013 along with auditor's certificate ensuring compliance with all Accounting Standards Specified by the Central Government in Section 2(2) of Companies Act, 2013.	1 month before it is presented to the court.
9.	25	Intimation regarding details of granting option by the company, if any.	Promptly notify the Exchange.
10.	26	Intimation with respect to the redemption of securities otherwise than pro rata or lot basis, if any.	Promptly notify the Exchange.
11.	27	Actions resulting redemption cancellation, retirement, drawing of securities and date of drawing and period of the closing of transfer books for such drawing.	Promptly notify the Exchange.
12.	28	Prior intimation of change in the form of nature of any of the securities of the company.	Promptly notify the Exchange.
13.	29	Intimation about any proposed change in the general character or nature of its business.	Notify promptly the Exchange.
14.	30	Notification of change in Board of Directors, MD, Managing agents, secretaries, treasurers, and auditors *etc.*	Notify promptly the Exchange.
15.	31	Six copies of the Statutory and Directors' Annual Reports, Balance Sheets and Profits & Loss Accounts and of all periodical and special reports, all notices, circulars relating to new issue. Three copies of all the notices, call letters or any other circulars including notices of meetings convened u/s 230 or Section 232 read with Section 230 of the Companies Act, 2013 together with Annexures.	Forward promptly to the Exchange.

		Copy of proceedings of all AGM/EGM.	
16.	33	File 6 copies of amended AOA & MOA (one of which will be certified) and copies of all notices sent to the shareholders with respect to such amendments.	As soon as the amendments to the MOA and AOA are approved in the general meeting.
17.	35	Filing of shareholding pattern separately for each class of equity shares/security. Corporate restructuring of the company resulting in a change exceeding +/- 2% of the total paid-up capital.	One day prior to listing of its securities on the stock exchanges. On a quarterly basis, within 21 days from the end of each quarter. Within 10 days of any corporate restructuring.
18.	35A	Submit details of the voting results of the AGM/EGM.	Within 48 hours of the conclusion of the AGM/ EGM.
19.	36	Intimation of events/happenings having important bearings and which are likely to materially affect the financial performance of the Company and its stock prices like strikes, lock-outs, closure of units for any reason, disruption of operations due to natural calamity, litigation/dispute having material impact. Any price sensitive information like acquisition, merger, amalgamation, delisting, share forfeiture etc;	Notify the Exchange on Occurrence and after the Event.
20.	43	Furnishing the details indicating the variations between projected utilisation of funds and/ or projected profitability statement made by it in its prospectus or letter of offer and the actual utilisation of funds and/or actual profitability.	On a quarterly basis.
21.	43A	Furnish a statement indicating material deviations, if any, in the use of proceeds of a public or rights issue from the objects stated in the offer document. Intimation about any deviation in the use of the proceeds or any other reservations about the end use of fund given by the monitoring agency.	On a quarterly basis. Immediately without any delay after receiving the reservations from the monitoring agency.
22.	47 (a)	The Company is required to appoint a Compliance Officer.	Inform on appointment and as and when there is change in the Compliance Officer.
23.	47 (e)	Submit copy of MOU executed with RTA	Within 48 hours of execution of MOU
24.	52	Electronic filing of information through Corporate Filing	Information as may be

		and Dissemination System(CFDS)	specified by the participating exchanges.
25.	53	Intimation to the exchange when entered into agreement with media companies about : – The shareholding (if any) of such media companies/ associates in the issuer company. – Details of nominee of the media companies on the Board of the issuer company, any management control or potential conflict of interest arising out of such agreements, *etc.* – Any other back to back treaties/contracts/agreements/ MoUs or similar instruments entered into by the issuer company with media companies and/or their associates for the purpose of advertising, publicity, *etc.*	Immediately upon entering into agreement with media companies or their associates.
26.	55	Listed entities shall submit, as part of their Annual Reports, Business Responsibility Reports, describing the initiatives taken by them from an environmental, social and governance perspective, in the format prescribed by SEBI.	Promptly to the stock exchange as soon as the annual report is issued

TIME BASED COMPLIANCES

Sl. No.	Particulars of Compliance	Clause of Listing Agreement	Due Date
For 1st Quarter ended 30th June			
1.	Submit quarterly Corporate Governance Compliance reports.	49 (VI)(ii)	15th July
2.	Submit Shareholding Pattern as at the end of quarter.	35	21st July
3.	Notice to Stock Exchange for holding Board Meeting to approve Unaudited Financial Results along with limited review report for the 1st Quarter	41	6th August
4.	Publication of Notice in 2 Newspapers (one English language circulating in substantially whole of India and in one Regional Language newspaper of the State in which Registered Office of the Company is situated).	41	6th August
5.	To hold Board Meeting for approval of Unaudited Financial Results	41	14th August
6.	Approved Unaudited Financial Results submitted to Stock Exchange within 15 minutes of conclusion of the Board Meeting	41	14th August
7.	Publish approved Unaudited Financial Results within 48 hours of Board Meeting	41	16th August
For 2nd Quarter ended 30th Sept & AGM			
8.	Submit quarterly Corporate Governance Compliance reports.	49 (VI) (ii)	15th October
9.	Submit Shareholding Pattern as at the end of quarter.	35	21st October

10.	Notice to Stock Exchange for holding Board Meeting to approve Un-audited Financial Results along with limited review report for the 2nd Quarter	41	7th November
11.	Publication of Notice in 2 Newspapers (one English language circulating in substantially whole of India and in one Regional Language newspaper of the State in which Registered Office of the Company is situated).	41	7th November
12.	To hold Board Meeting for approval of Un-audited Financial Results	41	15th November
13.	Approved Un-audited Financial Results submitted to Stock Exchange within 15 minutes of conclusion of the Board Meeting	41	15th November
14.	Publish approved Unaudited Financial Results within 48 hours of Board Meeting	41	17th November
15.	Submit Certificate obtained from Practising Company Secretary certifying that all certificates have been issued within one month of lodgement for transfer, sub-division *etc.* for the half year ended 30th September.	47(c)	30th Oct.
For 3rd Quarter ended on 30th December			
16.	Submit quarterly Corporate Governance Compliance reports.	49 (VI) (ii)	15th Jan.
17.	Submit Shareholding Pattern as at the end of quarter.	35	21st Jan
18.	Notice to Stock Exchange for holding Board Meeting to approve Un-audited Financial Results for the 3rd Quarter	41	6th February
19.	Publication of Notice in 2 Newspapers (one English language circulating in substantially whole of India and in one Regional Language newspaper of the State in which Registered Office of the Company is situated).	41	22nd Jan
20.	To hold Board Meeting for approval of Un-audited Financial Results	41	14th February
21.	Approved Un-audited Financial Results submitted to Stock Exchange along with limited review report for the 3rd Quarter within 15 minutes of conclusion of the Board Meeting	41	14th February
22.	Publish approved Un-audited Financial Results within 48 hours of Board Meeting held.	41	16th February
For 4th Quarter ended on March 31st			
23.	Submit quarterly Corporate Governance Compliance reports.	49 (VI) (ii)	15th April
24.	Submit Shareholding Pattern as at the end of quarter.	35	21st April
25.	Pay Annual Listing fee.	38	30th April
26.	Submit half yearly Certificate obtained from Practising Company Secretary.	47(c)	30th April
27.	Notice to Stock Exchange (SE) for holding Board Meeting (BM) to approve Un-audited Financial Results(UAFR), subject to Limited Review Report (LRR) by Statutory Auditors, for the quarter ended on 31st March	41	7th May

28.	Publication of Notice in 2 Newspapers (one English language circulating in substantially whole of India and in one Regional Language newspaper of the State in which Registered Office of the Company is situated).	41	7th May
29.	To hold Board Meeting for approval of un-audited financial results.	41	15th May
30.	Submit un-audited financial results to the SE within 15 minutes of conclusion of the BM.	41	15th May
31.	Publication of un-audited financial results in atleast one English daily newspaper and one daily regional newspaper within 48 hours of conclusion of Board Meeting.	41	17th May
32.	Notice to Stock Exchange (SE) for holding Board Meeting (BM) to approve Audited Financial Results	41	22nd May
33.	Publication of Notice in 2 Newspapers (one English language circulating in substantially whole of India and in one Regional Language newspaper of the State in which Registered Office of the Company is situated).	41	22nd May
34.	To hold Board Meeting for approval of financial results.	41	30th May
35.	Submit audited Financial Results to the Stock Exchange within 15 minutes of conclusion of the Board Meeting	41	30th May
36.	Publication of financial results in atleast one English daily newspaper and one daily regional newspaper within 48 hours of conclusion of Board Meeting.	41	June 1st
37.	Submit shareholding pattern, annual Corporate Governance Report, Quarterly Results, Half yearly financial statements, Statement of action taken against the company by any regulatory agency and full version of annual report on SEBI www.corpfiling.co.in	52	Within such time as specified by SEBI.

LISTING ON INSTITUTIONAL TRADING PLATFORM

(a) Applicability- These provisions shall apply to entities which seek listing of their securities exclusively on the ITP either pursuant to a public issue or otherwise. Provisions of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 that shall not apply to such entities.

(i) Provisions relating to minimum public shareholding would not be applicable to entities listed on institutional trading platform without making a public issue.

(ii) A cap on the money spent by companies on publicity and advertisements as start-ups need to spend much more for such purposes.

(b) Accessibility of ITP- ITP shall be accessible to institutional investors as well as non-institutional investors.

(c) Definitions:

(i) "Institutional Trading Platform" means the trading platform for listing and trading of specified securities of entities that comply with the eligibility criteria specified in these regulation.

(ii) "Institutional Investor" means qualified institutional buyer or family trust or systematically important NBFCs registered with RBI or intermediaries registered with SEBI, all with net-worth of more than 500 crore rupees, as per the last audited financial statements.

(d) Eligibility- The following entities eligible for listing on the institutional trading platform:-

(i) an entity which is intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value addition and at least 25% of its pre-issue capital is held by qualified institutional buyer(s) as on the date of filing of draft information document or draft offer document with SEBI, as the case may be; or

(ii) any other entity in which at least 15% of the pre-issue capital is held by qualified institutional buyers as on the date of filing of draft information document or draft offer document with SEBI, as the case may be.

(iii) No person, individually or collectively with persons acting in concert, shall hold 25% or more of the post-issue share capital in such entity.

(e) Listing without public issue.- An entity seeking listing of its specified securities without making a public issue shall file a draft information document along with necessary documents with SEBI in accordance with these regulations along with fee as specified in the regulations. The draft information document shall contain the disclosures as specified for draft offer document in these regulations. However, the following shall not be applicable in case of listing without public issue:

(i) Allotment

(ii) Issue opening / closing;

(iii) Advertisement;

(iv) Underwriting;

(v) Regulation 26(5)

(vi) Pricing;

(vii) Dispatch of issue material; and

(viii) Other such provisions related to offer of specified securities to public.

- The entity shall obtain in-principle approval from the recognised stock exchanges on which it proposes to get its specified securities listed and list its specified securities on the recognised stock exchange(s) within 30 days from the date of issuance of observations by SEBI or from the expiry of the period if SEBI has not issued any such observations.

- The entity which has received in-principle approval from the recognised stock exchange for listing of its specified securities on the institutional trading platform, without making a public issue, shall be deemed to have been waived by SEBI under Rule 19(7) from the requirement of Rule 19(2) (b) of Securities Contracts (Regulation) Rules, 1957 for the limited purpose of listing on the institutional trading platform.

- Provisions relating to minimum public shareholding shall not apply to entities listed on institutional trading platform without making a public issue.

- The draft and final information document shall be approved by the board of directors of the entity and shall be signed by all directors, the Chief Executive Officer, i.e., the Managing Director or Manager within the meaning of the Companies Act, 2013 and the Chief Financial Officer, i.e., the Whole-time Finance Director or any other person heading the finance function and discharging that function.

- The signatories shall also certify that all disclosures made in the information document are true and correct.

– In case of mis-statement in the information document or any omission therein, any person who has authorized the issue of information document shall be liable in accordance with the provisions of the SEBI Act, 1992 and regulations made thereunder.

(f) Listing pursuant to public issue.- An entity seeking issue and listing of its specified securities shall file a draft offer document along with necessary documents with SEBI in accordance with these regulations along with fees as specified in the regulations.

– The minimum application size shall be 10 lakh rupees.

– The number of allottees shall be more than 200.

– The allocation in the net offer to public category shall be as follows:

  • 75 % to institutional investors , there shall be no separate allocation for Anchor Investors.

  • 25 % to non-institutional investors

– Any under-subscription in the non-institutional investor category shall be available for subscription under the institutional investors' category.

– The allotment to institutional investors may be on a discretionary basis, no institutional investor shall be allotted more than 10% of the issue size. Whereas the allotment to non-institutional investors shall be on a proportionate basis.

– The mode of allotment to institutional investors, i.e., whether discretionary or proportionate, shall be disclosed prior to or at the time of filing of the Red Herring Prospectus.

– In case of discretionary allotment to institutional investors, no institutional investor shall be allotted more than 10% of the issue size.

– The offer document shall disclose the broad objects of the issue.

– The basis of issue price may include disclosures, except projections, as deemed fit by the issuers in order to enable investors to take informed decisions and the disclosures shall suitably caution the investors about basis of valuation.

(g) Lock- in.- (i) The entire pre-issue capital of the shareholders shall be locked-in for a period of six months from the date of allotment in case of listing pursuant to public issue or date of listing in case of listing without public issue:

However, this regulation shall not apply to:

– equity shares allotted to employees under an employee stock option or employee stock purchase scheme of the entity prior to the initial public offer, if the entity has made full disclosures with respect to such options or scheme;

– equity shares held by a venture capital fund or alternative investment fund of Category I or a foreign venture capital investor.

  However, such equity shares shall be locked in for a period of at least one year from the date of purchase by the venture capital fund or alternative investment fund or foreign venture capital investor.

– equity shares held by persons other than promoters, continuously for a period of at least one year prior to the date of listing in case of listing without public issue.

Explanation.- For the purpose of clause (ii) and (iii), in case such equity shares have resulted pursuant to conversion of fully paid-up compulsorily convertible securities, the holding period of such convertible securities as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period and the convertible securities shall be deemed to be fully paid-up, if the entire consideration payable thereon has been paid at the time of their conversion.

(ii) The specified securities held by promoters and locked-in may be pledged with any scheduled commercial bank or public financial institution as collateral security for loan granted by such bank or institution if the pledge of specified securities is one of the terms of sanction of the loan.

(iii) The specified securities that are locked-in may be transferable in accordance with these regulations.

(iv) All specified securities allotted on a discretionary basis shall be locked-in in accordance with the requirements for lock-in by Anchor Investors on main board of the stock exchange, as specified under clause 10(j) in Part A of Schedule XI.

(h) Trading lot.- The minimum trading lot shall be ten lakh rupees.

(i) Exit of entities listed without making a public issue.- (i) An entity whose specified securities are listed on the institutional trading platform without making a public issue may exit from that platform, if-

- its shareholders approve such exit by passing a special resolution through postal ballot where 90% of the total votes and the majority of non-promoter votes have been cast in favour of such proposal; and
- the recognised stock exchange where its shares are listed approve of such an exit.

(ii) The recognised stock exchange may delist the specified securities of an entity listed without making a public issue upon non-compliance of the conditions of listing and in the manner as specified by the stock exchange.

(iii) No entity promoted by promoters and directors of an entity delisted, shall be permitted to list on institutional trading platform for a period of five years from the date of such delisting. However, the provisions of this regulation shall not apply to another entity promoted by the independent directors of such a delisted entity.

(j) Migration to Main Board.- An entity that has listed its specified securities on a recognised stock exchange in accordance with the provisions of this chapter may at its option migrate to the main board of that recognised stock exchange after expiry of three years from the date of listing subject to compliance with the eligibility requirements of the stock exchange.

LISTING OF SECURITIES ON STOCK EXCHANGES

(a) In-Principle Approval Of Recognized Stock Exchange(s).- Regulation 107 stipulates that the issuer or the issuing company, as the case may be, shall obtain in-principle approval from recognised stock exchange as follows:

(i) In case of an initial public offer (IPO) or an issue of Indian Depository Receipts(IDR), from all the recognised stock exchange(s) on which the issuer or the issuing company, proposes to get its specified securities or IDRs, as the case may be, listed; and in case of other issues, before issuance of further securities, as follows:

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

(b) Application For Listing.- The issuer or the issuing company, as the case may be, shall complete the prelisting formalities within the time specified by SEBI. The issuer or the issuing company, as the case may be, shall make an application for listing, within twenty days from the date of allotment, to one or more recognized stock exchange(s) along with the documents specified by stock exchange(s).

In case of delay in making application for listing beyond twenty days from the date of allotment, the issuer or the issuing company, as the case may be, shall pay penal interest at the rate of at least 10% per annum to allottees for each day of delay from the expiry of thirty days from date of allotment till the listing of such securities to the allottees. In the event of non-receipt of listing permission from the stock exchange(s) by the issuer or the issuing company, as the case may be, or withdrawal of observation letter issued by SEBI, wherever applicable, the securities shall not be eligible for listing and the issuer or the issuing company, as the case may be, shall be liable to refund the subscription monies, if any, to the respective allottees immediately along with interest at the rate of 10% per annum from the date of allotment.

(c) Listing Agreement.- The issuer or the issuing company desirous of listing its securities on a recognised stock exchange shall execute a listing agreement with stock exchange. The issuer or the issuing company who has previously entered into agreement(s) with a recognised stock exchange to list its securities shall execute a fresh listing agreement with such stock exchange within six months of the date of notification of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

(d) Obligation Of Stock Exchange(s).- The stock exchange(s) shall grant in-principle approval/list the securities or reject the application for in-principle approval /listing by the issuer or issuing company, as the case may be, within thirty days from the later of the date of receipt of application for in-principle approval/listing from issuer or the issuing company, as the case may be, or the date of receipt of satisfactory reply from the issuer or the issuing company, as the case may be, in cases where the stock exchange(s) has sought any clarification from them.

OFFER FOR SALE (OFS) PROCESS

In order to further streamline the process of OFS with an objective to encourage greater participation of all investors including retail investors, it has been decided that:

(a) The seller shall notify to the stock exchanges its intention for sale of shares latest by 5 pm on T-1 day (T day being the day of the OFS). Stock exchanges shall inform the market immediately upon receipt of such notice.

(b) On the commencement of OFS on T day only non-retail investors shall be permitted to place their bids. Cut off price shall be determined based on the bids received on T day as per the extant guidelines.

(c) The retail investors shall bid on T+ 1 day and they may place a price bid or opt for bidding at cut off price. The seller shall make appropriate disclosures in this regard in the OFS notice.

(d) Settlement for bids received on T+1 day shall take place on T+3 days (T+1 day being trade day for retail investors). Discount, if any to retail investors, shall be applicable to bids received on T+1 day.

(e) In order to ensure that shares reserved for retail investors do not remain unallocated due to insufficient demand by the retail investors, the bids of non- retail investors shall be allowed to carry forward to T+1 day.

LESSON ROUND UP

– Public Issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus.

– Public Issue of shares are regulated by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

– Offer for Sale (OFS) is another form of share sale, very much similar to Follow–On Public Offer (FPO). OFS mechanism facilitates the promoters of an already listed company to sell or dilute their existing shareholdings through an exchange based bidding platform.

– SEBI has detailed guidelines on Offer for sale (OFS) of Shares by Promoters Through stock Exchange Mechanism.

– A company is required to issue a prospectus each time it accesses the capital market. The different form of prospectus are Offer document, Draft Offer document, Red Herring Prospectus, Shelf prospectus *etc.*

– Their main responsibilities of Lead Manager is to initiate the IPO processing, help company in road shows, creating draft offer document and get it approve by SEBI and stock exchanges and helping company to list shares at stock market.

– 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.

– Due diligence is a process of a thorough and objective examination that is undertaken before corporate entities enter into major transactions such as mergers and acquisitions, issuing new stock or other securities, project finance, securitization, *etc.*

– 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.

– “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 may, if its Articles provide, capitalize its profits by issuing fully–paid bonus shares.

– Preferential issue means issuance of equity shares to promoter group or selected investors. It covers allotment of fully convertible debentures, partly convertible debentures or any other financial instruments that could be converted into equity shares at a later date.

– A Qualified Institutions Placement means allotment of eligible securities by a listed issuer to qualified institutional buyers on private placement basis in terms of SEBI (ICDR) Regulations.

– Institutional Placement Programme means a further public offer of eligible securities by an eligible seller, in which the offer, allocation and allotment of such securities is made only to qualified institutional buyers in terms of Chapter VIII A of SEBI ICDR Regulations, 2009.

– Listing Agreement is a document which a company signs when being listed on the Stock Exchange, in which the company promises to abide by stock exchange regulations, bye laws.

SELF TEST QUESTIONS

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

1. Briefly discuss the different methods of raising funds from Primary Market.
2. Distinguish between Offer For Sale Process and IPO/FPO.
3. Define Shelf Prospectus. Enumerate the provisions relating to Shelf Prospectus.
4. What do you understand by Due Diligence? Describe the pre–issue and post–issue due diligence in public issue.
5. Explain how basis of allotment is determined.
6. Explain Green Shoe Option with the help of an example.

Lesson 6
Secondary Market

LESSON OUTLINE

- Introduction
- Corporate Actions
- From Listing Agreement to Listing Regulations, 2015 : A Bird's Eye View
- SEBI (Listing of Obligation and Disclosure Requirements) Regulations, 2015
- Compliance Calender under SEBI (LODR) Regulations, 2015
- Submission of Interim and Annual Financial Results under Listing Agreement
- Corporate Governance
- Regulatory Framework of Corporate Governance in India
- Corporate Governance and SEBI (LODR) Regulations, 2015
- Corporate Governance under Companies Act, 2013
- Arbitration Mechanism
- Arbitration Mechanism at Stock Exchanges
- Margining
- Trading of Securities
- Settlement System
- Clearing and settlement
- Trade Guarantee Fund
- Trading Software
- Stock Market Indices
- Sensex
- CNX Nifty
- Investible Weight Factors (IWFs)
- LESSON ROUND UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

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. A major part of the trading is conducted in the Secondary Market. When a company listed its securities on Stock Exchange it has to comply with certain conditions of the Stock Exchange under the listing agreement. Further Stock Exchange is an essential part of Secondary Market. The stock exchanges along with a host of other intermediaries provide the necessary platform for trading in Secondary Market and also for clearing and settlement.

The objective of this lesson is to give a detailed view of the compliance requirement need to be fulfilled by a company with respect to the Corporate Action, Disclosure, Price sensitive information, Corporate Governance Norms. Further, after going through this lesson a student will be able to understand the arbitration mechanism at the stock exchanges, Trading Clearing and Settlement process at Stock Exchanges. Basics of Stock indices, Calculation Methodology of index etc.

INTRODUCTION

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. For the general investor, the Secondary Market provides an efficient platform for trading of his securities. For the management of the company, Secondary Markets serve as a monitoring and control conduit—by facilitating value-enhancing control activities, enabling implementation of incentive-based management contracts, and aggregating information (via price discovery) that guides management decisions. When a company list its securities on the Stock Exchange, it has to comply with various conditions of the Listing Agreement of the Stock Exchange such as notice to be given under Corporate Action, continuous listing requirements, Disclosure of Price Sensitive Information, Material events, Submission of Financial results to the Stock Exchange etc. These compliance requirements are discussed below.

CORPORATE ACTIONS

Corporate action is a process by which a company gives benefits to the investors who are holding securities of the company. Corporate actions are classified in to two main categories Cash and Non-cash corporate actions.

– Cash corporate action results in investors getting benefits in form of cash. Examples of cash corporate actions are payment of interest / dividend.

– Non cash corporate actions result in the investors getting benefits in form of securities. Examples of non cash corporate action are bonus, rights, merger, split etc.

Corporate actions tend to have a bearing on the price of a security. When a company announces a corporate action, it is initiating a process that will bring actual change to its securities either in terms of number of shares increasing in the hands on the shareholders or a change to the face value of the security or receiving shares of a new company by the shareholders as in the case of merger or acquisition etc. By understanding these different types of processes and their effects, an investor can have a clearer picture of what a corporate action indicates about a company's financial affairs and how that action will influence the company's share price and performance. Corporate actions are typically agreed upon by a company's Board of Directors and authorized by the shareholders.

FROM LISTING AGREEMENT TO LISTING REGULATIONS, 2015: A BIRDS' EYE VIEW

With the enactment and enforcement of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 which have become effective from December 1, 2015, the Listing agreements between listed entities and exchanges have become redundant, as the contractual agreements between the two was replaced by a listing regulation. The Securities and Exchange Board of India listing regulations have been aimed to give more power to shareholders and converts contractual obligations into statutory requirements.

Rightly said about the SEBI (LODR) Regulations, 2015 that "Not only does this increases the legal force behind provisions, prescribing post-listing obligations and disclosure requirements, but also opens up new avenues for shareholders to enforce post-listing requirements." Indeed this is a major step towards bringing up the quality of post-listing disclosures to match primary market disclosures, and will lead to better corporate governance practice.

The regulation has consolidated all securities - equity, debt, non-convertible debt securities and preferential shares, depository receipts and mutual fund units - under one regulation that lays emphasis on corporate governance and enhanced disclosures.

The new listing regulations required listed companies to make disclosures of material events and information based on the policy framed by them for determination of materiality.

According to experts, the SEBI (LODR) Regulation, 2015 has given the principle-based approach, materiality standards and subjective disclosure requirements which is a necessary move towards effective corporate governance in the country. Adopting a materiality standard is a globally accepted practice and does away with dumping on investors hundreds of irrelevant disclosures, in effect hiding the most material ones. Thus this will in fact enhance the quality and readability of disclosures to the investors.

According to the SEBI regulation, the material nature of the information can be determined by key managerial personnel and need to be disclosed within 24 hours of the event. However, certain board outcomes would need to be disclosed within 30 minutes of the conclusion of the board meeting. This information needs to remain on the company website for at least five years.

With the new regulations, companies were required to draft a policy on preservation of documents. Among these documents, there would be some that would need to be preserved for eight years, while others will be required to be kept for the entire lifetime. These documents would typically include the ones related to financial statements, tax and legal matters.

To understand the systematic revolution under the SEBI (LODR) Regulation, 2015, it is pertinent to discuss the following heads:

Listing Agreement: Meaning

Listing Agreement is the basic document which is executed between companies and the Stock Exchange when companies are listed on the stock exchange. The main purposes of the listing agreement are to ensure that companies are following good corporate governance. The Stock Exchange on behalf of the Security Exchange Board of India ensures that companies follow good corporate governance. The Listing Agreement comprised of 54 clauses stating corporate governance, which listed companies have to follow, failing which companies have to face disciplinary actions, suspension, and delisting of securities. The companies also have to make certain disclosures and act by the clauses of the agreement. With the enactment of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, herein after referred as Listing Regulations, 2015, the concept of Listing Agreement became redundant and a comprehensive scenario of disclosure, transparency and corporate governance has been established in the India

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015: An Introduction

On 2nd September 2015, the Security and Exchange Board of India (SEBI) notified about the Security and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015. (Listing Regulations 2015). The listing regulations will apply to the companies recognized on the stock exchange. Section 2(52) of the Companies Act provides for the listed companies and any companies which have listed its securities under-recognized stock exchange and hence the listing regulations would be applied to them.

The primary objective of bringing this regulation into force was first to align the Listing agreement with the Companies Act, 2013.

Secondly, to make a single regulation for requirements under different securities listing agreements. The regulation 23(4) and 31A was made into immediate effect which talks about passing the of ordinary resolution instead of a special resolution in case of all material related party transaction subject to related parties from abstaining from voting on such resolution, in line with the provisions of the Companies Act, 2013 and the reclassification of promoters as public shareholders under various circumstances respectively.

The Regulation has been converted to a consolidated form, to make all the listed agreements a single structured document for easy referencing. The Listing Regulations have been sub-divided into two parts viz.,(a) substantive provisions incorporated in the main body of Regulations; (b) procedural requirements in the form of Schedules to the Regulations.

SEBI (LODR) Regulation, 2015: Basic Features

Basic features of the regulations are as follows:

Chapter II of the Regulation provides for the guiding principles governing disclosure and obligations of listed companies. The chapter provides for the principles for the listed entities for periodic disclosure and corporate governance followed by the companies.

Chapter III of the Regulations provides for a common obligation for listed companies, in the matter of compliance, the appointment of a compliance officer, filing on the electronic platform, etc.

Chapter IV to IX provides for the obligations applicable to specific securities incorporated in different chapters.

Chapter X to XI provides for the responsibilities to compliance given to stock exchanges to regulate, monitor and take action for compliance measures.

Differences between Listing Regulation and Listing Agreement

Changes made within the listing agreement:

- **Change for the separate period of the transmission of securities:** The listing agreement provides for the transfer or transmission of securities and issue of the certificate within 15 days from the date of such receipt of a request for transfer. While the listing regulation in accordance with regulation 40 (3) provides for the transfer and issue of the certificate within 15 days from the date of such receipt of request for transfer provided that the listed entity shall ensure that the transmission requested is processed for the securities held in the dematerialized mode and physical mode within 7 days and 21 days respectively, after receipt of the specified documents.
- **Change made regarding the requirement of sending notice to other stock exchange for the close transfer of books:** In the listing agreements, while closing the transfer of books, the companies have to send notice to the concerned stock exchange as well as other stock exchanges in an advance of 7 working days. While in the new regulation under reference to regulation 42 (2), (3) and (5) notice is to be given to the concerned stock exchange in an advance of 7 working days.
- **Extension of period for the disclosure to stock exchange:** In the listing agreement, the disclosure regarding all the dividends or cash bonuses recommended or declared or the decisions to pass any dividends or interest paid and date on which dividends shall be paid/dispatched, the decision on buyback of securities is to be made within 15 minutes of the Board Meeting. While the listing regulation provides for the disclosure to be made within 30 minutes of the board meeting regarding all the dividends or cash bonuses recommended or declared or the decisions to pass any dividends or interest paid and date on which dividends shall be paid/dispatched, the decision on buyback of securities.
- In the listing agreement, there is a provision of promptly notifying the stock exchange of short particulars on any increase of capital whether by the issue of bonus shares through capitalization, or by the way of right shares to be offered to the shareholders or debenture holder, or in any other way. Short particulars of the reissue or shares or securities held in reserve for future issue or the creation in any form or manner of new shares or securities or any rights, privileges or benefits to subscribing to, short particulars of any alterations of capital, including calls. While the listing regulation provides for at least 30 minutes of the closure of board meeting for, promptly notifying stock exchange of short particulars of any increase of capital whether by issue of bonus shares through capitalization, or by the way of right shares to be offered to the shareholders or debenture holder, or in any other way. Short particulars of the reissue or shares or securities held in reserve for a future issue or the creation in any form or manner of new shares or securities or any rights, privileges or benefits to subscribing to, short particulars of any alterations of capital, including calls.

- It has been mentioned in the listing agreement of prior intimidation of at least seven days in which the final result shall be considered. In the listing regulations, as per regulation 29 (1) (a) read with the proviso of regulation 29 (2), a five-day prior notice is to be given when the financial result is to be considered by the stock exchange about the board meeting.
- The listing agreement provides for the provision ensuring that the RTA and/or the In-house Share Transfer facility, as the case may be, produces a certificate from a PCS within 1 month of the end of each half of the financial year, certifying that all certificates have been issued within 15 days of the date of lodgment for transfer, sub-division, consolidation, renewal, exchange or endorsement of calls/allotment monies, and a copy of the same shall be made available to the Stock Exchanges within 24 hours of the receipt of the certificate by the Company. While the listing regulation provides for ensuring that the share transfer agent and/or the in-house share transfer facility, as the case may be, produces a certificate from a practicing company secretary within 1 month of the end of each half of the financial year, certifying that all certificates have been issued within 30 days of the date of lodgments for transfer, sub-division, consolidation, renewal, exchange or endorsement of calls/allotment monies and ensures that certificate is filed with the Stock Exchanges simultaneously.
- Provision wherein MD or the WTD appointed to provide compliance in the listing agreement has been given away, whereas in the listing regulation, the CEO, and the CFO have to provide a compliance certificate to the board of directors.
- New provisions have been added in the listing regulations which were not there in the listing agreement, regarding the preservation of documents. Two types of documents have to be maintained; one document is to be permanently preserved while the second record is to be reserved for the period of not less than eight years after the completion of the particular transaction.

While aligning one's thought on SEBI (LODR) Regulation, 2015, it has to be kept in mind that the main motive for the introduction of the listing regulation was to streamline all the regulations for all the securities so that it becomes convenient for the companies to follow one set of regulations rather than following two sets of regulation and also to avoid any confusion, which occurs on the overlapping of two sets of regulations. Also, with the introduction of a new set of regulation, the disclosure process to the SEBI has been improved, as more and more companies are under the strict surveillance of the regulatory mechanism and hence the process of compliance with The Securities and Exchange Board of India (SEBI) regulations by the companies have improved. With the introduction of the listing regulations, the contractual obligations have been converted to a legal requirement, which gives the regulations a legal recognition.

SEBI (LISTING OF OBLIGATION AND DISCLOSURE REQUIREMENT) REGULATION, 2015

SEBI vide its Notification No. SEBI/LAD-NRO/GN/2015-16/013 dated 2nd September, 2015 had notified SECURITIES AND EXCHANGE BOARD OF INDIA (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015 which have become effective from 01st December, 2015. These Regulations prescribe different Disclosure Requirements for different types of listed securities.

1.1 Objectives

SEBI Listing Obligations and Disclosure Requirements Regulations, 2015 ("2015 Regulations") were with two-fold objectives:

– Firstly, to align clauses of the listing agreement with Companies Act and

– Secondly, to consolidate the conditions under different securities' listing agreements in one single regulation.

1.2 Applicability

SEBI Listing Regulations came into force on the ninetieth day from date of publication in the official gazette i.e. 1 December 2015

SEBI Listing Regulations are applicable to a listed entity who has listed any of the following securities on recognized stock exchange(s).

- Specified securities listed on the main board or SME Exchange or Institutional Trading Platform;
- Non-Convertible Debt Securities, Non- Convertible Redeemable Preference Shares, perpetual debt instrument, perpetual non-cumulative preference shares;
- Indian depository receipts;
- Securitized debt instruments and
- Units issued by mutual funds.

In short, The 2015 Regulations are ,made applicable to any entity (whether a company or not) accessing the stock exchange, for listing equity shares (on main board, SME exchange, institutional trading platforms), debt securities, preference shares, depository receipts, securitized debt instruments, mutual fund units, and other securities as may be specified by SEBI.

1.3 Key Features

- SEBI Listing Regulations have been sub-divided into two parts (a) substantive provisions incorporated in the main body of Regulations (b) procedural requirements in the form of Schedules to the Regulations.
- Chapter II of the SEBI Listing Regulations provide the broad principles in relation to disclosures and obligations of the listed entities. In the event of absence of specific requirements or ambiguity, these principles would serve to guide the listed entities.
- Chapter III of the SEBI Listing Regulations provide Obligations which are common to all listed entities have been enumerated. These include general obligation of compliance of listed entity, appointment of common compliance officer, filings on electronic platform, mandatory registration on SCORES, etc.
- Chapter IV to IX of the SEBI Listing Regulations deal with obligations which are applicable to specific types of securities have been incorporated in various chapters.
- Chapter X and XI of the SEBI Listing Regulations provide that Stock Exchanges have been given responsibility to monitor compliance or adequacy / accuracy of compliance with provisions of these regulations and to take action for non-compliance.
- Ease of Reference: The related provisions have been aligned and provided at a common place for ease of reference. For example, all clauses dealing with disclosure of events or information which may be material or price sensitive spread across the Listing Agreement have been provided as a schedule to the regulations. All disclosures required to be made on the website of the listed entity have been enumerated at a single place for ease of reference and all requirements pertaining to disclosures in annual report have been combined.
- Streamlining and segregation of initial issuance/listing obligations: In order to ensure that there is no overlapping or confusion on the applicability of these regulations, pre-listing requirements have been incorporated in respective regulations viz. ICDR Regulations, ILDS Regulations, etc These provisions pertain to allotment of securities, refund and payment of interest, 1% Security Deposit (in case of public issuance), etc. Post-listing requirements have been incorporated in Listing Regulations.
- Listing Agreement – A shortened version of the Listing Agreement (2 page approximately) has been

prescribed which the companies are required to execute while listing its securities with the stock exchange. Existing listed entities will be required to sign the shortened version within six months of the notification of the regulations. The companies are required to adopt the fresh simplified listing agreement in a Board Meeting and also authorize director to sign the LA and then send the Extract of the BR to the SE along with 2 Copies of LA executed and signed by the authorized director of the company on a Rs. 100 /- Stamp Paper.

1.4 Major Transformation

1. Material Disclosures

The 2015 Regulations have rearranged and augmented the existing disclosure obligations of a listed entity. Regulation 30 which corresponds to Clause 36 of the equity listing agreement requires every listed entity to make such event based and information disclosures which are "material" in the opinion of the board of directors.

Deemed material: Certain events as provided in Schedule III are deemed "material" and they incorporate the earlier disclosures of Clause 36, such as (i) acquisition of control, shares or voting rights (direct or indirect), (ii) forms of inorganic restructuring like schemes of arrangement, sale or disposal of units, business divisions, subsidiaries; (iii) organic restructuring of share capital like issuance, forfeiture, split-ups, consolidation, transfer restrictions; and (iv) revision of ratings.

However, the 2015 Regulations also include new disclosure obligations with an objective to promote informed investor decision making.

Firstly, board decisions pertaining to dividends, cash bonuses, buy-back, funding, issue of bonus shares, re-issue of forfeited shares, capital alterations, financial results, and voluntary delisting shall be considered "material". The listed entity must disclose such decision to the stock exchange within 30 minutes from the closure of the board meeting. Non-compliance may result in fines, suspension of trading, freezing of promoter or promoter group shares or any other action as determined by SEBI.

Under the old clause, there was no such requirement; and listed companies were only mandated to disclose the relevant information immediately. This permitted companies to make disclosures within a reasonable time period. With specified time-frame under the 2015 Regulations, companies have to ensure that the compliance officer prepares the disclosure statement in prescribed formats and uploads it with the stock exchanges within 30 minutes. This short time frame may be unrealistic and is likely to create technical issues such as failure of connectivity, inadequate detailing, etc. if the prescribed formats are too elaborate.

Secondly, it is mandatory to disclose frauds and defaults committed by promoter, key managerial personnel or the company itself, as well as any arrest of the promoters or key managerial personnel. Fraud is committed when there is an act or omission with intent to deceive, irrespective whether there is any gain or not. In a fraud allegation, the accused must prove that the intent was absent based on lack of active participation, connivance or any knowledge of the alleged acts. Generally, such argument will necessitate production of documented proofs of board processes like meeting papers, minutes, etc. Further, involvement in fraud and statutory default are disqualifications for continuation and appointment as directors or key managerial personnel under the Companies Act. Thus, it becomes extremely important that directors and managerial personnel highlight their reservations and insist on recording their dissent in board noting and minutes. It also mandates companies to put in place effective vigil mechanism which will ensure protection of whistleblowers against any victimization, and not just as a listing compliance.

Materiality thresholds: Apart from disclosure of deemed "material" events and information, certain events as specified in Paragraph B of Schedule III shall be disclosed if they trigger the materiality thresholds.

These events include (i) commencement of business of any unit/division or delay in commencement; (ii) change in the character and nature of the business; (iii) capacity addition or product launch; (iv) effects due to change in the regulatory framework; (v) granting, withdrawal, suspension or cancellation of licenses; (vi) litigation, disputes or regulatory assessment and their impact; etc.

An event or information is material if omission of the event or disclosure of information is likely to result in (i) discontinuity or alteration of already available public information; or (ii) significant market reaction. Based on these guidelines, the board must frame a policy for determination of materiality, identify suitable events and information for reporting, and upload details on the website. The board is also empowered to authorize one key managerial personnel for the purpose of determining materiality.

This element of subjectivity and the board's determination of appropriate timing for making disclosures may not necessarily be binding on SEBI.

2. Stricter governance requirements on board of directors

The 2015 Regulations in certain instances moves beyond mere alignment with governance requirements and thresholds as provided under the Companies Act and adopts a stricter approach towards the composition of board, its committees and the duties of directors. It tends to retain the higher requirements of Clause 49 of the equity listing agreement as well as amends some of the voluntary guidelines, to make them mandatory.

Board composition and its committees: For instance, as per Companies Act, at least 1/3rd of the board of directors of a listed company must comprise of independent directors. However, Regulation 17 retains the earlier threshold requiring 50% of the board to be independent, if the chairperson is not a non-executive director. Similarly, while the Companies Act requires that the audit committee members must be financially literate (i.e. capable of reading and understanding financial statements), Regulation 18(1) (c) maintains the mandate of having at least 1 member who possesses "accounting or related financial management expertise". Further, it also retains the requirement of valid quorum of at least 2 independent directors for conducting an audit committee meeting, thereby making it indirectly imperative for all listed companies to appoint at least 2 independent directors.

The 2015 Regulations also provide for constitution of "risk management committee" for top 100 listed entities determined on the basis of market capitalization at the end of previous financial year. Earlier, the listing agreement merely mandated the board to inform the shareholders regarding risk assessment and minimization procedures adopted for the same without requirement of a specific committee as such. Furthermore, constitution of remuneration committee and framing of whistleblower policy are now made mandatory compliances as opposed to voluntary practice under the listing agreement. Additionally, Regulation 46 requires disclosure of composition of various board committees on company's website.

Duties of the board: Section 166 of the Companies Act codifies the fiduciary duties of directors and breach of the duties is punishable with fine between INR 100,000 (about US$ 1,500) to INR 500,000 (about US$ 7,700).

The 2015 Regulations further elaborate these codified duties, and provide principle-based guidelines in Regulation 4.

These principles impose a collective duty on the board of directors for ensuring good governance. For instance, it is mandated that the board must (i) disclose any matter that directly affects the company; (ii) conduct itself so as to meet expectations of operational transparency while maintaining confidentiality; (iii) monitor effectiveness of governance practices; (iv) align managerial remuneration with long term interests of the company and the shareholders; (v) ensure transparent nomination; (vi) monitor and manage conflict of interest; (vii) ensure integrity of accounting and financial reporting systems; etc. These principles are subjective and whether the duty has been fulfilled or not will be determined on a case-to-case basis. Further, it is expressly provided that in case of any ambiguity or inconsistency between the principles and the specific regulations, the principles shall prevail. It is unclear at this stage as to how will listed companies' boards ensure collective compliance with these ideologies and whether breach by any individual will result in impugning liability on the entire board as officer-in-default.

3. Related Party Transactions

Related party transactions ("RPTs") continue to garner constant attention for Indian companies. The Companies Act initially mandated special resolution for specific RPTs exceeding prescribed threshold. The government through an amendment in 2015 replaced the requirement of special resolution by an ordinary resolution. It was further clarified that only such related parties who are related to the particular transaction should abstain from voting on the proposed resolution. One of the objectives for notifying the 2015 Regulations was to streamline the process of RPT approval for listed companies in light of these changes.

Scope of RPTs: The 2015 Regulations defines RPT as transfer of resources, services or obligations between a listed entity and a related party, regardless of whether a price is charged. Further, "transaction" must be interpreted to include a single or a group of transactions under a particular contract. This definition is wider in scope than the Companies Act. As per Section 188 of the Companies Act, a transaction with related party is not an RPT and does not require prior board or shareholders' approval as long as it is at an "arm's-length" basis occurring in the "ordinary course of business". In light of the scope of RPTs under the 2015 Regulations, the exemption is taken away irrespective of the size of the listed entity and the value of the transaction in question. Hence, any transaction which is a RPT will require not only prior audit committee approval as mandated under Regulation 23(2), but also require board approval. However, shareholders' approval will be only necessitated if the transaction is a material RPT.

Approval of RPTs: Regulation 23(1) requires every listed entity to formulate a policy on materiality of RPTs. It also provides that any transaction with a particular related party (taken individually or combined with other transactions during the financial year) which exceeds 10% of listed company's annual consolidated turnover shall be considered a material RPT. It appears that a listed company may determine the variety of RPTs which will be classified as material ones. Since such materiality cannot transgress the threshold prescribed under the Companies Act; companies must take them into consideration while framing the policy on material RPTs. In order to align with the recent amendment in Companies Act, the 2015 Regulations substitute the old mandate of approving RPTs through special resolution, thereby permitting listed entities to approve RPTs through an ordinary resolution. But, the restriction on voting by related parties is not done away with, despite the clarification issued by the Ministry of Corporate Affairs which allows non-interested related parties to vote for approving a particular RPT. Regulation 23(4) read along with 23(7) states that while approving material RPTs, all related parties whether or not concerned with the particular RPT, must abstain from exercising their votes. Therefore, the RPTs approval process under the 2015 Regulations take away major exceptions and overall continue to remain stricter in comparison to the Companies Act, 2013.

4. Corporate governance for listed start-ups

In August 2015, SEBI amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 to enable listing of certain categories of start-ups without undergoing an initial public offer. The underlying objective was to liberalize the stricter listing compliances and disincentives start-ups opting to list on foreign stock exchanges. These start-ups must alter their structure into public companies prior to listing. Further, they can raise capital only through rights issue and private placement (which were otherwise available under Companies Act) and cannot invite retail investments or make any public offer. SEBI's model agreement for listing on the institutional trading platform did not relax the start-ups from complying with the corporate governance requirements as contained in the Companies Act. For instance, a listed start-up has to necessarily appoint 1/3rd of its board with independent directors, appoint 1 woman director, constitute board committees, set up vigil mechanism and put in place various internal controls and systems. Compliance with corporate governance provisions involves structural and compliance costs, substantial time for a start-up and continues to act as a deterrent for listing, despite floating of the alternative mechanism.

1.5 Listing Obligations

The listing obligations detailed by the SEBI (LODR) Regulation, 2015 can be analyzed as under:

Common Obligations of Listed Entities – Chapter III of Listing Regulations

It is pertinent to note the compliances under this Chapter have to be adhered to by listed entities who have listed any or all of the designated securities i.e. specified securities i.e. equity shares and/or convertible securities, non-convertible debt securities, non-convertible redeemable preference shares, perpetual debt instrument, perpetual non-cumulative preference shares, Indian depository receipts, securitised debt instruments, units issued by mutual funds and any other securities as may be specified by the SEBI.

1. The listed entity shall ensure that KMP, directors, promoters or any other person dealing with the listed entity, complies with responsibilities or obligations, if any, assigned to them under these regulations. Therefore, adequate information/training on Securities Law, etc. shall be provided to the said persons on time to time basis.
2. Company Secretary of the Company who shall be “Compliance Officer” shall ensure compliances under these regulations. Any qualified Company Secretary of the Listed Entity can be appointed as Compliance Officer for adhering compliance under these Regulations which shall be ideally approved by Resolution to be passed by Board of Directors at its duly convened Meeting/or through Circular Resolution.
3. “Compliance Certificate” to be provided to Stock Exchanges by Compliance Officer and Share Transfer Agent duly signed by both the compliance officer of the listed entity and the authorised representative of the share transfer agent, wherever applicable, within one month of end of each half of the financial year, certifying compliance with the requirements of Regulation 7(2) with respect to all the activities relating to Share Transfer in relation to both physical and electronic share transfer facility are maintained by RTA
4. The listed entity to have a Policy For Preservation Of Documents duly approved by Board, classifying them in at least two categories such as the documents to be preserved permanently and the documents for preservation for less than 8 years. Documents may also be kept electronically. These Policies shall be formulated and approved by the Board before November 30, 2015.
5. The listed entity shall file the reports, statements, documents, filings and any other information with the recognised stock exchange(s) on the electronic platform and proper infrastructure shall be put in place by listed entity. This means that electronic filing will be compulsory from December 01, 2015 and accordingly the listed entities shall ensure that appropriate infrastructure and electronic systems are in place in the listed entities to ensure the electronic filing.
6. Dividend/ Interest / Redemption or Repayment shall be paid in electronic mode and if not possible than by warrant ‘payable at par’ or cheque and if amount exceeds Rs. 1500 per warrant or cheque it has to be delivered through Speed Post only and Courier or ordinary post shall not be allowed.
7. The listed entity shall file with the recognised stock exchange(s) on a quarterly basis, within twenty one days from the end of each quarter, 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. The said statement shall be placed before the Board on Quarterly basis.

Obligations of listed entity which has listed its specified securities i.e. Equity shares and convertible securities – Chapter IV of Listing Regulations

The listed entities whose equity shares and convertible securities are listed on recognized Stock Exchanges shall comply under this Chapter:

1. The role of audit committee to review with the management, the annual financial statements and auditor’s report thereon before submission to the board for approval, with particular reference to the qualifications in

the audit report has now been amended to include review with respect to modified opinion in the draft audit report. Therefore, the umbrella of reviewing the qualifications/adverse remarks in the audit report has been expanded under the Regulations 2015. Concept of "Modified Opinion" is newly coined phenomena in Regulations which was earlier referred to as "Qualification in Audit Report" in Listing Agreement.

It is pertinent to note that as per SA 7057, ¯modified opinion includes qualified opinion, adverse opinion and disclaimer of opinion. Accordingly, as per the Regulation, the audit committee will have to also review adverse opinion on audit report and disclaimer of opinion on audit report.

2. All existing material related party contracts or arrangements entered into prior to the date of notification of these regulations i.e. September 02, 2015 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.

3. All related parties irrespective of the fact whether the party is related to a particular transaction or not, will be abstained from voting on any material related party transaction. This means that even if a certain related party is not interested in the transaction even then by virtue of the Listing Regulations, the dis-interested related party also would be abstained from voting.

4. Modification or reclassification of the status of the shareholders shall be allowed only on application made by Company to stock exchanges and all relevant evidence and on being satisfied with the compliance of conditions mentioned in this regulation.

5. When a new promoter replaces the previous promoter subsequent to an open offer or in any other manner, re-classification may be permitted subject to approval of shareholders in the general meeting and compliance of the conditions mentioned in Regulations. The compliance requirements are provided in brief below:

   – Shareholders' approval is required.

   – Outgoing promoters cannot hold more than 10% shares/ VRs &

   – Outgoing promoters cannot act as KMP for more than 3 years without shareholder approval.

   – They shall not exercise control over the listed entity & all Special rights shall be terminated.

   – In case of professionally managed companies-No group can hold more than 1%.

6. The Financial Results shall be approved by the Board of Directors which was not specifically provided under Listing Agreement earlier.

7. The listed entity shall on the direction issued by the Board, carry out necessary steps, for rectification of modified opinion and/or submission of revised pro-forma financial results, in the manner specified in Schedule VIII of the Listing Regulations.

8. There is no mention to submit the explanation of the reasons for variations between the unaudited quarterly or year to date financial results and the results amended pursuant to limited review for the same period.

9. The financial results shall be submitted to the stock exchange within thirty minutes of conclusion of the meeting of the Board in which they were approved. Previously, under the listing agreement the outcome was required to be provided within 15 minutes from the conclusion of the Board Meeting.

10. The timeline to give prior intimation regarding date of the Board meetings in which the financial results will be considered, has been reduced to five days prior to the meeting (excluding the date of the intimation and date of the meeting).

11. Listed entity shall inter- alia give prior intimation for fund raising by way of further public offer, rights issue, American Depository Receipts/Global Depository Receipts/Foreign Currency Convertible Bonds, qualified institutions placement, debt issue, preferential issue or any other method and for determination of issue price.

Provided that intimation shall also be given in case of any annual general meeting or extraordinary general meeting or postal ballot that is proposed to be held for obtaining shareholder approval for further fund raising indicating type of issuance.

12. The redundant requirement of serving six copies of Annual Report has been done away with altogether but sending Annual Report is now required to be sent to Stock Exchanges within 21 days of the same getting approved by the shareholders in the Annual General Meeting which earlier was required to be sent as soon as they were sent to shareholders.

13. Disclosure pertaining to Loans and advances in the nature of loans where there is: (I) no repayment schedule or repayment beyond seven years or (II) no interest or interest below section 372A of Companies Act, 1956 by name and amount was required to be provided in Consolidated Financial Statements in Annual Report, the same has been done away with in the Listing Regulations.

14. The listed entity shall submit to the stock exchange(s) an "Annual Information Memorandum" in the manner specified by the Board from time to time. The said requirement is not there in Equity Listing Agreement currently. The format of the said Annual Information Memorandum is yet to be prescribed by SEBI.

15. Disclosure of commodity price risk or foreign exchange risk and commodity hedging activities is required to be provided in Annual Report. There was no such requirement under the Equity Listing Agreement.

16. 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.

    i. Certain events are deemed to be material as per the list provided in the Regulations under Schedule III i.e. no test of materiality to be applied for such events.

    ii. Certain events have to be decided as material based on criteria provided in the Regulations.

17. The listed entity shall frame a Board approved policy for determination of materiality, based on criteria specified in the regulation 30 of the Listing Regulations and disclose on its website.

18. The Board needs to authorize one or more KMP(s) for determining the materiality of a certain event and the contact details of such personnel shall be also disclosed to the stock exchange(s) and as well as on the listed entity's website.

19. The listed entity shall make disclosures updating material developments on a regular basis, till such time the event is resolved/closed, with relevant explanations.

20. The listed entity shall disclose all material events or information with respect to subsidiaries for the listed entity.

21. Change in name of the listed entity shall be done only after receiving confirmation from Stock Exchange upon filing application of the same.

22. The Company whose specified securities are listed i.e. equity and / or convertible securities shall maintain functional website and inter – alia following information shall be disclosed which are additional requirements apart from one already required under exiting Listing Agreement:

    – details of its business;

    – composition of various committees of board of directors;

    – criteria of making payments to non-executive directors, if the same has not been disclosed in annual report;

    – details of familiarization programs imparted to independent directors including the following details:-

i. number of programs attended by independent directors (during the year and on a cumulative basis till date),

ii. number of hours spent by independent directors in such programmes (during the year and on cumulative basis till date), and

iii. other relevant details

– details of agreements entered into with the media companies and/or their associates, etc;

– schedule of analyst or institutional investor meet and presentations made by the listed entity to analysts or institutional investors simultaneously with submission to stock exchange;

Obligations of Listed Entity Which Has Listed Its Non-Convertible Debt Securities (NCD's) Or Non-Convertible Redeemable Preference Shares ('NCPS') Or Both – Chapter V of Listing Regulations

1. Prior intimation to the stock exchange(s) to be given by Listed Companies at least eleven working days before the date on and from which the interest on debentures and bonds, and redemption amount of redeemable shares or of debentures and bonds shall be payable.

   It is pertinent to note that aforesaid compliance is not required to be adhered if the listed entity whose specified securities i.e. equity shares and convertibles as well as NCD's or NCPS are listed as the same has been exempted under Chapter VI of the Regulations which exempts compliances of certain provisions of Chapter V whose specified securities as well as NCDs or NCPS are listed.

2. Listed entity shall intimate to the stock exchange(s), at least two working days in advance, excluding the date of the intimation and date of the meeting, regarding the meeting of its board of directors, at which the recommendation or declaration of issue of NCD's or any other matter affecting the rights or interests of holders of NCD securities or non-convertible redeemable preference shares is proposed to be considered.

3. The listed entity shall promptly inform the stock exchange(s) of all information having bearing on the performance/operation of the listed entity, price sensitive information or any action that shall affect payment of interest or dividend of NCPs or redemption of NCD's or redeemable preference shares.

4. Certain disclosures shall be required to be disclosed as per Part B of Schedule III to the Regulations by Listed entities.

5. The listed entity shall prepare and submit un-audited Limited Review Report or audited financial results along with Audit Report on a half yearly basis in the format as specified by the Board within forty five days from the end of the half year to the recognized stock exchange(s).

6. The listed entity shall, within two calendar days of the conclusion of the meeting of the board of directors, publish the financial results and statement referred to in sub-regulation 52(4), in at least one English national daily newspaper circulating in the whole or substantially the whole of India.

7. In respect of its listed NCD's, the listed entity shall maintain 100% asset cover sufficient to discharge the principal amount at all times for the NCD's issued.

8. The listed entity shall disclose to the stock exchange in quarterly, half-yearly, year-to-date and annual financial statements, as applicable, the extent and nature of security created and maintained with respect to its secured listed NCD's.

9. Each rating obtained by the listed entity with respect to non-convertible debt securities shall be reviewed at least once a year by a credit rating agency registered by the SEBI.

10. The listed entity shall forward certain prescribed information to the debenture trustee promptly as per Regulation 56.

11. The listed entity shall submit a certificate to the stock exchange within two days of the interest or principal or both becoming due that it has made timely payment of interests or principal obligations or both in respect of the non-convertible debt securities.

12. The listed entity shall provide an undertaking to the stock exchange(s) on annual basis stating that all documents and intimations required to be submitted to Debenture Trustees in terms of Trust Deed and SEBI (Issue and Listing of Debt Securities) Regulations, 2008 have been complied with.

13. Annual Reports shall be provided to holders of NCDs and also certain half yearly communication to be provided as per Regulation 52(4) and 52(5).

14. Notice of all meetings shall be sent to NCD's holder along with Proxy Forms.

15. The structure of NCD/NCPS shall not be modified unless application is made to Stock Exchange and approval is received thereon and approval of Board, Debenture Trustees and requisite approval after meeting of Debenture Holders is received.

16. Record date for purposes of payment of interest, dividend and payment of redemption or repayment amount or for such other purposes as specified by the stock exchange at least 7 working days (excluding the date of intimation and the record date) to the recognised stock exchange(s) of the record date or of as many days as the stock exchange(s).

17. The listed entity shall not declare or distribute any dividend wherein it has defaulted in payment of interest on debt securities or redemption thereof or in creation of security as per the terms of the issue of debt securities.

18. All listed entities who have listed their Debt Securities shall have functional website and the following information shall be displayed on website:

    (a) Details of its business;

    (b) Financial information including complete copy of the annual report including balance sheet, profit and loss account, directors report etc;

    (c) Contact information of the designated officials of the listed entity who are responsible for assisting and handling investor grievances;

    (d) Email address for grievance redressal and other relevant details;

    (e) Name of the debenture trustees with full contact details;

    (f) The information, report, notices, call letters, circulars, proceedings, etc. concerning non-convertible redeemable preference shares or non-convertible debt securities;

    (g) All information and reports including compliance reports filed by the listed entity;

    (h) Information with respect to the following events:

        (i) Default by issuer to pay interest on or redemption amount;

        (ii) Failure to create a charge on the assets;

        (iii) Revision of rating assigned to the non-convertible debt securities.

    The listed entities whose equity shares/convertibles as well as NCDs or NCPS are listed shall not comply with the aforesaid compliance requirement as per Chapter VI of the Regulations.

1.6 Quarterly / Half Yearly / Annual Compliances under SEBI (LODR) Regulation 2015

1. Regulation 7 (3) – Compliance Certificate certifying maintaining physical & electronic transfer facility - Within one month of end of each half of the financial year.

   The listed entity shall submit a compliance certificate to the exchange, duly signed by both that is by the compliance officer of the listed entity and the authorized representative of the share transfer agent, wherever applicable, within one month of end of each half of the financial year, certifying maintaining physical & electronic transfer facility either in house or RTA as applicable.

2. Regulation 13 (3) - Statement of Investor complaints - Within Twenty one days from the end of each quarter.

   The listed entity shall file with the recognized stock exchange(s) on a quarterly basis, within twenty one days from the end of each quarter, 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.

3. Regulation 27 (2) - Corporate Governance - Within 15 days from quarter end.

   The listed entity shall submit a quarterly compliance report on corporate governance within fifteen days from close of the quarter. Further it may be noted that it shall not apply, in respect of - (a) the listed entity having paid up equity share capital not exceeding rupees ten crore and net worth not exceeding rupees twenty five crore, as on the last day of the previous financial year: Provided that where the provisions of the regulations specified in this regulation becomes 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. (b) the listed entity which has listed its specified securities on the SME Exchange.

4. Regulation 31 - Shareholding Pattern - Within 21 days from quarter end.

   (1) 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 the Board from time to time within the following timelines -

   - one day prior to listing of its securities on the stock exchange(s);
   - on a quarterly basis, within twenty one days from the end of each quarter;
   - within ten days of any capital restructuring of the listed entity resulting in a
   - change exceeding two per cent of the total paid-up share capital.

   Provided that in case of listed entities which have listed their specified securities on SME Exchange, the above statements shall be submitted on a half yearly basis within twenty one days from the end of each half year.

5. Regulation 33 - Financial Results - Within 45 days from quarter end.

   And in case of Annual Financial Result, within 60 days from end of Financial Year.

   The listed entity shall submit quarterly and year-to-date standalone financial results to the stock exchange within forty-five days of end of each quarter, (other than last quarter) along with Limited Review Report or Audit Report as applicable.

   The listed entity shall submit Annual Audited standalone Financial results for the financial year, within sixty days from the end of the financial year along with the audit report and either with Statement on Impact of Audit Qualifications (applicable for audit report with modified opinion(s) or declaration (applicable for audit reports with unmodified opinion(s).

Provided that if the listed entity has subsidiaries, it shall, while submitting annual audited standalone financial results also submit annual audited consolidated financial results along with the audit report and Statement on Impact of Audit Qualifications (applicable for audit report with modified opinion). Provided further that, in case of audit reports with unmodified opinion(s), the listed entity shall furnish a declaration to that effect to the Stock Exchange(s) along with the annual audited financial results.

For the purpose of this Financial Result regulations, any reference to "quarterly/quarter" in case of listed entity which has listed their specified securities on SME Exchange shall be respectively read as "half yearly/half year"

6. Regulation 34 –Annual Report - Within twenty one working days of it being approved and adopted in the annual general meeting.

   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 as per the provisions of the Companies Act, 2013.

   In case of top 500 listed entities based on market capitalization (calculated as on March 31 of every financial year), Business responsibility report is required to include in Annual Report is compulsory as per prescribed Format. However in case of other than top 500 listed companies based on market capitalization and listed entities which have listed their specified securities on SME Exchange, may include these Business responsibility reports on a voluntary basis

   Further as per Regulation 43A, the top five hundred listed entities based on market capitalization (calculated as on March 31 of every financial year) shall formulate a dividend distribution policy which shall be required to disclosed in their annual reports and on their websites. However the listed entities other than top five hundred listed entities based on market capitalization may disclose their dividend distribution policies on a voluntary basis in their annual reports and on their websites

7. Regulation 40 (9) – Certificate from Practicing Company Secretary -Within one month of the end of each half of the financial year.

   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 practicing company secretary within one month of the end of each half of the financial year, certifying that all certificates have been issued within thirty days of the date of lodgment for transfer, sub-division, consolidation, renewal, exchange or endorsement of calls/allotment monies.

8. Reconciliation of Share Capital Audit - (SEBI- DP Reg.55A) - Within 30 days from quarter end.

   Listed entities are required to submit Reconciliation of Share Capital Audit Report on a quarterly basis to the stock exchanges audited by a qualified chartered accountant or a practicing company secretary for the purpose of reconciliation of share capital held in depositories and in physical form with the issued / listed capital. The Reconciliation of Share Capital Audit Report is required to be submitted to the stock Exchange within 30 days from the end of the Quarter under regulation 55A of the SEBI (Depositories and Participants) Regulations, 1996.

Other Compliance Requirements under SEBI Listing Regulations 2015.

Regulation 7 – Appointment of New Share Transfer Agent.

In case of any change or appointment of a new share transfer agent, the listed entity shall enter into a tripartite agreement between the existing share transfer agent, the new share transfer agent and the listed entity, in the manner as specified by the Board from time to time. The listed entity shall intimate such appointment, to the stock exchange(s) within seven days of entering into the agreement.

10. Regulation 14 – Listing Fees & Other charges.

The listed entity shall pay all such fees or charges, as applicable, to the recognized Stock Exchange(s), in the manner specified by the Board or the recognized Stock Exchange(s).

11. Regulation 29 – Notice for Board Meeting to consider the prescribed matters.

The Company shall give an advance notice of at least 5 days for Financial Result as per regulation 29 1 (a) & in case of other matters as stated in regulation 29 1 (b) to (f) - 2 Working days in advance (Excluding the date of the intimation and date of the meeting) to Stock Exchange. The Company shall give an advance notice of 11 working days in case matter related to alteration in i) Securities ;ii) date of interest or redemption of Debenture/bond as per regulation 29(3) (a) ,(b).

12. Regulation 30 – Disclosure of Price-Sensitive Information.

The Company has to intimate to the Stock Exchange about the material events which will have a bearing on the performance / operations of the company as well as price sensitive information both at the time of occurrence of the event and subsequently after the cessation of the event. 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.

13. Regulation 30 – Outcome of Board Meeting (Schedule III Part A- (4).

The listed entity shall disclose the information to the Exchange(s), within 30 minutes of the closure of the meeting.

14. Regulation 42 – Notice for Record Date \ Corporate Action.

The Company must ensure that there is a gap of at least 30 days between 2 book closure and record date. The Company shall give an advance notice of at least 7 working days (Excluding the date of the intimation and record date/book closure start date) to the Stock Exchange for corporate actions (Book closure/Record date) fixed for the purpose of corporate benefits like mergers, de-mergers, split , bonus, dividend, rights etc. The listed entity shall recommend or declare all dividend and/or cash bonuses at least five working days (excluding the date of intimation and the record date) before the record date fixed for the purpose.

15. Regulation 43 – Declaration of Dividend.

The Company has to declare and disclose the dividend on per share basis only.

16. Regulation 43 A – Dividend Distribution Policy.

The top five hundred listed entities based on market capitalization (calculated as on March 31 of every financial year) shall formulate a dividend distribution policy which shall be disclosed in their annual reports and on their websites.

The dividend distribution policy shall include the following parameters:

(a) The circumstances under which the shareholders of the listed entities may or may not expect dividend;

(b) The financial parameters that shall be considered while declaring dividend;

(c) Internal and external factors that shall be considered for declaration of dividend;

(d) Policy as to how the retained earnings shall be utilized; and

(e) Parameters that shall be adopted with regard to various classes of shares.

Provided that if the listed entity proposes to declare dividend on the basis of parameters in addition to clauses (a) to (e) or proposes to change such additional parameters or the dividend distribution policy contained in any of the parameters, it shall disclose such changes along with the rationale for the same in its annual report and on its website.

The listed entities other than top five hundred listed entities based on market capitalization may disclose their dividend distribution policies on a voluntary basis in their annual reports and on their websites.

17. Regulation 44 – Voting Result.

The listed entity shall submit to the stock exchange, within forty eight hours of conclusion of its General Meeting, details regarding the voting results in the format specified by the Board.

18. Regulation 46 - Company Website.

The listed entity shall maintain a functional website containing the basic information about the listed entity. The listed entity shall disseminate the information as stated in Regulation 46 (2). The listed entity shall ensure that the contents of the website are correct & the listed entity shall update any change in the content of its website within two working days from the date of such change in content.

19. Regulation 30(1) and 30(2) - SEBI Takeover Regulations 2011.

30(1) Every person, who together with persons acting in concert with him, holds shares or voting rights entitling him to exercise twenty-five per cent or more of the voting rights in a target company, shall disclose their aggregate shareholding and voting rights as of the thirty-first day of March, in such target company in such form as may be specified.

30(2) The promoter of every target company shall together with persons acting in concert with him, disclose their aggregate shareholding and voting rights as of the thirty-first day of March, in such target company in such form as may be specified.

The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within seven working days from the end of each financial year to;

– Every stock exchange where the shares of the target company are listed; and

– The target company at its registered office.

20. Regulation 7(2) - SEBI (Prohibition of Insider Trading) Regulations, 2015.

7 (2) Continual Disclosures:

(a) Every promoter, employee and director of every company shall disclose to the company the number of such securities acquired or disposed of within two trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of ten lakh rupees or such other value as may be specified;

(b) Every company shall notify the particulars of such trading to the stock exchange on which the securities are listed within two trading days of receipt of the disclosure or from becoming aware of such information.

Compliance Calendar under SEBI (LODR), Regulation 2015: A Snapshot

Regulation	Content	Period Covered	Last Date of Filing
Reg. 27(2)(a)	**Corporate Governance Report**– Quarterly Compliance Report on Corporate Governance in prescribed format (applicable on the listed companies having paid up capital of more than 10 cr. And more than 25 cr. Of net worth) **(Within 15 days of close of the quarter)**	i) April to June-Q1 ii) July to Sep.- Q2 iii) Oct. to Dec.-Q3 iv) Jan to March- Q4	i) 15th July ii) 15th Oct iii) 15th Jan iv) 15th April
Reg. 13(3)	**Statement Grievance Redressal Mechanism**– A statement giving number of investor i) Complaints pending at the beginning of the quarter, ii) Complaints received during the quarter, iii) Complaints disposed during the quarter, iv) Complaints remaining unresolved at the end of quarter **(Within 21 days of close of the quarter)**	i) April to June-Q1 ii) July to Sep.- Q2 iii) Oct. to Dec.-Q3 iv) Jan to March- Q4	i) 21st July ii) 21st Oct iii) 21st Jan iv) 21st April
Reg. 31(1)(b)	**Shareholding Pattern**– Shareholding Pattern **(Within 21 days of close of the quarter)**	i) April to June-Q1 ii) July to Sep.- Q2 iii) Oct. to Dec.-Q3 iv) Jan to March- Q4	i) 21st July ii) 21st Oct iii) 21st Jan iv) 21st April
Reg. 32(1)	**Statement of deviation and variation**– Statement of deviation and variation on quarterly basis for public issue, right issue, preferential issue indicating deviation as per regulation 32(1)	i) April to June-Q1 ii) July to Sep.- Q2 iii) Oct. to Dec.-Q3 iv) Jan to March- Q4	i) 31st July ii) 31st Oct iii) 31st Jan iv) 30thApril

Reg. 29(1)(a) & Proviso of Sub-Reg. (2)	**Prior intimation of Board Meeting for financial results-**Prior intimation of Board Meeting in which financial results is proposed to be considered and such intimation shall include the date of such meeting of Board of Director	i) April to June-Q1 ii) July to Sep.- Q2 iii) Oct. to Dec.-Q3 iv) Jan to March- Q4	At **list five days in advance** (excluding the date of intimation to stock exchange and date of Board Meeting. (**5 Clear days)**
Reg. 33(3)(a) **Reg. 33(3)(d)**	**Financial Results**– Quarterly financial results with Limited Review Report. **Annual Financial Results**– Audited standalone and consolidated financial results for the financial year along with audit report and either form A (unmodified report) or Form B (modified report) **(Within 45 days of close of the 1st, 2nd and 3rd quarter and Within 60 days of close of the 4th quarter)**	i) April to June-Q1 ii) July to Sep.- Q2 iii) Oct. to Dec.-Q3 iv) Jan to March- Q4	i) 14th Aug. ii) 14th Nov. iii) 14th Feb iv) 30th May
Reg. 7(3)	**Compliance Certificate related to share transfer**– Compliance certificate duly signed by both the Compliance Officer and Authorised Representative of Transfer Agent. **(Within one Month of end of each half year)**	i) April to Sep.- H1 ii) Oct. to March- H2	i) 31st Oct ii) 30th April
Reg. 40(9) and 40(10)	**Compliance Certificate related to transfer or transmission or transposition of securities**– Share Transfer Agent produce a certificate from Practicing	i) April to Sep.- H1 ii) Oct. to March- H2	i) 31st Oct ii) 30th April

	CS certifying that all the certificate within one month of the end of each of half financial year have been issued within 30 days of that lodgement for transfer, sub-division, consolidation, renewal, exchange, or endorsement of calls/ allotments monies **(Within one Month of end of each half year)**		
Reg. 14	**Payment of listing fees**– payment of listing fee or charges as applicable to the stock exchanges in the manner specified by SEBI	i) April to March	30th April
Reg. 34(1)	**Annual Report**– Annual Report to stock exchange within 21 working days of it being approved and adopted in the Annual General Meeting as per provision of Companies Act, 2013	i) April to March	Within 21 working days from the AGM
Reg. 44(3)	**Voting Result**– The listed entity shall submit to stock exchange, within 48 hours of conclusion of general meeting, details regarding the voting results in specified format.	Voting at General Meeting	Within 48 hour form the conclusion of general meeting
Reg. 7(5)	**Appointment of Share Transfer Agent**–		Within 7 days of agreement with RTA
Reg. 28(1)	Obtaining of 'in-principle approval' before issue of securities		Prior to issuance of securities
Reg. 29	**Prior intimation of Board Meeting**– Prior intimations of Board meeting for proposal to		At **least 2 clear working days** in advance excluding the date of intimation

	buy back of securities, voluntarily delisting, fund raising by public offer, right issue, ADR,GDR, FCCB, QIP, Debt issue, preferential issue, declaration of dividend, bonus issue		and date of meeting
Reg. 29(3)	**Prior intimation of Board Meeting**– Prior intimations of Board meeting for proposal toa) Any alteration in the form or nature of any of its securities that are listed or in the right or privileges of holders thereofb) Any alteration in the date on which, the interest on debentures or bonds or the redemption amount of redeemable shares or debentures or bonds shall be payable		At **least 11 clear working days** in advance
Reg. 30	**Disclosure of price sensitive information**– Listed entity shall first disclose to stock exchange(s) of all events, as specified in part A of the Schedule III, or information as soon as reasonably possible and not later than 24 hour from the occurrence of event or information. Provided that in case the disclosure is made after 24 hours of occurrence of the event or information the listed entity shall, along with such disclosures provide explanation for delay.		Not later than 24 hours from the occurrence of the event or information as per Part A Schedule III
Reg. 30	**Outcome of Meeting of Board of Directors**		Within 30 minutes of the closure of meetingThe

	Within 30 minutes of closure of meeting a) Dividends and/or cash bonuses recommended or declared or the decision to pass any dividend and the date on which dividend shall be paid/dispatched. b) any cancellation of dividend with reasons thereof c) the decision of buy back d) the decision with respect of fund raising proposed to be undertaken e) increase in capital by issue of bonus share through capitalization including the date on which such bonus shares shall be credited / dispatched f) re-issue of forfeited shares or securities or the issue of shares or securities held in reserve for future issue or the creation in any form or manner of new shares or securities or other rights, privileges or benefits to subscribes to g) alteration in capitale) financial resultf) decision on voluntary delisting by listed entity		intimation of outcome of the meeting shall also contain the time of commencement and conclusion of the meeting
Reg. 42(2)	**Intimation regarding fixing of Record date or Date of closure of transfer books-** Intimation of record date for following purpose;		The intimation shall be given in advance of at least 7 working days excluding the date of intimation and record dare to the stock

	a. declaration of dividendb. Issue of right or bonus sharesc. issue of shares for conversion of debentures or any other convertible securitiesd. share arising out of right attached to debentures or any other convertible securitye. corporate action like merger, demergers, splits and bonus sharesf. such other purpose as may be specified by the stock exchange		exchange of record dare specifying the purpose of the record date.
Reg. 42(3)	The listed entity shall recommend or declare all dividend and/or cash bonuses at least 5 working days (excluding the date of intimation and the record date fixed for the purpose)		At least 5 clear working days in advance
Reg. 45(3)	**Change of name-**On receipt of confirmation regarding name availability from ROC, before filing the request for change of name with the ROC in terms of provisions of Companies Act, 2013 and rules made thereunder the listed entity shall seek approval from stock exchange by submitting a certificate from chartered accountant stating compliance with the conditions at sub-regulation 45(1)		Prior Approval
Reg. 46(2)	Any change/updation in the content of its website		2 working days from the date of such change

CORPORATE GOVERNANCE

Corporate Governance may be defined as a set of systems, processes and principles which ensure that a company is governed in the best interest of all stakeholders. It is the system by which companies are directed and controlled. It is about promoting corporate fairness, transparency and accountability. In other words, 'good corporate governance' is simply 'good business'. It ensures:

- Adequate disclosures and effective decision making to achieve corporate objectives;
- Transparency in business transactions;
- Statutory and legal compliances;
- Protection of shareholder interests;
- Commitment to values and ethical conduct of business.

The fundamental objective of corporate governance is to enhance shareholders' value and protect the interests of other stakeholders by improving the corporate performance and accountability. Hence it harmonizes the need for a company to strike a balance at all times between the need to enhance shareholders' wealth whilst not in any way being detrimental to the interests of the other stakeholders in the company. Further, its objective is to generate an environment of trust and confidence amongst those having competing and conflicting interests.

REGULATORY FRAMEWORK OF CORPORATE GOVERNANCE IN INDIA

Good corporate governance practices are a sine qua non for sustainable business that aims at generating long term value to all its shareholders and other stakeholders. Some aspects of corporate governance have been enshrined in the law that is administered by the Ministry of Corporate Affairs, SEBI and other sectoral regulators.

The important legislations for regulating the various aspects of governance in companies are Companies Act, 2013. These laws have been introduced and amended, from time to time, to bring more transparency and accountability in the provisions of corporate governance. The SEBI Act, 1992 empowers SEBI to frame regulations, pursuant to which the regulator has introduced a comprehensive set of guidelines on insider trading, mergers and takeovers, fraudulent practices, etc all of which have a significant impact on corporate governance in the country. SEBI, as a market regulator, also decides the terms and conditions of listing agreement which govern the arrangement between stock exchanges and companies listed on the stock exchange. The corporate governance standards are elaborated under SEBI (LODR) Regulations, 2015.

The culture of the corporate governance in companies is discussed as below :

Corporate Governance and SEBI (Listing of Obligation and Disclosure Requirements) Regulation, 2015

SEBI as a regulator is playing a prospective role and taking a progressive view of regulation towards each and every development of progressive society. It will be apt to analyse SEBI's role in channelizing its sources towards the achievement of effective corporate government in the Indian capital market too.

During the current times, "corporate governance" has gained significant attention and focus all across the globe. It can be briefed that major corporate collapses and lack of governance standards cited has been one of the major reason for this renewed focus on inclusive corporate governance.

India is not an exception to the global changes; rather India participates more actively to achieve contemporary global targets. In India also, various initiatives have been taken in the recent past by the Ministry of Corporate Affairs and SEBI to ascertain that those entrusted with the responsibility of governing shareholder wealth are adequately regulated and made accountable.

Over the last two decades, there have been many reforms in the corporate governance framework at the level of market regulator. A timeline of reforms introduced to ensure corporate governance are as follows:

Time of Reforms in Indian Capital Market in line towards better Corporate Governance	
1999	**Constitution of the Kumar Mangalam Committee**
2000	Introduction of Clause 49 in the listing agreement
2006	Revision in Clause 49 based on recommendations of the Narayana Murthy Committee
2009	Issue of voluntary guidelines on corporate governance
2012	Issue of guiding principles on corporate governance based on recommendation of the Adi Godrej Committee
2013	Enactment of the revised Companies Act, 2013
2014	Introduction of new corporate governance norms by SEBI
2015	Enactment of SEBI (LODR) Regulation, 2015

Although, the Companies Act, 2013 specifies the minimum requirements of governance applicable to all companies, yet to establish strapping corporate governance in the interest of investor and to protect and secure investors and market as a whole, SEBI has taken a remarkable step of introducing standards of enhanced corporate governance to be observed by all corporate in practice. It is indeed a righteous move towards aligning the requirement for listed companies with that of the Companies Act and simultaneously raises the bar on governance standards for listed companies.

SEBI has clearly indicated this move towards increased transparency on conducting Board Matters and articulated several changes in the roles and responsibilities of the board, board committees and independent directors. This move is also reflecting the regulators objective on aligning Indian capital market with the global standards on corporate governance adopted in mature economies.

Before, the enactment of SEBI (LODR) Regulation, 2015, clause 49 of listing agreement used to take care the related aspects of Corporate Governance. With the enactment the LODR regulations, the Provisions under clause 49 of the erstwhile listing agreement have been brought under Regulations 17 to 27. More or less the provisions remains the same except for a few changes

– A new provision has been brought in respect of the Audit Committee in Regulation 18 (1) (f) that "occasionally the audit committee may meet without the presence of any executives of the listed entity"

– Applicability of Risk Management Committee has been brought in the Regulations itself under Regulation 21 (5), stating that "the provisions of this regulation shall be applicable to top 100 listed entities determined on the basis of market capitalisation, as at the end of the immediate previous financial year."

The detailed requirements for adopting corporate governance by listed company are issues in the form of SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015. As the board of directors is a vital link between shareholders and management, and therefore these regulations are drafted while regulating the very critical role and responsibility board and board members in the overall governance framework. A brief reading of LODR Rules confirms this aspect that SEBI's the primary focus is on the responsibilities of the board, its committees and independent directors.

Key Features of Corporate Governance under SEBI (LODR) Regulation, 2015

– Minimum information to be placed before the board of directors - Regulation 17(7)

– Compliance certificate to be given by CEO & CFO – Regulation 17 (8)

– Role of the audit committee and review of information – Regulation 18(3)

– Role of Nomination and Remuneration Committee and Stakeholder Relationship Committee – Regulation 19(4) and 20(4)

– Discretionary requirements – Regulation 27(1) (non-mandatory)

SEBI's Standard on Corporate Governance

In line with establishing corporate governance in the companies, SEBI has issued key standards to be observed by the companies. The mention major changes are as below:

Board of Directors and Its Committees	Independent Directors	Other Governance Directions
1. Mandatory Compliance of Stake-Holders Relationship in the nomination	1. Nominee Director not to act as an Independent Director	1. Prior Approval of all material related party transactions from audit party
2. Remuneration Committee with Independent Chairman	2. Prohibition of Stock Options	2. Definition and Explanation of various terms of Companies Act, 2013
3. One Women Director on Board	3. Mandatory Performance Evaluation	3. Definition and Explanation of Accounting Standards
4. Expanded Role of Audit Committee	4. Separate Meeting of Independent Directors	4. Disclosure of Remuneration Policy
5. Mandatory Evaluation of Performance	5. Restriction in the Participation on Company's Board. From 7, now it is 3 companies for joining as whole time director	5. Specification of Principles of Corporate Governance
6. Succession Planning for the Board	6. Maximum tenure is restricted to 2 terms of 5 years each.	6. Risk Management
7. Know Management Personnel (KMP)		7. Compulsory Whistle Blower Mechanism

Regulation 23 - Related Party Transactions

a. Listed entities shall formulate a policy on materiality of related party transaction and on dealing with related party transactions.

b. 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 latest audited financial statements.

c. Prior approval of the audit committee is required and omnibus bus approval may be given.

d. All material related party transactions shall require approval of the shareholders through are solution.

e. Related parties shall abstain from voting on such resolutions, whether the entity is a related party to the particular transaction or not - Regulation 23(4).

f. These provisions shall be applicable to all prospective transactions.

g. Pursuant to Regulation 23 (8), 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.

Regulation 25: Independent Director

Regulation 25(5) – an independent director shall be held liable, only in respect of such acts of omission or commission by the listed entity which had occurred with his knowledge, attributable through processes of board of directors and with his consent or connivance or where he had not acted diligently with respect to the provisions contained in these regulations. This is in alignment with section 149 (12) of the Companies Act, 2013.

Regulation 25(6) – an independent director who resigns or is removed from the directorship shall be replaced at the earliest but not later than the immediate next board meeting or three months form the date of such vacancy whichever is later. This is in alignment with Rule 4 of the Companies (appointment and qualification of directors) Rules 2014.

Audit Committee

Audit Committee shall mandatorily review the statement of deviations:

- Quarterly statement of deviations including report of monitoring agency, if applicable, submitted to stock exchanges in terms of Regulation 32(1);
- Annual statement of funds utilised for purposes other than those stated in the offer document/prospectus/ notice in terms of Regulation 32(7);

Role of NRC is also to review whether to extend or continue the term of the independent director, on the basis of the report of performance evaluation of independent directors.

Regulation 27 Compliance report on Corporate Governance

As against once in a quarter the report is now to be filed as under:

a. On quarterly basis i.e. within 15 days from the closure of the quarter;
b. At the end of the financial year (for the whole of financial year);
c. Within 6 months from the end of the financial year. This may be submitted along with second quarter report.

The above reports shall be placed before the board of directors in its next meeting.

This report shall be signed either by the compliance officer or of the CEO of the listed entity.

Corporate Governance under SEBI (LODR) Regulation, 2015

Sl. No.	Regulation	Content	Description
1.	**Regulation 16(1)(b)**	Independent Director	Independent Director” means a non-executive director, other than a nominee director of the listed entity – – who, in the opinion of the board of directors, is a person of integrity and possesses relevant expertise and experience; – who is or was not a promoter of the listed entity or its holding, subsidiary or associate company; – who is not related to promoters or directors in the listed entity, its holding, subsidiary or associate company;

			– who, apart from receiving director's remuneration, has or had no material pecuniary relationship with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year –- none of whose relatives has or had pecuniary relationship or transaction with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or Rs. 50 lakh or such higher amount as may be prescribed from time to time, whichever is lower, during the two immediately preceding financial years or during the current financial year; – who, neither himself, nor whose relative(s) holds or has held the position of a key managerial personnel or is or has been an employee of the listed entity or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed; – who, neither himself, nor whose relative(s) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed,
2.	**Regulation 17(1)**	Composition of Board of Directors	The Composition of Board of directors of the listed entity shall be as follows: **Executive/Non Executive:** – Board of Directors shall have an optimum combination of executive and non-executive directors:- • One Women Director • At least 50% of Board of Directors shall comprise of Non-Executive Director. **Independent Director:** – If Chairman of the Board is Non-Executive director • at least (1/3) one-third of the board of directors shall comprise of independent directors. – where the listed entity does not have a regular non-executive chairperson

			• at least (1/2) half of the board of directors shall comprise of independent directors – where the regular non-executive chairperson is a promoter of the listed entity; or is related to any promoter; or is related to person occupying management positions at the level of board of director; or at one level below the board of directors; • at least (1/2) half of the board of directors of the listed entity shall consist of independent directors.
4.	**Regulation 17(2)**	Frequency of Meeting	– At least 4 Board meeting – Maximum Gap Between two meetings 120 days
5.	**Regulation 17(3)**	Review of Compliance report	– The board of directors shall ***periodically review*** compliance reports pertaining toall laws applicable to the listed entity. – The board of directors shall ***periodically review steps taken*** by the listed entity torectify instances of non-compliances.
6.	**Regulation 17(4) & (5)**	Duties of Board of Directors	– ***Plans for Ordinary succession of appointment:*** The board of directors of the listedentity shall satisfy itself that plans are in place for orderly succession forappointment to the board of directors and senior management. **–** ***Code of Conduct:*** The board of directors shall lay down a Code of Conduct forall members of board of directors and senior management of the listed entity. **– Duties of Independent Director:** The code of conduct shall suitably incorporate theduties of independent directors as laid down in the Companies Act, 2013.
7.	**Regulation 17(6)**	Fees or Compensation	– The board of directors shall recommend all fees or compensation, if any, paid to non-executive directors, including independent directors and shall require approval of Shareholders in General Meetings. – The requirement of obtaining approval of shareholders in General Meeting shall not apply to payment of sitting fees to Non-Executive Directors, if made within the limits prescribed under Companies Act, 2013. *Approval of shareholders mentioned above, shall specify the limits for the maximum number of*

			stock options that may be granted to non-executive directors, in any financial year and in aggregate. – Independent Director shall not entitle to any Stock Option.
3.	**Regulation 17(8)**	Compliance Certificate	The Chief Executive Officer and the Chief Financial Officer shall provide the compliance certificate to the board of directors.
4.	**Regulation 17(10)**	Performance evaluation	The performance evaluation of independent directors shall be done by the entire board of directors. However, in the above evaluation the directors who are subject to evaluation shall not participate.
3.	**Regulation 18**	Audit Committee	• Every Listed Entity shall constitute a Qualified and independent audit committee in accordance with the terms subject to the followings: – The audit committee shall have minimum Three directors as members and – 2/3 (Two-thirds) of the members of committee shall be independent directors. – All members of Committee shall be financially literate and at least one member has expertise in accounting or related financial management. – The chairperson of the audit committee shall be an independent director and he shall be present at AGM to answer shareholder queries. – The Company Secretary shall act as the secretary to the audit committee. • The listed entity shall conduct the meetings of the audit committee in the following manner: – Four Meetings in a year – Maximum gap between two meetings 120 days – Quorum shall be 2 members or 1/3rd of the members of the audit committee, whichever is greater, with at least 2 independent directors. – The audit committee shall have powers to investigate any activity within its terms of reference, seek information from any employee, obtain outside legal or other

			professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary. ***Note: -*** *The Role of the audit committee and the **INFORMATION TO BE REVIEWD** by the audit committee shall be as specified in Part C of Schedule II.*
4.	**Regulation 19**	Nomination and remuneration committee	• The Board of Directors shall constitute the nomination and remuneration committee as follows: – The committee shall comprise of ***at least three directors***. – All the directors of the committee shall be ***Non- Executive directors*** and – ***At least 50%*** of the directors shall be ***Independent directors***.· • The Chairperson of the nomination committee shall be ***independent director.*** However, where chairperson of listed entity is executive or non-executive, ***may appoint as a member and shall not chair such committee.*** • The chairperson of such committee may present at the AGM, to answer the shareholder's queries.
5.	**Regulation 20**	Stakeholder Relationship Committee	***Purpose of constitution*** :- To look into the mechanism of redressal of grievances of :- – shareholders, – debenture holders and – other security holders • The chairperson of such committee shall be a ***Non-Executive Director***.
6.	**Regulation 21**	Risk Management Committee	• The board of directors shall constitute Risk Management Committee, shall be define the role and responsibility of the Risk Management Committee, and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit. • The majority of members of such Committee shall consist of members of the board of directors. • The Chairperson of such committee shall be a member of the board of directors and senior

			executives of the listed entity may be members of the committee.
7.	**Regulation 24**	Subsidiary Companies	**Corporate governance requirements with respect to subsidiary of listed entity** – At least one independent director of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, incorporated in India. – The audit committee of the listed entity shall also review the financial statements, in particular, the investments made by the unlisted subsidiary. – The minutes of the meetings of the board of directors of the unlisted subsidiary shall be placed at the meeting of the board of directors of the listed entity. – The management of the unlisted subsidiary shall periodically bring to the notice of the board of directors of the listed entity, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary. – A listed entity shall not dispose of shares in its material subsidiary resulting in reduction of its shareholding (either on its own or together with other subsidiaries) to less than fifty percent or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting except in cases where such divestment is made under a scheme of arrangement duly approved by a Court/Tribunal. – Selling, disposing and leasing of assets amounting to more than twenty percent of the assets of the material subsidiary on an aggregate basis during a financial year shall require prior approval of shareholders by way of special resolution, unless the sale/disposal/lease is made under a scheme of arrangement duly approved by a Court/Tribunal. – Where a listed entity has a listed subsidiary, which is itself a holding company, the provisions of thisregulation shall apply to the listed subsidiary in so far as its subsidiaries are concerned.
16.	**Regulation 25**	Obligations with respect to Independent directors:-	Obligations with respect to Independent directors:

		– Limit of Directorship as Independent Director	• A person shall serve as an independent director ***not more than seven listed entities.*** If such person is whole time director in any entities then he shall be serving as independent director ***not more than three listed entities.***
		– Tenure of Independent Director	• Maximum tenure of independent director shall be up to ***five consecutive years*** on the Board of a company. He shall be eligible for reappointment on ***passing of a special resolution*** by the company and disclosure of suchappointment in the Board's report.
		- Meeting of Independent Director	• The independent directors of the listed entity shall hold ***at least one meeting*** in a year. Non-Independent Director and Members of the Management will not present in such Meeting. All the Independent Directors shall strives to present in such Meeting.
		- Agenda for the Meeting of Independent Director	• The Independent director in the meeting shall : – Review the performance of non- independent directors and the board of directors as a whole. – Review the performance of the chairperson of the listed entity. (Taking into account the views of executive directors and non-executive directors) – Assess the quality, quantity and timeliness of flow of information between the management of the listed entity and the board of directors that is necessary for the board of directors to effectively and reasonably perform their duties.
		– Liability of Independent Director	• An independent director shall be held liable, ***ONLY*** in respect of such acts of omission or commission by the listed entity which had occurred : – with his knowledge and – attributable through processes of board of directors, and – with his consent or connivance or – Where he had not acted diligently with respect to the provisions contained inthese regulations.
			• Any Intermittent Vacancy of an Independent director shall be filled-up by the Board of

		– Intermittent vacancy of an Independent Director – Duties of the Company towards Independent Director	Directors at the earliest but not later than: – Immediate ***Next Board Meeting OR*** – ***3 (Three) Months*** from the date of such vacancy, ***whichever is Later*** • The listed entity shall familiarize the independent directors through various programmes about the listed entity, including thefollowing: – Nature of the industry in which the listed entity operates; – Business model of the listed entity; – Roles, rights, responsibilities of independent directors; and – Any other relevant information
17.	**Regulation 26**	Obligations of Directors and Senior Management	For the purpose of considering the limit of companies Private Company, Foreign Company and Section 8 of Companies Act, 2013 company are excluded. A Director shall not be : – Member in more than 10 committees – Chairman in more than 5 committees For reckoning the limit, **ONLY Audit committee and Stakeholder's relationship Committee** are considered.
18.	**Regulation 27**	Quarterly Compliance Report on Corporate Governance	• 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 fifteen days from close of the quarter.*** • Details of all material transactions with related parties shall be disclosed. • Report shall be sign either by Compliance officer or by Chief Executive officer.

CORPORATE GOVERNANCE UNDER COMPANIES ACT, 2013

Sl. No.	Particulars	Companies Act, 2013 & Rules, 2014
1.	**Partition of Nominee Director and IDs**	**Section 149(6)** An independent director in relation to a company, means a director other than a MD or a WTD or a nominee director.
2.	**Modified definition of IDs**	**Section 149(6)** of the Companies Act 2013 defines the term Independent Director.
3.	**Qualification of IDs**	**Companies (Appointment and Qualification of Directors) Rules, 2014:** An independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.
4.	**Whistle-Blowing Mechanism**	**Section 177(9):** Every listed company and other classesof companies to establish a Vigil mechanism for directors and employees to report genuine concern. It provide adequate safeguards against victimization of employees and directors who avail of the Vigil mechanism and also provide for direct access to the chairperson of the Audit committee or the director nominated to play the role of audit committee, as the case may be, in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization. The details of establishment of Vigil mechanism shall be disclosed by the company in the website, if any, and in the Board's Report.
5.	**Prohibited Stock options for IDs**	**Section 197(7)**: IDs shall not entitled to any stock option.
6.	**Separate meeting of IDs**	**Section 149 read with Schedule IV**: IDs of the company shall hold at least one meeting in a year, without the attendance of non independent directors and members of management. All the independent directors of the company shall strive to be present at such meeting.
7.	**Training of IDs**	The Companies Act 2013 did not specify any training of IDs and Board of Directors.
8.	**Liability of IDs**	**Section 149(12)** : An independent director; a NED not being promoter or KMP, shall be held liable, only in respect of such acts ofomission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

9.	**Stakeholders Relationship Committee**	**Section- 178(5):** The Board of Directors of a companywhich consists of more than one thousand shareholders, debenture-holders, depositholders and any othersecurity holders at any time during a financial year shall constitute a Stakeholders Relationship Committee (SRC) consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board. The SRC shall consider and resolve the grievances of security holders of the company.
10.	**Disclosure Policy for Remuneration**	**Section 197 (2) and Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014:** (1) Every listed company shall disclose in the Board's report: (i) the ratio of the remuneration of each director to the median remuneration ofthe employees of the company for the financial year. (ii) the percentage increase in remuneration of each director, CFO, CEO, CS or Manager, if any, in the financial year; (iii) the percentage increase in the median remuneration of employees in the financial year; (iv) the number of permanent employees on the rolls of company; (v) the explanation on the relationship between average increase in remuneration and company performance; (vi) comparison of the remuneration of the KMP against the performance of the company; (vii) variations in the market capitalisation of the company, price earnings ratio as at the closing date of the current financial year and previous financial year and percentage increase over decrease in the market quotations of the shares of the company in comparison to the rate at which the company came out with the last public offer in case of listed companies, andin case of unlisted companies, the variations in the net worth of the company as at the close of the current financial year and previous financial year; (viii) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration; (ix) the key parameters for any variable component of remuneration availed by the directors; (x) the ratio of the remuneration of the highest paid director to that of the employees who are not directors but receive remuneration in excess of thehighest paid director during the year; and (xi) affirmation that the remuneration is as per the remuneration policy of the company.

11.	**Performance evaluation of IDs**	**Section 178(2) read with Schedule IV:** The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal and shall carry out evaluation of every director's performance. The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated. On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.
12.	**Related Party Transaction (RPT)**	**Section 2 (76) & 188** "Related party", with reference to a company, means – (i) a director or his relative (ii) a KMP 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 is a member or director; (v) a public company in which a director or manager is a director or holds along with his relatives, more than 2% 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, or instructions of a director or manager; (vii) any person on whose advice, directions or instructions a director ormanager is accustomed to act; (viii) any company which is – (A) a holding, subsidiary or an associate company of such company; or (B) a subsidiary of a holding company to which it is also a subsidiary. "Related party" means a director or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party. No company shall enter into any contract or arrangement with a related party, except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions. A company having a paid-up share capital of Rs.10 Crores or more shall not entered into a contract or arrangement, except with the prior approval of the company by a special resolution. A company shall not enter into any contract or arrangement, except with the prior approval of the company by a special resolution. A company shall not enter into any contract or arrangement with related party subject to conditions;

		• sale, purchase or supply of any goods or materials directly or through appointment of agents exceeding 25%. • of the annual turnover selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agents exceeding 10% of Net Worth. • leasing of property of any kind exceeding 10% of the net worth or exceeding 10% of turnover. • availing or rendering of any services directly or through appointment of agents exceeding 10% of Net Worth. • appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding Rs.2,50,000/- remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding 1% of the net worth. Turnover or Net Worth shall be on the basis of the Audited Financial statements of the preceding Financial Year. In case of wholly owned subsidiary, the special resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between wholly owned subsidiary and holding company. No member of the company shall vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party: Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement. Every contract or arrangement entered into, shall be referred to in the Board's report to the shareholders along with the justification for entering into such contract or arrangement. Where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a special resolution in the general meeting and if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, such contract or arrangement shall be voidable at the option of the Board and if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.

13.	**Disclosure of RPTs**	No such Provision.
14.	**Disclosure of Different Accounting Standard**	**Section-129(5):** Where the financial statements of a company do not comply with the accounting standards, the company shall disclose in its financial statements, thedeviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.
15.	**Constitution of Nomination & Remuneration Committee**	**Section 178 and Companies (Meetings of Board and its Powers) Rules, 2014:** The Nomination and Remuneration Committee is applicable to the following classes of Companies: (i) Every listed Company (ii) Every other Public Company (a) Having Paid up capital of Rs.10 crores or more; or (b) Having turnover of Rs.100 Crores: • Which have, in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs.50 Crores. • The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule. The above mentioned companies shall constitute the Nomination and Remuneration Committee consisting of – • 3 or more NEDs out of which not less than one half shall be IDs. • The chairperson of the company (whether executive or non-executive)may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee. The Nomination and Remuneration Committee shall- • Identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, Recommend to the Board their appointment and removal, carry out evaluation of every director's performance. Formulate the criteria for determining qualifications, positive attributes and independence of a director and Recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees.The Nomination and Remuneration Committee shall ensure that – (a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully; (b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and

		(c) remuneration to directors, KMPs and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals: The policy shall be disclosed in the Board's report.
16.	**Appointment of one Woman Director**	**Section 149(1) and Companies (Appointment and Qualification of Directors) Rules, 2014:** (i) every listed company; (ii) every other public company having - (a) paid–up share capital of Rs.100 Crores or more; or (b) turnover of Rs.300 Crore or more shall appoint at least one woman director. A company shall comply with provisions within a period of six months from the date of its incorporation. Any intermittent vacancy of a woman director shall be filled up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.
17.	**Maximum No. of directorship of IDs.**	**Section 165:** A person shall hold not office as a director, including any alternate directorship in more than 20 companiesThe max no. of public companies in which a person can be appointed as a director shall not exceed 10.
18.	**Maximum tenure of IDs**	**Section 149:** An independent director shall hold office for a term up to five consecutiveyears on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report. No independent director shall hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director.
19.	**Risk management**	**Section 134(3):**A statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company.
20.	**Succession planning**	There is no such provision.
21.	**Filing of Casual Vacancy of IDs**	**Schedule IV:** An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within a period of not more than one hundred and eighty days from the date of such resignation or removal, as the case may be.Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation orremoval, as the case may be, the requirement of replacement by a newindependent director shall not apply.

22.	**Code of Conduct of Board of Directors & Senior Management**	**Section 149 & Part III of Schedule IV:** The independent directors shall– (1) undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company; (2) seek appropriate clarification or amplification of information and, wherenecessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company; (3) strive to attend all meetings of the Board of Directors and of the Board committees of which he is a member; (4) participate constructively and actively in the committees of the Board in which they are chairpersons or members; (5) strive to attend the general meetings of the company; (6) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting; (7) keep themselves well informed about the company and the external environment in which it operates; (8) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board; (9) pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company; (10) ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use; (11) report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy; (12) acting within his authority, assist in protecting the legitimate interests of the company, shareholders and its employees; (13) not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.
23.	**Disclosure of Appointment of Director**	A return containing the particulars of appointment of director or key managerial personnel and changes therein, shall be filed with the Registrar in Form DIR-12 along with such fee as may be provided in the Companies (Registration Offices and Fees) Rules, 2014 within thirty days of such appointment or change, as the case may be.
24.	**Disclosure of Resignation of Director**	**Section 169:** A director may resign from his office by giving a notice in writing to the company and the Board shall on receipt of such notice take note of the same and the company shall intimate the Registrar in such manner, within 30 days in form DIR- 12 and shall also place the fact of such resignation in the report of directors laid in the immediately following general meeting by the company.Where a director resigns from his office, he shall within a period of thirty days from the date of resignation, forward to the Registrar a copy of his

		resignation along with reasons for the resignation in Form DIR-11 along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014.

STOCK EXCHANGE MECHANISM

Stock Exchange is an integral part of Secondary Market. The Stock Exchange is a key institution facilitating the issue and sales of various types of securities and for this the Stock Exchange has mechanism like trading of securities, clearing and settlement of securities through which buying and selling takes place. Further, Stock Indices are an important part of stock market representing the performance of stock market and reflecting investor sentiment on the state of economy. When the stock exchange opens at 9.00 a.m., there is flurry of orders that are keyed - in from all over the world and from all strata of economic background. In this hurly burly, turbulent and apprehensive market scenario, there are bound to be mistakes, differences and disputes. These disputes can be between a broker, sub broker, constituents, clearing member, depositories, authorized persons, etc. To deal with such disputes, stock exchanges have devised a dispute resolution mechanism in accordance with the guidelines issued by SEBI from time to time.

ARBITRATION MECHANISM

Arbitration is a quasi judicial process of settlement of disputes between trading member, investor, clearing member, sub brokers, authorized persons etc. Arbitration aims at quicker resolution of the disputes. When either of the parties is not satisfied with the complaint resolution process or the complaint is not resolved amicably between parties, the parties may choose the route of arbitration.

Kinds of disputes covered under Exchange Arbitration Mechanism

All disputes arising out of transactions done on the Exchange by the parties are eligible for arbitration mechanism provided by the exchange.

Legal framework for Arbitration Mechanism provided by Exchange

Arbitration framework at Exchange is governed by the rules, Byelaws, Regulations & Circular issued by the exchange and SEBI, from time to time. SEBI issued circulars dated August 11, 2010 and August 31, 2010, bringing about sweeping amendments to the manner in which arbitrations were being conducted by the stock exchanges.

Arbitration Mechanism at Stock exchanges

A stock exchange shall provide an arbitration mechanism for settlement of disputes between a client and a member through arbitration proceedings in accordance with the provisions of this Circular read with Section 2(4) of the Arbitration and Conciliation, Act, 1996.

Maintenance of a Panel of Arbitrators

– A stock exchange shall maintain a panel of arbitrators. The number of arbitrators in the panel shall be commensurate to the number of disputes so that an arbitrator handles a reasonable number of references simultaneously and all arbitration references are disposed of within the prescribed time.

– The stock exchange shall have a set of fair and transparent criteria for inclusion of names in the panel of arbitrators.

– While deciding to include a particular person in the panel of arbitrators, the stock exchange shall take into account the following factors:

(i) age,

(ii) qualification in the area of law, finance, accounts, economics, management, or administration, and

** Reference: http://taxguru.in/company-law/clause-49-companies-act-2013.html*

(iii) experience in financial services, including securities market.

– The name of a person shall be included in the panel after obtaining:

(i) a declaration that he has not been involved in any act of fraud, dishonesty or moral turpitude, or found guilty of any economic offence,

(ii) disclosure of the nature of his association with securities market,

(iii) disclosure of the names of his dependents associated with the securities market as member, sub-broker or authorized person, and

(iv) an undertaking that he shall abide by the code of conduct as prescribed by SEBI.

– The stock exchange shall provide at least seven days of continuing education to every arbitrator each year.

– The stock exchange shall have a mechanism to appraise the performance of arbitrators and reconstitute the panel based on such appraisal atleast once a year.

– List of Arbitrators on the panel of all stock exchanges having nation-wide trading terminals shall be pooled and will be called a 'Common Pool'. This list shall be made publicly available including by way of display on websites of the stock exchanges.

– 'Common pool' of Arbitrators will consist of Arbitrators listed on the panels of all stock exchanges having nation-wide trading terminals. The pooling of arbitrators will be done centre-wise. To illustrate, the list of arbitrators on the panel of all stock exchanges for the region covered by the Delhi centre will be pooled. This would enable an applicant from the region to choose any arbitrator from the 'Common Pool' for Delhi.

– If the client and member (stock broker, trading member or clearing member) fail to choose the Arbitrator(s) from the Common Pool, the Arbitrator(s) will be chosen by an 'Automatic Process' wherein neither the parties to arbitration (i.e. client or member) nor the concerned Stock Exchanges will be directly involved.

– The 'Automatic Process' will entail a randomized, computer generated selection of Arbitrator, from the list of Arbitrators in the 'Common Pool'. The selection process shall be in chronological order of the receipt of arbitration reference i.e. only after selecting an arbitrator for the former arbitration reference received, selection for the latter shall be taken up.

– The 'Automatic Process' will send a system generated, real time alert (sms, email etc.) to all entities involved in the particular case. Further, the communication for the appointment of the Arbitrator will be sent immediately and in any case not later than the next working day from the day of picking of the Arbitrator. This communication will be sent by the stock exchange on which the dispute had taken place, to all concerned entities including clients, arbitrators, members, stock exchanges etc.

Code of Conduct for Arbitrators

An arbitrator shall –

(i) act in a fair, unbiased, independent and objective manner;

(ii) maintain the highest standards of personal integrity, truthfulness, honesty and fortitude in discharge of his duties;

(iii) disclose his interest or conflict in a particular case, i.e., whether any party to the proceeding had any dealings with or is related to the arbitrator;

(iv) not engage in acts discreditable to his responsibilities;

(v) avoid any interest or activity which is in conflict with the conduct of his duties as an arbitrator;

(vi) avoid any activity that may impair, or may appear to impair, his independence or objectivity;

(vii) conduct arbitration proceedings in compliance with the principles of natural justice and the relevant provisions of the Arbitration and Conciliation Act, 1996, the SEBI Act, 1992, the Securities Contracts (Regulation) Act, 1956 and the Rules, Regulations and Bye-laws framed thereunder and the circulars, directions issued by the Government / SEBI;

(viii) endeavour to pass arbitral award expeditiously and in any case not later than the time prescribed in this circular; and

(ix) pass reasoned and speaking arbitral awards.

Arbitration

– The limitation period for filing an arbitration reference shall be governed by the law of limitation, i.e., The Limitation Act, 1963.

– An arbitration reference for a claim / counter claim up to `25 lakh shall be dealt with by a sole arbitrator while that above `25 lakh shall be dealt with by a panel of three arbitrators.

– The stock exchange shall ensure that the process of appointment of arbitrator(s) is completed within 30 days from the date of receipt of application from the applicant.

– The arbitration reference shall be concluded by way of issue of an arbitral award within four months from the date of appointment of arbitrator(s).

– The Managing Director/ Executive Director of the stock exchange may for sufficient cause extend the time for issue of arbitral award by not more than two months on a case to case basis after recording the reasons for the same.

Appellate Arbitration

– A party aggrieved by an arbitral award may appeal to the appellate panel of arbitrators of the stock exchange against such award.

– An appeal before the appellate panel of arbitrators may be filed within one month from the date of receipt of arbitral award.

– The appellate panel shall consist of three arbitrators who shall be different from the ones who passed the arbitral award appealed against.

– The stock exchange shall ensure that the process of appointment of appellate panel of arbitrators is completed within 30 days from the date of receipt of application for appellate arbitration.

– The appeal shall be disposed of within three months from the date of appointment of appellate panel of such appeal by way of issue of an appellate arbitral award.

– The Managing Director/ Executive Director of the stock exchange may for sufficient cause extend the time for issue of appellate arbitral award by not more than two months on a case to case basis after recording the reasons for the same.

– A party aggrieved by the appellate arbitral award may file an application to the Court of competent jurisdiction in accordance with Section 34 of the Arbitration and Conciliation Act, 1996.

Arbitration Fees

– Each of the parties to arbitration shall deposit an amount, as may be prescribed by the stock exchange, at the time of making arbitration reference. The deposits (exclusive of statutory dues – stamp duty, service tax, etc.) shall not exceed the amount as indicated under:

Amount of Claim/ of Counter Claim, whichever is higher (₹)	If claim is filed within six months	If claim is filed after six months
≤10,00,000	1.3% subject to a minimum of ₹10,000	3.9% subject to a minimum of ₹30,000
>10,00,000 - ≤ 25,00,000	₹ 13,000 plus 0.3% amount above ₹10 lakh	₹ 39,000 plus 0.9% amount above ₹ 10 lakh
>25,00,000	₹ 17,500 plus 0.2% amount above ₹ 25 lakh subject to maximum of ₹30,000	₹ 52,500 plus 0.6% amount above ₹ 25 lakh subject to maximum of ₹ 90,000

Note: six months shall be computed from the end of the quarter during which the disputed transaction(s) were executed/ settled, whichever is relevant for the dispute.

– A client, who is a party to the arbitration for a claim/counter claim upto ₹ 10 lakh, shall be exempt from the deposit provided the arbitration reference for the same is filed within six months from the end of the quarter during which the disputed transaction(s) were executed/ settled.

– On issue of the arbitral award, the stock exchange shall refund the deposit, if any, to the party in whose favour the award has been passed and appropriate the deposit, if any, made by the party, against whom the award has been passed, towards arbitration fees.

– A party filing an appeal before the appellate panel shall pay a fee not exceeding ₹ 30,000,as may be prescribed by the stock exchange, in addition to statutory dues (stamp duty, service tax, etc) along with the appeal.

Place of Arbitration

– The Stock Exchanges having nationwide terminals, such as National Stock Exchange of India Ltd., Bombay Stock Exchange Ltd., MCX Stock Exchange Ltd., and United Stock Exchange of India Ltd., shall provide arbitration facility (arbitration as well as appellate arbitration) at all four regional centres (Delhi, Mumbai, Kolkata and Chennai). The arbitration and appellate arbitration shall be conducted at the regional centre nearest to the client.

– The application under Section 34 of the Arbitration and Conciliation Act, 1996, if any, against the decision of the appellate panel shall be filed in the competent Court nearest to such regional centre.

– Other stock exchanges shall provide the arbitration facility, including appellate arbitration, at the place where it is located.

Implementation of Arbitral Award in favour of Clients

– In case the arbitral / appellate arbitral award is in favour of the client, the stock exchange shall, on receipt of the same, debit the amount of the award from the security deposit or any other monies of the member (against whom an award has been passed) and keep it in a separate escrow account.

– The stock exchange shall implement the arbitral award, by making payment to the client, along with interest earned on the amount that has been set aside, as soon as the time for preferring an appeal before the appellate panel of arbitrators has expired and no appeal has been preferred.

– The stock exchange shall implement the appellate arbitral award, by making payment to the client, along with interest earned on the amount that has been set aside, as soon as:

(a) the time for making an application to a Court to set aside such appellate arbitral award under

Section 34 of the Arbitration and Conciliation Act, 1996 has expired, and no application has been made, or

(b) when an application to a Court to set aside such appellate arbitral award under Section 34 of the Arbitration and Conciliation Act, 1996, having been made, it has been refused by such Court, or

(c) an application to a Court to set aside such appellate arbitral award under Section 34 of the Arbitration and Conciliation Act, 1996, having been made, but where no stay has been granted by such Court within a period of three months from the date on which the party making that application had received the appellate arbitral award.

Record and Disclosures

– The stock exchange shall preserve the following documents related to arbitration:

(i) the arbitral and appellate arbitral award with acknowledgements, confirming receipt of award by the disputing parties, permanently;

(ii) other records pertaining to arbitration for five years from the date of arbitral award, appellate arbitral award or Order of the Court, as the case may be; and

(iii) register of destruction of records relating to (ii) above, permanently.

– The stock exchange shall disclose on its website, details of disposal of arbitration proceedings as per the format A and details of arbitrator-wise disposal of arbitration proceedings as per format B.

– The stock exchange shall continue to disclose on their website the arbitration awards (issued since April 1, 2007)

Things You May Know

What happens if the appellate tribunal award is in favour of the Investor?

When the appellate tribunal is passed in favour of investor:

– Trading member may settle the award and confirm the same to the Exchange.

– Trading member can further file petition in High court under section 34 of the Arbitration and Conciliation Act 1996. In case court dismisses the application or does not grant stay within three months from date of filing petition , then the award amount will be released to the investor.

In which court the petition under Section 34 of the Arbitration and Conciliation Act 1996 filed?

The petition under section 34 of the Arbitration and Conciliation Act 1996 shall be filed in the competent court nearest to regional arbitration centre situated near to the place of constituent.

MARGINING

Just as we are faced with day to day uncertainties pertaining to weather, health, traffic etc and take steps to minimize the uncertainties, so also in the stock markets, there is uncertainty in the movement of share prices. This uncertainty leading to risk is sought to be addressed by margining systems of stock markets.

Suppose an investor, purchases 1000 shares of ‘xyz’ company at ₹100/- on January 1, 2013. Investor has to give the purchase amount of ₹1,00,000/- (1000 x 100) to his broker on or before January 2, 2013. Broker, in turn, has to give this money to stock exchange on January 3, 2013.

There is always a small chance that the investor may not be able to bring the required money by required date. As an advance for buying the shares, investor is required to pay a portion of the total amount of ₹1,00,000/- to the broker at the time of placing the buy order. Stock exchange in turn collects similar amount from the broker upon execution of the order. This initial token payment is called margin.

For every buyer there is a seller and if the buyer does not bring the money, seller may not get his / her money and vice versa. Therefore, margin is levied on the seller also to ensure that he / she gives the 100 shares sold to the broker who in turn gives it to the stock exchange. Margin payments ensure that each investor is serious about buying or selling shares.

In the above example, assume that margin was 15%. That is investor has to give ₹15,000/-(15% of ₹1,00,000) to the broker before buying. Now suppose that investor bought the shares at 11 am on January 1, 2013. Assume that by the end of the day price of the share falls by ₹25/-. That is total value of the shares has come down to ₹75,000. That is buyer has suffered a notional loss of ₹25,000/-. In this example buyer has paid ₹15,000/- as margin but the notional loss, because of fall in price, is ₹25,000/-. That is notional loss is more than the margin given.

In such a situation, the buyer may not want to pay ₹1,00,000/- for the shares whose value has come down to ₹75,000/-. Similarly, if the price has gone up by ₹25/-, the seller may not want to give the shares at ₹1,00,000/. To ensure that both buyers and sellers fulfill their obligations irrespective of price movements, notional losses are also need to be collected.

Prices of shares keep on moving every day. Margins ensure that buyers bring money and sellers bring shares to complete their obligations even though the prices have moved down or up.

To execute a margin transaction, it is necessary to establish a margin account. It is opened either in the form of cash or securities. Margin credit can be obtained from a broker or a banker, although nearly all margin trading is done through brokers.

The broker will retain any securities purchased on margin as collateral for the loan. There are basically two types of margin requirements: initial margin and maintenance margin.

Initial Margin

Initial margin stipulates the minimum amount of equity that must be provided by the investor at the time of purchase. It is used to prevent overtrading and excessive speculation. Generally, it is this margin requirement that investors refer to when discussing margin trading. Any security that can be margined has a specific initial requirement, although these can be changed by the authorities from time to time.'

As long as the margin in an account remains at a level equal to or greater than prevailing initial requirements, the investor is free to use the account in any way he or she seems fit. If the value of the investor's holdings declines, the margin in his or her account will also drop.

This situation can lead to what is known as a restricted account, one whose equity is less than the initial margin requirement. It does not mean that the investor must put up additional cash or equity, but it does require the investor to bring the margin back to the initial level when securities are sold while the account is restricted.

Maintenance Margin

Maintenance margin is the absolute minimum amount of margin (equity) that an investor must maintain in the margin account at all times. If the margin falls below the maintenance margin, the broker is authorized to sell enough of the securities to bring the account back up to standard.

When an insufficient amount of maintenance margin exists, an investor will receive a margin call to remedy the situation. This call gives the investor a short period of time to find some means to bringing the equity up to the required level. If this is not done, the broker has no alternative but to sell enough of the investor's margined holdings to bring the equity in the account up to this level.

The maintenance margin protects both the brokerage house and investors: Brokers avoid having to absorb excessive investor losses, and investors avoid being wiped out. The maintenance margin on equity securities rarely changes, although it is often set slightly higher by brokerage houses for the added protection of both brokers and their customers. For straight debt securities, generally there is no official maintenance margin except that set by the brokerage houses themselves.

TYPES OF MARGINS IN CASH AND DERIVATIVE SEGMENT

Margins in the cash market segment comprise of the following three types:

- Value at Risk (VaR) margin
- Extreme loss margin
- Mark to market Margin

Value at Risk (VaR) margin

VaR is a technique used to estimate the probability of loss of value of an asset or group of assets (for example a share or a portfolio of a few shares), based on the statistical analysis of historical price trends and volatilities. A VaR statistic has three components: a time period, a confidence level and a loss amount (or loss percentage).

Example

Let us assume that an investor bought shares of a company. Its market value today is ₹50 lakhs. Obviously, we do not know what would be the market value of these shares next day. An investor holding these shares may, based on VaR methodology, say that 1-day VaR is ₹4 lakhs at the 99% confidence level. This implies that under normal trading conditions the investor can, with 99% confidence, say that the value of the shares would not go down by more than ₹4 lakhs within next 1-day.

In the stock exchange scenario, a VaR Margin is a margin intended to cover the largest loss (in %) that may be faced by an investor for his / her shares (both purchases and sales) on a single day with a 99% confidence level. The VaR margin is collected on an upfront basis (at the time of trade).

Extreme Loss Margin

The extreme loss margin aims at covering the losses that could occur outside the coverage of VaR margins. The Extreme loss margin for any stock is higher of 1.5 times the standard deviation of daily LN (Natural Log) returns of the stock price in the last six months or 5% of the value of the position.

This margin rate is fixed at the beginning of every month, by taking the price data on a rolling basis for the past six months and the resulting value shall be applicable for the next month.

Things You May Know

LN Return

LN is a natural log function in excel, it is used in calculating daily returns of a stock price.

Example

The VaR margin rate for shares of ABC Ltd. is 13%. Suppose that standard deviation of daily LN returns of the security is 3.1%. 1.5 times standard deviation would be 1.5 x 3.1 = 4.65. Then 5% (which is higher than 4.65%) will be taken as the Extreme Loss margin rate. Therefore, the total margin on the security would be 18% (13% VaR Margin + 5% Extreme Loss Margin). As such, total margin payable (VaR margin + extreme loss margin) on a trade of ₹10 lakhs would be 1,80,000/-.

Mark-to-Market (MTM) margin

MTM is calculated at the end of the day on all open positions by comparing transaction price with the closing price of the share for the day.

Example

A buyer purchased 1000 shares @ ₹100/- at 11 am on January 1, 2013. If close price of the shares on that day happens to be ₹75/-, then the buyer faces a notional loss of ₹25,000/- on his buy position. In technical terms this loss is called as MTM loss and is payable by January 2, 2013 (that is next day of the trade) before the trading begins.

In case price of the share falls further by the end of January 2, 2013 to ₹ 70/-, then buy position would show a further loss of ₹5,000/-. This MTM loss is payable by next day.

In case, on a given day, buy and sell quantity in a share are equal, that is net quantity position is zero, but there could still be a notional loss / gain (due to difference between the buy and sell values), such notional loss also is considered for calculating the MTM payable.

MTM Profit/Loss = [(Total Buy Qty X Close price) – Total Buy Value] - [Total Sale Value - (Total Sale Qty X Close price)]

DERIVATIVES SEGMENT

There are 3 types of margin levied by the exchanges in case of derivative contracts.

- Initial Margin
- Exposure Margin
- Premium Margin

Initial Margin

This margin is calculated on a portfolio basis and not on individual scrip basis. The margin calculation is done using SPAN (Standard Portfolio Analysis of Risk) a product developed by Chicago Mercantile Exchange. The margin is levied at trade level on real-time basis. The rates are computed at 5 intervals one at the beginning of the day 3 during market hours and one at the end of the day.

The objective of SPAN is to identify overall risk in a portfolio of futures and options contracts for each client. The system treats futures and options contracts uniformly, while at the same time recognizing the unique exposures associated with options portfolios like extremely deep out-of-the-money short positions, inter-month risk and inter-commodity risk.

Initial margin requirements are based on 99% value at risk over a one-day time horizon. However, in the case of futures contracts (on index or individual securities), where it may not be possible to collect mark to market settlement value, before the commencement of trading on the next day, the initial margin may be computed over a two-day time horizon, applying the appropriate statistical formula.

Exposure Margin

This margin is based on a single percentage on the value of the scrip determined at the beginning of every month for the following month by the exchange. This is charged over and above the initial margin and is popularly referred as second line of defence.

Premium Margin

In case of option purchase the margin levied will be equivalent to the premium amount. This margin will be levied till the time premium settlement is complete.

TRADING OF SECURITIES

The act of buying and selling of securities on a stock exchange is known as stock market trading. Following are the steps involved in the trading of securities at a stock exchange :

Order Placing

The first and foremost step in the trading of securities is placement of an order by an investor with the broker concerned either to buy or sell certain number of scrips at a certain specified price.

There are various kinds of orders. For instance, where in an order, the client places a limit on the price of the security; it is a case of 'limit order'. Where the order is to be executed by the broker at the best price, such an order takes the name of 'Best Rate Order'. An 'Immediate or Cancel Order' is one that has to be executed immediately and may have to be cancelled if the order is not executed immediately. A Limited Discretionary Order allows the broker to buy and sell within the specified price range and/or within the given time period as per the best judgement of the broker. Where the client orders the broker to sell as the price reaches a particular level, it is a case of 'Stop Loss Order'. Under the 'Open Order', the client does not fix any price limit or time limit on the execution of the order and relies on the judgement of the broker.

Order Execution

Brokers execute the orders placed by the clients for the purchase or sale of scrips. The execution takes place during the trading hours and during the working days of the exchange. However, the trading after the normal working hours may also take place and this is termed 'as kerb trading'.

Entry to the trading floor of the exchange is restricted only to the identified and regular members of the exchange. Such a member is called a 'single jobber' or 'tarawaniwala' for a particular script. In respect of actively traded scripts that involve a huge volume of business, there could be more than one jobber. Jobbers offer two-day quotes for scripts they deal in. This way, jobbers act as market-makers and provide liquidity to the market. The order is executed either by auction or negotiation. Settlement of a transaction takes place by a mutual agreement of the price between the parties concerned. Such prices are published in the newspaper every day.

Contract Note Preparation

When once an agreement is reached between the parties concerned as regards price, a contract note is made out between the broker and the client. Such a note forms the basis of the transactions recorded in the 'Pucca Sauda Book' after the execution of the order. Particulars such as the price, number of scrips, date of transaction, names of parties, brokerage, etc. are found in the note

Delivery and Clearing

After the preparation of the contract note, delivery of share takes place through the instrument known as 'transfer deed'. The transfer deed is signed by the transferor (seller) and is authenticated by a witness. It contains the details of the transferee, besides bearing the stamp of the selling broker. There different kinds of delivery. For instance, in the case of 'spot delivery,' the transaction is settled by delivery and payment takes place on the date of the contract or the next day. In the case of 'hand delivery', delivery and payment are completed within 14 days from the date of contract. Delivery and payment may be completed after 14 days as specified at the time of the bargain in the case of 'specified or special delivery'. Delivery and clearing of security takes place through a clearance house.

Share Transfer

For the purpose of effecting the transfer in the name of the transferee, the share certificate and the transfer deed are lodged with the Company. The parties also pay necessary stamp duty. The company issues the share certificate bearing a new ledger folio number, transfer number, date and buyer's name at the reverse of the certificate. The appropriate authority of the company endorses these particulars.

SETTLEMENT SYSTEM

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

There are two types of settlement systems that can be adopted in stock exchanges – Accounting period system and rolling settlement system. Now-a-days, stock exchange in India adopts rolling settlement only.

(a) Accounting period settlement systems -

- There is a predetermined period of usually 7 – 12 days, over which total trades are aggregated.
- Cumulative net obligations of each member are calculated on last day of cycle.
- It is more speculative than the rolling settlements. It may lead to payment crisis in case of wide fluctuations in the market.

(b) Rolling Settlement

In this system, each day constitutes the settlement period (T+2 System). Under rolling settlements, unlike the account period settlements the trades done on a particular day are settled after a given number of business days instead of settling all trades done during an account period of a week or fortnight. In case of Rolling Settlements, pay-in and pay-out of both funds and securities is completed on the same day. Each trading day is considered as a trading period and trades executed during the day are settled to obtain the net obligations for the day in a rolling settlement.

CLEARING AND SETTLEMENT

The transactions in secondary market pass through three distinct phases, viz., trading, clearing and settlement. While the stock exchanges provide the platform for trading, the clearing corporation determines the funds and securities obligations of the trading members and ensures that the trade is settled through exchange of obligations. The clearing banks and the depositories provide the necessary interface between the custodians/clearing members for settlement of funds and securities obligations of trading members. Several entities, like the clearing corporation, clearing members, custodians, clearing banks, depositories are involved in the process of clearing. The role of each of these entities is explained below:

- **Clearing Corporation:** The clearing corporation is responsible for post-trade activities such as risk management and clearing and settlement of trades executed on a stock exchange.
- **Clearing Members(CM):** Clearing Members are responsible for settling their obligations as determined by the clearing corporation. They do so by making available funds and/or securities in the designated accounts with clearing bank/ depositories on the date of settlement.
- **Custodians:** Custodians are clearing members but not trading members. They settle trades on behalf of trading members, when a particular trade is assigned to them for settlement. The custodian is required to confirm whether he is going to settle that trade or not. If the custodian confirm to settle that trade, then clearing corporation assigns that particular obligation to him.
- **Clearing Banks:** Clearing banks are a key link between the clearing members and Clearing Corporation to effect settlement of funds. Every clearing member is required to open a dedicated clearing account with one of the designated clearing banks. Based on the clearing member's obligation as determined through clearing, the clearing member makes funds available in the clearing account for the pay-in and receives funds in case of a pay-out.

– **Depositories:** Depository holds securities in dematerialized form for the investors in their beneficiary accounts. Each clearing member is required to maintain a clearing pool account with the depositories. He is required to make available the required securities in the designated account on settlement day. The depository runs an electronic file to transfer the securities from accounts of the custodians/clearing member to that of Clearing corporation and *vice-versa* as per the schedule of allocation of securities.

CLEARING & SETTLEMENT PROCESS

The clearing process involves determination of what counter-parties owe, and which counter-parties are due to receive on the settlement date, thereafter the obligations are discharged by settlement. The clearing and settlement process comprises of three main activities- clearing, settlement and risk management.

The clearing and settlement process for transaction in securities is given below:

1. Trade details from Exchange to Clearing Corporation (real-time and end of day trade file).
2. Clearing Corporation notifies the consummated trade details to clearing members/custodians who affirm back. Based on the affirmation, Clearing Corporation applies multilateral netting and determines obligations.
3. Download of obligation and pay-in advice of funds/securities.
4. Instructions to clearing banks to make funds available by pay-in time.
5. Instructions to depositories to make securities available by pay-in-time.
6. Pay-in of securities (Clearing Corporation advises depository to debit pool account of custodians/CMs and credit its account and depository does it)
7. Pay-in of funds (Clearing Corporation advises Clearing Banks to debit account of custodians/CMs and credit its account and clearing bank does it)
8. Pay-out of securities (Clearing Corporation advises depository to credit pool account of custodians/ CMs and debit its account and depository does it)
9. Pay-out of funds (Clearing Corporation advises Clearing Banks to credit account of custodians/CMs and debit its account and clearing bank does it)
10. Depository informs custodians/CMs through DPs.
11. Clearing Banks inform custodians/CMs.

The core processes involved in clearing and settlement include:

(a) Trade Recording: The key details about the trades are recorded to provide basis for settlement. These details are automatically recorded in the electronic trading system of the exchanges.

(b) Trade Confrmation: The parties to a trade agree upon the terms of trade like security, quantity, price, and settlement date, but not the counterparty which is the Clearing Corporation. The electronic system automatically generates confirmation by direct participants.

(c) Determination of Obligation: The next step is determination of what counter-parties owe, and what counterparties are due to receive on the settlement date. The Clearing Corporation interposes itself as a central counterparty between the counterparties to trades and nets the positions so that a member has security wise net obligation to receive or deliver a security and has to either pay or receive funds.

The settlement process begins as soon as members' obligations are determined through the clearing process. The settlement process is carried out by the Clearing Corporation with the help of clearing banks and depositories. The Clearing Corporation provides a major link between the clearing banks and the depositories. This link ensures actual movement of funds as well as securities on the prescribed pay-in and pay-out day.

(d) Pay-in of Funds and Securities: This requires members to bring in their funds/securities to the clearing corporation. The CMs make the securities available in designated accounts with the two depositories (CM pool account in the case of NSDL and designated settlement accounts in the case of CDSL). The depositories move the securities available in the pool accounts to the pool account of the clearing corporation. Likewise CMs with funds obligations make funds available in the designated accounts with clearing banks. The clearing corporation sends electronic instructions to the clearing banks to debit designated CMs' accounts to the extent of payment obligations. The banks process these instructions, debit accounts of CMs and credit accounts of the clearing corporation. This constitutes pay-in of funds and of securities.

(e) Pay-out of Funds and Securities: After processing for shortages of funds/securities and arranging for movement of funds from surplus banks to deficit banks through RBI clearing, the clearing corporation sends electronic instructions to the depositories/clearing banks to release pay-out of securities/funds. The depositories and clearing banks debit accounts of the Clearing Corporation and credit accounts of CMs. This constitutes pay-out of funds and securities. Settlement is deemed to be complete upon declaration and release of pay-out of funds and securities.

TRADE GUARANTEE FUND

Trade or Settlement Guarantee Fund means a fund whose objective is to provide the necessary funds and ensure timely completion of settlements in cases of failure of member brokers to fulfill their settlement obligations. Thus establishment of such funds would give greater confidence to investors in the settlement and clearing procedures of the stock exchanges. Keeping this objective in view, SEBI had advised all stock exchanges to set up a Trade or Settlement Guarantee Fund to ensure that the market equilibrium is not disturbed in case of payment default by the members. Accordingly Stock Exchange have instituted a system to guarantee settlement of bonafide transactions of Members which form part of the settlement system.

TRADING SOFTWARE

Trading software means computer programs that facilitate trading of financial products such as stocks and currencies. Software is usually provided by brokerage firms that enable their clients to trade financial products and manage their accounts. Different brokerages will have different software which determines the interface in which trades are made and information is searched. Other software can be purchased from third parties to enhance or add to what a brokerage provides. Trading software is aimed to help investors improve their stock picking decisions through its fundamental analysis and advanced technical analysis. Stock market trading software is relied on by traders to pick out shares quickly and is highly recommend to all types of traders.

STOCK MARKET INDICES

Stock Indices represents the performance of stock market and by proxy, reflects investor sentiment on the state of the economy. An Index is used to give information about the price movements of products in the financial, commodities or any other markets. A stock market index is created by selecting a group of stocks that are representative of the whole market or a specified sector or segment of the market.

Stock indices are barometers to measure general economic performance of an particular country / sector. It's updated every second throughout on every trading so as to reflect the exact picture of the economy. It's also a permanent record of the history of markets – it's highs and lows, booms and crashes. A stock index is created by selecting a group of high performing stocks. Irrespective of the type of index, the purpose of any index is the same. It provides to the public, a quick view of how the economy (based on which the index is constructed) is functioning. An index is calculated with reference to a base period and a base index value.

TYPES OF INDICES

There are different types of indices. Stock indices can be constructed –

- For the entire world (global indices) – For an entire continent (regional indices – for example S&P Latin America 40)
- For an entire country (national indices – for example Sensex & Nifty for India)
- For a particular sector in a country – (sectoral indices – for example BSE BANKEX which tracks top banking companies in India)
- For any other theme / group of economy / companies (example Dow Jones Islamic world market index)

BSE Indices

- Broad Indices- S&P BSE SENSEX, S&P BSE MID CAP, S&P BSE SMALL CAP, S&P BSE 100, S&P BSE 200, S&P BSE 500
- Investment Strategy Indices- S&P BSE IPO, S&P BSE SME IPO, S&P BSE DOLLEX 30, S&P BSE DOLLEX 100, S&P BSE DOLLEX 200
- Volatility Indices- S&P BSE REALVOL-1MTH, S&P BSE REALVOL-2MTH, S&P BSE REALVOL-3MTH
- Thematic Indices- S&P BSE GREENEX, S&P BSE CARBONEX
- Sectoral Indices- S&P BSE AUTO, S&P BSE BANKEX, S&P BSE CAPITAL GOODS, S&P BSE CONSUMER DURABLES, S&P BSE FMCG, S&P BSE HEALTHCARE, S&P BSE IT, S&P BSE METAL, S&P BSE OIL & GAS, S&P BSE POWER, S&P BSE PSU, S&P BSE REALTY, S&P BSE TECK

NSE Indices

- Broad Market Indices- CNX Nifty, CNX Nifty Junior, LIX 15, CNX 100, CNX 200, CNX 500, Nifty Midcap 50, CNX Midcap, CNX Smallcap
- Sectoral Indices- CNX Auto, CNX Bank, CNX Energy, CNX Finance, CNX FMCG, CNX IT, CNX Media, CNX Metal, CNX Pharma, CNX PSU Bank, CNX Realty
- Thematic Indices- CNX Commodities, CNX Consumption, CNX Infrastructure, CNX MNC, CNX PSE,CNX Service Sector, S&P ESG india Index
- Strategy Indices- CNX 100 Equal Weight, CNX Alpha Index, CNX Dividend Opportunities, CNX High Beta Index, CNX Low Volatility Index, CNX Nifty Dividend

BSE INDICES

Sensex stands for "sensitive index", it represents BSE (Bombay Stock Exchange). Sensex indicates all major companies of BSE. Sensex is calculated using share prices of 30 major companies which are listed in BSE. If the Sensex goes up it means that share values of most of the major companies have gone up and vice versa.

The launch of SENSEX in 1986 was followed up in January 1989 by introduction of BSE National Index (Base: 1983-84 = 100). It comprised 100 stocks listed at five major stock exchanges in India - Mumbai, Calcutta, Delhi, Ahmedabad and Madras. The BSE National Index was renamed BSE-100 Index from October 14, 1996 and since then, it is being calculated taking into consideration only the prices of stocks listed at BSE. BSE launched the dollar-linked version of BSE-100 index on May 22, 2006.

With a view to provide a better representation of the increasing number of listed companies, larger market capitalization and the new industry sectors, BSE launched on 27th May, 1994 two new index series viz., the 'BSE-200' and the 'DOLLEX-200'. Since then, BSE has come a long way in attuning itself to the varied needs of investors and market participants. In order to fulfill the need for still broader, segment-specific and sector-specific indices, BSE has continuously been increasing the range of its indices. BSE-500 Index and 5 sectoral indices were launched in 1999. In 2001, BSE launched BSE-PSU Index, DOLLEX-30 and the country's first free-float based index - the BSE TECk Index. Over the years, BSE shifted all its indices to the free-float methodology (except BSE-PSU index).

Sensex

Things You May Know

Market Capitalisation

Market capitalization is the total worth of all outstanding (issued) shares of a company. It represents the total worth of a company.

Market Capitalization= No. of shares outstanding x Market price of share

S&P BSE SENSEX, first compiled in 1986, was calculated on a "Market Capitalization-Weighted" methodology of 30 component stocks representing large, well-established and financially sound companies across key sectors. The base year of S&P BSE SENSEX was taken as 1978-79. S&P BSE SENSEX today is widely reported in both domestic and international markets through print as well as electronic media. It is scientifically designed and is based on globally accepted construction and review methodology. Since September 1, 2003, S&P BSE SENSEX is being calculated on a free-float market capitalization methodology. The "free-float market capitalization-weighted" methodology is a widely followed index construction methodology on which majority of global equity indices are based; all major index providers like MSCI, FTSE, STOXX, and Dow Jones use the free-float methodology.

Index Specification	
Base Year	1978-79
Base Index Value	100
Date of Launch	01-01-1986
Method of calculation	Launched on full market capitalization method and effective September 01, 2003, calculation method shifted to free-float market capitalization.
Number of scrips	30

SENSEX - Scrip Selection Criteria

The general guidelines for selection of constituents in SENSEX are as follows:

1. **Listed History:**The scrip should have a listing history of at least 3 months at BSE. Exception may be considered if full market capitalization of a newly listed company ranks among top 10 in the list of BSE universe. In case, a company is listed on account of merger/ demerger/ amalgamation, minimum listing history would not be required.

2. **Trading Frequency:**The scrip should have been traded on each and every trading day in the last three months at BSE. Exceptions can be made for extreme reasons like scrip suspension etc.

3. **Final Rank:**The scrip should figure in the top 100 companies listed by final rank. The final rank is arrived at by assigning 75% weightage to the rank on the basis of three-month average full market capitalization and 25% weightage to the liquidity rank based on three-month average daily turnover & three-month average impact cost.

4. **Market Capitalization Weightage:**The weightage of each scrip in SENSEX based on three-month average free-float market capitalization should be at least 0.5% of the Index.

5. **Industry/Sector Representation:**Scrip selection would generally take into account a balanced representation of the listed companies in the universe of BSE.

6. **Track Record:**In the opinion of the BSE Index Committee, the company should have an acceptable track record.

S & P BSE SENSEX Calculation Methodology

S&P BSE SENSEX is calculated using the “Free-float Market Capitalization” methodology, wherein, the level of index at any point of time reflects the free-float market value of 30 component stocks relative to a base period. The market capitalization of a company is determined by multiplying the price of its stock by the number of shares issued by the company. This market capitalization is further multiplied by the free-float factor to determine the free-float market capitalization.

The base period of S&P BSE SENSEX is 1978-79 and the base value is 100 index points. This is often indicated by the notation 1978-79=100. The calculation of S&P BSE SENSEX involves dividing the free-float market capitalization of 30 companies in the Index by a number called the Index Divisor. The Divisor is the only link to the original base period value of the S&P BSE SENSEX. It keeps the Index comparable over time and is the adjustment point for all Index adjustments arising out of corporate actions, replacement of scrips etc. During market hours, prices of the index scrips, at which latest trades are executed, are used by the trading system to calculate S&P BSE SENSEX on a continuous basis.

Definition of Free-float

Shareholdings of investors that would not, in the normal course, come into the open market for trading are treated as ‘Controlling/ Strategic Holdings’ and hence not included in free-float. Specifically, the following categories of holding are generally excluded from the definition of Free-float:

- Shares held by founders/directors/acquirers which has control element
- Shares held by persons/ bodies with “Controlling Interest”
- Shares held by Government as promoter/acquirer
- Holdings through the FDI Route
- Strategic stakes by private corporate bodies/ individuals
- Equity held by associate/group companies (cross-holdings)
- Equity held by Employee Welfare Trusts
- Locked-in shares and shares which would not be sold in the open market in normal course.

The remaining shareholders fall under the Free-float category.

Example

Company “XYZ Ltd’ issues 10000 shares, out of which 2000 shares held by government, 5000 shares by directors of the company and remaining 3000 shares are available in the open market for trading. Market price of share is ₹ 100

Here;

Total Shares = 10000

Shares Held by Government = 2000

Shares Held by Directors = 5000

Shares available in the Open Market = 3000 Market price of share = ₹ 100

Here total market capitalization of the company is 10,000 X ₹ 100 = ₹ 10,00,000 and Free float market capitalization of the company is 3000 X ₹ 100 = ₹ 300,000

According to the rules of BSE any shares which do not fall under the following categories are considered as free float (open market) shares.

– Government holding shares as promoters Holdings by Directors/ Founders Holdings through the FDI route

– Stakes held by private corporate bodies or individuals.

– Any cross holdings i.e. equity held by associate or group companies. Equity held by employee welfare trust.

Understanding Free-float Methodology Concept

Free-float Methodology refers to an index construction methodology that takes into consideration only the free-float market capitalization of a company for the purpose of index calculation and assigning weight to stocks in the Index. Free-float market capitalization takes into consideration only those shares issued by the company that are readily available for trading in the market. It generally excludes promoters' holding, government holding, strategic holding and other locked-in shares that will not come to the market for trading in the normal course. In other words, the market capitalization of each company in a Free-float index is reduced to the extent of its readily available shares in the market. Subsequently all BSE indices with the exception of BSE PSU index have adopted the free-float methodology.

Major Advantages of Free-float Methodology

– A Free-float index reflects the market trends more rationally as it takes into consideration only those shares that are available for trading in the market.

– Free-float Methodology makes the index more broad-based by reducing the concentration of top few companies in Index.

– A Free-float index aids both active and passive investing styles. It aids active managers by enabling them to benchmark their fund returns vis-à-vis an investible index. This enables an apple-to-apple comparison thereby facilitating better evaluation of performance of active managers. Being a perfectly replicable portfolio of stocks, a Free-float adjusted index is best suited for the passive managers as it enables them to track the index with the least tracking error.

– Free-float Methodology improves index flexibility in terms of including any stock from the universe of listed stocks. This improves market coverage and sector coverage of the index. For example, under a full-market capitalization methodology, companies with large market capitalization and low free-float cannot generally be included in the Index because they tend to distort the index by having an undue influence on the index movement. However, under the free-float Methodology, since only the free-float market capitalization of each company is considered for index calculation, it becomes possible to include such closely held companies in the index while at the same time preventing their undue influence on the index movement.

– Globally, the free-float Methodology of index construction is considered to be an industry best practice and all major index providers like MSCI, FTSE, S&P and STOXX have adopted the same. MSCI, a leading global index provider, shifted all its indices to the Free-float Methodology in 2002. The MSCI India Standard Index, which is followed by Foreign Institutional Investors (FIIs) to track Indian equities, is also based on the Free-float Methodology. NASDAQ-100, the underlying index to the famous Exchange Traded Fund (ETF) - QQQ is based on the Free-float Methodology.

Determining Free-float Factors of Companies

BSE has designed a Free-float format, which is filled and submitted by all index companies on a quarterly basis. BSE determines the Free-float factor for each company based on the detailed information submitted by the companies in the prescribed format. Free-float factor is a multiple with which the total market capitalization of a company is adjusted to arrive at the Free-float market capitalization. Once the Free-float of a company is determined, it is rounded-off to the higher multiple of 5 and each company is categorized into one of the 20 bands given below. A Free-float factor of say 0.55 means that only 55% of the market capitalization of the company will be considered for index calculation.

Free-float Bands

% Free-Float	Free-Float Factor%	Free-Float	Free-Float Factor
>0 – 5%	0.05	>50 – 55%	0.55>
5 – 10%	0.10	>55 – 60%	0.60
>10 – 15%	0.15	>60 – 65%	0.65
>15 – 20%	0.20	>65 – 70%	0.70
>20 – 25%	0.25	>70 – 75%	0.75
>25 – 30%	0.30	>75 – 80%	0.80
>30 – 35%	0.35	>80 – 85%	0.85
>35 – 40%	0.40	>85 – 90%	0.90
>40 – 45%	0.45	>90 – 95%	0.95
>45 – 50%	0.50	>95 – 100%	1.00

Formula for Calculation of Index

All BSE indices (except BSE-PSU index) are calculated using following formula:

Free-float market capitalization of index constituents/ Base Market capitalization * Base Index Value

Example

Suppose BSE index (SENSEX) consist of only two stocks such as ‘X’ and ‘Y’

Company ‘X’ has 10000 outstanding shares out of which only 5000 are available for trading in open market. Market price of share is ₹100.

Company ‘Y’ has 5000 outstanding shares out of which 2000 shares are held by promoters and remaining 3000 are free float shares (open market shares). Market price of share is ₹10.

Calculation of Market Capitalization

Stock	Issued Stocks	Market price	Market Cap.
X	10000	100	1000000
Y	5000	50	250000

Calculation of Free Float market capitalization

Stock	Open Market Stocks	Market price	Market Cap.
X	5000	100	500000
Y	2000	50	100000

Here;

Sum of free float market cap of company X and company Y is 500000+100000 = 600000. Assume market cap during 1978-79 is 500000.

Now Applying formula;

600000*100/500000 = 120

For calculation of BSE-PSU index, full market capitalization of index constituents is considered instead of free-float market capitalization. Dollex-30, Dollex-100 and Dollex-200 are dollar-linked versions of SENSEX, BSE-100 and BSE-200 index.

BSE IPO index & BSE TASIS Shariah 50 Index is calculated using following formula:

Capped market capitalization of index constituents/ Base Market capitalization * Base Index Value

Where capped market capitalisation for scrips in BSE IPO Index and BSE TASIS Shariah 50 Index is arrived by multiplying free-float adjusted market capitalisation of individual scrip with its respective capping factor. Such capping factor is assigned to the index constituent to ensure that no single scrip based on its free-float market capitalisation exceeds weightage of 20% in case BSE IPO Index and 8% in case of BSE TASIS Shariah 50 Index at the time of rebalancing. In case, weightage of all the constituents in the index is below 20% & 8% respectively, each company would be assigned capping factor of 1.

Index Closure Algorithm

The closing index value on any trading day is computed taking the weighted average of all the trades of index constituents in the last 30 minutes of trading session. If an index constituent has not traded in the last 30 minutes, the last traded price is taken for computation of the index closure. If an index constituent has not traded at all in a day, then its last day's closing price is taken for computation of index closure. The use of index closure algorithm prevents any intentional manipulation of the closing index value.

Maintenance of BSE Indices

One of the important aspects of maintaining continuity with the past is to update the base year average. The base year value adjustment ensures that replacement of stocks in Index, additional issue of capital and other corporate announcements like 'rights issue' etc. do not destroy the historical value of the index. The beauty of maintenance lies in the fact that adjustments for corporate actions in the Index should not per se affect the index values.

The Department of BSE Indices does the day-to-day maintenance of the index within the broad index policy framework set by the BSE Index Committee. Department of BSE Indices ensures that all BSE Indices maintain their benchmark properties by striking a delicate balance between frequent replacements in index and maintaining its historical continuity. The BSE Index Committee comprises capital market expert, fund managers, market participants, members of BSE Governing Board.

On - Line Computation of the Index

During trading hours, value of the indices is calculated and disseminated on real time basis. This is done automatically on the basis of prices at which trades in index constituents are executed.

Adjustment for Bonus, Rights and Newly Issued Capital

Index calculation needs to be adjusted for issue of bonus and rights issue. If no adjustments were made, a discontinuity would arise between the current value of the index and its previous value despite the non-occurrence of any economic activity of substance. At the BSE Index Cell, the base value is adjusted, which is used to alter market capitalization of the component stocks to arrive at the index value.

The BSE Indices Department keeps a close watch on the events that might affect the index on a regular basis and carries out daily maintenance of all BSE Indices.

– **Adjustments for Rights Issues**

When a company, included in the compilation of the index, issues right shares, the free-float market capitalization of that company is increased by the number of additional shares issued based on the theoretical (ex-right) price. An offsetting or proportionate adjustment is then made to the Base Market capitalization.

– **Adjustments for Bonus Issue**

When a company, included in the compilation of the index, issues bonus shares, the market capitalization of that company does not undergo any change. Therefore, there is no change in the Base Market capitalization; only the 'number of shares' in the formula is updated.

– **Other Issues**

Base Market capitalization Adjustment is required when new shares are issued by way of conversion of debentures, mergers, spin-offs etc. or when equity is reduced by way of buy-back of shares, corporate restructuring etc.

Base Market capitalization Adjustment

The formula for adjusting the Base Market capitalization is as follows:

$$\textbf{New Base Market capitalization} = \textbf{Old Base Market capitalization} \times \frac{\textbf{New Market capitalization}}{\textbf{Old Market capitalization}}$$

To illustrate, suppose a company issues additional shares, which increases the market capitalization of the shares of that company by say, ₹100 crore. The existing Base Market capitalization (Old Base Market capitalization), say, is ₹2450 crore and the aggregate market capitalization of all the shares included in the index before this issue is made is, say ₹4781 crore. The "New Base Market capitalization" will then be:

$$\frac{2450 \times (4781+100)}{4781} = ₹\ 2501.24 \text{ crores}$$

This figure of ₹ 2501.24 crore will be used as the Base Market capitalization for calculating the index number from then onwards till the next base change becomes necessary.

CNX NIFTY

The CNX Nifty is the flagship index on the National Stock Exchange of India Ltd. (NSE). The Index tracks the behavior of a portfolio of blue chip companies, the largest and most liquid Indian securities. It includes 50 of the approximately 1600 companies listed on the NSE, captures approximately 65% of its float-adjusted market capitalization and is a true reflection of the Indian stock market. The CNX Nifty covers 21 sectors of the Indian economy and offers investment managers exposure to the Indian market in one efficient portfolio. The Index has been trading since April 1996 and is well suited for benchmarking, index funds and index-based derivatives. It is calculated using base year 1995 and base index value 1000.

Selection Criteria for CNX Nifty

Selection of the index set is based on the following criteria:

- **Liquidity:** For inclusion in the index, the security should have traded at an average impact cost of 0.50 % or less during the last six months, for 90% of the observations.

  Impact cost is the cost of executing a transaction in a security in proportion to its index weight, measured by market capitalization at any point in time. This is the percentage mark up suffered while buying/ selling the desired quantity of a security compared to its ideal price — (best buy + best sell)/2.

- **Float -Adjusted Market Capitalization**: Companies eligible for inclusion in the CNX Nifty must have at least twice the float-adjusted market capitalization of the current smallest index constituent.
- **Float**: Companies eligible for inclusion in the CNX Nifty should have at least 10% of its stock available to investors (float). For this purpose, float is stocks which are not held by the promoters and associated entities (where identifiable) of such companies.
- **Domicile:** The company must be domiciled in India and trade on the NSE.
- **Eligible Securities:** All common shares listed on the NSE (which are of equity and not of a fixed income nature) are eligible for inclusion in the CNX Nifty index. Convertible stock, bonds, warrants, rights, and preferred stock that provide a guaranteed fixed return are not eligible.
- **Other Variables** .A company which comes out with an IPO is eligible for inclusion in the index if it fulfills the normal eligibility criteria for the index — impact cost, float-adjusted market capitalization and float — for a three-month period instead of a six-month period.

Price Index Calculations Formula

The CNX Nifty is computed using market capitalisation weighted method wherein the level of the Index reflects the total market value of all the stocks in the Index relative to the base period November 3,1995.

Free Float Market Capitalization = Equity Capital * Price * IWF (Investible Weight Factors)

Index Value = Current Market Value / Base Market Capital * Base Index Value (1000)

Base market capital of the Index is the aggregate market capitalisation of each scrip in the Index during the base period. The market cap during the base period is equated to an Index value of 1000 known as the base Index value.

INVESTIBLE WEIGHT FACTORS (IWFS)

IWF as the term suggests is a unit of floating stock expressed in terms of a number available for trading and which is not held by the entities having strategic interest in a company. Higher IWF suggest greater number of shares held by the investors as reported under public category within a shareholding pattern reported by each company.

The IWFs for each company in the index are determined based on the public shareholding of the companies as disclosed in the shareholding pattern submitted to the stock exchanges on quarterly basis. The following categories are excluded from the free float factor where identifiable separately:

- Shareholding of promoter and promoter group
- Government holding in the capacity of strategic investor

– Shares held by promoters through ADR/GDR

– Strategic stakes by corporate bodies

– Investments under FDI category

– Equity held by associate/group companies (cross-holdings)

– Employee Welfare Trusts

– Shares under lock-in category

Example

For XYZ Ltd.

	Shares	%
Total Shares	1,00,00,000	100.00

	Shares	%
Shareholding of promoter and promoter group	19,75,000	19.75
Government holding in the capacity of strategic investor	50,000	0.50
Shares held by promoters through ADR/GDRs.	2,50,000	2.50
Equity held by associate/group companies (cross-holdings)	12,575	0.13
Employee Welfare Trusts	1,45,987	1.46
Shares under lock-in category	14,78,500	14.79

IWF = [1,00,00,000 – (19,75,000 + 50,000 +2,50,000 +12,575 +1,45,987 +14,78,500)] / 1,00,00,000. =0.60870

LESSON ROUND UP

– 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.

– Corporate action is a process by which a company gives benefits to the investors who are holding securities of the company.

– A detailed culture of corporate governance has been established in India with the enactment of SEBI (LODR) Regulations, 2015

– SEBI notified SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, on September 2, 2015, which shall come into force from December 1, 2015 (a time period of 90 days was given for its implementation).

– These Regulations would replace the existing Listing Agreement

– Following two provisions shall come into force with immediate effect:

  – Passing of an ordinary resolution instead of a special resolution for all material related party transactions – Regulation 23(4).

  – Reclassification of promoters as public shareholders under various circumstances –Regulation 31A.

– The new Regulations got a greater statutory force and non-compliance would lead to violation of Securities Laws including SEBI Act and consequential penal provisions would be applicable.

- The listing regulations would consolidate and streamline the provisions of the existing listing requirements for different segments of the capital market.
- Listing regulations have been sub-divided into two parts viz;
  - Substantive provisions incorporated in the main body of the regulations and
  - Procedural requirements in the form of schedules to the regulations.
- The Regulations are divided into XII chapters and IX schedules.
- Arbitration is a quasi judicial process of settlement of dispute between trading member, investor clearing members, sub-brokers, authorised persons.
- Arbitration framework at Exchange is governed by the rules, Bye-laws, Regulations & Circular issued by the exchange and SEBI, from time to time.
- VaR is a technique used to estimate the probability of loss of value of an asset or group of assets (for example a share or a portfolio of a few shares), based on the statistical analysis of historical price trends and volatilities.
- The extreme loss margin aims at covering the losses that could occur outside the coverage of VaR margins.
- Mark-to-Market (MTM) margin is calculated at the end of the day on all open positions by comparing transaction price with the closing price of the share for the day.
- The act of buying and selling of securities on a stock exchange is known as stock market trading.
- Settlement is the process of netting of transactions and actual delivery or receipt of securities against receipts of payment of agreed amounts.
- The transactions in secondary market pass through three distinct phases, viz., trading, clearing and settlement.
- Trade or Settlement Guarantee Fund means a fund which objective is to provide the necessary funds and ensure timely completion of settlements in cases of failure of member brokers to fulfill their settlement obligations.
- Stock Indices represents the performance of stock market and by proxy, reflects investor sentiment on the state of the economy.
- Sensex is calculated using share prices of 30 major companies which are listed in BSE.
- The CNX Nifty is the flagship index on the National Stock Exchange of India Ltd.
- Investible Weight Factors (IWFs) as the term suggests is unit of floating stock expressed in terms of number available for trading and which is not held by the entities having strategic interest in a company.

SELF TEST QUESTIONS

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

1. Discuss are major features of SEBI (LODR) Regulations, 2015.
2. Write a note of Corporate Governance under SEBI (LODR) Regulations, 2015.
3. Discuss the concept of Corporate Governance in detail and its legislative Regulation in India.
4. What in a settlement systems? Discuss various types of settlement systems.
5. What do you understand by Investible Weight Factors (IWFs)? explain with the help of an example.

Lesson 7
Capital Market Investment Institutions

LESSON OUTLINE

- Introduction
- National Level Institutions
- All India Development banks
- Specialised financial Institutions
- Investment Institutions
- State Level Institutions
- Qualified Institutional Buyers
- Private Equity
- Types of Private Equity
- Venture Capital
- Stages of Investment Financing
- Angel Funds
- Pension Funds
- Foreign Portfolio Investor
- Mutual Fund
- Types of Mutual Fund schemes
- Alternative Investment Fund
- Hedge Funds
- LESSON ROUND UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

Financial Sector plays an indispensable role in the overall development of the countries economy. The impact of financial sector on the economic performance of country is of great importance. Financial sector mobilizes the savings and channelise 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.

INTRODUCTION

Financial sector plays an indispensable role in the overall development of countries economy. One of the most important constituent of this sector are financial institutions, which act as a means for the transfer of resources from net savers to net borrowers, that is, from those who spend less than their earnings to those who spend more than their earnings. 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, IFCI, IIBI; specialised financial institutions like IVCF, ICICI Venture Funds Ltd, TFCI and investment institutions 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(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 institutional investor and sub-account (other than a sub-account which is a foreign corporate or foreign individual), registered with SEBI;

(iii) a public financial institution as defined in 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;

SEBI has laid down certain criteria in SEBI (ICDR) Regulations, 2009, under which a QIB is entitled to get the shares in a public issue to the extent as specified by SEBI.

Anchor Investor

Anchor investors or cornerstone investors (as they are called globally) are marquee institutional investors like sovereign wealth funds, mutual funds and pension funds that are invited to subscribe for shares ahead of the IPO to boost the popularity of the issue and provide confidence to potential IPO investors.

InterGlobe Aviation, the company that operates the country's one of the most-profitable airline, IndiGo, raised Rs 832 crore in year 2015 from 43 anchor investors, ahead of its Initial Public Offering (IPO).

The benefit for institutional investors applying in anchor quota is that they get guaranteed allotment. Allotment to investors applying in an IPO depends on the number of times the issue gets subscribed. Anchor investors, however, cannot sell their shares for a period of 30 days from the date of allotment as against IPO investors who are allowed to sell on listing day.

Capital market regulator SEBI over the last two years has made number of changes to the rules related to anchor investors. Last year, the market regulator doubled the quota reserved for anchor investors, while earlier this year it removed the restrictions on the maximum number of anchor investors. An issuer can now allot up to

60% of shares reserved for qualified institutional buyers (QIBs) to anchor investors. As typically, the QIB portion in an IPO is 50%, anchor investors can buy up to 30% of an IPO.

Anchor allotment is done a day before an IPO opens. Roping in anchor investors gives a lot of comfort to the issuer and banker, as nearly a third of the IPO gets covered even before the opening day. A healthy anchor book also gives lot of comfort to small investors as it indicates the faith shown by institutional investors, say experts.

In a notification in year 2016, SEBI removed the maximum 25 anchor investor cap for IPOs above Rs 250 crore. Investment bankers can now rope in as many anchor investors as they want. The allotment to anchor investors is done on a discretionary basis, unlike an IPO, where the allotment has to be made on a proportionate basis.

PRIVATE EQUITY

Private equity is a type of equity (finance) and one of the asset classes case study 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 that result in a delisting of public equity. 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.

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. Unlike banks, which seek their return through interest payments, venture firms seek for capital appreciation. Generally Venture Capital firms look for a return of five to ten times the original investment.

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 may 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 favored by a lot of venture companies.

STAGES OF INVESTMENT FINANCING

Venture capital firms finance both early and later stage investments to maintain a balance between risk and profitability. Venture capital firms usually recognise the following two main stages when the investment could be made in a venture namely:

A. Early Stage Financing

(i) Seed Capital & Research and Development Projects.

(ii) Start Ups

(iii) Second Round Finance

B. Later Stage Financing

(i) Development Capital

(ii) Expansion Finance

(iii) Buy Outs

(iv) Replacement Capital

(v) Turn Arounds

A. EARLY STAGE FINANCING

I. Seed Capital and R & D Projects: Venture capitalists are more often interested in providing seed finance i. e. making provision of very small amounts for finance needed to turn into a business. Research and Development activities are required to be undertaken before a product is to be launched. External finance is often required by the entrepreneur during the development of the product. The financial risk increases progressively as the research phase moves into the development phase, where a sample of the product is tested before it is finally commercialised venture capitalists/ firms/ funds are always ready to undertake risks and make investments in such R & D projects promising higher returns in future.

II. Start Ups: The most risky aspect of venture capital is the launch of a new business after the Research and Development activities are over. At this stage, the entrepreneur and his products or services are still not tried and rested in the market forces. The finance required usually falls short of his own resources. Start-ups may include new industries / businesses set up by the experienced persons in the area in which they have knowledge, specialization and proficiency. Others may result from the research bodies or large corporations, where a venture capitalist joins with an industrially experienced or corporate partner. Along with this, other start-ups occur when a new company is floated to commercialise new technology by an existing company and is lacking adequate finances to establish & non.

III. Second Round Financing: It refers to the stage when product has already been launched in the market but has not earned enough profits to attract new investors. Additional funds are needed at this stage to meet the growing needs of business. Venture Capital Institutions (VCIs) provide larger funds at this stage than at other early stage financing in the form of debt. The time scale of investment is usually three to seven years.

B. LATER STAGE FINANCING

Those established businesses which require additional financial support but cannot raise capital through public issue approach venture capital funds for financing expansion, buyouts and turnarounds or for development capital. This is known as later stage financing. It includes the following :

I. Development Capital: It refers to the financing of an enterprise which has overcome the highly risky stage and have recorded profits but cannot go public, thus needs financial support. Funds are needed for the purchase of new equipment/ plant, expansion of marketing and distributing facilities, launching of product into new regions and so on. The time scale of investment is usually one to three years and falls in medium risk category.

II. Expansion Finance: Venture capitalists perceive low risk in ventures requiring finance for expansion purposes either by growth implying bigger factory, large warehouse, new factories, new products or new markets or through purchase of exiting businesses. The time frame of investment is usually from one to three years. It represents the last round of financing before a planned exit.

III. Buy Outs: It refers to the transfer of management control by creating a separate business by separating it from their existing owners. It may be of two types.

i. Management Buyouts (MBOs): In Management Buyouts (MBOs) venture capital institutions provide funds to enable the current operating management/ investors to acquire an existing product line/business. They represent an important part of the activity of VCIs.

ii. Management Buy-ins (MBIs): Management Buy-ins are funds provided to enable an outside group of manager(s) to buy an existing company. It involves three parties: a management team, a target company and an investor (i.e. Venture capital institution). MBIs are more risky than MBOs and hence are less popular because it is difficult for new management to assess the actual potential of the target company. Usually, MBIs are able to target the weaker or under-performing companies.

IV. Replacement Capital: VCIs another aspect of financing is to provide funds for the purchase of existing shares of owners. This may be due to a variety of reasons including personal need of finance, conflict in the family, or need for association of a well known name. The time scale of investment is one to three years and involve low risk.

V. Turnarounds: Such form of venture capital financing involves medium to high risk on a time scale of three to five years. It involves buying the control of a sick company which requires specialised skills in finance. It may require rescheduling of company's all the borrowings, change in management or even a change in ownership. An active "hands on" approach is required in the initial crisis period where the venture capitalists may appoint its own chairman or nominate its directors on the board.

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 crowdfunding 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.

Less is known about angel investing than venture capital because of the individuality and privacy of the investments. However, every success story can track its initial entry into the market to an Angel or group of Angels that provided the needed knowledge and capital to launch and gone that company. A small but increasing number of angel investors organise 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.

SEBI – Recent move in 2016 on Angel Investor

Recently in November 2016, the market regulator SEBI announced amendments to SEBI (Alternative Investment Funds) Regulations, 2012 regarding Angel Funds. It is said to increasing the upper limit for number of angel investors in a scheme from 49 to 200 even as it harmonized the definition of a start-up with that used by DIPP in the start-up policy.

In order to further develop the alternative investment industry and the start-up ecosystem in India, SEBI, in March 2015, constituted a Committee of experts drawn from the across market participants called the “Alternative Investment Policy Advisory Committee” (“AIPAC”) under the chairmanship of NR Narayana Murthy.

AIPAC had submitted its report to SEBI with various recommendations including certain recommendations relating to Angel Funds. Considering the recommendations in the report and public comments thereon, the SEBI Board has approved following amendments:

i) The upper limit for number of angel investors in a scheme is increased from forty nine to two hundred.

ii) The definition of start-up for Angel Funds investments will be similar to definition of DIPP as given in their start-up policy. Accordingly, Angel Funds will be allowed to invest in start-ups incorporated within five years, which was earlier three years.

iii) The requirements of minimum investment amount by an Angel Fund in any venture capital undertaking is reduced from Rs. 50 lakh to Rs. 25 lakh.

iv) The lock-in requirements of investment made by Angel Funds in the venture capital undertaking is reduced from three years to one year.

v) Angel Funds are allowed to invest in overseas venture capital undertakings upto 25% of their investible corpus in line with other AIFs.

TYPES OF ANGEL INVESTORS

There are several types of angel investors, and they fall into the following major categories:

Core Angels

These angel investors are individuals with extensive business experience who have operated and owned successful businesses of their own. Such Angel Investors possess a diversified portfolio that encompasses all industries, including public and private equity and real estate. They serve as valuable mentors and advisors to their invested firms.

High-tech Angels

These angel investors may have less experience than core angels, but invest significantly in the latest trends of modern technology. Their investments primarily depend on the value of their other high-tech holdings, which can vary considerably.

Return On investment (ROI) Angels

ROI angel investors are primarily concerned with the financial reward of high-risk investments. Their motivation behind investing is their perception of what other angel investor gross income may be. Return on investment angels tend to stay away from investing when market performance is poor and emerge once the market shows stability and improvement. They view each of their investments as another company added to their diversified portfolio and rarely become actively involved in the invested firms.

Enthusiast Angels

These angel investors are older (age 65 and above) businessmen who are independently wealthy before their investments.They often invest small amounts of capital in many different enterprises and view investing as a mere hobby. They do not take an active role in management.

Micromanagement Angels

These individuals are considered to be serious angel investors. They often demand a board position and are known to impose the same strategies they have used with their own companies towards their invested companies.

Professional Angels

These angel investors are professionally employed as doctors, lawyers, accountants, etc. who invest in companies in their related field. Professional angels invest in many companies at the same time. They may also provide services to their invested firm (legal, accounting or financial) at a discounted rate. Professional angel investors are of tremendous value for initial needed capital and rarely make follow-on investments.

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.

Pensions under an Act

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).

Pension Fund Management

Pension Fund is regulated by Pension Fund Regulatory and Development Authority (PFRDA). Pension Funds are managed by Pension Fund Administrators and they are responsible for taking investment decisions but in some jurisdictions, pension fund management can be managed by asset management and insurance companies and some management decisions may be the responsibility of Boards of Trustees in some corporate organisations. Pension Fund Custodians are those who keep custody of pension funds. Regulations of pension funds require the appointment of a custodian, depository institution or trustee, standards of conduct and minimum suitability of the operators of pension funds, the rights of investors to withdraw funds and the right of investors to full, timely and accurate information disclosure. Regulations required promoting both the performance and the financial security of pension assets. Main goals of pension investment are to ensure adequate, affordable and sustainable benefits to contributors, secure safety & security of funds and ensure adequate liquidity to pay all pension benefits of contributors as and when due risk management for pension assets established on quantitative limits which is maximum limits for individual, class or class of mix assets.

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 sub-accounts.

• 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.

Investment Conditions and Restrictions

- The instruments available for investments to FPIs are broadly in line with the instruments offered under the FII regime.
- Total investment by each FPI is restricted to 10% of the issued equity capital of the company.
- In case the same set of ultimate/end beneficial owner(s) invest through multiple entities, such entities shall be treated as part of the same group and the investment limits of all such entities shall be clubbed as applicable to a single FPI.

Note: A threshold of 50% of direct or indirect common shareholding/ beneficial ownership/ beneficial interest will be considered for the purpose of clubbing investment limits across a common investor group.

MUTUAL FUND

Meaning and Definition of Mutual Funds

Mutual funds have been created with the major objective that the house hold savings should get benefit from capital market.

Mutual funds refers to a trust that pools the savings of investors who share a common financial goal is known as mutual fund. The money collected is then invested in financial instruments such as shares, debentures and other securities the income and capital appreciation realized are shared by its unit holders in proportion to the number of units owned by them.

Investment in securities are spread over a wide cross section of industries and sectors reducing the risk of the portfolio.

Mutual funds are mobilizers of saving of the small investors in instruments like stock and money market instruments.Mutual funds are corporation that accept money from investors and use this money to buy stocks, long term bonds, short term debt instruments issued by businesses or Government.

How a Mutual Fund is Set Up

A mutual fund is set up in the form of a trust, which has sponsor, trustees, Asset Management Company (AMC) and custodian. The trust is established by a sponsor or more than one sponsor who is like promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unit holders. Asset Management Company (AMC) approved by SEBI manages the funds by making investments in various types of securities. 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.

SEBI Regulations require that at least two thirds of the directors of trustee company or board of trustees must be independent i.e. they should not be associated with the sponsors. Also, 50% of the directors of AMC must be independent. All mutual funds are required to be registered with SEBI before they launch any scheme.

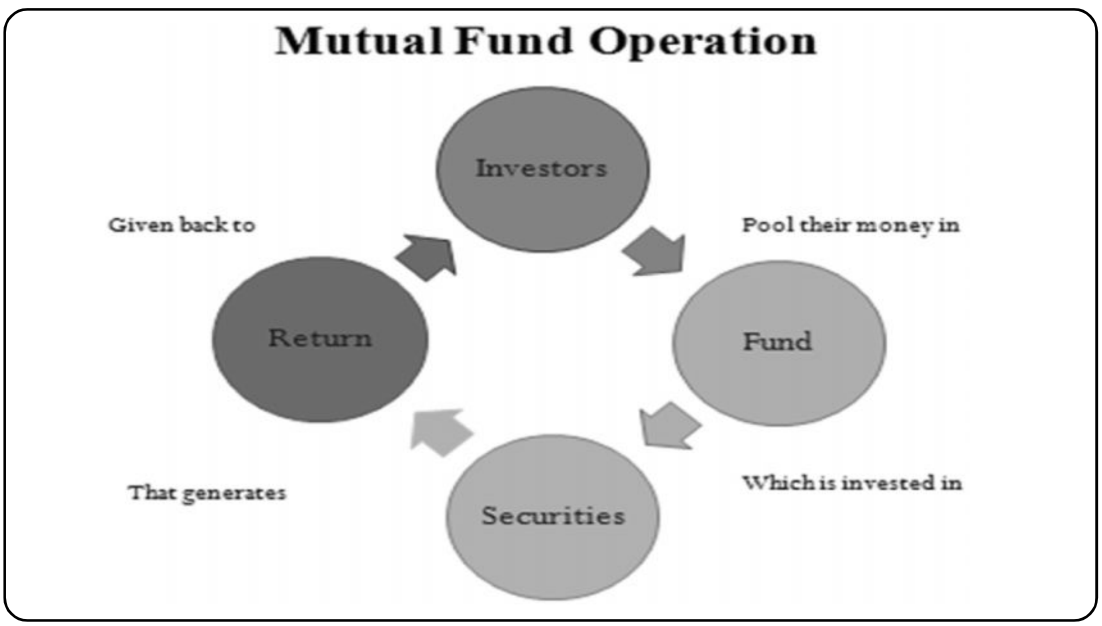
Mutual Funds in India follow a 3-tier structure; which is as follows:

— *Sponsor* – who thinks of starting the fund.

— *Trustee* – The Trustees role is not to manage the money. Their job is only to see, whether the money is being managed as per stated objectives. Trustees may be seen as the internal regulators of a mutual fund.

— *AMC* – Trustees appoint the Asset Management Company (AMC) who form the third tier, to manage investor's money. The AMC in return charges a fee for the services provided and this fee is borne by the investors as it is deducted from the money collected from them

Working of Mutual Funds



Types of Mutual Fund Schemes

Mutual funds can be studied thoroughly under three major classifications which are further classified into various schemes of mutual funds:

1. Structure Based Classification
2. Return Based Classification
3. Investment Based Classification

1. Structure Based Classification

Investors have the option of choosing from a wide variety of schemes in a mutual fund depending upon their requirements. MF's are classified as follows:

Open ended scheme: when a fund is accepted and liquidated on a continuous basis by a MF manager, it is called as open ended scheme. The fund manager buys and sells units constantly as demanded by the investors. The capitalization of the funds changes constantly as it is always open for the investors to buy or sell their units. The scheme provides excellent liquidity facility to the investors. The buying and selling of units takes place at a declared NAV(Net Asset Value)

Close ended scheme: when a units of a scheme liquidated only after the expiry of a specified period it is known as close ended fund. Such funds have fixed capitalization and remain with the mutual fund manager, units of close ended schemes are traded on stock exchange in the secondary market. The price is determined on the basis of supply and demand. There are 2 prices for such funds, one that is market determined and the other is NAV based the market price may be above or below NAV. Managing a close ended scheme is comparatively easy for the fund Manager. The fund can be liquidated after a specified period.

Interval scheme: it is kind of close ended scheme with a feature that it remains open during a particular part of the year for the benefit of investors, to either off load or to undertake purchase of units at a NAV.

2. Return based classification

Income fund scheme: this scheme is customized to suit the needs of investors who are particular about regular returns. The scheme offers maximum current income where by the income earned by the units is distributed periodically there are 2 types of such schemes, one that earns a target constant income at relatively low risk while the other offers maximum possible income.

Growth scheme: it is a MF scheme that offers the advantage of capital appreciation of the underlying investment such funds invests in growth oriented securities that are capable of appreciating in the long run. The risk attached with such funds is relatively higher.

Conservative fund Scheme: a scheme that aims at providing a reasonable rate of return, protecting the value of investment and achieving capital appreciation is called a conservative fund scheme. It is also known as middle of road funds as it offers a blend of the above features. Such funds divide their portfolio in stocks and bonds in such a way that it achieves the desired objective.

3. Investment based classification

Equity fund: such fund invest in equity shares they carry a high degree of risk such fund do well in favorable market conditions. Investments are made in equity shares in diverse industries and sectors.

Debt funds: Such fund invests in debt instruments like bonds and debentures. These funds carry the advantage of secure and steady income there is little chance of capital appreciation. Such funds carry no risk. A variant of this type of fund is called liquid fund which specializes in investing in short term money market instruments.

Balanced funds: Such schemes have a mix of debt and equity in their portfolio of investments. The portfolio is often shifted between debt and equity depending upon the prevailing market conditions.

Sectoral fund: Such fund invests in specific sectors of the economy. The specialized sectors may include real estate infrastructure, oil and gas etc, offshore investments, commodities like gold and silver.

Fund of Funds: such funds invest in units of other mutual funds there are a number of funds that direct investments into specified sectors of economy. This makes diversified and intensive investments possible.

Leverage funds: the funds that are created out of investments with not only the amount mobilized from investors but also from borrowed money from the capital markets are known as leveraged funds. Fund managers pass on the benefit of leverage to the mutual fund investors. Additional provisions must be made for such funds to operate. Leveraged funds use short sale to take advantage of declining markets in order to realize gains. Derivative instruments like options are used by such funds.

Gilt fund : These funds seek to generate returns through investment in govt. securities. Such funds invest only in central and state govt. securities and REPO/ reverse REPO securities. A portion of the corpus may be invested in call money markets to meet liquidity requirements. Such funds carry very less risk. Their prices are influenced only by moment in interest rates.

Indexed funds: these funds are linked to specific index. Funds mobilized under such schemes are invested in securities of companies included in the index of any exchange. The fund performance is linked to the growth in concerned index.

Tax saving schemes: certain MF schemes offer tax rebate on investments made in equity shares under section 88 of income tax act. Income may be periodically distributed depending on surplus. Subscriptions made up to Rs.10000 are eligible for tax rebate under section 88 for such scheme. The investment of the scheme includes investment in equity, preference shares and convertible debentures and bonds to the extent 80-100% and rest in money market instruments.

Fixed Maturity Plans

Fixed Maturity Plans (FMPs) are investment schemes floated by mutual funds and are close ended with a fixed tenure, the maturity period ranging from one month to three/five years. These plans are predominantly debt-oriented, while some of them may have a small equity component. The objective of such a scheme is to generate steady returns over a fixed-maturity period and protect the investor against market fluctuations. FMPs are typically passively managed fixed income schemes with the fund manager locking into investments with maturities corresponding with the maturity of the plan. FMPs are not guaranteed products.

Exchange Traded Funds (ETFs)

Exchange Traded Funds (ETFs) are mutual fund units which investors buy or sell from the stock exchange, as against a normal mutual fund unit, where the investor buys / sells through a distributor or directly from the AMC.

ETFs have relatively lesser costs as compared to a mutual fund scheme

The ETF structure is such that the AMC does not have to deal directly with investors or distributors. It instead issues units to a few designated large participants, who are also called as Authorized Participants (APs), who in turn act as market makers for the ETFs.The Authorized Participants provide two way quotes for the ETFs on the stock exchange, which enables investors to buy and sell the ETFs at any given point of time when the stock markets are open for trading. Prices are available on real time and the ETFs can be purchased through a stock exchange broker just like one would buy / sell shares. There are huge reductions in marketing expenses and commissions in case of ETFs.

Assets in ETFs: Practically any asset class can be used to create ETFs. Globally there are ETFs on Silver, Gold, Indices etc. In India, we have ETFs on Gold, Indices such as Nifty, Bank Nifty etc.

Globally, ETFs have opened a whole new panorama of investment opportunities to retail as well as institutional investors. ETFs enable investors to gain broad exposure to entire stock markets as well as in specific sectors with relative ease, on a real-time basis and at a lower cost than many other forms of investing.

An ETF is a basket of stocks that reflects the composition of an index, like S&P CNX Nifty, BSE Sensex, CNX Bank Index, CNX PSU Bank Index, etc. The ETF's trading value is based on the net asset value of the underlying stocks that it represents. It can be compared to a stock that can be bought or sold on real time basis during the market hours. Benchmark Nifty Bees was the first ETF in India.

Capital Protection Oriented Schemes

Capital Protection Oriented Schemes are schemes that endeavour to protect the capital as the primary objective by investing in high quality fixed income securities and generate capital appreciation by investing in equity / equity related instruments as a secondary objective. Franklin Templeton Capital Protection Oriented Fund was the first Capital Protection Oriented Fund in India.

Gold Exchange Traded Funds (GETFs)

Gold Exchange Traded Funds offer investors an innovative, cost-efficient and secure way to access the gold market. Gold ETFs are intended to offer investors a means of participating in the gold bullion market by buying and selling units on the Stock Exchanges, without taking physical delivery of gold. Benchmark GETF was the first Gold ETF in India and listed on the NSE.

Quantitative Funds

A quantitative fund is an investment fund that selects securities based on quantitative analysis. The managers of such funds build computer based models to determine whether or not an investment is attractive a not. In a pure "quant shop" the final decision to buy or sell is made by the model. However, there is a middle ground where the fund manager will use human judgment in addition to a quantitative model. Lotus Agile Fund was the first Quant based Mutual Fund Scheme in India.

Funds Investing Abroad

With the opening up of the Indian economy, Mutual Funds have been permitted to invest in foreign securities/ American Depository Receipts (ADRs) / Global Depository Receipts (GDRs). Some of such schemes are dedicated funds for investment abroad while others invest partly in foreign securities and partly in domestic securities. While most such schemes invest in securities across the world there are also schemes which are country specific in their investment approach.

Fund of Funds (FOFs)

Fund of Funds are schemes that invest in other mutual fund schemes. The portfolio of these schemes comprise only of units of other mutual fund schemes and cash / money market securities/ short term deposits pending deployment. The first FOF was launched by Franklin Templeton Mutual Fund on October 17, 2003. Fund of Funds can be Sector specific e.g. Real Estate FOFs, Theme specific e.g. Equity FOFs, Objective specific e.g. Life Stages FOFs or Style specific e.g. Aggressive/ Cautious FOFs etc.

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.

The text of the Regulation 2(1)(b) is as under:

“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:

Provided that 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; and

(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 .

Types of AIFs

AIFs are categorized into the following three categories, based on their impact on the economy and the regulatory regime intended for them:

– **Category I AIF** are those AIFs with positive spillover effects on the economy, for which certain incentives or concessions might be considered by SEBI or Government of India; Such funds generally invests in start-ups or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable. They cannot engage in any leverage except for meeting temporary funding requirements for not more than thirty days, on not more than four occasions in a year and not more than ten percent of the corpus.eg. Venture Capital Funds, SME Funds, Social Venture Funds and Infrastructure Funds.

– **Category II AIF** are those AIFs for which no specific incentives or concessions are given. They do not undertake leverage or borrowing other than to meet the permitted day to day operational requirements, as is specified for Category I AIFs. eg. Private Equity or debt fund.

– **Category III AIF** are funds that are considered to have some potential negative externalities in certain situations and which undertake leverage to a great extent; These funds trade with a view to make short term returns. These funds are allowed to invest in Category I and II AIFs also. They receive no specific incentives or concessions from the government or any other Regulator.eg. Hedge Funds (which employs diverse or complex trading strategies and invests and trades in securities having diverse risks or complex products including listed and unlisted derivatives).

Where an AIF can Invest

An AIF is allowed to invest in following:

- In securities of companies incorporated outside India subject to such conditions as may be prescribed by SEBI and RBI;
- Co-investment in an investee company by a Manager or Sponsor shall not be on terms more favourable than those offered to the AIF;
- Category I and II AIFs are not allowed to invest not more than twenty five percent of the corpus in one Investee Company;
- Investee company includes an LLP, meaning an AIF can also invest in LLPs.
- Category III AIF are allowed to invest up to ten percent of the investible funds in one Investee Company;
- AIFs are allowed to invest in associates subject to approval of seventy five percent of investors;
- Un-invested portion of the investible funds may be invested in liquid mutual funds or bank deposits or other liquid assets of higher quality such as Treasury bills, Collateralised Borrowing and Lending Obiligations (CBLOs), Commercial Papers, Certificates of Deposits, etc. till deployment of funds as per the investment objective;
- Alternative Investment Fund may act as Nominated Investor as specified in clause (b) of sub-regulation (1) of regulation 106N of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirments) Regulations, 2009

Category wise Investment Condition

Investment conditions for Category 1: Category 1 AIFs are allowed to invest in SPVs, LLPs, investee companies, venture capital undertakings and even in units of other AIFs of category 1. The AIFs in this category are not allowed to borrow funds directly or indirectly or engage in any leverage except for meeting temporary funding requirements for not more than thirty days, on not more than four occasions in a year and not more than ten percent of the investible funds. Additional conditions have been prescribed for Venture Capital Funds (VCFs) under this category:

- The same were previously there in the VCF Regulations.
- Investments in SME segment (in listed or proposed to be listed SME companies) have been permitted by the new Regulations which were not allowed earlier.
- Limited investment through Qualified Institutional Placement in preferential allotment is allowed in equity linked instruments of listed entities.

Additional conditions provided for SME Funds:

- Atleast seventy five percent of the investible funds shall be invested in unlisted securities or partnership interest of venture capital undertakings or investee companies which are SMEs or in companies listed or proposed to be listed on SME exchange or SME segment of an exchange.

Additional condition for Social Welfare Funds include:

- Atleast seventy five percent of the investible funds shall be invested in unlisted securities or partnership interest of social ventures.
- Such funds may accept grants, provided that such utilization of such grants shall be restricted to clause mentioned above.

Additional conditions for Infrastructure Funds:

- Atleast seventy five percent of the investible funds shall be invested in unlisted securities or units or partnership interest of venture capital undertaking or investee companies or special purpose vehicles, which are engaged in or formed for infrastructure projects.

– These funds may also invest in listed securitized debt instruments or listed debt securities of investee companies or special purpose vehicles, engaged in infrastructure projects.

Conditions for Category II AIFs

These shall primarily invest in unlisted investee companies or in units of other AIFs of Category I and II. May not borrow funds directly or indirectly and shall not engage in leverage except for meeting temporary funding requirements for not more than thirty days, not more than four occasions in a year and not more than ten percent of the investible funds. Category II AIFs may engage in hedging, subject to guidelines as specified by SEBI.

Conditions for Category III AIFs

These AIFs may invest in securities of listed or unlisted investee companies or derivatives or complex or structured products and in units of other AIFs of Category I and II. Such AIFs may engage in leverage or borrow subject to consent from the investors in the fund and subject to a maximum limit, as may be specified by SEBI.

HEDGE FUNDS

Hedge funds, are unregistered private investment partnerships funds or pools that may invest and trade in many different markets, strategies and instruments (including securities, non-securities and derivatives) and are not subject to the same regulatory requirements as mutual funds.

The term can also be defined by considering the characteristics most commonly associated with hedge funds. Usually, hedge funds:

– are organized as private investment partnerships or offshore investment corporations;

– use a wide variety of trading strategies involving position-taking in a range of markets;

– employ as assortment of trading techniques and instruments, often including short-selling, derivatives and leverage;

– pay performance fees to their managers; and

– have an investor base comprising wealthy individuals and institutions and relatively high minimum investment limit (set at US $1,00,000 or higher for most funds).

Hedge funds are aggressively managed portfolio of investments that uses advanced investment strategies such as leveraged, long, short and derivative positions in both domestic and international markets with the goal of generating high returns,

Hedge funds are most often set up as private investment partnerships that are open to a limited number of investors and require a very large initial minimum investment

Hedge funds are a more risky variant of mutual funds. Hedge funds are aimed at high net worth investors. They operate with high fee structures and are less closely monitored by the regulatory authorities.

How Hedge Funds Work:

The original concept of a hedge fund was to offer plays against the market using short selling, futures, and derivatives. Today, hedge funds follow any number of strategies and cannot be considered a homogenous asset class.

Hedge funds (as an asset class) use various strategies, including leverage, hedging, and macroeconomic bets on commodities, currencies, and interest rates. The common denominator of hedge funds is not their investment strategy but their search for absolute returns (as opposed to relative returns). Absolute return strategies focus on generating a positive return on investment (ROI) regardless of the direction of the financial markets.

Hedge fund managers seek freedom to achieve high absolute returns and wish to be rewarded for their performance. The compensation arrangement for the manager typically specifies considerable profit participation. The specific legal organization of hedge funds and the considerable fee structure expected by fund managers are probably the only uniform characteristics of hedge funds.

Only accredited investors are eligible to invest in hedge funds. The term accredited investor includes wealthy individuals and organizations like corporations, endowments, or pension funds. Accredited investors invest in hedge funds because they are looking for investments with negative correlation to the broad market.

A Taxonomy of Hedge Fund Strategies

Strategy	Description
Directional Trading	Based upon speculation of market direction in multiple asset classes. Both model-based systems and subjective judgment are used to make trading decisions.
Relative Value	Focus on spread relationships between pricing components of financial assets. Market risk is kept to minimum and many managers use leverage to enhance returns.
Specialist Credit	Based around lending to credit sensitive issuers. Funds in this strategy conduct a high level of due diligence in order to identify relatively inexpensive securities.
Stock Selection	Combine long and short positions, primarily in equities, in order to exploit under and overvalued securities. Market exposure can vary substantially.

Market Benefits of Hedge Funds

Hedge funds can provide benefits to financial markets by contributing to market efficiency and enhance liquidity. Many hedge fund advisors take speculative trading positions on behalf of their managed hedge funds based extensive research about the true value or future value of a security. They may also use short term trading strategies to exploit perceived mis-pricings of securities. Because securities markets are dynamic, the result of such trading is that market prices of securities will move toward their true value. Trading on behalf of hedge funds can thus bring price information to the securities markets, which can translate into market price efficiency. Hedge funds also provide liquidity to the capital markets by participating in the market.

Hedge funds play an important role in a financial system where various risks are distributed across a variety of innovative financial instruments. They often assume risks by serving as ready counter parties to entities that wish to hedge risks. For example, hedge funds are buyers and sellers of certain derivatives, such as securitised financial instruments, that provide a mechanism for banks and other creditors to un-bundle the risks involved in real economic activity. By actively participating in the secondary market for these instruments, hedge funds can help such entities to reduce or manage their own risks because a portion of the financial risks are shifted to investors in the form of these tradable financial instruments. By reallocating financial risks, this market activity provides the added benefit of lowering the financing costs shouldered by other sectors of the economy. The absence of hedge funds from these markets could lead to fewer risk management choices and a higher cost of capital. Hedge fund can also serve as an important risk management tool for investors by providing valuable portfolio diversification. Hedge fund strategies are typically designed to protect investment principal. Hedge funds frequently use investment instruments (e.g. derivatives) and techniques (e.g. short selling) to hedge against market risk and construct a conservative investment portfolio – one designed to preserve wealth.

In addition, hedge funds investment performance can exhibit low correlation to that of traditional investments in the equity and fixed income markets. Institutional investors have used hedge funds to diversify their investments based on this historic low correlation with overall market activity.

LESSON ROUND UP

– The most important constituent of financial sector is the financial institutions, which act as a conduit for the transfer of resources from net savers to net borrowers, that is, from those who spend less than their earnings to those who spend more than their earnings.

– All-India Development Banks (AIDBs) Includes those development banks which provide institutional credit to not only large and medium enterprises but also help in promotion and development of small scale industrial units.

– Specialised Financial Institutions (SFIs) are the institutions which have been set up to serve the increasing financial needs of commerce and trade in the area of venture capital, credit rating and leasing, etc.

– Investment Institutions 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.

– Several financial institutions have been set up at the State Level which supplements the financial assistance provided by the all India institutions.

– Qualified Institutional Buyers (QIB) means those buyers who are recommended by SEBI and generally perceived to possess expertise and the financial muscle to evaluate and invest in the Capital Market.

– 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.

– 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.

– Angel Investors are often former entrepreneur themselves and typically enjoy working with companies at the earliest stages of business formation.

– Pension Fund means a fund established by an employer to facilitate and organize the investment of employees' retirement funds contributed by the employer and employees.

– A Foreign Portfolio Investor (FPI) has been defined to mean a person who satisfies the prescribed eligibility criteria and has been registered under the SEBI (Foreign Portfolio Investor) Regulations, 2014. All existing Foreign Institutional Investors (FIIs) and QFIs are to be merged into one category called FPI.

– Mutual Fund means a fund established in the form of trust to raise money through the sale of units to the public or a section of public under one or more schemes for investing in securities including the money market instruments or gold or gold related instruments.

– In India AIF is regulated by SEBI (Alternative Investment Funds) Regulations, 2012.

– Hedge funds play an important role in a financial system where various risks are distributed across a variety of innovative financial instruments. They often assume risks by serving as ready counter parties to entities that wish to hedge risks.

SELF TEST QUESTIONS

(These are meant for recapitulation only. Answers 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. Discuss about different stages of venture capital financing.
4. Discuss the provisions relating to Investment made by FPIs under the SEBI (Foreign Portfolio Investors) Regulations, 2014.
5. Define Alternative Investment Fund under SEBI (Alternative Investment Funds) Regulations, 2012.
6. Briefly discuss the concept of mutual funds regulations of mutual funds in India.

Lesson 8
Capital Market Instruments

LESSON OUTLINE

– Introduction
– Equity Shares
– Shares with Differential Voting Rights (DVRs)
– Preference Shares
– Fully Convertible Cumulative Preference Share (Equipref)
– Debentures
– Non Convertible Debentures with Put and Call Option
– Bonds
– Sweat Equity Shares
– Warrant
– Secured Premium Notes
– Equity Shares with detachable warrants
– Foreign Currency Convertible Bonds (FCCBs)
– Foreign Currency Exchangeable Bonds (FCEBs)
– American Depository Receipts(ADRs)
– Global Depository Receipts(GDRs)
– Indian Depository Receipts(IDRs)
– Derivatives
– Futures
– Options
– Index Futures & options
– Currency Futures
– Interest Rate Futures
– Exchange Traded Funds (ETFs)
– LESSON ROUND UP
– SELF TEST QUESTIONS

LEARNING OBJECTIVES

Capital market institutions are the financial instruments that are used for raising capital resources in the capital market are known as Capital Market Instruments. Capital Market instruments are responsible for generating funds for companies, corporations and governments. These are used by the investors to make a profit out of their respective markets based on their needs. There are large number of capital market instruments playing in the market including Equity shares, Preference shares, Bonds, Debentures, variants of equity shares etc. Further, the capital markets have continued to produce a multitude of new products, including various new forms of derivatives.

Keeping this in view, it is imperative for a student to know the various types of Capital Market Instruments as well as financial innovation prevailing in the market .The aim of this lesson is to give a consolidated overview of various financial instruments like equity, preference shares, debentures and derivatives including Interest Rate Futures, Currency Futures, Exchange Traded Funds etc. and companies issuing such instruments.

INTRODUCTION

Financial instruments that are used for raising capital resources in the capital market are known as 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. The changes in the regulatory framework of the capital market and fiscal policies of financial instruments (securities) being introduced in the market. Along with, a lot of financial innovation by companies who are now permitted to undertake treasury operations, has resulted in introduction of newer kinds of instruments - all of which can be traded at par. The variations in all these instruments depend on the tenure, the nature of security, the interest rate, the collateral security offered and the trading features, etc. While all Capital Market Instruments are designed to provide a return on investment, the risk factors are different for each and the selection of the instrument depends on the choice of the investor.

There are a large number of Capital Market Instruments playing in the market namely Equity Shares, Preference Shares, Bonds, Debentures, Derivative Products like Futures, Options, , Interest rate derivatives etc. The different types of Capital Market Instruments are explained below:

EQUITY SHARES

Equity shares, commonly referred to as ordinary share also represents the form of fractional ownership in which a shareholder, as a fractional owner, undertakes the maximum entrepreneurial risk associated with a business venture. The holder of such shares is the member of the company and has voting rights.

According to explanation given in 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.

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, with regard to the 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.

CHARACTERISTICS OF EQUITY SHARES

Equity shares, other than non-voting shares, have voting rights at all general meetings of the company. These votes have the affect of the controlling the management of the company. Equity shareholders have the right to share the profits of the company in the form of dividend and bonus shares. However the equity shareholders cannot demand declaration of dividend by the company as this 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. The important provisions relating to the rights of an equity shareholder are laid down in Companies Act, 2013. Equity share holders enjoy different rights as members such as:

- Right of pre-emption in the matter of fresh issue of capital. (Section 62)
- Right to vote in general meetings.
- Right to apply to Tribunal to call for the Annual General Meeting, if the company fails to call such a meeting. (Section 97)
- Right to apply to Tribunal for calling for an extra-ordinary general meeting of the company. (Section 98)
- Right to receive audited financial statement along with the auditors report, directors report and other information. (Section 136)

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

SHARES WITH DIFFERENTIAL VOTING RIGHTS

Section 43 (a) (ii) of the Companies Act, 2013 provides that the company may have equity share capital with differential rights as to dividend, voting or otherwise .

Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014 prescribe the conditions for issue of equity shares with differential rights. These condtions are:-

(a) the articles of association of the company should contain the authority to issue of shares with differential rights;

(b) the issue of shares should be authorized by an ordinary resolution passed at a general meeting of the shareholders:

(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 should having consistent track record of distributable profits 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;

(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 , the Securities and Exchange Board of India Act, 1992, the 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.

Some other conditions prescribed under the said rules are:

– The company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and vice–versa.

– The Board of Directors shall, inter alia, disclose in the Board's Report for the financial year in which the issue of equity shares with differential rights was completed, the following details, namely:-

  (a) the total number of shares allotted with differential rights;

  (b) the details of the differential rights relating to voting rights and dividends;

  (c) the percentage of the shares with differential rights to the total post issue equity share capital with differential rights issued at any point of time and percentage of voting rights which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;

(d) the price at which such shares have been issued;

(e) the particulars of promoters, directors or key managerial personnel to whom such shares are issued;

(f) the change in control, if any, in the company consequent to the issue of equity shares with differential voting rights;

(g) the diluted Earning Per Share pursuant to the issue of each class of shares, calculated in accordance with the applicable accounting standards;

(h) the pre and post issue shareholding pattern along with voting rights

Examples

Pantaloons Retail India Ltd. (PRIL)

In July 2008, PRIL, India's leading retailer, was the first to issue bonus shares with a Differential Voting Rights (DVR) option. The company made a bonus issue of 1: 10 shares with differential voting rights and 5% additional dividends as well. Although there is no fund-raising involved in a bonus issue of shares, the idea was to get the markets familiar with such instruments and create another alternative to raise funds in the future.

Tata Motors

In October 2008, Tata Motors became the first Indian company to make a rights issue of shares carrying differential voting rights (DVR) (issue size: ₹1960.42 crores). DVR shares had 1/10th of voting rights of ordinary shares and offer a 5% higher rate of dividend over the normal shares. It issued these shares at ₹305 i.e., about 10% lower than the issue of normal rights at ₹340.

PROHIBITION OF SUPEROR RIGHTS - CLAUSE 28A

Clause 28A of the Listing Agreement, provides that a listed company cannot issue shares in any manner which may confer on any person, superior rights as to voting or dividend vis-à-vis the rights on equity shares which are already listed.

Anand Jaiswal v. Jagatjit Industries Limited - Case Law

Karamjit Jaiswal and his unlisted firm, LP Jaiswal and Sons Pvt. Ltd, together owned 23.59% (8.59% by Karamjit Jaiswal and 15% by his firm) in liquor firm Jagatjit Industries. In pursuance to an approval by the Board and shareholders of Jagatjit Industries, LP Jaiswal and Sons Pvt. Ltd. subscribed to 2.5 million shares in Jagatjit Industries, increasing its stake to 19.1% from 15%. However, each of these 2.5 million shares carried 20 voting rights. Karamjit Jaiswal later acquired around 2.19 million ordinary shares, increasing his stake to 13% from 8.59%. With this, he and LP Jaiswal together owned a combined 32.1% in Jagatjit Industries Ltd. However, because of the differential voting rights of the shares acquired by LP Jaiswal and Sons, this minority holding had corresponding voting rights of 62%, giving Karamjit Jaiswal complete control over the company. In 2006, LP Jaiswal and Sons Pvt. Ltd. along with associated persons, after their holding crossed 15% made a public announcement of open offer to the extent of 20% of the voting capital of Jagatjit Industries as required under SEBI Takeover Regulations. Meanwhile Anand Jaiswal and Jagatjit Jaiswal, who together own 12% in Jagatjit Industries filed a petition before SEBI challenging that the pricing of differential voting shares has been done in an inappropriate manner. Moreover, they also contended that the in-principle approval from stock exchanges has not been received and the provisions of Companies Act have been violated. SEBI held in its order that it is not competent to decide the present issue. The powers of SEBI have been enumerated under Section 55A of the Companies Act, 1956. At present, section 55A of the Companies Act, 1956 confers upon SEBI the right to administer certain provisions relating to the issue and transfer of securities and non-payment of dividend in the case of listed public companies and those companies that intend to get their securities listed. Since Section 86 of the Act doesn't come under the purview of the Section 55A, SEBI left it to the Company Law Board to decide upon.

Ruling by Company Law Board

Mr. Anand Jaiswal and Jagatjit Jaiswal had petitioned before the Company Law Board to declare a resolution passed at the company's Extraordinary General Meeting on June 16, 2004 as null and void through which 2.5 million preferential shares were allotted to LP Jaiswal & Sons, each share containing 20 voting rights. The Company Law Board upheld the validity of the resolution passed at the meeting thus stating that issue of differential voting shares is permissible under Section 86 of the Companies Act read with the Rules prescribed by Central Government. The Company Law Board directed Karamjit Singh and associated persons to buy out, on behalf of the Company, Mr. Anand and Jagatjit Jaiswal's stake in the company for around ₹ 73 crores. The company would acquire the stake as buyback of shares in cash, and consequently the equity share capital, would stand reduced to that extent. The transaction is to be completed within three months from the date of the order of Company Law Board.

Reform by SEBI

Subsequent to the ruling by Company Law Board in the case of Jagatjit Industries Limited, SEBI came up with some changes vis-a-vis shares with superior voting rights in a SEBI Board Meeting on Primary Market Reforms on June 18, 2009. It proposed that no listed company can issue shares with superior voting rights. This was brought in to prevent the possible misuse by the persons in control to the detriment of public shareholders. Moreover, SEBI apprehended that the precedence set by JIL may be followed by the promoters of other listed companies also to increase their voting power through preferential allotment of DVRS. Further, the pricing formula for preferential allotment of shares, i.e., average of the closing price of the shares at the stock exchange during the last 26 weeks or last two weeks preceding the relevant date, whichever is higher, cannot be applied as it is for the issue of DVRS because the issue of superior voting rights shares on preferential basis considerably dilutes the voting power of the other shareholders vis-a-vis the promoter group.

SEBI issued a Circular on July 21, 2009 instructing the stock exchanges to amend the equity listing agreement by inserting a new clause 28A thereby prohibiting issue of shares which may confer on any person, superior rights as to voting or dividend vis-a-vis the rights on equity shares that are already listed.

In other words, the listed companies have been forbidden from issuing not only superior voting rights shares but also inferior voting rights shares if such inferior voting rights shares confer on the holders thereof superior dividend rights. Inferior voting rights shares would always carry higher dividend rate in order to make them attractive for the investors, otherwise why would investors subscribe to such shares? It may be noted that whenever higher dividend rate would be offered on new shares with inferior voting rights, it would tantamount to contravention of clause 28A of the listing agreement because clause 28A prohibits issue of shares which would confer on the holder superior rights as to dividend vis-a-vis the dividend on the already listed equity shares.

Thus, the aforesaid amendment has not only altogether banned the issue of superior voting rights shares but also marred to a great extent the possibility of issue of inferior voting rights shares. Although the DVRS issued by Tata Motors and Pantaloon Retail entitle the holders thereof to an additional 5 per cent dividend over and above the dividend paid on the normal equity shares, nonetheless they are valid since they were issued before the amendment in the listing agreement. However, henceforth no listed company could issue DVRS on the same terms and conditions, as issued by Tata Motors and Pantaloon, as although these DVRS would carry fewer voting rights (1:10) but they would entitle their holder to 5 per cent additional dividend every year over and above the dividend paid on the normal equity shares.

PREFERENCE SHARES

According to explanation given in 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 at the time of winding up. They generally carry a fixed rate of dividend and redeemable after specific period of time. A company having a share capital may, if so authorised by its articles, issue preference shares on the following conditions, namely:-

(a) the issue of such shares has been authorized by passing a special resolution in the general meeting of the company

(b) the company, at the time of such issue of preference shares, has no subsisting default in the redemption of preference shares issued either before or after the commencement of this Act or in payment of dividend due on any preference shares.

CUMULATIVE PREFERENCE SHARES

In this type of preference shares the dividend payable every year becomes a first claim while declaring dividend by the company. In case the company does not have adequate profit or for some reason the company does not want to pay preference dividend, it gets accumulated for being paid subsequently. Such arrears of preference dividend will be carried forward and paid out of the profits of the subsequent years, before payment of equity dividend. However, if a company goes into the liquidation no arrears of preference dividend will be payable unless the Articles of Association of the issuing company contains a specific provision to make such payment even in winding up.

NON-CUMULATIVE PREFERENCE SHARES

In the case of these preference shares, dividend does not accumulate. If there are no profits or the profits are inadequate in any year, the shares are not entitled to any dividend for that year. Unless there is a specific provision in the Articles of Association of the company, the preference shareholders have no right to participate in the surplus profits or in the surplus assets in a winding up. They are entitled to payment of the declared preference dividend in any particular year and to the repayment of their preference capital in the event of winding up before payment to the equity shareholders.

CONVERTIBLE PREFERENCE SHARES

If the terms of issue of preference shares includes a right for converting them into equity shares at the end of a specified period they are called convertible preference shares. In the absence of such condition or right, the preference shares are not converted into equity shares to become eligible for various rights such as voting, higher dividend, bonus issue etc. as in the case of equity shares. These shares are sometimes referred to as quasi equity shares in common parlance. Companies may even charge a premium as part of the terms of conversion of preference shares, as they do sometimes while converting debentures into equity shares.

REDEEMABLE PREFERENCE SHARES

If the articles of a company so authorize, redeemable preference shares can be issued. These are such preference shares in which are redeemed after specific period and money is returned to shareholders. According to Section 55 of the Companies Act, 2013, a company cannot issues preference shares which are irredeemable. If Article of association permits, the Company can issue preference shares which are redeemable not later than 20 years. Companies engaged in infrastructure projects can issue shares redeemable exceeding 20 years.

PARTICIPATING PREFERENCE SHARES

In general, preference shareholders are not entitled to the dividend more than what has been indicated as part of the terms of issue, even in a year in which the company has made huge profits. Subject to the provision in the terms of issue, participating preferential shares are those shares which can be entitled to participate in the surplus profits left, after payment of dividend to the preference and the equity shareholders to the extent provided therein. Subject to provisions in the terms of issue such preference shares can be entitled even to bonus shares.

NON PARTICIPATING PREFERENCE SHARES

Unless the terms of issue indicate specifically otherwise, all preference shares are to be regarded as non participating preference shares.

FULLY CONVERTIBLE CUMULATIVE PREFERENCE SHARE (EQUIPREF)

This instrument is issued in two parts, Part A & B. Part A is convertible into equity shares automatically and compulsorily on the date of allotment without any application by the allottee, and Part B is redeemed at par/ converted into equity after a lock in period at the option of the investor, at a price 30% lower than the average market price. The dividend is given only for part B shares. The dividend on fully convertible cumulative preference shares is fixed and shall be given only for the portion that represents second part shares.

DEBENTURES

Section 2(30) of the Companies Act, 2013 defines debenture which 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 fulfills either of these conditions is a debenture.

Features of Debentures

The important features of a debenture are:

- It is issued by a company as a certificate of indebtedness.
- It usually indicates the date of redemption and also provides for the repayment of principal and payment of interest at specified date or dates.
- 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.

Types of Debentures

- **Naked or unsecured debentures:** Debentures of this kind do not carry any charge on the assets of the company. The holders of such debentures do not therefore have the right to attach particular property by way of security as to repayment of principal or interest.
- **Secured debentures:** Debentures that are secured by a mortgage of the whole or part of the assets of the company are called mortgage debentures or secured debentures. The mortgage may be one duly registered in the formal way or one which is secured by the deposit of title deeds in case of urgency.
- **Redeemable debentures:** Debentures that are redeemable on expiry of certain period are called redeemable debentures. Such debentures after redemption can be reissued in accordance with the provisions of the Companies Act, 2013.
- **Perpetual debentures:** If the debentures are issued subject to redemption on the happening of specified events which may not happen for an indefinite period, e.g. winding up, they are called perpetual debentures.
- **Bearer debentures:** Such debentures are payable to bearer and are transferable by mere delivery. The name of the debenture holder is not registered in the books of the company, but the holder is entitled to claim interest and principal as and when due. A *bona fide* transferee for value is not affected by the defect in the title of the transferor.
- **Registered debentures:** Such debentures are payable to the registered holders whose name appears on the debenture certificate/ letter of allotment and is registered on the companies register of debenture holders maintained as per Section 88 of the Companies Act, 2013.

Classification of Debentures based upon Convertibility

Based on convertibility, debentures can be classified under three categories:

- Fully Convertible Debentures (FCDs)
- Non Convertible Debentures (NCDs)
- Partly Convertible Debentures (PCDs)

Basic Features of Convertible Debentures

- Debentures are issued for cash at par.
- They are converted into specified or unspecified number of equity shares at the end of the specified period. The ratio at which the convertible debentures are exchanged for equity shares is known as conversion price or conversion ratio which is worked out by dividing the face value of a convertible debenture by its conversion price. For instance if the face value of a convertible debenture is ₹100 and it is convertible into two equity shares, the conversion price is ₹50 and the conversion ratio is 2. The difference between the conversion price and the face value of the equity share is called conversion premium.
- Convertible debentures may be fully or partly convertible. In case it is fully convertible the entire face value is converted into equity shares on expiry of the stipulated period. If partly convertible, the convertible portion is converted into equity shares on expiry of the specified period and the non convertible portion is redeemed at the expiry of certain period.
- Conversion into equity shares may take place in one or more stages at the end of specified period or periods in the case of fully or partly convertible debentures.
- If one or more parts of the debentures are convertible after 18 months, a company should get a credit

rating done by a credit rating agency approved by SEBI. Fresh rating is required if debentures are rolled over.

– Convertible debentures of public companies can be listed on the stock exchanges to assure liquidity to the holders.

It may bring action against the company to realise their dues by sale of the assets/undertaking earmarked as security for the debt.

Advantages of Convertible Debentures

Advantages to the company

The advantages of convertible debentures to the company are –

1. Capitalisation of interest cost till the date of commissioning of the project is allowed in accordance with accounting principle. If the conversion of the debentures is duly linked with the commissioning of the project the entire interest cost can be capitalised, without charging the interest to profit & loss account and pulling down the profits of the company.
2. Convertible debentures carry lower interest as compared to the rate charged by the Banks and Financial Institutions.
3. From the point of view of the debt equity ratio the convertible part of the debentures is treated as equity by financial institutions. The company is thus enabled to have a high degree of flexibility in financing its future projects.
4. Equity capital gets increased after each conversion, facilitating easier servicing of equity by payment of dividend.
5. Tax benefits are higher as interest on debentures is allowed as a deduction in computation of taxable income of the company. Additionally a company having a proven track record and future earning potential will be able to reasonable premium at the time of conversion. This will result in reducing the servicing cost of equity.
6. This is a popular form of financing in companies as the interest rates are cheaper than those charged by Financial Institutions on term loans.
7. In the case of term loans from Financial Institutions (FIs) and Banks they usually impose many conditions on management including placing their representative on the Board. In the case of convertible debentures there is thus a greater degree of autonomy for the companies.

Advantages to the Investor

The advantages of the convertible debentures to the investors are –

1. The investor is assured of a fixed return by way of interest on the debentures till conversion. On conversion equity shares the investor becomes entitled to receive dividend declared on equity shares. The advantage to the investor is that he receives a fixed return on his investment by way of interest even during the gestation period and project implementation period.
2. As price of equity shares tends to rise on completion of the project of the company, the investor gets value appreciation on his investment, if converted into equity share.
3. In most cases, debentures carry security with a charge on all or a part of movable/immovable properties of the company. This assures prompt payment of principal and interest by invoking the assistance of a debenture trustee. However in terms of SEBI Regulations where the debentures have a maturity period of 18 months or less it is mandatory for the company to create security on the debentures.

4. A fair amount of liquidity is enjoyed by convertible debentures listed on the stock exchanges depending on the track record of the companies. Even if debentures are not traded as actively as equity shares, convertible debentures of good companies command reasonable liquidity. Where a debenture has several parts, each part of the convertible debentures can be traded separately or in full on the stock exchanges.

5. The following options are available to the investor who has bought convertible debentures issued in several parts:

   (a) To sell all the parts immediately on allotment;

   (b) To sell one or more parts and retain other or others till conversion and to obtain equity shares for retention or sale.

Fully Convertible Debentures With Interest (Optional)

In this case there is no interest payment involved say for the first 6 months. Then the holder can exercise option and apply for securities at a premium without paying additional amount. However interest will be payable at a determined rate from the date of first conversion to second/final conversion and in lieu thereof equity shares are issued. Upon conversion of each part, the face value stands reduced proportionately on the date of conversion.

NON CONVERTIBLE DEBENTURES WITH PUT AND CALL OPTION

Put Options in NCD

A "put" option means that the investor has an option to surrender the debenture if he wants to, and get back the principal. A put option gives a lot of flexibility to the investor – if interest rates go up, he can get better rates from the market. He can exercise the put option and get back the money and invest it elsewhere.

Call Option in NCD

A "call" option means that the company has an option to ask the investor to surrender the debenture, and pay back the principal to the investor. A call option gives flexibility to the company – if interest rates go down, and the company can get funds at lower rates from the market, it can exercise the call option and give the money back and can raise money from the market at lower rates.

Example

TATA Capital has issued Non Convertible Debentures in the year 2009 and the rate of interest offered by the issue was 12% compounded per annum. The company has offered that the NCD holder can exercise put or call option after completion of 36 months of the issue. As interest rates offered in 2009 was higher than in March 2012(Option exercising period) the company decided to offer revised interest rates, if not agreed then investors can exercise put option and exit from the NCDs with principal and accumulated interest (if any) as on the date.

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 know as a 'coupon payment.'

Types of Bond

There are various types of bonds in India:

(1) **Government Bonds:** 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.

(2) **Corporate Bonds:** These are the bonds issued by the private corporate companies. Indian corporates issue secured or non secured bonds. E.g. IIFL bonds issue which came up during Sep-2012 was unsecured bond and Shriram city union bond issue in Sep-2012 was a secured bond issue.

(3) **Banks and other financial institutions bonds**: 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. However care to be taken to consider the credit rating given by Credit Rating Agencies before investing in these bonds. In case of poor credit rating, better to stay away from such bonds.

(4) Tax saving bonds: 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.

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 capital gains, he will convert the warrants, else he may simply let the warrant lapse. Thus in such cases, there is no possibility of the investor suffering any capital losses.

For example if the conversion price of the warrant is ₹ 70/-and the current market price is ₹110/-, then the investor will convert the warrant and enjoy the capital gain of ₹40/-. In case the conversion is at ₹ 70/-and the current market price is ₹40/-, then the investor will simply let the warrant lapse without conversion.

SWEAT EQUITY SHARES

Section 2 (88) of the Companies Act, 2013 defines "sweat equity shares" 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.

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) Not less than one year has elapsed at the date of the issue, since the date on which the company was entitled to commence business.

(d) The sweat equity shares of a company whose equity shares are listed on a recognised stock exchange are issued in accordance with the regulations made by SEBI in this regard 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.

SECURED PREMIUM NOTES (SPN)

These instruments are issued with detachable warrants and are redeemable after a notified period say 4 to 7 years. The warrants enable the holder to get equity shares allotted provided the secured premium notes are fully paid. During the lock in period no interest is paid. The holder has an option to sell back the SPN to the company at par value after the lock in period. If the holder exercises this option, no interest/premium is paid on redemption. In case the holder keeps it further, he is repaid the principal amount along with the additional interest/premium on redemption in installments as per the terms of issue. The conversion of detachable warrants into equity has to be done within the specified time.

Example

TISCO in the year 1992 wanted to raise money for its modernization program without expanding its equity excessively in the next few years. The company made the issue to the existing shareholders on a rights basis along with the rights issue. The salient features of the TISCO issue were as follows :

(a) Face value of each SPN was ₹300.

(b) No interest was payable during the first three years after allotment.

(c) The redemption started at the end of the fourth year of issue.

(d) Each of the SPN of ₹300 was repaid in four equal amount instalments of ₹ 75 which comprised of the principal, the interest and the relevant premium. (Low interest and high premium or high interest and low premium, at the option to be exercised by the SPN holder at the end of the third year.

(e) Warrant attached to each SPN entitled the holder the right to apply for or seek allotment of one equity share for cash payment of ₹ 80 per share. Such a right was exercisable between first year and one-and-a-half year after allotment by which time the SPN would be fully paid-up. The instrument tremendously benefited TISCO, as there was no interest outgo. This helped TISCO to meet the difficulties associated with the cash generation. In addition, the company was able to borrow at a cheap rate of 13.65 per cent as against 17 to 18 per cent offered by most companies. This enabled the company to start redemption earlier through the generation of cash flow by the company's projects. The investors had the flexibility of tax planning while investing in SPNs. The company was also equally benefited as it gave more flexibility.

EQUITY SHARES WITH DETACHABLE WARRANTS

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

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	₹ 1000
Coupon rate	2%
Maturity	2 years

Convertible into equity shares @ ₹ 800 per share

Now suppose an investor subscribes to 4 of these bonds. Thus the total investment is ₹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 @ ₹ 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₹ 800, let's say ₹ 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 ₹ 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.

AMERICAN DEPOSITORY RECEIPTS

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

Advantages of ADRs

- **Cost-effective** - ADRs are an easy and cost-effective way to buy shares in a foreign company. They save money by reducing administration costs and avoiding foreign taxes on each transaction.
- **Diversification** - Investor gains the potential to capitalize on emerging economies by investing in different countries.
- **More US exposure** - Foreign entities favour ADRs because they get more US exposure, allowing them to tap into the wealthy North American equity markets

GLOBAL DEPOSITORY RECEIPTS

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

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

Advantages to issuing company

- Accessibility to foreign capital markets
- Increase in visibility of the issuing company
- Rise in the capital because of foreign investors

Advantages to investor

- Helps in diversification, hence reducing risk
- More transparency since competitor's securities can be compared.
- Prompt dividend and capital gain payments..

According to Section 2(44) of Companies Act, 2013, "Global Depository Receipt" means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorised by a company making an issue of such depository receipt. Section 41 provides that a company may, after passing a special resolution in its general meeting, issue depository receipts in any foreign country in such manner, and subject to such conditions, as may be prescribed.

Difference between American Depository Receipts (ADR) and Global Depository Receipts (GDR)

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

INDIAN DEPOSITORY RECEIPTS (IDRS)

IDRs is an instrument denominated in Indian Rupees 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 the 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 form the underlying shares. Standard Chartered PLC was the first global company to issue Indian depository receipts in India.

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 the Companies (Registration of foreign Companies) Rules, 2014 lay down the procedure for issue of India Depository Receipts.

Benefits of IDRs

Issuing Company: Any foreign company listed in its home country and satisfying the eligibility criteria can issue IDRs. A company which has significant business in India can increase its value through IDRs by breaking down market segmentations, reaching trapped pools of liquidity, achieving global benchmark valuation, accessing international shareholder base and improving its brands presence through global visibility.

Investors: IDRs can lead to better portfolio management and diversification for investors by giving them a chance to buy into the stocks of reputed companies abroad.

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 contact 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 contacts where the option can be exercised only on the expiration date. –American Option-American style options are those contacts 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 ₹ 250. This contract allows Rajesh to sell 100 shares of Infosys at ₹ 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 ₹25,000 (₹ 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	₹ 1040
May Put at 1050	₹10
May Put at 1070	₹ 30

So the inevstor purchases 1000 "Ray Technologies" Put at strike price of ₹1070 and Put price of ₹ 30/-. The investor pay ₹ 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 ₹ 1,070/-the price of which is ₹ 1020/-. By exercising the option the investor earn ₹(1070-1020) =₹ 50 per Put, which amounts to ₹ 50,000/. The net income in this case is ₹ (50000-30000) = ₹ 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 ₹ 30,000.

INDEX FUTURES & OPTIONS

An Index Future is a future contract with the index as the underlying asset. There is no underlying security or a stock, which is to be delivered to fulfill the obligations as index futures are cash settled. They can be used for hedging against an existing equity position, or speculating on future movements of the index. E.g., futures contract on NIFTY Index and BSE-30 Index. These contracts derive their value from the value of the underlying index.

Index Option is an option contract where the option holder has the call or put option on the index. However, unlike Index Futures, the buyer of Index Option Contracts has only the right but not the obligation to buy / sell the underlying index on expiry. Index Option Contracts are generally European Style options i.e. they can be exercised/ assigned only on the expiry date.

An index, in turn derives its value from the prices of securities that constitute the index and is created to represent the sentiments of the market as a whole or of a particular sector of the economy. Indices that represent the whole market are broad based indices and those that represent a particular sector are sectoral indices. In the beginning futures and options were permitted only on S&P Nifty and BSE Sensex. Subsequently, sectoral indices were also permitted for derivatives trading subject to fulfilling the eligibility criteria. Derivative contracts may be permitted on an index if 80% of the index constituents are individually eligible for derivatives trading. However, no single ineligible stock in the index shall have a weightage of more than 5% in the index. The index is required to fulfill the eligibility criteria even after derivatives trading on the index have begun. If the index does not fulfill the criteria for 3 consecutive months, then derivative contracts on such index would be discontinued. By its very nature, index cannot be delivered on maturity of the Index futures or Index option contracts therefore, these contracts are essentially cash settled on Expiry.

CURRENCY FUTURES

A currency futures contract is a standardized forward contract that is traded on an exchange. It is an agreement to buy or sell a particular currency in the future at a specified rate and at a specified date. E.g., buying one lot of December, 200X, USD/INR at 49.50 on 17th November, 200X, means the buyer has agreed to buy USD 1,000 at the rate of INR 49.50 per USD on 29th December, 200X, assuming 29th December, 200X, is the maturity date for December 200X USD/INR Futures.

A country's currency exchange rate is typically affected by the supply and demand for the country's currency in the international foreign exchange market. The demand and supply dynamics is principally influenced by factors like interest rates, inflation, trade balance, and the state of economic and political affairs in the country. The level of confidence in the economy of a particular country also influences the currency of that country. Currency futures are standardized depending on what is being traded, the quantity, delivery time and delivery location for each specific commodity. They consist of secondary markets and can also be dealt numerous times much like a bond and opposed to a bank loan.

INTEREST RATE FUTURES

On August, 2009, RBI issued directions for trading of Interest Rate futures on Currency Derivative segment of a Recognized Stock Exchange. The term "Interest Rate Futures" has been defined in the Regulation as:-

Interest Rate Futures means a standardized interest rate derivative contract traded on a recognized stock exchange to buy or sell a notional security or any other interest bearing instrument or an index of such instruments or interest rate at a specified future date, at a price determined at the time of the contract.

Products that can be traded in the market are futures on long bond (10 year notional G-Secs) and T-bills (91 days notional) and any other product which is approved by RBI.

Interest rate futures on 91-day treasury bill are interest rate-driven derivative products that help banks, mutual funds and primary dealers to hedge their interest rate exposure on treasury bills. Financial institutions can lock in the interest rate or the yield on the 91-day treasury at a given date when counter parties enter into the interest rate futures contract.

The 91-day T-bill interest rate futures are cash settled. In case of the 91-day treasury bill, the final settlement price of the futures contract is based on the weighted average price/ yield obtained in the weekly auction of the 91-day treasury bills on the date of expiry of the contract. But in case of interest rate futures on the 10-year benchmark government security, the contract is physically settled.

STOCK FUTURES AND STOCK OPTIONS

Stock Futures are financial contracts where the underlying asset is an individual stock. Stock Future contract is an agreement to buy or sell a specified quantity of underlying equity share for a future date at a price agreed upon between the buyer and seller. The contracts have standardized specifications like market lot, expiry day, unit of price quotation, tick size and method of settlement.

In stock options, the option buyer has the right and not the obligation, to buy or sell the underlying share. In case of stock futures, both the buyer and seller are obliged to buy/sell the underlying share. Risk-return profile is symmetric in case of single stock futures whereas in case of stock options payoff is asymmetric. Also, the price of stock futures is affected mainly by the prices of the underlying stock whereas in case of stock options, volatility of the underlying stock affects the price along with the prices of the underlying stock.

Pricing of Stock Futures

The theoretical price of a future contract is sum of the current spot price and cost of carry. However, the actual price of futures contract very much depends upon the demand and supply of the underlying stock. Generally, the futures prices are higher than the spot prices of the underlying stocks.

Futures Price = Spot Price + Cost of Carry

Cost of carry is the interest cost of a similar position in cash market and carried to maturity of the futures contract less any dividend expected till the expiry of the contract.

Example

Spot Price of Infosys = 1600, Interest Rate = 7% p.a. Futures Price of 1 month contract=1600 + 1600*0.07*30/365 = 1600 + 11.51 = 1611.51

EXCHANGE TRADED FUNDS (ETFS)CHANGE TRADED FUNDS (ETFS)

Exchange Traded Fund is a security that tracks an index, a commodity or a sector like an index fund or a sectoral fund but trades like a stock on an exchange. It is similar to a close-ended mutual fund listed on stock exchanges. ETF's experience price changes throughout the day as they are bought and sold.

There are different types of ETFs:

(i) **Equity ETFs –** Equity ETF is a basket of stocks that reflects the composition of an Index, like S and P CNX Nifty or S&P BSE SENSEX. The ETFs trading value is based on the net asset value of the underlying stocks that it represents. Think of it as a Mutual Fund that one can buy and sell in real-time at a price that change throughout the day.

(ii) **Gold ETFs –** Gold ETFs are units representing physical gold which may be in paper or dematerialized form. These units are traded on the exchange like a single stock of any company.

(iii) **Liquid ETFs –** Liquid ETFS are funds whose unit price is derived from money market securities comprising of government bonds, treasury bonds, call money market etc. The funds seek to deliver reasonable market related returns with lower risk and higher liquidity through portfolio of debt and money market instruments.

LESSON ROUND UP

– Financial instruments that are used for raising capital resources in the capital market are known as Capital Market Instruments.

– Equity shares have the right to share the profits of the company in the form of dividend (cash) and bonus shares.

– Where the voting rights on new shares are different from the voting rights on the equity shares already issued, the new shares are known as Differential Voting Rights Shares (DVRS).

– Preference shares are those shares which have rights of preference over equity shares in case of distribution of dividend and distribution of surplus in the case of winding up.

– Debenture includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not.

– Warrant means an option issued by a company whereby the buyer is granted the right to purchase a number of share (usually one) of its equity share capital at a given exercise price during a given period.

– Sweat Equity Share is an instrument as specified in section 2(88) of the Companies Act, 2013 permitted to be issued by specified Indian companies, under Section 54 of Companies Act, 2013.

– Derivatives are contracts which derive their values from the value of one or more of other assets (known as underlying assets).

– An Index Future is a future contract with the index as the underlying asset. There is no underlying security or a stock, which is to be delivered to fulfill the obligations as index futures are cash settled.

– Index Option is an option contract where the option holder has the call or put option on the index.

– Interest Rate Futures means a standardized interest rate derivative contract traded on a recognized stock exchange to buy or sell a notional security or any other interest bearing instrument or an index of such instruments or interest rate at a specified future date, at a price determined at the time of the contract.

– Exchange Traded Fund is a security that tracks an index, a commodity or a sector like an index fund or a sectoral fund but trades like a stock on an exchange.

SELF TEST QUESTIONS

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

1. What is a warrant? Briefly discuss.
2. Briefly explain about equity shares with detachable warrants.
3. Explain Non convertible Debentures with call and put option.
4. What is an Option contract? Explain it with the help of an example.
5. What do you understand by Exchange Traded Funds? Briefly discuss the various types of ETFs traded on the Stock Exchanges.

Lesson 9
Resource Mobilization Through International Markets

LESSON OUTLINE

- Introduction
- American Depository Receipts (ADRs)
- Types of ADRs
- Global Depository Receipts (GDRs)
- Advantage of ADRs and GDRs
- Process involved in Issue of ADR/GDR
- Provisions of Companies Act, 2013 relating to issue of GDR
- Issuance of Shares under ADR/GDR
- Statutory Approvals Required for issue of GDR/ADR
- Agencies involved in ADR/GDR issue
- Agreements and related Documents
- Procedural Requirements
- Procedure for issue of ADR/GDR
- Reporting of ADR/GDR issue
- Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993
- Listing of GDR
- London Stock Exchange
- Listing on Main Market
- Listing on Professional Security Market
- Listing on AIM
- Luxembourg Stock Exchange
- Listing of ADR
- NASDAQ
- The NASDAQ Global Select Market
- The NASDAQ Capital Market
- The NASDAQ Global Market
- NewYork Stock Exchange (NYSE)
- LESSON ROUND UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

Increased globalization and investor appetite for diversification, offer a unique opportunity to companies looking to tap a new investor base to raise capital. Indian companies are allowed to raise equity capital in the international market through the issue of GDR/ADR in accordance with the Scheme for issue of Foreign Currency Convertible Bonds (FCCBs) and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government there under from time to time.

The objective of this lesson is to give a complete overview of the advantages, structure, issuance and fungibility of ADR/GDR, choice of stock exchanges for cross-listing of companies, criteria for Listing on NASDAQ, London stock Exchange, New York Stock Exchange.

INTRODUCTION

Companies either raise funds from the domestic market or through international market. For international funding, the most popular source amongst the Indian companies in the recent times has been American Depository Receipts (ADR) and Global Depository Receipts (GDR).

AMERICAN DEPOSITORY RECEIPT

An American Depository Receipt (ADR) is a negotiable security representing ownership in some underlying shares of a non-US company, which can be traded on US stock exchanges. ADRs are denominated in US dollars and function on the lines of the shares of a US company in terms of trading and dividend payment.

Example I

The following example would give a clear understanding of the mechanism of the working of an ADR and the parties involved.

1. Suppose there is a broker, say Mr. X. He buys the shares of a company, say Reliance Industries Ltd. (RIL) from the Bombay Stock Exchange.

2. He then goes to his custodian bank, say ICICI, to hold the shares for the issuance of ADRs.

3. He then goes to another bank, called the Depository bank, say JP Morgan and asks them to issue ADRs on the basis of shares in the custody of ICICI.

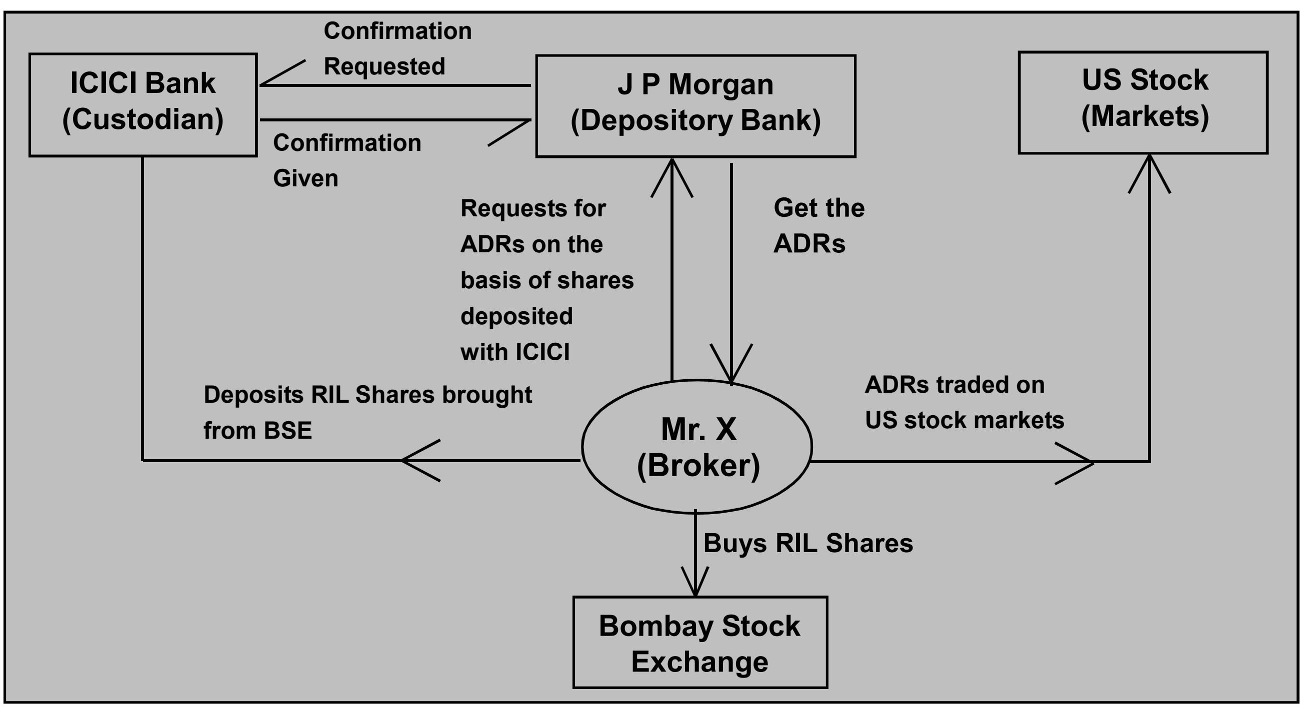
Note: In case of sponsored ADRs, the company (RIL in this case) can itself have a designated depository for issuance of ADRs, bypassing the custodian.

4. JP Morgan then confirms the shares held by ICICI and issues ADRs to Mr. X.

5. An ADR issued can represent a fraction of a share (say 1 ADR=1/2 a share of RIL), or even 1 single share or multiple shares also (say 10 shares of RIL make 1 ADR).

6. These ADRs then can be traded on the US stock exchanges in a way similar to the trading of stocks of US companies.

The diagram below will make the working of an ADR clear :



Example II

Let us take Infosys example – trades on the Indian stock market at around ₹ 2000/-

- This is equivalent to US$ 40 – assume for simplicity
- Now a US bank purchases 10000 shares of Infosys and issues them in US in the ratio of 10:1
- This means each ADR purchased is worth 10 Infosys shares.
- Quick calculation means 1 ADR = US $400
- Once ADR is priced and sold, its subsequent price is determined by supply and demand factors, like any ordinary share.

ADR RATIO

– Single: 1 ADR = 1 SHARE

ADR Ratio = 1:1

– Multiple : 1 ADR = 5 SHARES

ADR Ratio = 1:5

– Fraction : 1 ADR = ½ SHARE

ADR Ratio = 2:1

Types of ADRs

ADRs can be classified into two broad categories:

Unsponsored ADRs: In such ADRs, the company has got no agreement with the custodian or depository bank for the issuance of ADRs. These are traded on the over-the-counter (OTC) market and are issued according to the market demand forces. Unsponsored ADRs can be issued by a number of depository banks. Each depository services only the ADRs issued by it.

Sponsored ADRs: These are the ADRs which are sponsored by the company itself. In this case, the foreign company itself wants to issue ADRs and it does so by designating a depository bank that will issue ADRs in the foreign market on its behalf. It is of the following types:

(a) *Level 1 Sponsored ADRs:* These are the lowest level of sponsored ADRs. These are traded only on the OTC market. The company is required to adhere to minimal US Securities and Exchange Commission (SEC) requirements and is not required to publish reports in accordance with the US GAAP standards.

(b) *Level 2 Sponsored ADRs:* In level 2 ADRs, the ADRs are listed on a recognized US stock exchange and can be traded thereafter. The stock exchanges in which these ADRs can be traded are New York Stock Exchange (NYSE), NASDAQ, and the American Stock Exchange (AMEX). In such ADRs, the company is supposed to adhere to higher level of SEC regulations and is also required to publish annual reports in accordance with US GAAP or IFRS (International Financial reporting Standards).

(c) *Level 3 Sponsored ADRs:* These are the highest level of sponsored ADRs. As such, it requires adherence to stringent rules and regulations similar to those applicable to the US companies. In these type of ADRs, the company rather than letting its shares from the home market to be deposited in for the ADR program, actually issues fresh shares in the form ADRs to raise capital from the US market.

GLOBAL DEPOSITORY RECEIPTS

Global Depository Receipts (GDRs) came into existence long after the American Depository Receipts and function on the same lines. GDRs were first issued by Citibank in 1990. Samsung Corporation, a Korean trading company, wanted to raise equity capital in the United States through a private placement, but also had a strong European investor base that it wanted to include in the offering. The GDR issue allowed Samsung to raise capital in the US and Europe through one security issued simultaneously into both markets.

The mechanism of the operations of Global Depository Receipts is similar to that of the ADRs, the modulation being they can be traded anywhere in the world (or most of the stock exchanges in the world for that matter). GDRs are usually listed in the Luxembourg Stock Exchange and in the London Stock Exchange. They are usually traded on the International Order Book (IOB) which is normally 1 GDR = 10 Shares.

Since one type of security can be issued anywhere in the world, GDRs are inherently very flexible. Like ADRs, GDRs can be unsponsored and sponsored. Sponsored GDRs, again like ADRs, are of the three types mentioned previously with similar features.

Difference between American Depository Receipts (ADR) and Global Depository Receipts (GDR)

ADR are US $ denominated and traded in US only.

GDRs are traded in various places such as Luxembourg Stock Exchange, London Stock Exchange, *etc*.

ADVANTAGE OF ADRS AND GDRS

To the Investors

- Easy to purchase and hold.
- Investor does not need to go through the hassles of govt. regulations and currency conversion to buy stocks of foreign companies.
- Trades and settles in the same manner as any other security available in the investor's home country's stock markets.
- Facilitates portfolio diversification by inclusion of foreign stocks.
- Better comparison between stocks of various companies.
- Since GDRs are denominated in the investors' home currency (like ADR in US Dollars), they tend to reduce foreign exchange risks.

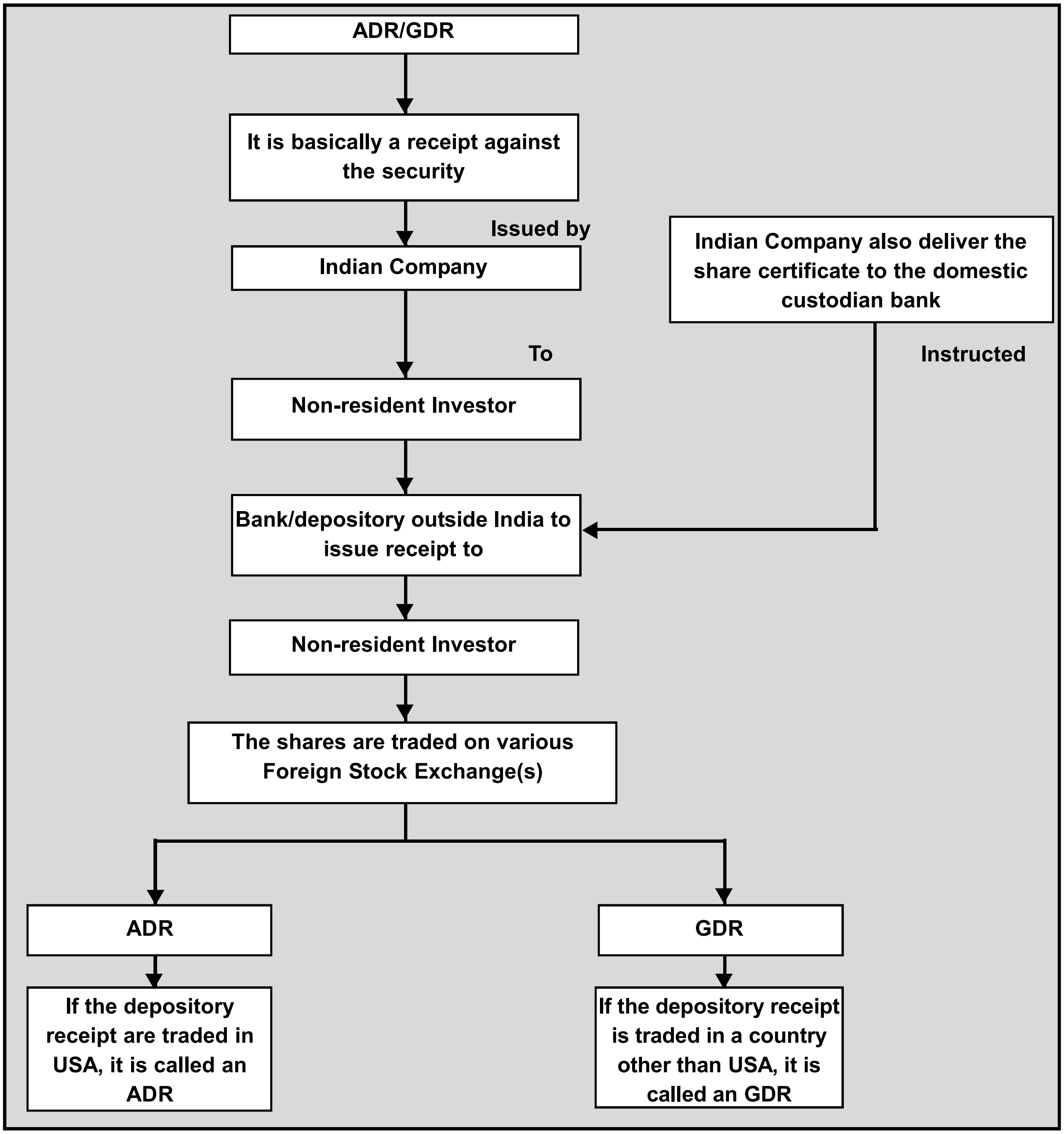
To the Issuers

- Broadens investor base.
- Increases global presence.
- More avenues to raise funds.
- Price parity with global competitors.
- Facilitates mergers and acquisitions.

Point to Remember

An Indian corporate can raise foreign currency resources abroad through the issue of GDR/ADR. Regulation 4 of Schedule I of FEMA Notification no. 20 issued by RBI, allows an Indian company to issue its Rupee denominated shares to a person resident outside India being a depository for the purpose of issuing ADRs/ GDRs.

Process involved in Issue of ADR/GDR



SPONSORED ADR/GDR ISSUE

An Indian company can also sponsor an issue of ADR / GDR. Under this mechanism, the company offers its resident shareholders a choice to submit their shares back to the company so that on the basis of such shares, ADRs / GDRs can be issued abroad. The proceeds of the ADR / GDR issue are remitted back to India and distributed among the resident investors who had offered their Rupee denominated shares for conversion. These proceeds can be kept in Resident Foreign Currency (Domestic) accounts in India by the resident shareholders who have tendered such shares for conversion into ADRs / GDRs.

TWO-WAY FUNGIBILITY SCHEME

A limited two-way Fungibility scheme has been put in place by the Government of India for ADRs / GDRs. Under this Scheme, a stock broker in India, registered with SEBI, can purchase shares of an Indian company from the market for conversion into ADRs/GDRs based on instructions received from overseas investors. Re-issuance of ADRs / GDRs would be permitted to the extent of ADRs / GDRs which have been redeemed into underlying shares and sold in the Indian market.

TERMS ONE SHOULD KNOW

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

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

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

ISSUANCE OF SHARES UNDER ADR/GDR

(i) Indian companies can raise foreign currency resources abroad through the issue of (ADRs/GDRs) FCCB/DR, in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India thereunder from time to time.

(ii) A company can issue ADRs / GDRs, if it is eligible to issue shares to a person resident outside India under the FDI Scheme. However, an Indian listed company, which is not eligible to raise funds from the Indian Capital Market including a company which has been restrained from accessing the securities market by SEBI will not be eligible to issue ADRs/GDRs.

(iii) Unlisted companies shall be allowed to raise capital abroad without the requirement of prior or subsequent listing in India initially for a period of two years w.e.f 11th October, 2013, subject to the following conditions:

(a) Unlisted companies shall list abroad only on exchanges in IOSCO/FATF compliant jurisdictions or those with which SEBI has signed bilateral agreements;

(b) Such Companies shall file a copy of the return which they have submitted to the proposed exchange/ regulators also to SEBI for the purpose of Prevention of Money Laundering Act (PMLA). They shall comply with SEBI's disclosure requirements in addition to that of the primary exchange prior to the listing abroad;

(c) While raising resources abroad, the listing company shall be fully compliant with the FDI policy in force;

(d) The capital raised abroad may be utilized for retiring outstanding overseas debt or for *bona fide* operations abroad including for acquisitions;

(e) In case the funds raised are not utilized abroad as stipulated at (d) above, such companies shall remit the money back to India within 15 days from the date of raising of funds and such money shall be parked only in AD Category-1 banks recognized by RBI and may be used domestically;

(f) The ADRs/GDRs shall be issued subject to sectoral cap, entry route, minimum capitalization norms, pricing norms, *etc.*, as applicable as per FDI regulations notified from time to time;

(g) The pricing of such ADRs/GDRs to be issued to a person resident outside India shall be determined in accordance with sub-paragraph (viii) below;

(h) The number of underlying equity shares offered for issuance of ADRs/GDRs to be kept with the local custodian shall be determined upfront and ratio of ADRs/GDRs to equity shares shall be decided upfront based on applicable FDI pricing norms of equity shares of unlisted company;

(i) The unlisted Indian company shall comply with the instructions on downstream investment as notified from time to time;

(j) The criteria of eligibility of an unlisted company raising funds through ADRs/GDRs shall be as prescribed by the Government of India;

(iv) There are no end-use restrictions except for a ban on deployment / investment of such funds in real estate or the stock market.

(v) The ADR/GDR proceeds can be utilized for first stage acquisition of shares in the disinvestment process of Public Sector Undertakings/Enterprises and also in the mandatory second stage offer to the public in view of their strategic importance.

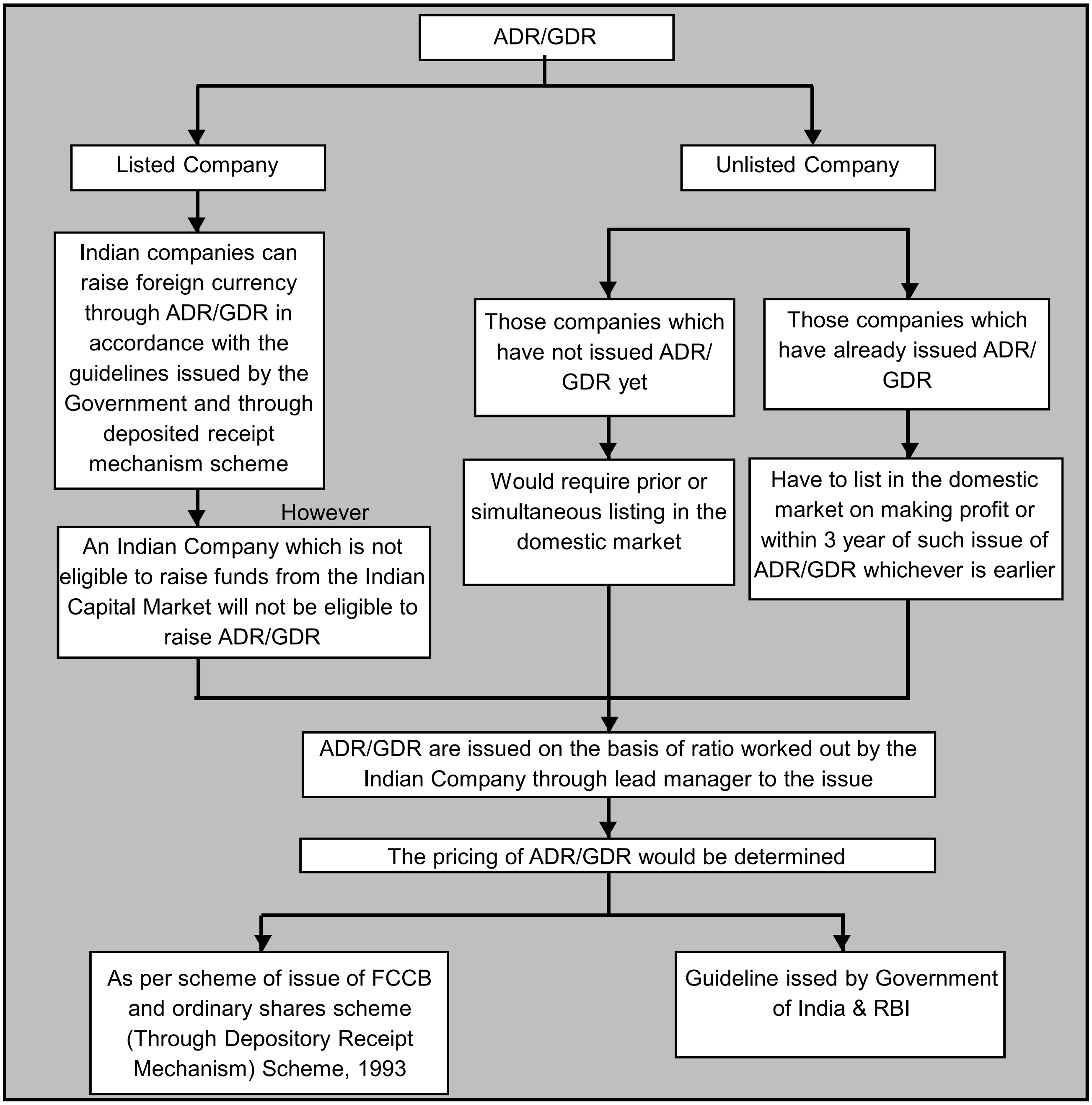
(vi) Voting rights on shares issued under the Scheme shall be as per the provisions of Companies Act, 2013 and in a manner in which restrictions on voting rights imposed on ADR/GDR issues shall be consistent with the Company Law provisions. Voting rights in the case of banking companies will continue to be in terms of the provisions of the Banking Regulation Act, 1949 and the instructions issued by the Reserve Bank from time to time, as applicable to all shareholders exercising voting rights.

(vii) Erstwhile Overseas Corporate Bodies (OCBs) which are not eligible to invest in India and entities prohibited to buy / sell or deal in securities by SEBI will not be eligible to subscribe to ADRs / GDRs issued by Indian companies.

(viii) The pricing of ADR / GDR issues including sponsored ADRs / GDRs should be made at a price determined under the provisions of the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India and directions issued by the Reserve Bank, from time to time.

(NOTE: There is no monetary limit up to which an Indian company can raise ADRs / GDRs.)

This can be understood with the help of the following diagram:



Provisions of Companies Act, 2013 relating to issue of GDR

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

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

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

Companies (Issue of Global Depository Receipts) Rules, 2014

Eligibility to issue depository receipts :

Rule 3 lays down that a company may issue depository receipts provided it is eligible to do so in terms of the Scheme and relevant provisions of the Foreign Exchange Management Rules and Regulations.

Conditions for issue of depository receipts

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

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

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

(3) The depository receipts shall be issued by an overseas depository bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank.

(4) The company shall ensure that all the applicable provisions of the Scheme and the rules or regulations or guidelines issued by the Reserve Bank of India are complied with before and after the issue of depository receipts.

(5) The company shall appoint a merchant banker or a practising chartered accountant or a practising cost accountant or a practising company secretary to oversee all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practising chartered accountant or practising cost accountant or practising company secretary, as the case may be, shall be placed at the meeting of the Board of Directors of the company or of the committee of the Board of directors authorised by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts.

Provided that the committee of the Board of directors referred to above shall have at least one independent director in case the company is required to have independent directors.

Manner and form of depository receipts

Rule 5 deals with the manner and form of issue of depository receipts.

(1) The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent abroad and may be listed or traded in an overseas listing or trading platform.

(2) The depository receipts may be issued against issue of new shares or may be sponsored against shares held by shareholders of the company in accordance with such conditions as the Central Government or Reserve Bank of India may prescribe or specify from time to time.

(3) The underlying shares shall be allotted in the name of the overseas depository bank and against such shares, the depository receipts shall be issued by the overseas depository bank abroad.

Voting rights

Rule 6 provides the provsions for voting rights of depository receipts holder.

(1) A holder of depository receipts may become a member of the company and shall be entitled to vote as such only on conversion of the depository receipts into underlying shares after following the procedure provided in the Scheme and the provisions of this Act.

(2) Until the conversion of depository receipts, the overseas depository shall be entitled to vote on behalf of the holders of depository receipts in accordance with the provisions of the agreement entered into between the depository, holders of depository receipts and the company in this regard.

Proceeds of issue

Rule 7 provides that the proceeds of issues of depository receipts shall either be remitted to a bank account in India or deposited in an Indian bank operating abroad or any foreign bank (which is a Scheduled Bank under the Reserve Bank of India Act, 1934) having operations in India with an agreement that the foreign bank having operations in India shall take responsibility for furnishing all the information which may be required and in the event of a sponsored issue of Depository Receipts, the proceeds of the sale shall be credited to the respective bank account of the shareholders.

Non applicability of certain provisions of the Act

(1) The provisions of the Act and any rules issued thereunder insofar as they relate to public issue of shares or debentures shall not apply to the issue of depository receipts abroad.

(2) The offer document, by whatever name called and if prepared for the issue of depository receipts, shall not be treated as a prospectus or an offer document within the meaning of this Act and all the provisions as applicable to a prospectus or an offer document shall not apply to a depository receipts offer document.

(3) Notwithstanding anything contained under section 88 of the Companies Act, 2013, until the redemption of depository receipts, the name of the overseas depository bank shall be entered in the Register of Members of the company.

Statutory Approvals Required for issue of GDR/ADR

(i) Approval of the Foreign Investment Promotion Board (FIPB)

Under the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000, a person resident outside India may purchase shares of an Indian company under the foreign direct investment scheme, subject to the terms and conditions specified in Schedule I of the Regulations.

Schedule I provides that an issuer company which is engaged or proposes to engage in any activity specified in this regard or beyond the specified sectoral cap, shall only issue shares to a person resident outside India, provided it has secured prior approval of Secretariat for Industrial Assistance ("SIA") or, as the case may be of FIPB of the Government of India and the terms and conditions of such an approval are complied with.

(ii) Approval of Reserve Bank of India

The issuer company has to obtain approvals from Reserve Bank of India under circumstances specified under the guidelines issued by the concerned authorities from time to time. The issuing company is required to furnish a statement to the Exchange Control Department of RBI, Central Office, Mumbai, within thirty (30) days from the date of closing, stating details of the issue such as number of GDRs issued, number of underlying fresh shares issued, capital structure before and after the issue, *etc*.

(iii) In-principle consent of Stock Exchanges for listing of underlying shares

In principal approval from the Stock Exchanges in India where the shares of the Company are listed, is required prior to listing on the Overseas Exchange. The issuing company has to make a request to the domestic stock exchange for its in-principle consent for listing of underlying shares which shall be lying in the custody of domestic custodian. These shares, when released by the custodian after cancellation of GDR, are traded on Indian stock exchanges like any other equity share.

(iv) Filings with SEBI

Issue of shares requires the filing of an Offering Circular with SEBI for its information and records.

(v) In-principle consent of Financial Institutions

Prior to the launch of its issue the company must obtain in-principle consent on the broad terms of the proposed issue. Where term loans have been obtained by the company from the financial institutions, the agreement relating to the loan containing a stipulation that the consent of the financial institution has to be obtained.

Agencies involved in ADR/GDR issue

The following agencies are normally involved in the issue of ADR/GDR:

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

(i) Lead Manager

The company has to choose a competent lead manager to structure the issue and arrange for the marketing. Lead managers usually charge a fee as a percent of the issue. The issues related to public or private placement, nature of investment, coupon rate on bonds and conversion price are to be decided in consultation with the lead manager.

(ii) Co-Lead/Co-Manager

In consultation with the lead manager, the company has to appoint co-lead/co-manager to coordinate with the issuing company/lead manager to make the smooth launch of the issue.

(iii) Overseas Depository Bank

It is the bank which is authorised by the issuing company to issue Depository Receipts against issue of ordinary shares of issuing company.

(iv) Domestic Custodian Bank

This is a banking company which acts as custodian for the ordinary shares of an Indian company, which are issued by it. The domestic custodian bank functions in co-ordination with the depository bank. When the shares are issued by a company the same are registered in the name of depository and physical possession is handed over to the custodian. The beneficial interest in respect of such shares, however, rests with the investors.

(v) Listing Agent

The appointment of listing agent is necessary to co-ordinate with issuing company for listing the securities on Overseas Stock Exchanges.

(vi) Legal Advisors

The issuing company should appoint legal advisors who will guide the company and the lead manager to prepare offer document, depository agreement, indemnity agreement and subscription agreement.

(a) *Indian Legal advisors* – It is a firm that undertakes the Legal and Financial Due Diligence of the Issuing Companies on behalf of the Lead Manager. It also assists the Company in preparation of the Information Memorandum/ offer document for submitting it with the Overseas Stock Exchange.

(b) *Overseas Legal Advisor* – An overseas legal person who on the basis of the Due Diligence Report of the Indian Counsel submits its report to the Overseas Stock Exchange. They also assist the Lead Manager in preparation of the various documents such as the Deposit Agreement, Subscription Agreement and vet the Information Memorandum (IM).

(vii) Printers

The issuing company should appoint printers of international repute for printing Offer Circular.

(viii) Auditors

The role of issuer company's auditors is to prepare the auditors report for inclusion in the offer document, provide requisite comfort letters and reconciliation of the issuer company's accounts between Indian GAAP/UK GAAP/US-GAAP and significant differences between Indian GAAP/UK GAAP/US GAAP.

(ix) Underwriters

It is desirable to get the issue underwritten by banks and syndicates. Usually, the underwriters subscribe for a portion of the issue with arrangements for tie-up for the balance with their clients. In addition, they will interact with the influential investors and assist the lead manager to complete the issue successfully.

(x) Escrow Agent

An Overseas Bank where an Escrow Account has to be opened for deposit of the monies received from Investors against the ADR/ Issue till the Final Listing Approval is obtained from the Overseas Stock Exchange.

Agreements and related Documents

The following principal documents are involved: (i) Subscription Agreement (ii) Depository Agreement (iii) Custodian Agreement (iv) Escrow Agreement (v) Offering Circular.

(i) Subscription Agreement

Subscription Agreement provides that Lead Managers and other managers agree, severally and not jointly, with the company, subject to the satisfaction of certain conditions, to subscribe for GDRs at the offering price set forth. It may provide that obligations of managers are subject to certain conditions precedent.

Subscription agreement may also provide that for certain period from the date of the issuance of GDR the issuing company will not (a) authorise the issuance of, or otherwise issue or publicly announce any intention to issue; (b) issue offer, accept subscription for, sell, contract to sell or otherwise dispose off, whether within or outside India; or (c) deposit into any depository receipt facility, any securities of the company of the same class as the GDRs or the shares or any securities in the company convertible or exchangeable for securities in the company of the same class as the GDRs or the shares or other instruments representing interests in securities in the company of the same class as the GDRs or the shares.

Subscription agreement also provides, an option to be exercisable within certain period after the date of offer circular, to the lead manager and other managers to purchase upto a certain prescribed number of additional GDRs solely to cover over-allotments, if any.

(ii) Depository Agreement

Depository agreement lays down the detailed arrangements entered into by the company with the Depository, the forms and terms of the depository receipts which are represented by the deposited shares. It also sets forth the rights and duties of the depository in respect of the deposited shares and all other securities, cash and other property received subsequently in respect of such deposited shares. Holders of GDRs are not parties to deposit agreement and thus have no contractual rights against or obligations to the company. The depository is under no duty to enforce any of the provisions of the deposit agreement on behalf of any holder or any other person. Holder means the person or persons registered in the books of the depository maintained for such purpose as holders. They are deemed to have notice of, be bound by and hold their rights subject to all of the provisions of the deposit agreement applicable to them. They may be required to file from time to time with depository or its nominee proof of citizenship, residence, exchange control approval, payment of all applicable taxes or other governmental charges, compliance with all applicable laws and regulations and terms of deposit agreement, or legal or beneficial ownership and nature of such interest and such other information as the depository may deem necessary or proper to enable it to perform its obligations under Deposit Agreement.

The company may agree in the deposit agreement to indemnify the depository, the custodian and certain of their respective affiliates against any loss, liability, tax or expense of any kind which may arise out of or in connection with any offer, issuance, sale, resale, transfer, deposit or withdrawal of GDRs, or any offering document.

Copies of deposit agreement are to be kept at the principal office of Depository and the Depository is required to make available for inspection during its normal business hours, the copies of deposit agreement and any notices, reports or communications received from the company.

(iii) Custodian Agreement

Custodian works in co-ordination with the depository and has to observe all obligations imposed on it including those mentioned in the depository agreement. The custodian is responsible solely to the depository. In a case of the depository and the custodian being the same legal entity, references to them separately in the depository agreement or otherwise may be made for convenience and the legal entity will be responsible for discharging both functions directly to the holders and the company.

Whenever the depository in its discretion determines that it is in the best interests of the holders to do so, it may, after prior consultation with the company terminate, the appointment of the custodian and in such an event the depository shall promptly appoint a successor custodian, which shall, upon acceptance of such appointment, become the custodian under the depository agreement. The depository shall notify holders of such change promptly. Any successor custodian so appointed shall agree to observe all the obligations imposed on him.

(iv) Escrow Agreement

An escrow agreement includes information such as specifying the appointed escrow agent, and specific sections for each of the following: descriptions of any definition pertinent to the agreement, the escrow fund and release of funds, and the acceptable use of funds by the escrow agent, the duties and liabilities of the escrow agent, the escrow agent's fees and expenses, and the jurisdiction and venue in the event of a legal action, *etc*.

(v) Offering Circular

Offering Circular is a mirror through which the prospective investors can access vital information regarding the company in order to form their investment strategies.

It is to be prepared very carefully giving true and complete information regarding the financial strength of the company, its past performance, past and envisaged research and business promotion activities, track record of promoters and the company, ability to trade the securities on Euro capital market.

The Offering Circular should be very comprehensive to take care of overall interests of the prospective investor. The Offering Circular for Euro-issue offering should typically cover the following contents:

(i) Background of the company and its promoters including date of incorporation and objects, past performance, production, sales and distribution network, future plans, *etc*.

(ii) Capital structure of the company-existing, proposed and consolidated.

(iii) Deployment of issue proceeds.

(iv) Financial data indicating track record of consistent profitability of the company.

(v) Group investments and their performance including subsidiaries, joint venture in India and abroad.

(vi) Investment considerations.

(vii) Description of shares.

(viii) Terms and conditions of Global Depository Receipt and any other instrument issued along with it.

(ix) Economic and Regulatory policies of the Government of India.

(x) Details of Indian Securities Market indicating stock exchange, listing requirements, foreign investments in Indian securities.

(xi) Market price of securities.

(xii) Dividend and capitalisation.

(xiii) Securities regulations and exchange control

(xiv) Tax aspects indicating analysis of tax consequences under Indian law of acquisition, membership and sale of shares, treatment of capital gains tax, *etc*.

(xv) Status of approvals required to be obtained from Government of India.

(xvi) Summary of significant differences in Indian GAAP, UK GAAP and US GAAP and expert's opinion.

(xvii) Report of statutory auditor.

(xviii) Subscription and sale.

(xix) Transfer restrictions in respect of instruments.

(xx) Legal matters *etc*.

(xxi) Other general information not forming part of any of the above.

A copy of the Offering Circular is required to be sent to the Registrar of Companies, the SEBI and the Indian Stock Exchanges for record purposes.

PROCEDURAL REQUIREMENTS

The procedural requirements for issue of GDRs/ADRs are briefly set out here below:

(i) Preliminary Meetings

The Issuer generally holds preliminary discussions and meets with different global merchant/ investment bankers (who would act as the Lead Manager, Co- Managers, Underwriters), Legal Advisors (Indian and Foreign), Auditors, and other intermediaries before deciding to float a GDR/ADR Issue.

(ii) Authorization by the Board of Directors

– The Issuer is required to pass a Board Resolution approving the proposed GDR/ADR issue.

– The Issuer's Board should also approve the notice calling for a General Meeting of the shareholders for the purpose.

– It is advisable to constitute a Committee of Directors and confer on it necessary powers for approving various matters/ documents connected with the Euro issue, once the Board of Directors (the "Board") of the Issuer has decided to float GDRs/ADRs in the global market. The following matters /documents could then be approved by the Committee of Directors, namely:

(a) Offering Circular

(b) Escrow Agreement to be executed by the Escrow Agent

(c) Agreement to be executed by the Lead Manager and the Issuer

(d) Deposit Agreement to be executed by the Depository

(e) Allotment of shares in favour of the Depository

(f) Opening of bank account outside India and operation of the said account

(g) Making/filing the necessary applications of the Securities and Exchange Commission, U.S., and /or making applications to Luxembourg Stock Exchange or other exchanges

(h) Signing and executing any deed, document, writing, confirmation, undertaking, indemnity in favour of any party including, Lead Manager, Co- Managers, Underwriters, Legal Advisors, Accountants and others who may be related to the issue.

– As per the listing agreement of the stock exchanges, the Issuer should notify the stock exchange, the date of the Board Meeting at which the proposal will be considered and also inform it of the decision of the Board of Directors.

(iii) Organizational Meetings

The Issuer formally appoints the Lead Manager, Co- Managers, Underwriters to market the issue and organize the road shows, printers, Legal Advisors (Indian and Foreign), Depository (to issue GDRs/ADRs to the Underwriters to arrange to place them with the ultimate investors), the Custodian (who physically holds the shares of the Issuer on behalf of the Depository) and the overseas bankers.

The Issuer gives the necessary details about the Issue to the Lead Manager, Co- Managers and other intermediaries. It also provides the relevant clarifications to the Indian and foreign Legal Advisors relating to legal matters of the company and the issue. The Issuer will, along with the Lead Manager to the issue decide the following issues, namely:

1. Public private placement
2. The number of GDRs/ADRs to be issued
3. The issue price

(iv) Authorization by shareholders

– The shareholders must approve the proposed foreign issues of GDR/ADRs by a special resolution passed at the general meeting according to the provisions of section 62 of the Companies Act, 2013.

– Approvals should be also taken from the Issuer's shareholders with regard to Section 61 (increase in authorized share capital), Section 13 (alteration of Capital Clause of the Memorandum of Association for change in authorised share capital) and Section 14 (alteration of Share capital Clause in Articles of Association) of the Companies Act, 2013, if required.

ROADSHOWS

Roadshows represent meetings of issuers, analysts and potential investors. Details about the company are presented in the road shows and such details usually include the following information about the company making the issue:

– History
– Organisational structure
– Principal objects
– Business lines
– Position of the company in Indian and international market
– Past performance of the company
– Future plans of the company

– Competition - domestic as well as foreign

– Financial results and operating performance

– Valuation of shares

– Review of Indian stock market and economic situations.

Thus, at road shows, series of information presentations are organised in selected cities around the world with analysts and potential institutional investors. It is, in fact, a conference by the issuer with the prospective investors. Road show is arranged by the lead manager by sending invitation to all prospective investors.

STEPWISE PROCEDURE FOR ISSUE OF ADR/GDR

1. Convene a Board Meeting to approve the proposed Issue for not exceeding certain value in foreign currency.
2. Convene the Extra ordinary General Meeting for the approval of the shareholders for the proposed GDR Issue under Section 62 of the Companies Act, 2013.
3. Identify the Agencies.
4. Convene a Board Meeting to approve the Agencies.
5. Appoint the Agencies and sign the Engagement Letters.
6. The Indian Legal Counsel to undertake the Due Diligence.
7. Prepare the first draft of the Information Memorandum (IM) in consultation with the Indian Legal Counsel and submit the same to various Agencies for their comments thereon.
8. Prepare the 2nd/3rd draft of IM incorporating the comments.
9. The Listing Agent to submit the IM with the overseas Stock Exchange for their comments and In principle Listing Approval.
10. Simultaneously submit draft IM to the Indian Stock Exchanges where the Issuing Company's shares are listed for In principle approval for listing of the underlying share.
11. Hold Board Meeting to approve the Deposit Agreement, Subscription Agreement and the Escrow Agreement.
12. On receipt of the comments on the IM from the Overseas and Indian Stock Exchanges incorporate the same and file the final IM with Overseas Stock Exchange and obtain Final Listing.
13. The Issuing Company can open the Issue for the ADR/GDR on receipt of the In principle Listing Approval from the Overseas and the Indian Stock Exchanges.
14. Open the Escrow Account with the Escrow Agent and execute the Escrow Agreement.
15. In consultation with the Lead Manager to finalize :
    (a) whether the issue will be through public or a private placement,
    (b) the number of ADR/ GDRs to be issued.
    (c) the issue price.
    (d) number of underlying shares to be issued against each ADR/ GDR.
16. On the day of the opening of the Issue execute the Deposit and Subscription Agreements.
17. The Issue should be kept open for a minimum period of 3 working days.
18. Immediately on closing of the Issue convene a Board/ Committee Meeting for allotment of the underlying shares against the Issue of the GDRs.

19. Then Deliver the share certificate to the Domestic Custodian Bank who will in terms of the Agreement instruct the Overseas Depository Bank to Issue the ADR/ GDR to Non Resident Investor against the shares held by the Domestic Custodian Bank.
20. On receipt of Listing Approval from Overseas Stock Exchange submit the required documents for Final In principle Listing Approval from Indian Stock Exchange.
21. After GDRs are listed the Lead Manager to instruct the Escrow Agent to transfer the Funds to the Company's Account.
22. The Company can either remit the entire funds or in part as per its discretion.
23. On obtaining the Final Approval from Indian Stock Exchanges admit the underlying shares to the depository *i.e.*, NSDL and CDSL.
24. Obtain Trading approval.
25. Intimate the Custodian for converting the physical shares into Demat form.
26. Within 30 days of the closing of the issue, details of the ADR/ GDR Issue along with the IM should be submitted to :
    (a) the Ministry of Finance.
    (b) the Registrar of Companies
    (c) SEBI
27. Return of Allotment in PAS-3 of Companies (Prospectus and Allotment of Securities) Rules, 2014 is to be filed with ROC within 30 days of Allotment.
28. Annexure 9 is to be filed with RBI, Central office within 30 days of closure of the ADR/ Issue.

REPORTING OF ADR/GDR ISSUES

The Indian company issuing ADRs / GDRs has to furnish to the Reserve Bank, full details of such issue in the Form as Annex 9 specified in Schedule I of Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, within 30 days from the date of closing of the issue. The company should also furnish a quarterly return in the Form Annex 10 as specified in Schedule I of the said regulation, to the Reserve Bank within 15 days of the close of the calendar quarter. The quarterly return has to be submitted till the entire amount raised through ADR/GDR mechanism is either repatriated to India or utilized abroad as per the extant Reserve Bank guidelines.

After completing the transaction, the Issuer would be required to furnish the following information to RBI:

- Details of the purpose for which the GDRs/ADRs have been raised. If funds are deployed for overseas investment, details thereof;
- Details about the Depository, Lead Manager, Sub-Mangers to the Issue, Indian Custodian;
- Details of the FIPB Approval or the relevant NIC Code in case of automatic route;
- Details of Authorized and Issued paid up capital before the issue and after the issue;
- In case of private placement, details of investors and ADRs/GDRs issued to each of them:
- Number of GDRs/ADRs issued
- Ratio of GDRs/ADRs to the underlying shares
- Details of Issue related expenses

– Details of listing arrangements

– Amount raised and the amount repatriated

Points to Remember

The GDR holders shall not have any voting rights until the conversion of the depository receipts into underlying shares. Untill the conversion of depository receipts, the overseas depository shall be entitled to vote on behalf of the holders of depository receipts.

FCCB AND ORDINARY SHARES (THROUGH DEPOSITORY RECEIPT MECHANISM) SCHEME, 1993

Indian companies can raise foreign currency resources abroad through the issue of ADRs/GDRs, in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India thereunder from time to time.

Eligibility

An issuing company desirous of raising funds by issuing Global Depository Receipts is required to obtain prior permission of the Department of Economic Affairs, Ministry of Finance, Government of India.

An Indian company, which is not eligible to raise funds from the Indian capital market, including a company which has been restrained from accessing the securities market by the SEBI, is not eligible to issue shares under this scheme.

Transfer and redemption

A non-resident holder of Global Depository Receipts may transfer those receipts, or may ask the Overseas Depository Bank to redeem those receipts. In the case of redemption, Overseas Depository Bank shall request the Domestic Custodian Bank to get the corresponding underlying shares released in favour of the non-resident investor, for being sold directly on behalf of the non-resident, or being transferred in the books of account of the issuing company in the name of the non-resident.

In case of redemption of the Global Depository Receipts into underlying shares, a request for the same is to be transmitted by the Overseas Depository Bank to the Domestic Custodian Bank of India, with a copy of the same being sent to the issuing company for its information and record. On redemption, the cost of acquisition of the shares underlying the Global Depository Receipts shall be reckoned as the cost on the date on which the Overseas Depository Bank advises the Domestic Custodian Bank for redemption. The price of the ordinary shares of the issuing company prevailing in the Bombay Stock Exchange or the National Stock Exchange on the date of the advice of redemption shall be taken as the cost of acquisition of the underlying ordinary shares.

LISTING OF GDR

In order to list equity securities on a stock exchange, or to maintain a listing once admitted to trading, an issuer must meet certain criteria. These requirements vary from exchange to exchange.

LONDON STOCK EXCHANGE

The London Stock Exchange (LSE) is one of the world's most prominent international equity markets with international companies representing more than 55 countries currently listed and traded.

The LSE has several different trading markets for negotiable equity instruments. GDRs can trade on three markets: the Main Market, the Professional Securities Market (known as the PSM) and, in certain circumstances, the Alternative Investment Market (known as AIM). Most GDRs have chosen to list on the Main Market, which is the most highly regulated of the three.

The UK financial markets are regulated by the Financial Services Authority (FSA), an independent non-governmental body. The FSA, often known amongst issuers as UKLA (UK Listing Authority), reviews and approves prospectuses and other documents required for the listing. The UKLA grants securities listed status on regulated markets. However, the LSE is responsible for admitting a security to the exchange to trade. When applying to the LSE for admission, the Company specifies the market on which it would like its GDRs to trade.

Different ways in which a company can list in London

When considering a capital raising and listing in London, companies have two choices:

(i) *Public offer:* GDRs are offered to institutional investors and are usually underwritten. A public offering is generally used by companies seeking to raise substantial amounts of capital or looking to raise their profile in the London market. This is the most expensive option.

(ii) *Placing:* A placing is usually a more selective process whereby GDRs are offered to a small number of institutions. While this route gives the Company more control over the distribution, it can restrict the shareholder base and inherently limit liquidity.

LISTING ON THE MAIN MARKET

Prior to starting the formal listing process, the Company will first spend time organizing itself thoroughly. Once the formal listing process begins, it usually takes not more than approximately 24 weeks. However, these timeframes are largely governed by the ability of the issuer and its advisors to prepare the required documents and complete the due diligence process.

Sponsor

The sponsor plays a pivotal role as an advisor, liaising with the Exchange and UK Listing Authority (UKLA) and coordinator and working with other advisers. The sponsor is normally an investment bank, corporate finance house, stockbroker or accountancy firm. The UKLA has a list of approved sponsors. It is important to note that this is a different role from that of a Depository Bank, which manages the DR program.

FSA's requirements for a company to receive listed status

Before starting work on the forms and documents, such as the prospectus, a company must be in compliance with, or willing to comply with, the following requirements:

1. Company's incorporation status

The Company must be validly incorporated and operating in conformity with its constitution besides complying with the following:

(i) Authorization and Validity of Shares

The shares which will underly the GDRs must:

(a) Conform with the law of the Company's place of incorporation,

(b) Be duly authorized in accordance with the Company's statutes, and

(c) Have any other necessary legal or corporate consents.

(ii) Transferability of the Underlying Shares

The shares underlying the GDRs must be freely transferable, fully paid and free from any restriction on transfer.

2. GDR requirements

In order to be able to validly list the GDRs, the FSA requires that the Company must be willing to ensure that the GDRs comply with the need for any legal or statutory consents as well as:

(i) **Free float requirement :** 25% of the GDRs (not total share capital) must be in public hands. The Company will need to notify that the FSA that this requirement has been met. Therefore, if at any time the Company becomes aware that it will not be able to comply with this rule, an additional conversation with the FSA should take place. This 25% should not include any investor taking more than 5%.

(ii) **Authorization of GDRs :** GDRs must:

(a) Conform with the law of the Depository's place of incorporation and

(b) Be duly authorized according to the requirements of the Depository's constitution.

(iii) **Admission to trading :** The GDRs must be admitted to trading on a Recognized Investment Exchange, such as the LSE for listed securities.

(iv) **Transferability :** To be listed, GDRs must be fully paid, freely transferable and free from any liens and restriction.

(v) **Market capitalization :** The expected aggregate market value of all GDRs to be listed must be at least £700,000 unless there are shares of the same class already listed on the LSE. **Please note**, the FSA may modify this rule to admit shares of a lower value if it is satisfied there will be an adequate market for the securities concerned.

(vi) **Whole class to be listed :** An application for listing of securities of any class must relate to all securities of that class, issued or proposed to be issued. If already listed, the application must relate to further securities of that class to be issued.

(vii) **No additional obligations to be imposed on the Depository by the GDRs:** The GDRs must not impose obligations on the Depository except to the extent necessary to protect the GDR holders' rights to and the transmission of entitlements of the Shares.

3. Continuing Obligations

The issuer must be willing to comply with ongoing continuing obligations and market reporting requirements.

3.1 Prospectus

A published prospectus is a condition necessary for admittance to the LSE. This prospectus must be approved by the relevant competent authority. The prospectus is the company's information and sales document, analyzed by market participants as they create opinions and decide whether to participate in the offering.

(i) *Information*

A GDR prospectus must include the necessary information that enables the investors to make an informed assessment of : (i) the assets and liabilities, financial position, profits and losses and prospects of the Company and, (ii) the rights attached to the GDRs. This information must take into account the particular nature of GDRs and the Company. The prospectus must be presented in a form which is comprehensible and easy to analyze.

(ii) *Accounting standard*

Companies should prepare their accounts in accordance with IFRS (International Financial Reporting Standards) or an equivalent standard.

(iii) *Financial information*

An operating and financial review, audited financial information for the last three financial years or such shorter period as the Company has been in operation. In the event the prospectus is issued more than nine months after the end of the last financial year, unaudited half yearly accounts will be included as well. The prospectus also requires details of any material contract.

(iv) *Risk summary*

Management will write a summary describing the Company that includes any risks associated with investing in the Company. The UKLA requires that the Company draft this in non-technical language that can be easily understood by the investors. When preparing the summary, the Company should be aware that this summary must use the same data as the rest of the prospectus, and it cannot be misleading or contradict what has been written in the rest of the document.

3.2 Block listing

The number of shares "listed" when the GDRs are admitted to the LSE is the maximum number that can be issued without approval and publication of another prospectus. Therefore, most issuers choose to list the maximum number of GDRs that can be created and traded on the LSE, which is likely to be greater than the number of GDRs issued at the time of the original listing. In some cases, this may be 100% of the share capital, while in others it might be 20% due to local restrictions on foreign ownership.

3.3 Documents required to be provided to the FSA

The FSA requires that it should receive the following documents, in their final form, by the mid day, two business days before the FSA is to consider the application:

(i) A completed Application for Admission of Securities to the Official List ;

(ii) One of the following:

(a) The prospectus or listing particulars that have been approved by the FSA; or,

(b) A copy of the prospectus, a certificate approval and (if applicable) a translation of the summary of the prospectus, if another EEA State is the home Member State for the securities; and

(c) Any approved supplementary prospectus or approved supplementary listing particulars, if applicable.

3.4 Documents to be provided on the day of the listing

A company must submit, in their final form, the following documents to the FSA before 9 am on the day the FSA is to consider the application:

(i) A copy of the resolution of the board authorizing the issue of the securities, or

(ii) Written confirmation from the applicant that the board has authorized the issue of the securities.

3.5 Documents to be provided after the listing

The following documents must be submitted in final form to the FSA as soon as practicable after the FSA has considered the application:

(i) A statement of the number of securities that were issued ; and

(ii) A completed Issuer's Declaration.

4. Continuing obligations on the Main Market

By listing on the Main Market, the Company is agreeing to abide by the ongoing obligations to the market and to the exchange. These include:

(i) Publishing an annual financial report within six months of its year end. The annual financial report must include audited financial statements, a management report and responsibility statements and must remain publicly available for at least five years.

(ii) Publishing an unaudited semi-annual financial report within four months of the end of the financial period.

(iii) Publication of price sensitive information. By keeping the market informed in a timely manner through press releases and other announcements, the Company allows all investors on all its markets to trade in a informed manner. Further, if the Company believes that its information has been leaked regarding a confidential or price sensitive corporate matter, it will be important to communicate with the market to remove uncertainty regarding the stock.

LISTING ON PROFESSIONAL SECURITY MARKET

The Professional Security Market (PSM) is part of the London Stock Exchange and is operated within the scope of its status as a Recognized Investment Exchange. This means that the same regulatory standards currently applied to its markets, in respect of on-going monitoring and enforcement, also apply to the PSM.

The Professional Security Market (PSM) was created in 2005 to enable those companies which are only interested in accessing the “wholesale” market to be able to do so without the regulatory requirements of the Main Market. The PSM is a more restricted access market, and as such, the FSA is able to exercise flexibility in the implementation of the Directives.

1. Requirement of prospectus

The prospectus required by the PSM does not require historical financial information in IFRS (International Financial Reporting Standards) or an EU approved equivalent standard, either in listing documents or as a continuing obligation requirement. This may be a cost saving incentive for many companies as re-stating or providing additional disclosure, as required by the Prospectus, could be very expensive. However, issuers may need to provide a description of the key differences between their local accounting standards and IFRS.

Issuers choosing the PSM will have their listing particulars approved by the UK Listing Authority and be admitted to listing, so a key requirement for investment by funds and institutional investors will have been met. Further, although IFRS does not apply, disclosure obligations for listed companies do apply to companies represented on the PSM. Therefore, important regulatory information, such as annual reports and on-going disclosure, needs to be readily available to investors.

2. Key eligibility criteria

Issuers wishing to list on the PSM must meet the following criteria:

(i) Minimum of 25% of shares in public hands ;

(ii) Latest three years of audited accounts (or such shorter period as the issuer has been operating) ;

(iii) Minimum GDR market capitalization of £700,000 ;

(iv) National GAAP may be used in the preparation of the prospectus.

3. Admission process

Admitting securities to the PSM is a two part process. The first part is to submit listing particulars to the UK Listing Authority (UKLA) for approval and admission to the Official List. Next, the Company applies to the LSE for admission of the DRs to trade on the PSM.

4. Trading

DRs admitted to the PSM are traded on the International Order Book.

5. Key continuing obligations

Issuers admitted to trading on the PSM must meet certain continuing obligations, including:

(i) Disclosing inside information to the market as soon as possible ;

(ii) Publishing an annual report and accounts within six months of the year end ;

(iii) Preparing and maintaining a list of people considered insiders.

LISTING ON AIM

AIM is the London Stock Exchange's international market for smaller growing companies. AIM was designed to be a highly flexible public market. As such, it offers many unique attributes to both companies and investors.

With respect to listing GDRs on AIM, the LSE has stated that a listing of GDRs would only be appropriate if the relevant company is incorporated in a jurisdiction which prohibits or unduly restricts the offering or trading of its underlying securities outside that country.

1. Admissions criteria

(i) The main requirement is that a company coming to AIM must have a Nominated Adviser (Nomad) at all times

(ii) No minimum size of company

(iii) No minimum proportion of shares to be in public hands

(iv) No trading record requirement

(v) No prior shareholder approval for the majority of transactions

(vi) No requirement to be incorporated in the UK.

2. Nominated Advisers (Nomads)

All Nomads are approved by the London Stock Exchange. To be authorized to act as Nomads, these investment banks, corporate finance firms or brokers must demonstrate that they have the experience and ability to assess whether a company is suitable and ready for admission to AIM and to act as that company's formal 'mentor' once it has been admitted to the market.

The Nomad will:

(i) Undertake extensive due diligence to ensure the Company is suitable for AIM ;

(ii) Guide the Company through the flotation process ;

(iii) Administer the admission documents and financial statements ;

(iv) Act as the Company's 'referee' throughout its time on AIM ;

Along with company directors, a Nomad is responsible for ensuring that the business adheres correctly to AIM's rules and regulations. Its role also includes keeping the Company abreast of AIM Notices and rule revisions and making sure that the Company honors the continuing obligations of being a public company once the Company is trading.

3. Admission process

The Company must announce its intention to float on the market via the Exchange at least 10 business days before the start of trading of the shares (or 20 business days where they are joining from a designated market).

The application form signed by the applicant company and the admission document signed by the Nomad must then be submitted at least three business days before the Company's admission to trading. Unlike the other exchanges, there is no pre-vetting of documents by the exchange.

4. Key continuing obligations

Issuers admitted to trading on the AIM must meet certain continuing obligations (with all documents produced in English or with English translations), including:

(i) Disclosing inside information to the market as soon as possible

(ii) Annual report and accounts must be published within six months of the year end and prepared in accordance with US or UK GAAP or with International Accounting Standards (IAS) ; and

(iii) Issuers are required to prepare and maintain a list of people considered insiders.

LUXEMBOURG STOCK EXCHANGE

Like London Stock Exchange, Luxembourg Stock Exchange offers issuers a choice of venue: either the Luxembourg Stock Exchange Main Market or the Euro Multilateral Trading Facility Market known as Euro MTF. The listing requirements for the Main Market are very similar to the London Stock Exchange while the Euro MTF is more akin to the PSM.

1. Listing requirements

Most of the listing and prospectus requirements are similar to the other main exchanges with access to the general public:

(i) Minimum public free float of 25%

(ii) Minimum market value of at least €1,000,000

(iii) Three years operating history

2. Continuing obligations

The full list of continuing obligations are contained in the Rules and Regulations of the Luxembourg Stock Exchange and include:

(i) Inside information, corporate actions and significant transactions disclosed as soon as possible.

(ii) Annual report and accounts published as soon as possible. The EU Transparency Directive requires four months.

(iii) Half yearly reports must be published as soon as possible. The Transparency Directive requires two months.

LISTING OF ADR

Many public offerings by non-U.S. companies are in the form of depositary receipts, usually as American Depositary

Receipts (ADRs). Non-US companies seeking to raise capital in the US do not necessarily have to become registered with the SEC. An exemption called Rule 144A entitles a company to offer securities for sale or resale to certain institutional investors without requiring registration of the offer or sale with the SEC. As a result, companies can raise capital in the US without having to meet the ongoing reporting requirements associated with a SEC registration. Financing objectives, costs and timing are among the many factors that need to be considered in deciding whether to initiate a public or private offering. A public issue allows a company to establish a wider trading market for its securities, as well as broader exposure to the business and investing public than is possible in a private offering. The advantages of a private issue include potentially lower costs of preparing the offer document and faster processing. Companies commonly use private offerings as an interim step to going public. Such private offerings may come with registration rights to enhance post closing liquidity of the securities sold in the offering. Registration rights are rights given to investors to sell or register with SEC unregistered shares.

There are a number of stock exchanges in the US, but the majority of foreign and domestic companies want to be traded on the New York Stock Exchange ("NYSE") or the National Association of Securities Dealers Automated Quotations ("NASDAQ"). Each exchange has minimum entry listing requirements, including profit history, shareholders' equity, size of market capitalization, number of expected shareholders and corporate governance as discussed below.

NASDAQ

There are three distinct markets within NASDAQ: the NASDAQ Global Market (NGM), the newly created NASDAQ Global Select Market (NGSM) and the NASDAQ Capital Market (NCM). The NGSM mandates the highest initial listing requirements of any market in the world, while its maintenance requirements are identical to those of the NGM. The NGM, in turn, has more stringent quantitative listing and maintenance requirements than does the NCM. The quantitative listing and maintenance criteria applicable to non-Canadian foreign private issuers for the NGM, NGSM and NCM are identical to those of US domestic and Canadian issuers. Foreign Private Issuers (FPI) (including Canadian issuers) may, however, elect to follow home country practice in lieu of compliance with the NASDAQ corporate governance requirements.

THE NASDAQ GLOBAL SELECT MARKET (NGSM)

NGSM Quantitative Listing and Maintenance Standards

1. Quantitative Initial Listing Standards

An issuer that satisfies all of the requirements for listing on the NGM will be eligible for listing on the NGSM if it meets the additional liquidity and financial requirements described below. Each October, NASDAQ will review the qualifications of all securities listed on the NGM to determine if any security meets the initial listing requirements of the NGSM. Securities meeting the requirements of the NGSM at such time will be transferred to the NGSM in January of the following year. In addition, an issuer of a security listed on either the NGM or NCM may, at any time, apply to transfer the respective security to the NGSM.

(a) Liquidity Requirements

The security must demonstrate either:

– a minimum of 550 beneficial shareholders and an average monthly trading volume during the prior 12 months of at least 1.1 million shares per month; or a minimum of 2,200 beneficial shareholders; or

– a minimum of 450 beneficial shareholders where the issuer lists in connection with a court-approved reorganization under the federal bankruptcy laws or comparable foreign laws, or where the issuer is an affiliate of another company listed on the NGSM.

  - In computing each of the above, the number of beneficial shareholders excludes shares held by an officer, director or 10 percent shareholder of the issuer.

- The security must have 1.25 million publicly held shares; and
- The publicly held shares must have either:
  (a) a market value of at least $110 million; or
  (b) a market value of at least $100 million so long as the issuer has stockholders' equity of at least $110 million; or
  (c) a market value of at least $70 million where the issuer is listing in connection with an initial public offering or where the issuer is an affiliate of, or a spin-off from, another company listed on the NGSM.

(b) Financial Requirements

The issuer must meet one of the following financial standards:

Standard 1:

- aggregate income from continuing operations before income taxes of at least $11 million over the prior three fiscal years; and
- positive income from continuing operations before income taxes in each of the prior three fiscal years; and
- at least $2.2 million in income from continuing operations before income taxes in each of the two most recent fiscal years.

Standard 2

- aggregate cash flows of at least $27.5 million over the prior three fiscal years; and
- positive cash flows in each of the prior three fiscal years; and
- both average market capitalization of at least $550 million over the prior 12 months and total revenue of at least $110 million in the previous fiscal year.

Standard 3

- average market capitalization of at least $850 million over the prior 12 months; and
- total revenue of at least $90 million in the previous fiscal year.
- In addition, other than an issuer listed on the NGM that transfers its listing to the NGSM, the issuer shall have a minimum bid price for the security of $5 per share.

2. Quantitative Maintenance Requirements

Once an issuer has been listed on the NGSM, it is subject to the same maintenance standards as issuers listed on the NGM, as described below.

An issuer, whether a domestic issuer or Foreign Private Issuer (FPI), must generally meet all the criteria under atleast one of the four financial standards and the liquidity requirements stated below:

Financial and Qualitative Requirements	Standard 1	Standard 2	Standard 3	Standard 4
Minimum total revenue in - the previous fiscal year		US$ 110 million	US$ 90 million	
Minimum average market - capitalization at the time of listing		US$ 550 million	US$ 850 million	US$ 160 million
Bid price	US$ 4	US$ 4	US$ 4	US$ 4
Market makers	3 or 4	3 or 4	3 or 4	3 or 4
Corporate governance	Yes	Yes	Yes	Yes
Other	Minimum income from continuing operations before income taxes of: • US$ 11 million over the prior three fiscal years in aggregate and • US$ 2.2 million in each of the two most recent fiscal years Positive income from continuing operations before income tax in each of the prior three fiscal years	Minimum cash flows of: • US$ 27.5 million over the prior three fiscal years in aggregate • Positive cash flows in each of the prior three fiscal years		US$ 80 million of total assets and US$ 55 million of stockholders equity in the most recent publicly reported financial statements
Liquidity Requirement for New Company Listings (IPOs)				
Round lot shareholders or total shareholders	450 or 2,200	450 or 2,200	450 or 2,200	450 or 2,200
Publicly held shares	1.25 million	1.25 million	1.25 million	1.25 million
Market value of publicly held shares	US$ 45 million	US$ 45 million	US$ 45 million	US$ 45 million

THE NASDAQ CAPITAL MARKET (NCM)

NCM Quantitative Listing and Maintenance Standards

1. Quantitative Initial Listing Standards

For initial listing on NCM, an issuer must have:

– either: stockholders' equity of at least $5 million, a market value of publicly held shares of at least $15 million and an operating history of at least two-years; or

– stockholders' equity of at least $4 million, a market value of listed securities (i.e., securities listed on NASDAQ or another national securities exchange) of at least $50 million and a market value of publicly held shares of at least $15 million; or

– income from continuing operations of at least $750,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years and a market value of publicly held shares of at least $5 million;

– at least 300 round lot shareholders;

– at least 1 million publicly held shares;

– a minimum bid price of $4 per share;

– at least three registered and active market makers;

– in the case of ADRs, at least 400,000 issued.

2. Maintenance Requirements

For continued listing on NCM, an issuer must maintain:

– either (i) stockholders' equity of at least $2.5 million, (ii) a market value of listed securities of at least $35 million or (iii) net income from continuing operations of at least $500,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years;

– at least 300 round lot shareholders;

– at least 500,000 publicly held shares;

– a market value of publicly held shares of at least $1 million;

– a minimum bid price of $1 per share; and

– at least three registered and active market makers.

As is the case for securities listed on the NGM, a failure to meet the continued listing requirements will be determined to exist only if the deficiency continues for a period of either 10 or 30 consecutive business days (depending on the requirement with respect to which there is a deficiency)125 and in each case an issuer will have a period after notification by NASDAQ of the failure in which to achieve compliance with the applicable requirement.

An issuer, whether a domestic issuer or FPI, must meet all the criteria under at least one of the following financial standards

Requirements	**Net Income Standard**	**Equity Standard**	**Market Value of Listed Securities Standard**
Stockholders' equity	US$ 4 million	US$ 5 million	US$ 4 million
Bid price	US$ 4	US$ 4	US$ 4
Market makers	3	3	3
Corporate governance	Yes	Yes	Yes
Total shareholders (round lot shareholders)	300	300	300
Publicly held shares	1 million	1 million	1 million
Market value of publicly held shares	US$ 5 million	US$ 15 million	US$ 15 million
Other	US$ 0.75 millon of net income from continuing operations in latest fiscal year or in two of last three fiscal years at least	2 years of operating history	US$ 50 million of market value of listed securities

THE NASDAQ GLOBAL MARKET (NGM)

NGM Quantitative Listing and Maintenance Standards

1. Quantitative Initial Listing Standards

An issuer, whether a US domestic issuer or a foreign private issuer, generally must meet the following standards to be listed on the NGM.

(a) Entry Standard 1

An issuer must have:

- annual pre-tax income from continuing operations of at least $1 million in the most recently completed fiscal year or in two of the last three most recently completed fiscal years;
- at least 1.1 million publicly held shares;
- market value of publicly held shares (i.e., excluding shares held by directors, officers and 10 percent shareholders) of at least $8 million;
- bid price per share of $5 or more;
- stockholders' equity of at least $15 million;
- at least 400 round lot shareholders (i.e., a holder of a normal unit of trading); and
- at least three registered and active market makers with respect to the security.

(b) Entry Standard 2

An issuer must have:

- stockholders' equity of at least $30 million;
- at least 1.1 million publicly held shares;
- market value of publicly held shares of at least $18 million;
- bid price per share of $5 or more;
- at least three registered and active market makers with respect to the security;
- a two-year operating history; and
- at least 400 round lot shareholders.

(c) Entry Standard 3

An issuer must have:

- at least 1.1 million publicly held shares;
- market value of publicly held shares of at least $20 million;
- a bid price per share of $5 or more;
- at least four registered and active market makers with respect to the security;
- at least 400 round lot shareholders; and

- either a market capitalization of $75 million or total assets and total revenue of $75 million each for the most recently completed fiscal year or two of the last three most recently completed fiscal years.

2. Quantitative Maintenance Requirements

Once an issuer has been listed on the NGM, it must continue to satisfy one of the following maintenance standards.

(a) Maintenance Standard 1

An issuer must maintain:

- at least 750,000 publicly held shares;
- market value of publicly held shares of at least $5 million;
- stockholders' equity of at least $10 million;
- at least 400 round lot shareholders;
- a bid price per share of $1 or more; and
- at least two registered and active market makers with respect to the security.

(b) Maintenance Standard 2

An issuer must maintain:

- at least 1.1 million publicly held shares;
- market value of publicly held shares of at least $15 million;
- a bid price per share of $1 or more;
- at least 400 round lot shareholders;
- at least four registered and active market makers with respect to the security;and
- either a market value of listed securities of $50 million or total assets and total revenue of $50 million each for the most recently completed fiscal year or two of the last three most recently completed fiscal years.

(c) Failure to Meet Maintenance Requirements

A failure to meet the maintenance requirements will be determined to exist only if the deficiency continues for a period of either 10 or 30 consecutive business days (depending on the requirement with respect to which there is a deficiency), and an issuer will have a period after notification by NASDAQ of the failure in which to achieve compliance with the applicable requirement.

An issuer, whether a domestic issuer or FPI, must meet all the criteria under at least one of the following financial standards:

Requirements	Income Standard	Equity Standard	Market Value Standard	Total Assets/Total Revenue
Stockholders' equity	US$ 15 million	US$ 30 million	–	–
Bid price	US$ 4	US$ 4	US$ 4	US$ 4
Market makers	3	3	4	4
Corporate governance	Yes	Yes	Yes	Yes
Total shareholders (round lot shareholders)	400	400	400	400
Publicly held shares	1.1 million	1.1 million	1.1 million	1.1 million
Market value of publicly held shares	US$ 8 million	US$ 18 million	US$ 18 million	US$ 18 million
Other	US$ 1 millon of income continuing operations before income taxes in lates fiscal year or in two of last three fiscal years	2 years of operating history	US$ 75 million of market value of listed securities	US$ 75 million of total assets and US$ 75 million of total revenue in latest fiscal year or in two of last three fiscal years

NEWYORK STOCK EXCHANGE (NYSE)

The NYSE's requirements for initial listing and listing maintenance are set forth below. The foreign private issuers may satisfy either the general NYSE listing standards applicable to US domestic issuers or the NYSE's Alternate Listing Standards for foreign private issuers, which are specifically designed for Foreign Private Issuers (FPI) with a broad, liquid market for their securities in their country of origin.

A. NYSE Quantitative Listing and Maintenance Standards

1. Quantitative Initial Listing Standards

Under the NYSE's initial listing standards, an issuer typically must meet the following minimum distribution and market value criteria and must meet one of the two financial standards described below.

(a) Minimum Distribution and Market Value Criteria (must satisfy each of the following requirements)

Minimum Distribution Requirements:

(i) IPOs: An IPO issuer must have 400 holders of 100 shares or more and 1.1 million publicly held shares.

(ii) Transfer or Quotation: An issuer seeking to transfer to the NYSE or list its existing securities must have either:

  (a) 400 holders of 100 shares or more and 1.1 million publicly held shares; or

  (b) 2,200 total stockholders, an average monthly trading volume of 100,000 shares for the most recent six months and 1.1 million publicly held shares; or

  (c) 500 total stockholders, an average monthly trading volume of 1 million shares for the most recent 12 months and 1.1 million publicly held shares.

Market Value of Publicly Held Shares:

– The aggregate market value of publicly held shares must be at least $60 million for IPO issuers or $100 million for issuers seeking to transfer to the NYSE or list their existing securities.

(b) Financial Standards (must satisfy one of the following requirements)

Earnings Test:

(i) An issuer's pre-tax earnings (from continuing operations and after minority interest, amortization and equity in the earnings or losses of investees, subject to certain adjustments) must total:

(ii) at least $10 million in the aggregate for the last three fiscal years including a minimum of $2 million in each of the two most recent fiscal years and positive amounts in all three years; or

(iii) at least $12 million in the aggregate for the last three fiscal years including a minimum of $5 million in the most recent fiscal year and $2 million in the next most recent fiscal year; or

Valuation/Revenue Test:

An issuer must have:

(i) Valuation/Revenue with Cash Flow Test: At least $500 million in global market capitalization, at least $100 million in revenues during the most recent 12-month period, and at least $25 million aggregate cash flows for the last three fiscal years and with positive cash flows in all three fiscal years (subject to certain adjustments); or

(ii) Pure Valuation/Revenue Test: At least $750 million in global market capitalization, and at least $75 million in revenues during the most recent fiscal year.

2. Initial Alternate Listing Standards for Foreign Private Issuers

Under the NYSE's initial Alternate Listing Standards, a foreign private issuer typically must meet the following minimum distribution and market value criteria and must meet one of the two financial standards described below.

(a) Minimum Distribution and Market Value Criteria (must satisfy each of the following requirements)

– *Minimum Distribution Requirements*

A foreign private issuer must have 5,000 worldwide holders of 100 shares or more; and 2.5 million shares held publicly worldwide.

– *Market Value of Publicly Held Shares*

The aggregate worldwide market value of publicly held shares of the foreign private issuer must be at least $100 million.

(b) Financial Standards (must satisfy one of the following requirements)

– *Earnings Test:*

The pre-tax earnings (from continuing operations and after minority interest, amortization and equity in the earnings or losses of investees, subject to certain adjustments) of the foreign private issuer must be at least $100 million in the aggregate for the last three fiscal years, including a minimum of $25 million in each of the most recent two fiscal years; or

– *Valuation/Revenue Test*

A foreign private issuer must have

(i) *Valuation/Revenue with Cash Flow Test*

At least $500 million in global market capitalization, at least $100 million in revenues during the most recent 12-month period, and $100 million in the aggregate cash flows for the last three fiscal years including $25 million in each of the two most recent fiscal years (subject to certain adjustments); or

(ii) *Pure Valuation/Revenue Test*

At least $750 million in global market capitalization and $75 million in revenues during the most recent fiscal year.

3. Quantitative Maintenance Requirements

In order to maintain its listing on the NYSE, a US domestic issuer or a foreign private issuer must meet certain quantitative maintenance standards which are summarized below:

(a) Minimum Distribution and Financial Standards

Minimum Distribution Requirements:

The NYSE may promptly initiate suspension and delisting procedures against an issuer if:

(i) the total number of stockholders is less than 400;

(ii) the total number of stockholders is less than 1,200 and the average monthly trading volume for the most recent 12 months is less than 100,000 shares; or

(iii) the number of publicly held shares is less than 600,000.

Minimum Financial Standards:

The NYSE will consider an issuer to be below compliance (and thus eligible for suspension and delisting) if:

(i) an issuer qualified to list under the Earnings Test, and its average global market capitalization over a consecutive 30 trading-day period is less than $75 million and, at the same time, total stockholders' equity is less than $75 million;

(ii) an issuer qualified to list under the Valuation/Revenue with Cash Flow Test and:

- average global market capitalization over a consecutive 30 trading-day period is less than $250 million and, at the same time, total revenues are less than $20 million over the last 12 months (unless the issuer qualifies as an original listing under one of the other original listing standards); or
- average global market capitalization over a consecutive 30 trading–day period is less than $75 million; and
- an issuer qualified to list under the Pure Valuation/Revenue Test and:
- its average global market capitalization over a consecutive 30 trading-day period is less than $375 million and, at the same time, its total revenues are less than $15 million over the last 12 months (unless the issuer qualifies as an original listing under one of the other original listing standards); or
- its average global market capitalization over a consecutive 30 trading–day period is less than $100 million.

(b) Other Maintenance Requirements

The NYSE may in its sole discretion subject an issuer to suspension and delisting on a number of additional grounds, including:

- a substantial reduction in operating assets and/or scope of operations;
- the failure of an issuer to make timely, adequate and accurate disclosures of information to its shareholders and the investing public; and
- the failure to observe good accounting practices in reporting of earnings and financial position.

An issuer, whether a domestic issuer or FPI, must meet minimum distribution and market value criteria and one of the following financial standards:

	NYSE quantitative listing standards applicable to Domestic Issuers and Foreign Private Issuers'	**NYSE Alternate Listing Standards for Foreign Private Issuers**
Minimum distribution and market value criteria:		
Number of holders of 100 shares or more or of a unit of trading if less than 100 shares	400	5,000 worldwide
Number of publicly held shares	1.1 million	2.5 million worldwide
Aggregate market value of publicly held shares	US$ 40 million	US$ 100 million worldwide
Price at the time of listing	US$ 4	US$ 4
Financial standards (must satisfy one of the following requirements):		
Earnings Test: Income before tax from continuing operations and after minority interest, amortization and equity in the earnings or losses of investees (subject to certain adjustments) must total at least	US $10 million in the aggregate for the last three fiscal years, together with a minimum of US $2 million in each of the two most recent fiscal years, and positive amounts in all three years OR	US $100 million in the aggregate for the last three fiscal years, together with a minimum of US $25 million in each of the two most recent fiscal years
	US$ 12 million in the aggregate for the three fiscal years, together with a minimum last of US$ 5 million in the most recent fiscal year and US$ 2 million in the next most recent fiscal year	
OR		
Valuation/Revenue Test:		
Valuation/Revenue with Cash Flow Test Issuer must have at least	1) US$ 500 million in global market capitalization,	1) US$ 500 million in global market capitalization,
	2) US$ 100 million in revenues during the most recent 12 month period, and	2) US$ 100 million in revenues during the most recent 12 month period, and
	3) US$ 25 million in aggregate cash flows for the last three fiscal years with positive amounts in all three years (subject to certain adjustments)	3) US$ 100 million in aggregate cash flows for the last three fiscal years, where each of the two most recent years is reported at a minimum of US$ 25 million (subject to certain adjustments)
Pure Valuation./Revenue Test Issuer must have at least	1) US$ 750 million in global market capitalization, and 2) US$ 75 million in revenues during the most recent fiscal year	
OR		
Assets and Equity Test		
Issuer must have at least	1) US$ 150 million in global market capitalization, 2) US$ 75 million in total assets together with at least US$ 50 million in stockholders' equity (in each case subject to certain adjustments)	
Corporate governance	Yes	Yes

RESOURCE MOBILISATION IN INTERNATIONAL CAPITAL MARKET

(A) EXTERNAL COMMERCIAL BORROWINGS (ECB).- ECBs are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc. The parameters apply in totality and not on a standalone basis. The framework for raising loans through ECB comprises the following three tracks:

- ***Track I:*** Medium term foreign currency denominated ECB with minimum average maturity of 3/5 years.
- ***Track II:*** Long term foreign currency denominated ECB with minimum average maturity of 10 years.
- ***Track III:*** Indian Rupee (INR) denominated ECB with minimum average maturity of 3/5 years.

FORMS OF ECB.- The ECB Framework enables permitted resident entities to borrow from recognized non-resident entities in the following forms:

- Loans including bank loans;
- Securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares/debentures);
- Buyers' credit;
- Suppliers' credit;
- Foreign Currency Convertible Bonds (FCCBs);
- Financial Lease; and
- Foreign Currency Exchangeable Bonds (FCEBs)

AVAILABLE ROUTES FOR RAISING ECB.- Under the ECB framework, ECBs can be raised either under the automatic route or under the approval route. For the automatic route, the cases are examined by the Authorised Dealer Category-I (AD Category-I) banks. Under the approval route, the prospective borrowers are required to send their requests to the RBI through their ADs for examination.

While the regulatory provisions are mostly similar, there are some differences in the form of amount of borrowing, eligibility of borrowers, permissible end-uses, etc. under the two routes. While the first six forms of borrowing, mentioned above, can be raised both under the automatic and approval routes, FCEBs can be issued only under the approval route.

PARAMETERS FOR ECBs.- Various parameters of raising loan under ECB framework are mentioned in the following sub-paragraphs.

1. Minimum Average Maturity Period: The minimum average maturities for the three tracks are set out as under:

Track I	Track II	Track III
(i) 3 years for ECB up to USD 50 million or its equivalent. (ii) 5 years for ECB beyond USD 50 million or its equivalent. (iii) 35 years for eligible borrowers under para 2.4.2.vi, irrespective of the amount of borrowing. (iv) 5 years for Foreign Currency Convertible Bonds (FCCBs)/ Foreign Currency	10 years irrespective of the amount.	Same as under Track I.

Exchangeable Bonds (FCEBs) irrespective of the amount of borrowing. (v) 5 years for Foreign Currency Convertible Bonds (FCCBs)/ Foreign Currency Exchangeable Bonds (FCEBs) irrespective of the amount of borrowing. The call and put option, if any, for FCCBs shall not be exercisable prior to 5 years.		

2. Eligible Borrowers: The list of entities eligible to raise ECB under the three tracks is set out in the following table:

Track I	Track II	Track III
(i) Companies in manufacturing and software development sectors. (ii) Shipping and airlines companies. (iii) Small Industries Development Bank of India (SIDBI). (iv) Units in Special Economic Zones (SEZs) (v) Export Import Bank of India (Exim Bank) (only under the approval route). (vi) Companies in infrastructure sector, Non-Banking Financial Companies -Infrastructure Finance Companies (NBFC-IFCs), NBFCs-Asset Finance Companies (NBFC-AFCs), Holding Companies and Core Investment Companies (CICs).	(i) All entities listed under Track I. (ii) Companies in infrastructure sector, (iii) Holding companies. (iv) Core Investment Companies (CICs). (v) Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (INVITs) coming under the regulatory framework of SEBI.	(i) All entities listed under Track II. (ii) All Non-Banking Financial Companies (NBFCs) coming under the regulatory purview of the Reserve Bank. (iii) NBFCs-Micro Finance Institutions (NBFCs-MFIs), Not for Profit companies registered under the Companies Act,1956/ 2013, Societies, trusts and cooperatives (registered under the Societies Registration Act, 1860, Indian Trust Act, 1882 and State-level Cooperative Acts/ Multi-level Cooperative Act/ State-level mutually aided Cooperative Acts respectively), Non-Government Organisations (NGOs) which are engaged in micro finance activities. (iv) Companies engaged in miscellaneous services viz. research and development (R&D), training (other than educational institutes), companies supporting infrastructure, companies providing logistics services. (v) Developers of Special Economic Zones (SEZs)/ National Manufacturing and Investment Zones (NMIZs).

Note: *Entities engaged in micro-finance activities to be eligible to raise ECB: (i) should have a satisfactory borrowing relationship for at least three years with an AD Category I bank in India, and (ii) should have a certificate of due diligence on 'fit and proper' status from the AD Category I bank.*

3. *Recognised Lenders/Investors:* The list of recognized lenders / investors for the three tracks will be as follows:

Track I	Track II	Track III
i. International banks. ii. International capital markets. iii. Multilateral financial institutions (such as, IFC, ADB, etc.) / regional financial institutions and Government owned (either wholly or partially) financial institutions. iv. Export credit agencies. v. Suppliers of equipment. vi. Foreign equity holders. vii. Overseas long term investors such as: a. Prudentially regulated financial entities; b. Pension funds; c. Insurance companies; d. Sovereign Wealth Funds; e. Financial institutions located in International Financial Services Centres in India; viii. Overseas branches / subsidiaries of Indian banks	All entities listed under Track I but for overseas branches / subsidiaries of Indian banks.	All entities listed under Track I but for overseas branches / subsidiaries of Indian banks. In case of NBFCs-MFIs, other eligible MFIs, not for profit companies and NGOs, ECB can also be availed from overseas organisations and individuals.

Notes:

1. Overseas branches / subsidiaries of Indian banks can be lenders only under Track I. Further, their participation under this track is subject to the prudential norms issued by the Department of Banking Regulation, RBI. Indian banks are not permitted to participate in refinancing of existing ECBs.
2. Overseas Organizations proposing to lend ECB would have to furnish to the authorised dealer bank of the borrower a certificate of due diligence from an overseas bank, which, in turn, is subject to regulation of host-country regulators and such host country adheres to the Financial Action Task Force (FATF) guidelines on anti-money laundering (AML)/ combating the financing of terrorism (CFT). The certificate of due diligence should comprise the following: (i) that the lender maintains an account with the bank at least for a period of two years, (ii) that the lending entity is organised as per the local laws and held in good esteem by the business/local community, and (iii) that there is no criminal action pending against it.
3. Individual lender has to obtain a certificate of due diligence from an overseas bank indicating that the lender maintains an account with the bank for at least a period of two years. Other evidence /documents such as audited statement of account and income tax return, which the overseas lender may furnish, need to be certified and forwarded by the overseas bank. Individual lenders from countries which do not adhere to FATF guidelines on AML / CFT are not eligible to extend ECB.

4. ***All-in-Cost (AIC):*** The all-in-cost requirements for the three tracks will be as under:

Track I	Track II	Track III
i. The all-in-cost ceiling is prescribed through a spread over the benchmark as under: • For ECB with minimum average maturity period of 3 to 5 years - 300 basis points per annum over 6 month LIBOR or applicable bench mark for the respective currency. • For ECB with average maturity period of more than 5 years – 450 basis points per annum over 6 month LIBOR or applicable bench mark for the respective currency. ii. Penal interest, if any, for default or breach of covenants should not be more than 2 per cent over and above the contracted rate of interest.	i. The maximum spread over the benchmark will be 500 basis points per annum. ii. Remaining conditions will be as given under Track I.	The all-in-cost should be in line with the market conditions.

5. End-use prescriptions: The end-use prescriptions for ECB raised under the three tracks are given in the following table:

Track I	Track II	Track III
(i) ECB proceeds can be utilised for capital expenditure in the form of: • Import of capital goods including payment towards import of services, technical know-how and license fees, provided the same are part of these capital goods; • Local sourcing of capital goods; • New project; • Modernization /expansion of existing units; • Overseas direct investment in Joint ventures (JV)/ Wholly owned subsidiaries (WOS); • Acquisition of shares of public sector undertakings at any stage of disinvestment under the disinvestment programme	(i) The ECB proceeds can be used for all purposes excluding the following: • Real estate activities; • Investing in capital market; • Using the proceeds for equity investment domestically; • On-lending to other entities with any of the above objectives; • Purchase of land (ii) Holding companies can also use ECB proceeds for providing loans to their infrastructure SPVs.	(i) NBFCs can use ECB proceeds only for: • On-lending for any activities, including infrastructure sector as permitted by the concerned regulatory department of RBI; • providing hypothecated loans to domestic entities for acquisition of capital goods/equipment; and • providing capital goods/ equipment to domestic entities by way of lease and hire-purchases (ii) Developers of SEZs/ NMIZs can raise ECB only for providing infrastructure facilities within SEZ/ NMIZ. (iii) NBFCs-MFI, other eligible MFIs, NGOs and not for profit companies registered under the Companies Act, 1956/ 2013 can raise ECB only for

of the Government of India; • Refinancing of existing trade credit raised for import of capital goods; • Payment of capital goods already shipped / imported but unpaid; • Refinancing of existing ECB provided the residual maturity is not reduced. (ii) SIDBI can raise ECB only for the purpose of on-lending to the borrowers in the Micro, Small and Medium Enterprises (MSME sector), where MSME sector is as defined under the MSME Development Act, 2006, as amended from time to time. (iii) Units of SEZs can raise ECB only for their own requirements. (iv) Shipping and airlines companies can raise ECB only for import of vessels and aircrafts respectively. (v) ECB proceeds can be used for general corporate purpose (including working capital) provided the ECB is raised from the direct / indirect equity holder or from a group company for a minimum average maturity of 5 years. (vi) NBFC-IFCs and NBFCs-AFCs can raise ECB only for financing infrastructure. (vii) Holding Companies and CICs shall use ECB proceeds only for on-lending to infrastructure Special Purpose Vehicles (SPVs). (viii) ECBs for the following purposes will be considered only under the approval route: • Import of second hand goods as per the Director General of Foreign Trade (DGFT) guidelines; • On-lending by Exim Bank.		on-lending to self-help groups or for micro-credit or for *bona fide* micro finance activity including capacity building. (iv) For other eligible entities under this track, the ECB proceeds can be used for all purposes excluding the following: i. Real estate activities ii. Investing in capital market iii. Using the proceeds for equity investment domestically; iv. On-lending to other entities with any of the above objectives; v. Purchase of land

6. Individual Limits: The individual limits refer to the amount of ECB which can be raised in a financial year under the *automatic route*.

(i) The individual limits of ECB that can be raised by eligible entities under the automatic route per financial year for all the three tracks are set out as under:

- Up to USD 750 million or equivalent for the companies in infrastructure and manufacturing sectors, Non-Banking Financial Companies -Infrastructure Finance Companies (NBFC-IFCs), NBFCs-Asset Finance Companies (NBFC-AFCs), Holding Companies and Core Investment Companies;
- Up to USD 200 million or equivalent for companies in software development sector;
- Up to USD 100 million or equivalent for entities engaged in micro finance activities; and
- Up to 500 million or equivalent for remaining entities.

(ii) ECB proposals beyond aforesaid limits will come under the approval route. For computation of individual limits under Track III, exchange rate prevailing on the date of agreement should be taken into account.

(i) In case the ECB is raised from direct equity holder, aforesaid individual ECB limits will also subject to ECB liability: equity ratio requirement. For ECB raised under the automatic route, the ECB liability of the borrower (including all outstanding ECBs and the proposed one) towards the foreign equity holder should not be more than four times of the equity contributed by the latter. For ECB raised under the approval route, this ratio should not be more than 7:1. This ratio will not be applicable if total of all ECBs raised by an entity is up to USD 5 million or equivalent.

***Notes:** For the purpose of ECB liability: equity ratio, the paid-up capital, free reserves (including the share premium received in foreign currency) as per the latest audited balance sheet can be reckoned for calculating the 'equity' of the foreign equity holder. Where there are more than one foreign equity holders in the borrowing company, the portion of the share premium in foreign currency brought in by the lender(s) concerned shall only be considered for calculating the ratio.*

7. Currency of Borrowing: ECB can be raised in any freely convertible foreign currency as well as in Indian Rupees. Further details are given below:

(i) In case of Rupee denominated ECB, the non-resident lender, other than foreign equity holders, should mobilize Indian Rupees through swaps/outright sale undertaken through an AD Category I bank in India.

(ii) Change of currency of ECB from one convertible foreign currency to any other convertible foreign currency as well as to INR is freely permitted. Change of currency from INR to any foreign currency is, however, not permitted.

(iii) Change of currency of ECB into INR can be at the exchange rate prevailing on the date of the agreement between the parties concerned for such change or at an exchange rate which is less than the rate prevailing on the date of agreement if consented to by the ECB lender.

8. Hedging Requirements.- Borrowers eligible in terms of paragraph 2.4.2.vi above shall have a board approved risk management policy and shall keep their ECB exposure hedged 100 per cent at all times. Further, the designated AD Category-I bank shall verify that 100 per cent hedging requirement is complied with during the currency of ECB and report the position to RBI through ECB 2 returns. Also, the entities raising ECB under the provisions of tracks I and II are required to follow the guidelines for hedging issued, if any, by the concerned sectoral or prudential regulator in respect of foreign currency exposure.

9. Security for raising ECB: AD Category I banks are permitted to allow creation of charge on immovable assets, movable assets, financial securities and issue of corporate and/ or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised / raised by the borrower, subject to satisfying themselves that:

i. the underlying ECB is in compliance with the extant ECB guidelines,

ii. there exists a security clause in the Loan Agreement requiring the ECB borrower to create charge, in favour of overseas lender / security trustee, on immovable assets / movable assets / financial securities / issuance of corporate and / or personal guarantee, and

iii. No objection certificate, as applicable, from the existing lenders in India has been obtained.

Once aforesaid conditions are met, the AD Category I bank may permit creation of charge on immovable assets, movable assets, financial securities and issue of corporate and / or personal guarantees, during the currency of the ECB with security co-terminating with underlying ECB.

10. Issuance of Guarantee etc. by Indian banks and Financial Institutions.- Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by Indian banks, All India Financial Institutions and NBFCs relating to ECB is not permitted. Further, financial intermediaries (viz. Indian banks, All India Financial Institutions, or NBFCs) shall not invest in FCCBs in any manner whatsoever.

11. Debt Equity Ratio: The borrowing entities will be governed by the guidelines on debt equity ratio issued, if any, by the sectoral or prudential regulator concerned.

12. Parking of ECB proceeds: ECB proceeds are permitted to be parked abroad as well as domestically in the manner given below:

(i) ***Parking of ECB proceeds abroad:*** ECB proceeds meant only for foreign currency expenditure can be parked abroad pending utilization. Till utilisation, these funds can be invested in the following liquid assets (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/ Fitch IBCA or Aa3 by Moody's; (b) Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above and (c) deposits with overseas branches/ subsidiaries of Indian banks abroad.

(ii) ***Parking of ECB proceeds domestically:*** ECB proceeds meant for Rupee expenditure should be repatriated immediately for credit to their Rupee accounts with AD Category I banks in India. ECB borrowers are also allowed to park ECB proceeds in term deposits with AD Category I banks in India for a maximum period of 12 months. These term deposits should be kept in unencumbered position.

13. Procedure of raising ECB: For approval route cases, the borrowers may approach the RBI with an application in prescribed format Form ECB for examination through their AD Category I bank. Such cases shall be considered keeping in view the overall guidelines, macro-economic situation and merits of the specific proposals by an Empowered Committee set up by RBI. The Empowered Committee will have external as well as internal members. Entities desirous to raise ECB under the automatic route may approach an AD Category I bank with their proposal along with duly filled in Form 83. Formats of Form ECB and Form 83 are available at Annex I and II respectively of Part V of the Master Directions – Reporting under Foreign Exchange Management Act, 1999.

14. Refinancing of ECB: Refinancing of existing ECB with fresh ECB is permitted provided the fresh ECB is raised at a lower all-in-cost and residual maturity is not reduced. Indian banks are not permitted to participate in refinancing of existing ECB.

15. Corporates under Investigation: All entities against which investigation / adjudication / appeal by the law enforcing agencies for violation of any of the provisions of the Regulations under FEMA pending, may raise ECBs as per the applicable norms, if they are otherwise eligible, notwithstanding the pending investigations / adjudications / appeals, without prejudice to the outcome of such investigations / adjudications / appeals. The borrowing entity shall inform about pendency of such investigation / adjudication / appeal to the AD Cat-I bank / RBI as the case may be. Accordingly, in case of all applications where the borrowing entity has indicated about the pending investigations / adjudications / appeals, the AD Cat I Banks / Reserve Bank while approving the proposal shall intimate the agencies concerned by endorsing a copy of the approval letter.

16. Reporting Requirements: Borrowings under ECB Framework are subject to reporting requirements in respect of the following:

(i) **Loan Registration Number (LRN):** Any draw-down in respect of an ECB as well as payment of any fees / charges for raising an ECB should happen only after obtaining the LRN from RBI. To obtain the LRN, borrowers are required to submit duly certified Form 83, which also contains terms and conditions of the ECB, in duplicate to the designated AD Category I bank. In turn, the AD Category I bank will forward one copy to the Director, Balance of Payments Statistics Division, Department of Statistics and Information Management (DSIM), Reserve Bank of India, Bandra-Kurla Complex, Mumbai – 400 051. Copies of loan agreement for raising ECB are not required to be submitted to the Reserve Bank.

(ii) **Changes in terms and conditions of ECB:** Permitted changes in ECB parameters should be reported to the DSIM through revised Form 83 at the earliest, in any case not later than 7 days from the changes effected. While submitting revised Form 83 the changes should be specifically mentioned in the communication.

(iii) **Reporting of actual transactions:** The borrowers are required to report actual ECB transactions through ECB 2 Return through the AD Cat I bank on monthly basis so as to reach DSIM within seven working days from the close of month to which it relates. Changes, if any, in ECB parameters should also be incorporated in ECB 2 Return. Format of ECB 2 Return is available at Annex III of Part V of Master Directions – Reporting under Foreign Exchange Management Act.

17. Refinancing of ECB: Refinancing of existing ECB with fresh ECB is permitted provided the fresh ECB is raised at a lower all-in-cost and residual maturity is not reduced. Indian banks are not permitted to participate in refinancing of existing ECB.

18. ECB raised under the erstwhile USD 5 million Scheme: Designated AD Category I banks are permitted to approve elongation of repayment period for loans raised under the erstwhile USD 5 Million Scheme, provided there is a consent letter from the overseas lender for such reschedulement and the reshedulement is without any additional cost. Such approval with existing and revised repayment schedule along with the Loan Key/Loan Registration Number should be initially communicated to the Principal Chief General Manager, Foreign Exchange Department, ECB Division, Reserve Bank of India, Central Office, Mumbai within seven days of approval and subsequently in ECB 2 Return.

19. ECB arrangements prior to December 02, 2015: Entities raising ECB under the framework in force prior to December 02, 2015 can raise the said loans by March 31, 2016 provided the agreement in respect of the loan is already signed by the date the new framework comes into effect. It is clarified that all ECB loan agreements entered into before December 02, 2015 may continue with the disbursement schedules as already provided in the loan agreements without requiring any further consent from the RBI or any AD Category I bank. For raising of ECB under the following carve outs, the borrowers will, however, have time up to March 31, 2016 to sign the loan agreement and obtain the LRN from the Reserve Bank by this date:

- ECB facility for working capital by airlines companies;
- ECB facility for consistent foreign exchange earners under the USD 10 billion Scheme; and
- ECB facility for low cost affordable housing projects (low cost affordable housing projects as defined in the extant Foreign Direct Investment policy)

(i) **ECB facility for Carve Outs:** More information about the ECB facility for carve outs listed above as under:

(a) **ECB facility for working capital by airlines companies:** Airline companies registered under the Companies Act, 1956 and possessing scheduled operator permit license from DGCA for passenger transportation are eligible to raise ECB. Such ECBs will be allowed based on the cash flow, foreign exchange earnings and the capability to service the debt. The ECBs can be raised with a minimum average maturity period of three years and will be subject to the following terms and conditions:

- The overall ECB ceiling for the entire civil aviation sector would be USD one billion and the maximum permissible ECB that can be availed by an individual airline company will be USD 300 million.
- This limit can be utilized for working capital as well as refinancing of the outstanding working capital Rupee loan(s) availed of from the domestic banking system.
- ECB availed for working capital/refinancing of working capital as above will not be allowed to be rolled over.
- The foreign exchange for repayment of ECB should not be accessed from Indian markets and the liability should be extinguished only out of the foreign exchange earnings of the borrowing company.

(b) ECB facility for consistent foreign exchange earners under the USD 10 billion Scheme: Indian companies in the manufacturing, infrastructure sector and hotel sector (with a total project cost of INR 250 crore or more irrespective of geographical location for hotel sector), can raise ECBs for repayment of outstanding Rupee loans availed of for capital expenditure from the domestic banking system and/ or fresh Rupee capital expenditure subject to the following terms and conditions:

- The borrower should be consistent foreign exchange earners during the past three financial years and should not be in the default list/caution list of the Reserve Bank of India.
- The maximum permissible ECB that can be availed of by an individual company will be limited to 75 per cent of the average annual export earnings realized during the past three financial years or 50 per cent of the highest foreign exchange earnings realized in any of the immediate past three financial years, whichever is higher. In case of Special Purpose Vehicles (SPVs), which have completed at least one year of existence from the date of incorporation and do not have sufficient track record/past performance for three financial years, the maximum permissible ECB that can be availed of will be limited to 50 per cent of the annual export earnings realized during the past financial year.
- The foreign exchange for repayment of ECB should not be accessed from Indian markets and the liability arising out of ECB should be extinguished only out of the foreign exchange earnings of the borrowing company.
- The overall ceiling for such ECBs shall be USD10 (ten) billion and the maximum ECB that can be availed by an individual company or group, as a whole, under this scheme will be restricted to USD 3 billion.
- Within the overall ceilings given above, Indian companies in the aforesaid three sectors which have established Joint Venture (JV)/ Wholly Owned Subsidiary (WOS) / have acquired assets overseas in compliance with extant regulations under FEMA can raise ECB for repayment of all term loans having average residual maturity of 5 years and above and credit facilities availed of from domestic banks for overseas investment in JV/WOS, in addition to Capital Expenditure. The maximum permissible ECB that can be availed of by an individual company will be limited to 75 per cent of the average annual export earnings realized during the past three financial years or 75 per cent of the assessment made about the average foreign exchange earnings potential for the next three financial years of the Indian companies from the JV/ WOS/ assets abroad as certified by Statutory Auditors/ Chartered Accountant/ Certified Public Accountant/ Category I Merchant Banker registered with SEBI/ an Investment Banker outside India registered

with the appropriate regulatory authority in the host country. The past earnings in the form of dividend/repatriated profit/ other forex inflows like royalty, technical know-how, fee, etc. from overseas JV/WOS/assets will be reckoned as foreign exchange earnings for the purpose.

- Under the USD 10 billion scheme, ECB cannot be raised from overseas branches /subsidiaries of Indian banks.

(c) **ECB facility for low cost affordable housing projects:** The terms and conditions for the ECB facility for low cost affordable housing projects are as under:

- For the purpose of ECB, a low cost affordable housing project is as defined in the extant foreign direct investment policy
- ECB proceeds shall not be utilized for acquisition of land.
- Developers/builders registered as companies may raise ECB for low cost affordable housing projects provided they have minimum 3 years‘ experience in undertaking residential projects, have good track record in terms of quality and delivery and the project and all necessary clearances from various bodies including Revenue Department with respect to land usage/ environment clearance, etc., are available on record. They should also not have defaulted in any of their financial commitments to banks/ financial institutions or any other agencies and the project should not be a matter of litigation. Builders/ developers meeting the eligibility criteria shall have to apply to the National Housing Bank (NHB) in the prescribed format. NHB shall act as the nodal agency for deciding a project‘s eligibility as a low cost affordable housing project, and on being satisfied, forward the application to the Reserve Bank for consideration under the approval route. Once NHB decides to forward an application for consideration of RBI, the prospective borrower (builder/developer) will be advised by the NHB to approach RBI for availing ECB through his Authorised Dealer in the prescribed format.
- The ECB should be swapped into Rupees for the entire maturity on fully hedged basis.
- Housing Finance Companies (HFCs) registered with the National Housing Bank (NHB) and operating in accordance with the regulatory directions and guidelines issued by NHB are eligible to avail of ECB for financing low cost affordable housing units. The minimum Net Owned Funds (NOF) of HFCs for the past three financial years should not be less than INR 300 crore. Borrowing through ECB should be within overall borrowing limit of 16 (sixteen) times of their Net Owned Fund (NOF) and the net non-performing assets (NNPA) should not exceed 2.5 % of the net advances. The maximum loan amount sanctioned to the individual buyer will be capped at INR 25 lakh subject to the condition that the cost of the individual housing unit shall not exceed INR 30 lakh. HFCs while making the applications shall submit a certificate from NHB that the availment of ECB is for financing prospective owners of individual units for the low cost affordable housing and ensure that the interest rate spread charged by them to the ultimate buyer is reasonable.
- NHB is also eligible to raise ECB for financing low cost affordable housing units of individual borrowers. Further, in case, a developer of low cost affordable housing project not being able to raise ECB directly as envisaged above, National Housing Bank is permitted to avail of ECB for on-lending to such developers which satisfy the conditions prescribed to developers / builders subject to the interest rate spread set by RBI.
- Interest rate spread to be charged by NHB may be decided by NHB taking into account cost and other relevant factors. NHB shall ensure that interest rate spread for HFCs for on-lending to prospective owners’ of individual units under the low cost affordable housing scheme is reasonable.

- Developers/ builders/ HFCs/ NHB will not be permitted to raise Foreign Currency Convertible Bonds (FCCBs) under this scheme.
- An aggregate limit of USD 1(one) billion each for the financial years 2013-14, 2014-15 and 2015-16 is fixed for ECB under the low cost affordable housing scheme which includes ECBs to be raised by developers/builders and NHB/specified HFCs.

CONVERSION OF ECB INTO EQUITY

(i) Conversion of ECB into equity is permitted subject to the following conditions:

- The activity of the borrowing company is covered under the automatic route for Foreign Direct Investment (FDI) or approval from the Foreign Investment Promotion Board (FIPB), wherever applicable, for foreign equity participation has been obtained as per the extant FDI policy;
- The foreign equity holding after such conversion of debt into equity is within the applicable sectoral cap;
- Applicable pricing guidelines for shares are complied with.

(ii) Partial or full Conversion of ECB may be reported to the RBI as follow:

- For partial conversion, the converted portion is to be reported to the concerned Regional Office of the Foreign Exchange Department of RBI in Form FC-GPR prescribed for reporting of FDI flows, while monthly reporting to DSIM in ECB 2 Return will be with suitable remarks "ECB partially converted to equity".
- For full conversion, the entire portion is to be reported in Form FC-GPR, while reporting to DSIM in ECB 2 Return should be done with remarks ¯ECB fully converted to equity . Subsequent filing of ECB 2 Return is not required.
- For conversion of ECB into equity in phases, reporting through ECB 2 Return will also be in phases.

DEPOSITORY RECEIPTS SCHEME, 2014

The Depository Receipts Scheme, 2014 was notified by the Central Government with effect from December 15, 2014.

DEFINITIONS:

(a) ***Permissible Jurisdiction:*** Permissible Jurisdiction' as foreign jurisdiction which is a member of the Financial Action Task Force on Money Laundering and the regulator of the securities market in that jurisdiction is a member of the International Organization of Securities Commission. Schedule I of the scheme gives the list of permissible jurisdiction.

(b) ***Unsponsored Depository Receipts:*** Unsponsored depository receipts' mean depository receipts issued without specific approval of the issuer of the underlying permissible securities.

Eligibility.- Clause 3 of the scheme describes the eligibility of issue of depository receipts. The following persons are eligible to issue or transfer permissible transactions to a foreign depository for the issue of depository receipts:

- Any Indian company, listed or unlisted, private or public;
- Any other issuer of permissible securities;
- Any person holding permissible securities

which has not been specifically prohibited from accessing the capital market or dealing in securities. Unsponsored depository receipts on the back of the listed permissible securities can be issued only if such depository receipts gave the holder the right to issue voting instruction and are listed on an international exchange.

PROCEDURE FOR THE ISSUE OF DEPOSITORY RECEIPTS.- The following is the procedure for the issue of depository receipts:

- The aggregate of permissible securities which may be issued or transferred to foreign depositories for issue of depository receipts, along with permissible securities already held by persons resident outside India shall not exceed the limit on foreign holding of such permissible securities under the FEMA, 1999;
- The depository receipts may be converted to underlying permissible securities and vice versa;
- A foreign depository may issue depository receipts by way of a public offering or private placement or in any other manner prevalent in a permissible jurisdiction;
- An issuer may issue permissible securities to a foreign depository for the purpose of issue of depository receipts by any mode permissible for issue of such permissible securities to investors;
- The holders of permissible securities may transfer permissible securities to a foreign depository for the purpose of the issue of depository receipt, with or without the approval of issue of such permissible securities through transactions on a recognized stock exchange, bilateral transactions or by tendering through a public platform;
- The permissible securities shall not be issued to a foreign depository for the purpose of issuing depository receipts at a price less than the price applicable to a corresponding mode of issue of such securities to domestic investors under the applicable laws;

Any approval necessary for issue or transfer of permissible securities to a person resident outside India shall apply to the issue or transfer of such permissible securities to a foreign depository for the purpose of issue of depository receipts. Subject to this the issue of depository receipts shall not require any approval from any Government agency, if the issuance is in accordance with the scheme.

RIGHTS AND DUTIES.- The following are the rights and duties for the foreign depository:

- The foreign depository shall be entitled to exercise voting rights, if any, associated with the permissible securities whether pursuant to voting instruction from the holder of depository receipts or otherwise;
- The shares of a company underlying the depository receipts shall form part of the public shareholding of the company under Securities Contracts (Regulation) Rules, 1957, if:
  - the holder of such depository receipts has the right to issue voting instruction; and
  - such depository receipts are listed on an international exchange;
- In the cases not covered under second point, shares of the company underlying depository receipts shall not be included in the total shareholding and in the public shareholding for the purpose of computing the public shareholding of the company;

A holder of depository receipts issued on the back of equity shares of a company shall have the same obligations as if it is the holder of the underlying equity shares, if it has the right to issue voting instruction.

OBLIGATIONS.- Clause 8 of the scheme imposes certain obligations on the domestic custodian which are-

- to ensure that the relevant provisions of the scheme related to the issue and cancellation of depository receipts is complied with;
- to maintain records in respect of, and report to, Indian depositories all transactions in the nature of issue and cancellation of depository receipts for the purpose of monitoring limits under the FEMA, 1999;

- to provide the information and data as may be called upon by SEBI, the RBI, Ministry of Finance, Ministry of Corporate Affairs and any other authority of law; and
- to file with SEBI a copy of the document by whatever name called, which sets the terms of issue of depository receipts issued on the back of securities, as defined under Section 2(h) of SCRA, 1956, in a permissible jurisdiction.

The following are the obligations imposed on the Indian Depositories-

- they shall co-ordinate among themselves;
- they shall disseminate the outstanding permissible securities against which the depository receipts are outstanding; and
- they shall disseminate the limit up to which permissible securities can be converted to depository receipts.

A person issuing or transferring permissible securities to a foreign depository for the purpose of the issue of depository receipts shall comply with relevant provisions of the Indian law, including the scheme, related to the issue and cancellation of depository receipts.

APPROVAL.- Any approval necessary for issue or transfer of permissible securities to a person resident outside India shall apply to the issue or transfer of such permissible securities to a foreign depository for the purpose of issue of depositary receipts. No approval is required if the issue of depositary receipt is in accordance with the scheme.

LESSON ROUND UP

– Companies either raise funds from the domestic market or through international market. For international funding, the most popular source amongst the Indian companies in the recent times has been American Depository Receipts (ADR) and Global Depository Receipts (GDR).

– An American Depository Receipt (ADR) is a negotiable security representing ownership in some underlying shares of a non-US company, which can be traded on US stock exchanges.

– GDRs are usually listed on the Luxembourg Stock Exchange and on London Stock Exchange.

– An Indian corporate can raise foreign currency resources abroad through the issue of GDR/ADR. Regulation 4 of Schedule I of FEMA Notification no. 20 issued by RBI allows an Indian company to issue its Rupee denominated shares to a person resident outside India being a depository for the purpose of issuing ADRs/ GDRs.

– Indian companies can raise foreign currency resources abroad through the issue of ADRs/GDRs, in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and the guidelines issued by the Government of India thereunder from time to time.

– The following agencies are normally involved in the issue of ADR/GDR: (i) Lead Manager (ii) Co-Lead/ Co-Manager (iii) Overseas Depository Bank (iv) Domestic Custodian Banks (v) Listing Agent (vi) Legal Advisors (vii) Printers (viii) Auditors (ix) Underwriter(x) Escrow Agent.

– The following principal documents are involved: (i) Subscription Agreement (ii) Depository Agreement (iii) Custodian Agreement (iv) Escrow Agreement (v) Offering Circular.

– An Indian company issuing ADRs / GDRs has to furnish to the Reserve Bank, full details of such issue in the Form enclosed as Annex 9 in Schedule I of Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, within 30 days from the date of closing of the issue.

- In order to list equity securities on a stock exchange, or to maintain a listing once admitted to trading, an issuer must meet certain criteria. These requirements vary from exchange to exchange.
- The London stock Exchange has several different trading markets for negotiable equity instruments. GDRs can trade on three markets: the Main Market, the Professional Securities Market (known as the PSM) and, in certain circumstances, the Alternative Investment Market (known as AIM).
- Many public offerings by non-U.S. companies are in the form of depository receipts, usually as American Depository Receipts (ADRs).
- There are three distinct markets within NASDAQ: the NASDAQ Global Market (NGM), the newly created NASDAQ Global Select Market (NGSM) and the NASDAQ Capital Market (NCM).
- The NGSM mandates the highest initial listing requirements of any market in the world, while its maintenance requirements are identical to those of the NGM.
- The NGM, has more stringent quantitative listing and maintenance requirements than does the NCM.
- The quantitative listing and maintenance criteria applicable to non-Canadian foreign private issuers for the NGM, NGSM and NCM are identical to those of US domestic and Canadian issuers.
- The foreign private issuers may satisfy either the general NYSE listing standards applicable to US domestic issuers or the NYSE's Alternate Listing Standards for foreign private issuers, which are specifically designed for foreign private issuers with a broad, liquid market for their securities in their country of origin.

SELF TEST QUESTIONS

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

1. What do you mean by American Depository Receipts(ADRs) ? Discuss various types of ADRs.
2. What are the advantages of Issuing ADRs/GDRs?
3. Briefly enumerate the provisions relating to issuance of shares under ADR/GDR mechanism.
4. Explain the information required to be furnished to RBI with respect to the process of issue of ADR/ GDR.
5. Discuss briefly the criteria required to be fulfilled by a company to be listed on London Alternative Investment Market (AIM).

Lesson 10
Economics of Commodities Marketing

LESSON OUTLINE

– Introduction
– Types of Commodities
– Commodities Market
– Marketing of Agricultural Commodities
– Direct Marketing
– Indirect Marketing
– Contract Farming
– Storage
– Warehousing
– Variance in Commodity Market
– Weather Derivatives
– Freight Derivatives
– Electricity Derivatives
– Catastrophe Derivatives
– Carbon Derivatives
– Hedging
– Hedging Risks
– Understanding Basis Risk
– LESSON ROUND UP
– SELF TEST QUESTIONS

LEARNING OBJECTIVES

A commodity may be defined as an article, a product or material that is bought and sold in an established market between willing buyers and sellers. Commodity Market is an important constituent of the financial markets in any country. This helps investors to hedge their commodity risks, take speculative positions in commodities and exploit arbitrage opportunities in the market.

In this lesson the student will understand as to what does commodity mean; Different types of commodities available; Marketing of agricultural commodities; Variance of commodities; Using hedge mechanism for price risk management *etc*.

INTRODUCTION

A Commodity is an economic good, tradable good, product or article of commerce; something for which there is an established market where the commodity can be bought and sold in commercial transactions between willing buyers and sellers. One of the important characteristics of a commodity is that its price is determined as a function of its market as a whole. So a commodity is understood to mean a *Good* with the following properties :

- Is usually produced and/or sold by many different producers
- Is uniform in quality between producers who produce and sell it.
- Is traded at a price resulting from its demand and supply.

TYPES OF COMMODITIES

Commodities can be perishable or non –perishable. Non-perishable commodities such as metals are called hard commodities. Perishable commodities such as agricultural commodities are called soft commodities. Hard commodities are typically natural resources that must be mined or extracted (gold, rubber, oil, *etc.*), whereas soft commodities are agricultural products or livestock (corn, wheat, coffee, sugar, soybeans, pork, *etc.*)

Agricultural Products	Industrial Metals	Precious Metals	Energy
Oil & Oil Seeds	Copper	Gold	Crude Oil
Spices	Nickel	Silver	Natural Gas
Pulses	Zinc	Platinum	Furnace Oil
Cereals	Aluminum		Aviation Turbine Fuel (ATF)
Plantations	Palladium		Power
Fibers	Lead		
Potato	Tin		
Sugar	Steel		
Livestock	Sponge Iron		

COMMODITY MARKETS

Every commodity that is produced (or grown) must eventually come to a marketplace wherein it can be bought and sold. It is in this marketplace that all the elements of commerce will come together to settle a price at which the commodity will get traded. For a commodity market to be established there must be very broad consensus on the variations in the product that make it acceptable for one purpose or another. Such goods are raw or partly refined materials whose value mainly reflects the costs of finding, gathering, or harvesting them; they are traded for processing or incorporation into final goods, *e.g.,* include crude oil, cotton, rubber, grains, and metals and other minerals.

The two core participants in a commodity market are the sellers and the buyers. They meet each other in the market, with sellers representing the supply side and buyers representing the demand side of this market. The market functions as a price discovery mechanism, prices being determined by the supply of and demand for the commodity. The prices are discovered through an auction mechanism such that sellers asking for a certain price, and buyers offering them a price, come around to setting upon one mutually agreeable price. Most often, sellers and buyers may participate in the market through intermediaries or agents, called brokers. Commodity Markets have existed for centuries around the world because producers and buyers of good products and other items have always needed a common place to trade. Though the place of trade and many of the detailed mechanisms have changed, the basics of commodity trading remain the same.

The trading of commodities in commodity markets consists of direct physical trading (spot trading) and derivatives trading. A market in which goods are sold for cash and delivered immediately is called the physical market. Deals in these markets are immediately effective. The physical market is also known as the cash market or spot market, because prices are settled in cash on the spot at current market prices, as opposed to forward prices. In the physical markets, participation is restricted to people who are involved with that commodity, say, the farmer, processor, wholesaler, *etc.* Since transactions take place directly between principals, there is a high degree of flexibility in these transactions.

The most popular physical commodities contracts can be broken down into metals, energy, grains, livestock, food and fiber and exotic commodities. Trading is delivery based, and is typically done through brokers and other intermediaries. For most commodities that are physically traded, there is no market in a central meeting place, and where it exists, it typically handles only a small part of the total trade.

The spot price or spot rate of a commodity is the price that is quoted in the physical market for immediate or spot settlement (payment and delivery). Spot settlement is normally one or two business days from trade date. This is in contrast with the forward price established in a forward contract or futures contract, where contract terms (price) are set now, but delivery and payment will occur at a future date. Depending on the item being traded, spot prices can indicate market expectations of future price movements in different ways. For a non-perishable commodity like good, spot price reflects market expectations of future price movements. In theory, the difference in spot and forward prices should be equal to the finance charges, plus any earnings due to the holder of the commodity, according to the cost of carry mode. In contrast, a perishable commodity does not allow this arbitrage- the cost of storage is effectively higher than the expected future price of the commodity. As a result, spot prices will reflect current supply and demand, not future price movements. Spot prices can therefore be quite volatile and move independently from forward prices.

MARKETING OF AGRICULTURAL COMMODITIES

Agricultural marketing includes the movement of agricultural produce from the farm where it is produced to the end-consumers or manufacturers. This covers physical handling and transport, initial processing and packing to simplify handling and reduce wastage, grading and quality control to simplify sales transactions and meet different consumers' requirements, and holding over time to match concentrated harvest seasons with the continuing demands of consumers throughout the year.

For the farmer, the vital function of the marketing system is to offer him a suitable outlet for his produce at a remunerative price. To the consumers and the manufacturers of products based on agricultural raw materials, assured and steady supply at a reasonable price is the critical service. The agricultural marketing system in India operates primarily according to the forces of supply and demand in the private sector. Prices are determined through a free market process by negotiations at rural purchasing, wholesale and retail stages, and represent a balance between the consumers' ability to pay and the farmers' need for an incentive to produce. An efficient marketing system is also vital to (a) provide an incentive to the farmer to produce more; (b) convey the changing production needs of the economy to the producers to enable production planning; (c) foster true competition among the traders and (d) eliminate the exploitation of farmers, particularly the small and marginal ones.

India is one of the largest agrarian economies of the world. Its agriculture sector is at the core of the economy's purchasing power. The agriculture produce sector is the most important component of the Indian commodity sector. India's commodity sector comprises activities, regulations, institutions and producers, consumers, intermediaries, service providers and marketplaces that collectively cause and explain some part of the economy's total output.

Government intervention is aimed at protecting the interests of producers and consumers and promoting organized marketing of agricultural commodities. The Indian government has adopted various measures to improve agricultural marketing. These steps include establishing regulated markets, constructing warehouses, grading and standardizing produce, standardizing weights and measures and providing information on agricultural prices over the national radio network. The government also provides assistance in the establishment of infrastructure for regulated markets, and in the setting up of rural warehouses.

(i) Various Central Government organizations are involved in agricultural marketing, including the Commission for Agricultural Costs and Prices, the Food Corporation of India, the Cotton Corporation of India, and the Jute Corporation of India. There also are specialized marketing boards for rubber, coffee, tea, tobacco, spices, coconut, oilseeds, vegetable oil and horticulture.

(ii) The National Agricultural Cooperative Marketing Federation of India, the apex body of the state marketing federations, handles much of the domestic and most of the export marketing for its member organizations.

(iii) A network of cooperatives at the local, state, and national levels assist in agricultural marketing in India. The major commodities handled are food grains, jute, cotton, sugar, milk, and areca nuts.

(iv) The Directorate of Marketing and Inspection of the Ministry of Agriculture administers all laws related with the marketing of agricultural produce, besides carrying out market research. The directorate also works closely with states to provide agricultural marketing services that constitutionally are a matter of state purview.

(v) The Central Warehousing Corporation, an entity of the Central Government, operates warehouses at major points within its jurisdictions, and cooperatives operate warehouses in towns and villages.

Due to the characteristics of agricultural produce, such as small production from scattered farms, seasonality and perishability of products, transportation and communication bottlenecks, *etc.*, a large number of intermediaries are required between the producer and the end-consumer. These intermediaries participate in the assembling and distribution of agricultural products. Broadly, the methods adopted for marketing of agricultural produce can be classified as :

Direct Marketing

The process of direct marketing enables farmers to meet the specific demands of wholesalers or traders from the farmer's inventory of graded and certified produce on one hand and of consumers based on consumers preference on the other hand. This helps the farmers to reduce marketing costs and, thus, improve their net margins. Besides helping farmers to improve price realization, some farmers have discovered that adding value or marketing some minimally processed farm products directly to the consumer is another way of enhancing financial viability. A farmer selling his produce directly to a supermarket is one example of this form of marketing.

Indirect Marketing

In this form of marketing, rather than the agricultural commodities directly passing from producers to end-consumers, they move from producers to end-consumers through a chain of intermediaries or middlemen. The number of intermediaries may vary from one to many, and may include several levels of wholesale dealers (local/provincial/national) and then the retailers. Indirect marketing makes it necessary for the farmer to haul produce to regulated markets for sale. There are three marketing functions involved in this chain of indirect marketing, i.e., assembling, packing and distribution. Farmers going to the mandis and selling their produce through traders is an example of indirect marketing.

Contract Farming

The process of contract farming is a newer concept that involves cultivating and harvesting for and on behalf of big business establishments or Government agencies and forwarding the produce at a pre-determined price. In return, the contracted farmers are offered high price against their farm produce. This stipulates a commitment on the part of the farmers to provide a specific commodity in terms of quality and quantity as determined by the purchaser and commitment on the part of company to support the farmer for production through inputs and other technical support. The role of contract farming in Indian economy is becoming important, since organized farming practice has become the need of the hour in the world of rapid industrialization. Some of the success stories include National Dairy Development Board and PEPSICO.

Recently, India's commodity exchanges have also set-up national-level electronic spot markets, the Spot Exchanges, in recognition of the need to help farmers increase their income from farm and non-farm activities. These spot exchanges provide a platform where farmers can sell their produce at the best possible rate and the end-users can buy at the most competitive price, and in addition, provide services like quality certification, storage of goods and other customized value-added services. As a result, the Indian farmers have multiple options to sell their produce and are no longer dependent on Agricultural Produce Market Committees. The spot exchanges also create a market where the processors end users, exporters, corporates (both private and government) and other traders can procure agricultural produce at the most competitive price, without any counter-party and quality risk.

STORAGE

Storage is an important marketing function, which involves holding and preserving goods from the time they are produced until they are needed for consumption. The storage of goods, therefore, from the time of production to the time of consumption, ensures a continuous flow of goods in the market. Storage protects the quality of perishable and semi-perishable products from deterioration;

Some of the goods e.g., woolen garments, have a seasonal demand. To cope with this demand, production on a continuous basis and storage become necessary; It helps in the stabilization of prices by adjusting demand and supply. Storage is necessary for some period for performance of other marketing functions.

TYPES OF STORAGE

Underground Storage Structures

Underground storage structures are dugout structures similar to a well with sides plastered with cowdung. They may also be lined with stones or sand and cement. They may be circular or rectangular in shape. The capacity varies with the size of the structure.

Advantages

- Underground storage structures are safer from threats from various external sources of damage, such as theft, rain or wind;
- The underground storage space can temporarily be utilized for some other purposes with minor adjustments; and
- The underground storage structures are easier to fill up owing to the factor of gravity.

Surface storage structures

Foodgrains in a ground surface structure can be stored in two ways - bag storage or bulk storage.

I. Bag storage

- Each bag contains a definite quantity, which can be bought, sold or dispatched without difficulty;
- Bags are easier to load or unload;
- It is easier to keep separate lots with identification marks on the bags;

- The bags which are identified as infested on inspection can be removed and treated easily; and
- The problem of the sweating of grains does not arise because the surface of the bag is exposed to the atmosphere.

II. Bulk or loose storage

- The exposed peripheral surface area per unit weight of grain is less. Consequently, the danger of damage from external sources is reduced; and
- Pest infestation is less because of almost airtight conditions in the deeper layers;
- The Government of India has made efforts to promote improved storage facilities at the farm level;
- Improved grain storage structures.

WAREHOUSING

Warehouses are scientific storage structures especially constructed for the protection of the quantity and quality of stored products.

Importance of warehousing

(i) Scientific storage**:** The product is protected against quantitative and qualitative losses by the use of such methods of preservation as are necessary.

(ii) Financing**:** Warehouses meet the financial needs of the person who stores the product. Nationalized Banks advance credit on the security of the warehouse receipt issued for the stored products to the extent of 75 to 80% of their value.

(iii) Price Stabilization**:** Warehouses help in price stabilization of agricultural commodities by checking the tendency to make post-harvest sales among the farmers.

(iv) Market Intelligence**:** Warehouses also offer the facility of market information to persons who hold their produce in them.

Working of Warehouses

(i) Acts**:** The warehouses (CWC and SWCs) work under the respective Warehousing Acts passed by the Central or State Govt.

(ii) Eligibility**:** Any person may store notified commodities in a warehouse on agreeing to pay the specified charges.

(iii) Warehouse Receipt (Warrant)**:** This is receipt/warrant issued by the warehouse manager/owner to the person storing his produce with them. This receipt mentions the name and location of the warehouse, the date of issue, a description of the commodities, including the grade, weight and approximate value of the produce based on the present prices.

(iv) Use of Chemicals**:** The produce accepted at the warehouse is preserved scientifically and protected against rodents, insects and pests and other infestations. Periodical dusting and fumigation are done at the cost of the warehouse in order to preserve the goods.

(v) Financing: The warehouse receipt serves as a collateral security for the purpose of getting credit.

(vi) Delivery of produce**:** The warehouse receipt has to be surrendered to the warehouse owner before the withdrawal of the goods. The holder may take delivery of a part of the total produce stored after paying the storage charges.

TYPES OF WAREHOUSE

1. On the basis of Ownership

(i) Private warehouses**:** These are owned by individuals, large business houses or wholesalers for the storage of their own stocks. They also store the products of others.

(ii) Public warehouses**:** These are the warehouses, which are owned by the Govt. and are meant for the storage of goods.

(iii) Bonded warehouses**:** These warehouses are specially constructed at a seaport or an airport and accept imported goods for storage till the payment of customs by the importer of goods. These warehouses are licensed by the Govt. for this purpose. The goods stored in this warehouse are bonded goods. Following services are rendered by bonded warehouses:

- The importer of goods is saved from the botheration of paying customs duty all at one time because he can take delivery of the goods in parts;
- The operation necessary for the maintenance of the quality of goods - spraying and dusting, are done regularly, and
- Entrepot trade (re-export of imported goods) becomes possible.

2. On the basis of Type of Commodities Stored

General Warehouses: These are ordinary warehouses used for storage of most of foodgrains, fertilizers, *etc.*

Special Commodity Warehouses: These are warehouses, which are specially constructed for the storage of specific commodities like cotton, tobacco, wool and petroleum products.

Refrigerated Warehouses: These are warehouses in which temperature is maintained as per requirements and are meant for such perishable commodities as vegetables, fruits, fish, eggs and meat.

WAREHOUSING IN INDIA

Central Warehousing Corporation (CWC)

This corporation was established as a statutory body in New Delhi on 2nd March 1957. The Central Warehousing Corporation provides safe and reliable storage facilities for about 120 agricultural and industrial commodities.

Functions

- To acquire and build godowns and warehouses at suitable places in India;
- To run warehouses for the storage of agricultural produce, seeds, fertilizers and notified commodities. for individuals, co-operatives and other institutions;
- To act as an agent of the Govt. for the purchase, sale, storage and distribution of the above commodities;
- To arrange facilities for the transport of above commodities;
- To subscribe to the share capital of State Warehousing Corporations; and
- To carry out such other functions as may be prescribed under the Act.

The Central Warehousing Corporation is running air-conditioned godowns at Calcutta, Bombay and Delhi, and provides cold storage facilities at Hyderabad. Special storage facilities have been provided by the Central Warehousing Corporation for the preservation of hygroscopic and fragile commodities. The corporation has also evolved techniques for the storage of spices, coffee, seeds and other commodities.

State Warehousing Corporations (SWCs)

State Warehousing Corporations are also set up in different States of the Indian Union. The areas of operation of the State Warehousing Corporations are centres of district importance. The total share capital of the State Warehousing Corporations is contributed equally by the concerned State Govt. and the Central Warehousing Corporation.

Food Corporation of India (FCI)

Apart from CWC and SWCs, the Food Corporation of India has also created storage facilities. The Food Corporation of India is the single largest agency which has a capacity of 26.62 million tonnes.

VARIANCE IN COMMODITY MARKET

Contracts traded on the commodity exchanges are no longer limited to traditional commodities and standardized contracts have come to be traded on the ever-increasing range of products and indices-like electricity, freight rates, carbon dioxide and even weather, besides the conventional base metals, soft commodities oil, gas *etc.*

During the past several decades, the global derivatives industry has grown manifold and derivatives contracts on a progressively diverse array of underlying products have been launched by exchanges. The past several decades have witnessed the emergence and rapid developments and innovations in the filed of financial engineering and derivatives. In fact, the concept of 'commodity' has been stretched beyond the traditional tangible physical products to contracts that are based on an increasing range of physical commodities, market instruments and indices (whether settled by physical delivery or in cash). The diverse range of potential underlying assts and payoff alternatives leads to a huge range of derivatives contracts available for trading in the market. Today, derivatives contracts are traded on Commodity Exchange Markets around the globe, based on the following commodities (among others) :

- Agricultural crops and livestock
- Metals, both precious and industrial
- Energy, including electricity
- Interest rates
- Freight rates
- Equities and indices
- Foreign Exchange
- Insurance
- Carbon emissions
- Weather.

Variety is the very essence of commodity trading, and depends on the ability to build liquid and transparent derivatives in emerging asset classes. Agriculture is a risk-prone sector. Combating risk in agriculture has been, and continues to be, one of the major challenges to scientists and policy makers. Notable among the risk sources plaguing agriculture include a host of weather-related risks. These include extreme rainfall, temperature events, as well as natural disasters. Economic losses from weather risks have tended to increase in the past few decades. The energy and shipping markets also operate in an environment exposed to a variety of risks responsible for high volatility in the prices of oil, natural gas, electricity and freight rates. The need to control this price volatility has promoted the development of risk management methods for weather, energy assets and their derivatives, analogous to those widely used in fixed income, equity and foreign exchange markets. A totally different class of markets and derivatives with exotics underlying has emerged.

WEATHER DERIVATIVES

Weather Derivatives are financial instruments that seem like an insurance policy but are more like options. They are unique in that there is no physical underlying asset. The underlying asset is any measureable weather factor, that is, temperature measured in degrees Celsius or Fahrenheit, rainfall measured in centimeters, or snowfall measured in inches. On the Chicago Mercantile Exchange, the values of these contracts are calculated based on a weather index. Most temperature contracts in current practice are based on a Heating Degree Day (HDD) for winter protection, or a Cooling Degree day (CDD) for summer protection. Pay-off is based on a measurable index like HDD or CDD, and it performs relative to the strike value (not the actual loss). Coverage has a defined maximum limit.

Heating degree days are one of the most common types of weather derivatives. HDD is the difference between the baseline temperature and the average temperature for a day in winters. The baseline temperature is fixed; it is 65 degrees Fahrenheit in the U.S. and 18 degrees Celsius in Europe.

HDD = Max (0.65F-average temperature in a day)

The value of the contract would be a multiple of the HDD. The contract can be valued on a daily basis, or can be valued on a weekly, fortnightly or monthly basis, or for a season, depending on the contract specifications. Typical terms for a HDD contract could be: for the November to March period, for each day when the temperature falls below 65 degrees Fahrenheit, or 18 degrees Celsius, keep a cumulative count of its difference from the average daily temperature. Depending upon whether the option is a put option or a call option, it pays out a set amount per heating degree day that the actual count differs from the strike.

Weather Derivatives contracts are being used successfully by farmers, theme parks, ski resorts, ice-cream manufacturers, energy and utilities companies, *etc.*, for over a decade now. Gas and power companies may use HDD or CDD contracts to smooth earnings.

For example, a ski resort located in Auli may buy a put option by paying a premium of ₹1,00,000 to buy a right to receive ₹20,000 for every inch of snow below the strike amount of say, 50 inches, offsetting somewhat the loss in revenues due to insufficient snowfall. The ski resort could also sell a call option by receiving a premium of ₹1.20,000 and paying ₹30,000 for every inch of snow over the strike of 50 inches, again assuming higher revenue for the resort with heavy snowfall,.

The index could also be based on rainfall. In 2005, NCDEX launched a rain day index for Mumbai city for informational purposes only, though it can very well be used as an alternative form of crop insurance that makes payments, based not on measures of farm yields, but rather on some objective weather event, such as rainfall. Similarly, MCX also has rainfall indices-RAINDEXMUM, RAINDEXIDR and RAINDEXJAI-that record rainfall at Mumbai (Colaba), Indore and Jaipur, respectively, and are designed to also consider normal rainfall in Mumbai, Indore and Jaipur.

FREIGHT DERIVATIVES

Just as weather is a source of risk for farmers, organizations and individuals, freight rates can also cause harm to the revenues of organizations by impacting their shipping costs adversely. This is freight market risk. Given the current volatility of the freight markets, managing freight market risk is a significant issue for the shipping industry. Volatility in freight rates drives the need for financial tools for risk management, and attracts speculation on the future price movements of freight. The ability to hedge the cost of freight permits traders to price their businesses with greater degree of certainty and long-term stability.

Freight Derivatives are financial instruments used by organizations and individuals as part of their risk management strategy to counter the negative economic effects of freight rate alterations that harm the financial prospect of a company. Freight derivatives are financial contracts between two parties to settle upon an agreed future price for carrying commodities at sea. The freight derivatives market began with the trading of voyage rates for certain 'dry' cargo routes in the early 1990s, and was later expanded to include 'wet' tanker routes. Dry cargo is of solid, dry material, rather than liquid or gas, and generally does not require special temperature controls. Wet cargo consists of liquids or gases that may also require special temperature conditions. Recently, with commodities now standing at the forefront of international economics, large financial trading houses, including banks and hedge funds, have entered this market. Freight derivatives are primarily used by ship-owners and operators, oil companies, trading companies and grain houses, as tools for managing freight rate risk.

Take the case of a trader who has agreed in August 2012 to ship 3000 tonnes of sugar from Brazil to Japan in April, 2013. Assume that in August 2012, for this route, the freight rate per tonne of sugar is $90 per tonne. The trader expects the rates to go up. He can book a ship now, for April loading, but the ship owner may not want to commit for so far into the future. The trader can, alternatively, purchase a contract for settlement in April 2013, at $92 per tonne, and lock in this rate. The settlement is against an index, like the Baltic Dry Index (BDI) which is a daily average of prices paid by an end customer to have a shipping company transport dry raw materials across 26 different routes throughout the world averaged into one index. BDI is based on January 1985 as 1,000, and is made up of an average of the Baltie Supramax, Panamax, and Capesize indices. If in April 2013, the freight index is $95 per tonne, the trader makes a profit of $3 per tonne, which is offset by the increased cost of shipping. If the freight index has fallen to $88 per tonne, then the trader makes a loss of $4 per tonne, which is offset by the now lower cost of shipping.

ELECTRICITY DERIVATES

Energy derivatives are derivative instruments with the underlying asset being any energy product, including oil, natural gas and electricity, which trade either on an exchange or over-the counter. Like other derivative products, energy derivatives can be used as a form of insurance to protect against the often volatile changes of energy prices. Electricity futures are one type of energy derivatives. They can be options, futures or swap agreements, among others. The value of a derivative will vary based on the changes in the price of the underlying energy product. Electricity is a commodity characterized by :

- Seasonality of demand
- High volatility of prices
- Non-elasticity of demand
- Limited transportability
- Non-storability

In fact, electricity derivatives were visualized as hedging instruments for suppliers and users of electricity in the United States, where electricity suppliers charge the consumers a variable tariff; the per unit rate depending on weather, which determines the levels of electricity consumption. A need was felt for derivatives because consumers preferred paying a fixed rate. To meet the requirement of both the parties, an intermediary structured an arrangement with the electricity supplier to collect a fixed amount from each consumer based on an average energy consumption pattern in the past. This is how the arrangement would work.

Electricity sector reforms initiated in the early nineties in India led to the commencement of power trading. The Electricity Act, 2003, recoginsed power trading as a distinct licensed activity. Open access regulations and inter State trading regulations made power trading in India a reality. The Power Trading Corporation (PTC) played the role of a trader by purchasing power from surplus units and selling it to deficit state electricity boards (SEBs) at mutually agreed rates. The growth in volumes necessiated a natural market based platform that would encourage Liquidity.

The Central Electricity Regulatory Commission (CERC), in 2007, granted in principle approval to commence exchange trading, and also issued guidelines for setting up and operation of the power exchange. Indian energy Exchange (IEX), promoted by MCX became India's first nation-wide automated online electricity platform to trade spot electricity, to indentify the supply side, and to act as an effective price discovery mechanism. This was followed by Power Exchange of India Ltd. (PXIL), promoted by NCDEX and NSE. Power Exchange for Electricity trading streamline power trading along with standardizing electricity as tradable product, by acting as a platform for buying, selling and trading of electricity.

MCX, with an existing basket of energy products-including crude oil, furnace oil, natural gas and aviation turbine fuel, in January 2009, received the approval from Forward Market Commisson (FMC) for the launch of weekly and monthly electricity contracts. The exchange launched eight weekly contracts and four monthly contracts for trading. The contract trading unit is 1MWx24 hours with tick size as ₹1 per MWh. The delivery is optional for both buyers and sellers, and due date rate is the average of daily system prices of day-ahead market of Indian Energy Exchange (IEX) for delivery during the contract week/month.

With the launch of electricity futures, the industry has a platform to manage price risk on energy-related raw material or output better. The launch of electricity futures will even-out the price curve in the medium-to-long run that will help the market participants to facilitate price discovery and take an informed decision after looking at the future prices.

CATASTROPHE DERIVATIVES

Insurers are exposed to the risk of natural and man-made Catastrophes, and need to effectively insure themselves by fixing their projected catastrophic loss ratios irrespective of the magnitude and frequency of Catastrophes. They have been able to protect themselves against such losses by opting for reinsurance. Whenever a primary insurer has exposure to excessive underwriting risk, it can pass on some of this risk to reinsurers. Reinsurance agreements can be on a pro-rata agreement wherein the primary insurer gives a portion of its premium income to a reinsurer, and the reinsurer agrees to pay roughly the same portion of the former’s losses. There can also be an excess-of-loss basis wherein the reinsurer agrees to pay all losses incurred by the primary insurer in excess of a certain amount, in exchange for a flat premium from the latter.

Catastrophes represent a major source of risk for property/casualty underwriters. This is a Catastrophe risk. The Catastrophe Derivatives market was developed in response to the need of insurance, reinsurance and other financial companies to manage their bottom line exposure to major seasonal weather events, such as hurricanes, that cause significant material damage.

Insurers, acting as hedgers, will buy CAT futures or CAT call options. Sellers of CAT derivatives are normally construction companies, reinsurance companies and speculators willing to take risk for profits. Speculators are attracted to CAT derivatives because they are perfect diversification instruments, like zero-beta assets that have low correlation to financial markets.

CARBON DERIVATIVES

Carbon Derivatives are financial contracts with carbon dioxide emissions as the underlying. Since carbon credits are earned by reduction in CO_2 emissions, the Carbon Derivatives derive their value from these reductions. Member firms that do not have enough allowances to cover their emissions must either make reductions or buy another firm’s spare credits. Members with extra allowances can choose to either sell them or stock them for future use. This is what forms the basis for the functioning of carbon derivatives markets. Market forces drive the prices of credits.

A carbon exchange operates like a stock exchange for pollution. The Chicago Climate Exchange (CCX) was the world’s first carbon exchange when it started in 2003. It now has over 300 members, including Intel and Kodak. Currently, emissions-related trading is dominated by the European Climate Exchange, the world’s largest platform for carbon emissions trading and the Chicago Climate Exchange. The establishment of the European Union’s Emission Trading Scheme (EUETS), which commits most big businesses and airlines to emission caps, has led to London becoming the global carbon centre, with all major investment banks running carbon trading desks alongside traditional commodity desks.

After China, India is the leading net seller of Certified Emission Reductions in the world, and will benefit from the carbon credit trade. In India, MCX launched carbon trading for the first time in January 2008 through a strategic alliance with Chicago Climate Exchange (CCX). There are five contracts of carbon credits with expiry on 15th of respective expiry months, starting from December 2008 through December 2012. The trading unit for a contract is of 200 tonnes, where each tonne carbon credit (carbon dioxide emission allowance) being an entitlement to emit one tonne of carbon dioxide equivalent gases. NCDEX started carbon trading in April 2008, with each contract of 500 tonnes.

HEDGING

Hedging is the most common method of price risk management. Hedging means reducing or controlling risk. It entails using the futures market to take a position that balances the position in the physical market with the objective of reducing or limiting risks associated with price changes. Hedging is a two-step process. A gain or loss in cash position due to the changes in price levels will be countered by changes in value of future position due to changes in future position. For instance, a wheat-grower can sell wheat futures to protect the value of his crop prior to harvest. If there is a fall in price, the loss in cash market position will be countered by a gain in futures position.

HEDGING RISKS

Hedging implies taking a position to reduce your risk. There are several risks inherent in business transactions. These risks can be managed more efficiently by unbundling the risks and allowing hedging by the use of derivatives. These risks can be separated for different businesses.

For instance, if we buy and keep copper with us as inventory, we take following risks :

Price risk : Copper prices may go up or down due to any specific reasons, If it goes down, value of our inventory goes down.

Liquidity risk : If our position is very large, we may not be able to cover our position at the prevailing price (called impact cost). Liquidating the position may cause loss in value as price goes down.

Counterparty (credit risk) : It may happen that after negotiating the deal and receiving the prices, the supplier goes bankrupt or even that after the delivery, we realize that the quality is significantly different.

Once you have the physical copper with you, you can hedge by going short on the copper futures. The credit risk will be absorbed by the exchange in this case.

In the case of a hedger seeking to offset the price risk on his holding of inventory of commodities by selling futures in the same, his position will be as follows :

Hedging in the futures market is a two-step process. Depending upon the hedger's cash market situation, he either will buy or sell futures first. For instance, if he is going to buy a commodity in the cash market at a later time, his first step is to buy futures contracts. Or if he is going to sell cash commodity at a later time, his first step is to sell futures contracts. The second step occurs when the cash market transaction takes place. At this time, the futures position is no longer needed for price protection and should be offset (closed out). If the hedger was initially long (long hedge), he would offset his position by selling the contract. If he was initially short (short hedge), he would buy back the futures contract. Both the opening and closing positions must be for the same commodity, number of contracts, and delivery month.

However, here we have assumed that the farmer expects and finally produces the output in the same quantity. But what in real markets do not happen is the quantity matching. There is always a gap between expected and actual output. This is defined as a quantity risk.

If the output on the maturity is lesser, the quality mismatch may affect the hedge. Besides, it will also affect the final revenue that the producer generates. Even with the hedging plan using futures contract, the producer is not able to cover the losses. But unfortunately, such risk cannot be hedged using the commodity derivative.

UNDERSTANDING BASIS RISK

The primary definition of basis is the difference between cash price and futures price.

Basis = Cash Price – Futures Price

Basis is used to determine :

(i) The best time to buy or sell

(ii) When to use the futures market to hedge a purchase or sale

(iii) The futures month in which to place a hedge.

(iv) When to accept a supplier's offer or a buyer's bid.

(v) Resale bids.

Basis is the difference between the local cash price of a commodity and the price of a specific futures contract of the same commodity at any given point in time.

Local cash price	₹2400
Jan futures price	₹2600
Basis	₹200 Jan

In such case, the cash price is ₹200 lower than the January futures price. In market terms, it is said that the basis is "200 under January", On the other hand, if the cash price is ₹200 higher than the January futures price, you had say the basis is "200 over January".

Local cash price	₹2800
Jan futures price	₹2600
Basis	₹200 Jan

In a normal (contango) market, basis is always under but in an inverted market (backwardation) it is over.

If a futures contract does not exist for a specific commodity, the price of a related futures contract may be used; e.g., a Crude oil future is used to calculate the basis for jet fuel. We can call basis as "localizing" a futures price. The futures market price represents the single nation/International price for commodity and is used as a benchmark in determining the value of grain at the local level. Because basis reflects local market conditions, it is directly included by several factors including transportation costs, local supply and demand conditions, such as quality, availability, need local weather, storage costs, handling costs and profit margins.

Revision in Position Limits for Agricultural Commodities.- In continuation of SEBI circular No CIR/CDMRD/DMP/2/2016 dated January 15, 2016, the following directions are hereby issued with respect to provisions of open position limits for futures contracts on agricultural commodities:

(a) Client level -

- Overall position limit for a particular commodity shall be restricted to numerical position limits as mandated from time to time. For the present, the numerical position limits as existing shall be continued. It is clarified that client level position limit equal to 5% of market wide open interest permitted earlier, is hereby discontinued.

- Position limit for a particular commodity shall be restricted to one-fourth of the client level overall position limit in that commodity.
- For the purpose of calculating overall position, all long and short positions of the client across all contracts on the underlying will be added up separately and higher of the two shall be considered as overall open position.
- For calculating near month open position, higher of long and short positions of the client in near month contracts to be considered.
- Thus henceforth, netting out near month contract with off-setting positions in far months contracts shall not be permitted for the purpose of computation of near month position of any client.

(b) Member level –

- Overall position limit for a particular commodity shall be the numerical position limits as mandated from time to time or 15% of market wide open interest, whichever is higher.
- Position limit for a particular commodity shall be one-fourth of the member's overall position limit in that commodity.
- For the purpose of calculating overall position, the position of the clients as determined above will be added without netting off among themselves as also against proprietary position of the member (which will also be treated like a client position). All longs and shorts will be added up separately and higher of the two will be reckoned.
- For calculating near month open position, the position of the clients as determined above will be added without netting off among themselves as also against proprietary position of the member (which will also be treated like a client position). All longs and shorts will be added up separately and higher of the two will be reckoned.
- Position limits for member's proprietary positions shall be same as client level position limits.

LESSON ROUND UP

– A Commodity is an economic good, tradable good, product or article of commerce; something for which there is an established market where the commodity can be bought and sold in commercial transactions between willing buyers and sellers.

– Commodities can be perishable or non-perishable. Non-perishable commodities such as metals are called hard commodities. Perishable commodities such as agricultural commodities are called soft commodities.

– Every commodity that is produced (or grown) must eventually come to a market place where it can be bought and sold. It is in this marketplace that all the elements of commerce will come together to settle a price at which the commodity will get traded.

– The trading of commodities in commodity markets consists of direct physical trading (spot trading) and derivatives trading.

– Agricultural Marketing includes the movement of agricultural produce from the farm where it is produced to the end-consumers or manufacturers.

– The process of Direct Marketing enables farmers to meet the specific demands of wholesalers or traders from the farmer's inventory of graded and certified produce on one hand and of consumers based on consumers preference on the other hand.

– In Indirect Marketing, rather than the agricultural commodities directly passing from producers to end-consumers, they move from producers to end-consumers through a chain of intermediaries or middlemen.

– Variety is the very essence of commodity trading, and depends on the ability to build liquid and transparent derivatives in emerging asset classes.

– Weather Derivatives are financial instruments that seem like an insurance policy but are more like options. The underlying asset is any measureable weather factor, that is, temperature measured in degrees Celsius or Fahrenheit, rainfall measured in centimeters, or snowfall measured in inches.

– Freight Derivatives are financial instruments used by organizations and individuals as part of their risk management strategy to counter the negative economic effects of freight rate alterations that harm the financial prospect of a company.

– Energy derivatives are derivative instruments with the underlying asset being any energy product, including oil, natural gas and electricity, which trade either on an exchange or over-the counter.

– The Catastrophe Derivatives Market was developed in response to the need of insurance, reinsurance and other financial companies to manage their bottom line exposure to major seasonal weather events, such as hurricanes, that cause significant material damage.

– Carbon Derivatives are financial contracts with carbon dioxide emissions as the underlying. Since carbon credits are earned by reduction in CO_2 emissions, the Carbon Derivatives derive their value from these reductions.

– Hedging is the most common method of price risk management. Hedging means reducing or controlling risk. It entails using the futures market to take a position that balances the position in the physical market with the objective of reducing or limiting risks associated with price changes.

SELF TEST QUESTION

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

1. What is a commodity? What are its properties?
2. Explain various types of commodities.
3. What is contract farming? Briefly discuss.
4. What do you understand by Weather Derivative? Briefly explain how it works?
5. What is Hedging? How risk can be reduced by using hedge mechanism?

Lesson 11
Commodities Market Operations

LESSON OUTLINE

– Introduction
– Role of Commodity Exchanges
– Evolution of Commodity Exchanges
– Origin of Commodity Market in India
– Regulatory Framework
– Forward Market Commission
– Commodity Exchanges in India
– Participants/ Players
– Trading in Commodity Market
– Order Types
– Electronic Spot Exchanges
– Exchange Membership
– Clearing and Settlement
– Entities involved in physical settlement
– Instruments available for Trading
– Using Commodity Exchanges for Hedging, Speculation and Arbitrage
– LESSON ROUND UP
– SELF TEST QUESTIONS

LEARNING OBJECTIVES

Commodity Markets are an important aspect of economic growth in most of the emerging markets. Commodity Markets in India have also witnessed rapid growth in the recent period. The Forward Markets Commission (FMC), a regulatory authority entrusted with the regulation and development of commodity markets in India, has created an extensive framework of regulation and market conduct along with development of institutions and intermediaries that led to impressive growth of commodity markets, including spot and futures exchanges, warehouses and delivery points, quality standards and specifications, specialized investors, risk management products and processes, and hedging tools and techniques.

In this background, it becomes important that awareness, information, and education on the functioning of commodity markets be required to be provided to the students.

This lesson will enable the students to understand the concepts and terms of the Commodity Market i.e. participants in the Commodity Market, Trading, Clearing and Settlement Systems and Mechanisms at Commodity Exchanges, instruments available for trading, regulatory framework of Commodity Market in India etc.

INTRODUCTION

Commodity Exchanges are defined as centers where futures trade is organized in a wider sense; it is taken to include any organized market place where trade is routed through one mechanism, allowing effective competition among buyers and among sellers. This would include auction-type exchanges, but not wholesale markets, where trade is localized, but effectively takes place through many non-related individual transactions between different permutations of buyers and sellers.

ROLE OF COMMODITY EXCHANGES

Commodity Exchanges provide platforms to suit the varied requirements of customers. Firstly, they help in price discovery as players get to set future prices which are also made available to all participants. Hence, a farmer in the southern part of India would be able to know the best price prevailing in the country which would enable him to take informed decisions.

Secondly, these exchanges enable actual users (farmers, agro processors, industry where the predominant cost is commodity input/output cost) to hedge their price risk given the uncertainty of the future - especially in agriculture where there is uncertainty regarding the monsoon and hence prices. This holds good also for non-agro products like metals or energy products as well where global forces could exert considerable influence. Purchasers are also assured of a fixed price which is determined in advance, thereby avoiding surprises to them. It must be borne in mind that commodity prices in India have always been woven firmly into the international fabric. Today, price fluctuations in all major commodities in the country mirror both national and international factors and not merely national factors.

Thirdly, Commodity Exchanges provide liquidity and buoyancy to the system by involving the group of Investors and Speculators.

Lastly, the arbitrageurs play an important role in balancing the market as arbitrage conditions, where they exist, are ironed out as arbitrageurs trade with opposite positions on different platforms and hence generate opposing demand and supply forces which ultimately narrows down the gaps in prices.

It must be pointed out that while the monsoon conditions affect the prices of agro-based commodities, the phenomenon of globalization has made prices of other products such as metals, energy products, etc., vulnerable to changes in global politics, policies, growth paradigms, etc. This would be strengthened as the world moves closer to the resolution of the WTO impasse, which would become a reality shortly. Commodity exchanges would provide a valuable hedge through the price discovery process while catering to the different kinds of players in the market.

EVOLUTION OF COMMODITY EXCHANGES

Most of the Commodity Exchanges, which exist today, have their origin in the late 19th and earlier 20th century. The first central exchange was established in 1848 in Chicago under the name Chicago Board of Trade. The emergence of the derivatives markets as the effective risk management tools in 1970s and 1980s has resulted in the rapid creation of new Commodity Exchanges and expansion of the existing ones. At present, there are major Commodity Exchanges all over the world dealing in different types of commodities.

ORIGIN OF COMMODITY MARKET IN INDIA

Cotton was the first commodity to attract futures trading in the country leading to the setting up of the Bombay Cotton Trade Association Ltd in 1875. It was the first organized futures market. Bombay Cotton Exchange Ltd. was established in 1893 following the widespread discontent amongst leading cotton mill owners and merchants over functioning of Bombay Cotton Trade Association. The Futures trading in oilseeds started in 1900 with the establishment of the Gujarati Vyapari Mandali, which carried on futures trading in groundnut, castor seed and cotton. Futures trading in wheat was existent at several places in Punjab and Uttar Pradesh. But the most notable futures exchange for wheat was Chamber of Commerce at Hapur set up in 1913. Futures trading in bullion began in Mumbai in 1920. Calcutta Hessian Exchange Ltd. was established in 1919 for futures trading in raw jute and jute goods. But organized futures trading in raw jute began only in 1927 with the establishment of East Indian Jute Association Ltd. These two associations amalgamated in 1945 to form the East India Jute & Hessian Ltd. to conduct organized trading in both Raw Jute and Jute goods. Forward Contracts (Regulation) Act was enacted in 1952 and the Forwards Markets Commission (FMC) was established in 1953 under the Ministry of Consumer Affairs and Public Distribution.

India was in an era of physical controls since independence. Agricultural commodities were associated with the poor and were governed by policies such as Minimum Price Support and Government Procurement. Further, as production levels were low and had not stabilized, there was the constant fear of misuse of these platforms which could be manipulated to fix prices by creating artificial scarcities. This was also a period which was associated with wars, natural calamities and disasters which invariably led to shortages and price distortions. Hence, in an era of uncertainty with potential volatility, the government banned futures trading in commodities in the 1960s. The Khusro Committee which was constituted in June 1980 had recommended reintroduction of futures trading in most of the major commodities, including cotton, kapas, raw jute and jute goods and suggested that steps may be taken for introducing futures trading in commodities, like potatoes, onions, etc. at appropriate time. The government, accordingly initiated futures trading in Potato during the latter half of 1980 in quite a few markets in Punjab and Uttar Pradesh.

With the gradual trade and industry liberalization of the Indian Economy pursuant to the adoption of the economic reform package in 1991, Government of India constituted another committee on Forward Markets under the chairmanship of Prof. K.N. Kabra. The committee recommended that some of the existing commodity exchanges particularly the ones in pepper and castor seed, may be upgraded to the level of international futures markets.

The Expert Committee on Strengthening and Developing Agricultural Marketing (Guru Committee: 2001) emphasized the need for and role of futures trading in price risk management and in marketing of agricultural produce. This Committee's Group on Forward and Futures Markets recommended that it should be left to interested exchanges to decide the appropriateness/usefulness of commencing futures trading in products (not necessarily of just commodities) based on concrete studies of feasibility on a case-to-case basis. It, however, noted that all the commodities are not suited for futures trading. For a commodity to be suitable for futures trading it must possess some specific characteristics.

The liberalized policy being followed by the Government of India and the gradual withdrawal of the procurement and distribution channel necessitated setting in place, a market mechanism to perform the economic functions of price discovery and risk management. The National Agriculture Policy announced in July 2000 and the announcements of Hon'ble Finance Minister in the Budget Speech for 2002-2003 were indicative of the Governments resolve to put in place a mechanism of futures trade/market. As a follow up, the Government issued notifications on 1.4.2003 permitting futures trading in the commodities. With the issue of these notifications futures trading is not prohibited in any commodity. **Options trading in commodity is, however presently prohibited.**

The year 2003 is a landmark in the history of commodity futures market witnessing the establishment and recognition of three new national exchanges National Commodity and Derivatives Exchange of India Ltd. (NCDEX), Multi Commodity Exchange of India Ltd (MCX) and National Multi Commodity Exchange of India Ltd. (NMCE) with on-line trading and professional management. Not only was prohibition on forward trading completely withdrawn, the new exchanges brought capital, technology and innovation to the market.

REGULATORY FRAMEWORK

After Independence, the Parliament passed Forward Contracts (Regulation) Act, 1952 which regulated forward contracts in commodities all over India. The Act applies to goods, which are defined as any movable property other than security, currency and actionable claims. The Act prohibited options trading in goods along with cash settlements of forward trades. Under the Act, only those associations/exchanges, which are granted recognition by the Government, are allowed to organize forward trading in regulated commodities. The Act envisages three-tier regulation: (i) The Exchange which organizes forward trading in commodities can regulate trading on a day-to-day basis; (ii) the Forward Markets Commission provides regulatory oversight under the powers delegated to it by the central Government, and (iii) the Central Government - Department of Consumer Affairs, Ministry of Consumer Affairs, Food and Public Distribution - is the ultimate regulatory authority.

THREE-TIER REGULATORY SYSTEM

First tier: Central Government

Central Government has been given with highest authority to control FMC as well as Exchanges.

(a) It has powers to grant / withdraw recognition of Exchanges.

(b) It notifies the commodities under section 15,17 and 18(3).

(c) It supersedes the governing body of recognized association or exchange.

Second tier: Forward Market Commission

Forward Market Commission comes under the second tier of the authority hierarchy. It has control over Exchanges and it works under the control of Central Government. In brief, it

(a) Approves Rules and Bye-laws of Exchanges.

(b) Grants trading permissions subject to appropriate regulatory.

(c) Monitors and surveys the markets.

(d) Conducts inspection of Exchanges and their Members.

(e) Appoints independent directors on the boards of Exchanges.

(f) May suspend a Member of the Exchange.

(g) Informs and assists Police Authorities in investigation and prosecution for illegal irregular trading.

Third tier: Exchanges

Functions of the exchanges are, –

(a) Conduct trading on the basis of the articles, bye laws approved by the commission

(b) May take action against any intermediary.

FORWARD MARKET COMMISSION OF INDIA

The Forward Markets Commission is a regulatory body for Commodity Markets in India. The forward contracts in commodities are regulated as per F.C.(R) Act, 1952 by this body. Inherent objective is to achieve price stability by means of price discovery and risk management. The Commission also collects information regarding the trading conditions in respect of goods to which any of provisions of Act is made applicable. It also advises Central Government regarding recognition of associations.

Functions of Forward Market Commission of India

(a) To advice the Central Government in respect of the recognition or withdrawal of recognition from any association. It also advices Government about any other matter arising out of the administration of this act.

(b) Second function of the act includes the task of keeping forward markets under observation and take necessary actions. The actions taken should be according to powers given to the commission by the "Forward Contract Regulation Act".

(c) To collect information regarding the trading conditions in respect of goods (to which any of the provisions of this Act is made applicable) including information regarding supply, demand and prices, and publish information whenever the Commission thinks it necessary,

It also performs the task of submitting to the Central Government periodical reports on the operation of this Act and on the working of forward markets relating to such goods.

(d) To make recommendations generally with a view to improving the organization and working of forward markets

(e) To undertake the inspection of the accounts and other documents of any recognized association or registered association or any member of such association whenever it considers it necessary.

(f) To perform such specified duties and exercise assigned powers by the "Forward Contract Regulation Act".

Powers of Forward Market Commission

1. The Commission shall, in the performance of its functions, have all the powers of 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 any document.

(c) Receiving evidence on affidavits.

(d) Requisitioning any public record or copy thereof from any office.

(e) Any other matters which may be prescribed.

2. The Commission shall have the power to require any person, subject to any privilege which may be claimed by that person under any law for the time being in force, to furnish information on such points or matters as in the opinion of the Commission may be useful for, or relevant to any matter under the consideration of the Commission and any person so required shall be deemed to be legally bound to furnish such information within the meaning of Sec. 176 of the Indian Penal code, 1860.

3. The Commission shall be deemed to be a civil court and when any offence described in Sections. 175, 178, 179, 180 or Sec. 228 of the Indian Penal Code, 1860 , is committed in the view or presence of the Commission, the Commission may, after recording the facts constituting the offence and the statement of the accused as provided for in the Code of Criminal Procedure, 1898 forward the case to a Magistrate having jurisdiction to try the same and the Magistrate to whom any such case is forwarded shall proceed to hear the complaint against the accused as if the case had been forwarded to him under Section 482 of the said Code.

4. Any proceeding before the Commission shall be deemed to be a judicial proceeding within the meaning of Sections. 193 and 228 of the Indian Penal Code, 1860.

COMMODITY EXCHANGES IN INDIA

There are more than 20 recognised commodity futures exchanges in India under the purview of the Forward Markets Commission (FMC). The country's commodity futures exchanges are divided majorly into two categories:

– National exchanges

– Regional exchanges

The six exchanges operating at the national level are:

(i) National Commodity and Derivatives Exchange of India Ltd. (NCDEX)

(ii) National Multi Commodity Exchange of India Ltd. (NMCE)

(iii) Multi Commodity Exchange of India Ltd. (MCX)

(iv) Indian Commodity Exchange Ltd. (ICEX)

(v) Ace Derivatives and Commodity Exchange Limited

(vi) Universal Commodity Exchange Ltd.

The leading regional exchange is the National Board of Trade (NBOT) located at Indore. There are 16 regional Commodity Exchanges in India.

Features

Some of the features of national and regional exchanges are listed below:

National Exchanges

- Compulsory online trading
- Transparent trading
- Exchanges to be de-mutualised
- Exchange recognised on permanent basis
- Multi commodity exchange
- Large expanding volumes

Regional Exchanges

- Online trading not compulsory
- De-mutualisation not mandatory
- Recognition given for fixed period after which it could be given for re regulation
- Generally, these are single commodity exchanges. Exchanges have to apply for trading each commodity.
- Low volumes in niche markets.

PARTICIPANTS/PLAYERS

Broadly, the participants in commodity market can be classified as Hedgers, Arbitraguers and Speculators. In other words, manufacturers, traders, farmers, exporters and investors are all participating in this market.

HEDGERS

Hedger is the person who basically wants to avoid risk and enters into a contract with speculator. Hedger is a user of the market, who enters into futures contract to manage the risk of adverse price fluctuation in respect of his existing or future asset. Hedgers are those who have an underlying interest in the commodity and are using futures market to insure themselves against adverse price fluctuations. Examples could be stockists, exporters, producers, etc

Hedging means taking a position in the futures or option market that is opposite to a position in the physical market. It reduces or limits risks associated with unpredictable changes in price. The objective behind this mechanism is to offset a loss in one market with a gain in another.

Hedging is a mechanism by which the participants in the physical/ cash markets can cover their price risk. Theoretically, the relationship between the futures and cash prices is determined by cost of carry. This enables the participants in the physical/ cash markets to cover their price risk by taking opposite position in the futures market.

Hedging is a mechanism of avoiding exposure to risk of fluctuating prices in futures markets will be effective only when the following requirements are met.

– Driven by the demand and supply over a period the prices of cash and futures markets tend to move together

– As the maturity date approaches, cash and futures prices tend to converge or reach a predictable difference called the basis.

Hedging in the futures market in general is a two-step process, depending upon the hedger's cash market situation

First step: If the hedger is going to buy a commodity in the cash market at a later time, his first step is to buy futures contracts. Or if he is going to sell cash commodity at a later time, his first step in the hedging process is to sell futures contracts.

Second step: when the cash market transaction takes place, the futures position is no longer needed for price protection and should therefore be offset (closed out). Depending on the initial position taken long (long hedge) or short (short hedge), hedger would offset his position by selling or buying back the futures contract. Both the opening and closing positions must be for the same commodity, number of contracts, and delivery month.

For example, in June if a farmer expects an output of 100 tonnes of soyabean in October. Soyabean prices in October are expected to rule relatively lower as it is harvesting season for soya bean. In order to hedge against the price fall, the farmer/producer sells 100 contracts of one tonne each at ₹ 1347 on June 22. On a fall of price to ₹ 1216 per tonne in October he makes a profit of ₹ 131 per tonne.

SPECULATOR

A trader, who trades or takes position without having exposure in the physical market, with the sole intention of earning profit is a speculator. Speculators are those who may not have an interest in the ready contracts, etc. but see an opportunity of price movement favourable to them. They are prepared to assume the risks, which the hedgers are trying to cover in the futures market. They provide depth and liquidity to the market. They provide a useful economic function and are an integral part of the futures the market. It would not be wrong to say that in absence of speculators the market will not be liquid and may at times collapse.

A speculator is one who enters the market to profit from the future price movements. He does not have any physical exposure. Speculators accept the risk that hedgers seek to avoid, giving the required liquidity to the market.

Contrary to the hedging, speculation involves risk but no offsetting of cash market position. Speculators on the other hand, wish to take risk that hedgers want to avoid with a motive to make profits and provide the necessary liquidity through bids and offer that result into a continuous flow of transactions. Commodities are becoming increasingly attractive to investor and hedge fund managers as an alternative asset class that may allow reduction in overall risk of financial portfolio and enhance returns.

For example if an investor wants to diversify his investment portfolios, he can chose commodities as a bright option. Unlike in spot markets, he has to invest only a margin amount instead of the total amount and can gain profits to the total extent.

Need of speculators in futures market

Participants in physical markets use futures market for price discovery and price risk management. In fact, in the absence of futures market, they might speculate on prices in unorganized markets. Futures market helps them to avoid speculation by entering into hedge contracts. It is however extremely unlikely for every hedger to find a hedger counterpart with matching requirements. The hedgers intend to shift price risk, which they can only if there are participants willing to accept the risk. Speculators are such participants who are willing to take risk of hedgers in the expectation of making profit. Speculators provide liquidity to the market, therefore, it is difficult to imagine a futures market functioning without speculators.

Difference between a speculator and gambler

Speculators are not gamblers, since they do not create risk, but merely accept the risk, which already exists in the market. The speculators are the persons who try to assimilate all the possible price-sensitive information, on the basis of which they can expect to make profit. The speculators therefore contribute in improving the efficiency of price discovery function of the futures market.

ARBITRAGEURS

Arbitrage refers to the simultaneous purchase and sale in two markets so that the selling price is higher than the buying price by more than the transaction cost, resulting in risk-less profit to the arbitrageur. Arbitrage is making purchases and sales simultaneously in two different markets to profit from the price differences prevailing in those markets. The factors driving arbitrage are the real or perceived differences in the equilibrium price as determined by supply and demand at various locations.

A third category of market participants is the arbitrageurs. Arbitrage is a risk-less profit realized by simultaneous trading in two or more markets. However, arbitrage opportunities are very desirable but not easy to uncover, as they do not last longer since the prices get adjusted soon with buying and selling

Arbitrage is possible when one of the three conditions is met:

- The same asset must trade at the different prices on all markets.
- Two assets with identical cash flows must trade at different prices.
- An asset with a known price in the future, must trade today at a different price than its future price discounted at the risk-free interest rate.

COMMODITY PRODUCERS/CONSUMERS

These participants have natural underlying outright long (producers) and short (consumers) positions in the relevant commodity. The inherent risk-exposure drives the use of commodity derivatives by producers and users.

The application of commodity derivatives in frequently driven by the pattern of cash flows. Producers must generally make significant capital investments (sometime significant in scale) to undertake the production of the commodity. This investment must generally be made in advance of production and sale of the commodity. This means that the producer is exposed to the price fluctuations in the commodity.

If prices decline sharply, then revenues may be insufficient to cover the cost of servicing the capital investment (including debt service). This means that there is a natural tendency for producers to hedge at levels that ensure adequate returns without seeking to optimize the potential returns from higher returns. This may also be necessitated by the need to secure financing for the project.

Commodity Processors

These participants have limited outright price exposure. This reflects the fact that the processors have a spread exposure to the price differential between the cost of the input and the cost of the output. For example, oil refiners are exposed to the differential between the price of the crude oil and the price of the refined oil products (diesel, gasoline, heating oil, aviation fuel, etc.). The nature of the exposure drives the types of hedging activity and the instruments used.

Commodity Traders

Commodity Markets have complex trading arrangements. This may include the involvement of trading companies. Where involved, the traders act as an agent or principal to secure the sale/purchase of the commodity. Traders increasingly seek to add value to pure trading relationship by providing derivative/risk management expertise. Traders also occasionally provide financing and other services. Commodity traders have complex hedging requirements, depending on the nature of their activities.

A trader as a pure agent will generally have no price exposure. Where a trader acts as a principal, it will generally have outright commodity price risk that requires hedging. Where traders provide ancillary services such as commodity derivatives as the principal, the market risk assumed will need to be hedged or managed.

Financial Institution/Dealers

Dealer participation in Commodity Markets is primarily as a provider of finance or provider of risk management products. The dealers' role is similar to that in the derivative market in other asset classes. The dealers provide credit enhancement, speed, immediacy of execution and structural flexibility. Dealers frequently bundle risk management products with other financial services such as provision of finance.

Investors

This covers financial investors seeking to invest in commodities as a distinct and a separate asset class of financial investment. The gradual recognition of commodities as a specific class of investment assets is an important factor that has influenced the structure of commodity derivatives markets.

TRADING IN COMMODITY MARKET

These are few important terms and its explanations which are essential for any person entering to trade in commodities market.

Margin money

Margin money is the security deposit given by the trading members to the exchange in order to deal in different contracts listed over there. The clients deposit this money with the members who in turn transfer it to the respective exchanges.

The aim of margin money is to minimize the risk of default by either counter party. The amount of initial margin is so fixed as to ensure that the probability of loss on account of worst possible price fluctuation (which cannot be met by the amount of ordinary/initial margin) is very low. The Exchanges fix rates of ordinary/initial margin keeping in view, need to balance high security of contract and low cost of entering into contract.

In futures trading, the entire value of a contract need not be paid, rather a margin that is typically between 2 per cent and 10 per cent of the total value of the contract need to be paid while entering into the contract. It is part of the risk management system as prescribed by the market regulator, Forward Markets Commission (FMC).

Different types of margins payable on futures

Different margins payable on futures contracts are:

(i) ordinary/initial margin,

(ii) mark-to-market margin,

(iii) special margin,

(iv) volatility margin

(v) delivery margin

(i) Initial/ordinary margin: It is the amount required to be deposited by the market participants in his margin account with clearing house before they can place order to buy or sell futures contracts. This must be maintained throughout the time their position is open and is returnable at delivery, expiry or closing out.

When a futures trader enters into a futures position, he or she is required to post initial margin of an amount specified by the exchange or clearing organization. Thereafter, the margin becomes "marked-to-market" and the margin account will be adjusted automatically according to the changes in futures price

(ii) Mark-to-Market (MTM or M2M): At the end of every trading day, the margin account of the trader / client is adjusted to reflect the participant's gain or loss. The price changes on the close of every trading day may result in some gain or loss as compared to the previous day's closing price. These price variations are netted into the daily margin account. This process is known as marking to the market.

Mark-to-market margins (MTM or M2M) are payable based on closing prices at the end of each trading day. These margins will be paid by the buyer if the price declines and by the seller if the price rises. This margin is worked out on difference between the closing/clearing rate and the rate of the contract (if it is entered into on that day) or the previous day's clearing rate. The Exchange collects these margins from buyers if the prices decline and pays to the sellers and vice versa.

Collecting mark-to-market margin on a daily basis reduces the possibility of accumulation of loss, particularly when futures price moves only in one direction. Hence the risk of default is reduced. Also, the participants are required to pay less upfront margin - which is normally collected to cover the maximum, say, 99.9%, of the potential risk during the period of mark-to-market, for a given limit on open position. Alternatively, for the given upfront margin the limit on open position would have to be reduced, which has the effect of restraining the trade and liquidity.

(iii) Special Margin/Additional Margin: It is the additional margin imposed by the exchange to curb excess volatility in the market. Again, this varies from commodity to commodity.

(iv) Maintenance margin: it is the minimum level at which the equity in a futures account must be maintained. If the equity in an account falls below this level, a margin call will be issued, and funds must be added to bring the account back to the initial margin level. The maintenance margin level generally is normally 75 per cent of the initial margin requirement. If the amount of money in the margin account falls below the specified maintenance margin, the futures trader will be required to post additional variation margin to bring the account up to the initial margin level and if the futures position is profitable, the profits will be added to the margin account.

(v) Delivery period margin: It is the extra margin imposed by the exchange on the contracts when it enters the concluding phase (starts with tender period and goes up to delivery / settlement). This amount is applicable on both the outstanding buy and sell positions.

ORDER TYPES

An electronic trading system allows the trading members to enter orders with various conditions attached to them as per their requirements. These conditions are broadly divided into the following categories.

(i) Time conditions

(ii) Price conditions

(iii) Other conditions

(i) Time condition

Good till day order (GTO): A day order as the name suggests is an order which is valid for the day on which it is entered . If the order is not executed during the day , the system cancels the order automatically at the end of the day.

Good till cancelled (GTC) :GTC order remains in the system until the user cancels it. Consequently, it spans trading days, if not traded on the day the order is entered.

Good till date (GTD): A GTD order allows the user to specify the date till which the order should remain in the system if not executed.

Immediate or cancel (IOC)/Fill or kill order: An IOC order allows the user to buy or sell a contract as soon as the order is released in to the system,failing which the order is cancelled from the system . Partial match is possible for the order, and the unmatched portion of the order is cancelled immediately.

(ii) Price condition

Limit order : An order to buy or sell a stated amount of commodity at a specified price , or at a better price , if obtainable at the time of execution.

Stop loss order : A stop loss order is an order , placed with the broker , to buy or sell a particular futures contract at the market price if and when the price reaches a specified level.Futures traders often use stop orders in an effort to limit the amount they might lose if the futures price moves against their position.

(iii) Other Conditions

Market price : Market orders are orders for which no price is specified at the time the order is entered (Price is market price).

Trigger price : Price at which an order gets triggered from stop loss book.

Spread order : A simple spread order involves two positions , one long and one short. They are taken in a same commodity with different months (calendar spread) or in closely related commodities.

ELECTRONIC SPOT EXCHANGES

Electronic Spot Exchanges is an emerging phenomenon in the country. These spot exchanges provide real time, online, transparent and vibrant spot platform for commodities. The contracts allow participants from all over the country to buy and sell, thereby enabling producers and users to discover best price.

The Government has allowed the National Commodity Exchanges to set up three spot exchanges in the country, namely the National Spot Exchange Ltd. (NSEL), NCDEX Spot Exchange Ltd. (NSPOT) and National Agriculture Produce Marketing Company of India Ltd. (NAPMC). During 2009, there was significant expansion of spot exchanges trading facilities in India. These spot exchanges have created an avenue for direct market linkage among farmers, processors, exporters and end users with a view to reducing the cost of intermediation and enhancing price realization by farmers. They will also provide the most efficient spot price inputs to the futures exchanges. The spot exchanges will encompass the entire spectrum of commodities across the country and will bring home the advantages of an electronic spot trading platform to all market participants in the agricultural and non-agricultural segments. On the agricultural side, the exchanges would enable farmers to trade seamlessly on the platform by providing real-time access to price information and a simplified delivery process, thereby ensuring the best possible price. On the buy side, all users of the commodities in the commodity value chain would have simultaneous access to the exchanges and be able to procure at the best possible price. Therefore, the efficiency levels attained as a result of such seamless spot transactions would result in major benefits for both producers and consumers. In order to overcome current inefficiencies in the commodities spot market and to bring transparency in trading in commodity spot markets, the National Commodity and Derivatives Exchange Limited (NCDEX) has set up an electronic spot exchange called NCDEX Spot Exchange Limited.

EXCHANGE MEMBERSHIP

The Commodity Exchange membership is open to any person, association of persons, partnerships, co-operative societies, companies etc. that fulfills the eligibility criteria set by the Exchange. FIs, NRIs, Banks, MFs etc are not allowed to participate in Commodity Exchanges at the moment. All the members of the Exchange have to register themselves with the competent authority before commencing their operations. The members of commodity exchange fall into following categories:

1. Trading cum Clearing Member (TCM) : Members can carry out the transactions (Trading, clearing and settlement) on their own account and also on their clients' accounts. Applicants accepted for admission as TCM are required to pay the requisite fees/ deposits and also maintain net worth as specified by the commodity exchange.

2. Professional Clearing Members (PCM): Members can carry out the settlement and clearing for their clients who have traded through TCMs or traded as TMs. Applicants accepted for admission as PCMs are required to pay the requisite fee/ deposits and also maintain net worth.

3. Trading Member (TM): Member who can only trade through their account or on account of their clients and will however clear their trade through PCMs/STCMs.

4. Strategic Trading cum Clearing Member (STCM): This is up gradation from the TCM to STCM. Such member can trade on their own account, and also on account of their clients. They can clear and settle these trades and also clear and settle trades of other trading members who are only allowed to trade and are not allowed to settle and clear.

CLEARING AND SETTLEMENT

Most futures contracts do not lead to the actual physical delivery of the underlying asset. The settlement is done by closing out open positions, physical delivery or cash settlement. All these settlement functions are taken care of by an entity called clearing house or clearing corporation.

CLEARING

Clearing of trades that take place on an Exchange happens through the Exchange Clearing House. A clearing house is a system by which Exchanges guarantee the faithful compliance of all trade commitments undertaken on the trading floor or electronically over the electronic trading systems. The main task of the clearing house is to keep track of all the transactions that take place during a day so that the net position of each of its members can be calculated. It guarantees the performance of the parties to each transaction. Typically it is responsible for the following:

1. Effecting timely settlement.

2. Trade registration and follow up.

3. Control of the open interest.

4. Financial clearing of the payment flow.

5. Physical settlement (by delivery) or financial settlement (by price difference) of contracts.

6. Administration of financial guarantees demanded by the participants.

The clearing house has a number of members, who are responsible for the clearing and settlement of commodities traded on the Exchange. The margin accounts for the clearing house members are adjusted for gains and losses at the end of each day (in the same way as the individual traders keep margin accounts with the broker). Everyday the account balance for each contract must be maintained at an amount equal to the original margin times the number of contracts outstanding. Thus, depending on a day's transactions and price movement, the members either need to add funds or can withdraw funds from their margin accounts at the end of the day. The brokers who are not the clearing members need to maintain a margin account with the clearing house member through whom they trade.

Clearing Mechanism

Only clearing members including professional clearing members (PCMs) are entitled to clear and settle contracts through the clearing house. The clearing mechanism essentially involves working out open positions and obligations of clearing members. This position is considered for exposure and daily margin purposes. The open positions of PCMs are arrived at by aggregating the open positions of all the Trading Members clearing through him, in contracts in which they have traded. A Trading-cum-Clearing Member's (TCM) open position is arrived at by the summation of his clients' open positions, in the contracts in which they have traded. Client positions are netted at the level of individual client and grossed across all clients, at the member level without any set-offs between clients. Proprietary positions are netted at member level without any set-offs between client and proprietary positions. After the trading hours on the expiry date, based on the available information, the matching for deliveries takes place firstly, on the basis of locations and then randomly, keeping in view the factors such as available capacity of the vault/ warehouse, commodities already deposited and dematerialized and offered for delivery etc. Matching done by this process is binding on the clearing members. After completion of the matching process, clearing members are informed of the deliverable/ receivable positions and the unmatched positions. Unmatched positions have to be settled in cash. The cash settlement is only for the incremental gain/ loss as determined on the basis of final settlement price.

Clearing Banks

Commodity exchange has designated clearing banks through whom funds to be paid and/ or to be received must be settled. Every clearing member is required to maintain and operate a clearing account with any one of the designated clearing bank branches. The clearing account is to be used exclusively for clearing operations i.e., for settling funds and other obligations to commodity exchange including payments of margins and penal charges. A clearing member having funds obligation to pay is required to have clear balance in his clearing account on or before the stipulated pay-in day and the stipulated time. Clearing members must authorise their Clearing Bank to access their clearing account for debiting and crediting their accounts as per the instructions of commodity exchange, reporting of balances and other operations as may be required by commodity exchange from time to time.

The clearing bank will debit/ credit the clearing account of clearing members as per instructions received from Commodity Exchange.

Depository participants

Every clearing member is required to maintain and operate two CM pool account each at NSDL and CDSL through any one of the empanelled depository participants. The CM pool account is to be used exclusively for clearing operations i.e., for effecting and receiving deliveries from Commodity Exchange.

SETTLEMENT

Settlement involves payments (Pay-Ins) and receipts (Pay-Outs) for all the transactions done by the members. Trades are settled through the Exchange's settlement system.

Future contracts have two types of settlements, the Mark-to-Market (MTM) settlement which happens on a continuous basis at the end of each day, and the final settlement which happens on the last trading day of the futures contract. For Instance, on the NCDEX, daily MTM settlement and final MTM settlement in respect of admitted deals in futures contracts are cash settled by debiting/ crediting the clearing accounts of CMs with the respective clearing bank. All positions of a CM, either brought forward, created during the day or closed out during the day, are marked to market at the daily settlement price or the final settlement price at the close of trading hours on a day.

(i) Daily settlement price: Daily settlement price is the consensus closing price as arrived after closing session of the relevant futures contract for the trading day. However, in the absence of trading for a contract during closing session, daily settlement price is computed as per the methods prescribed by the Exchange from time to time.

(ii) Final settlement price: Final settlement price is the polled spot price of the underlying commodity in the spot market on the last trading day of the futures contract. All open positions in a futures contract cease to exist after its expiration day.

Settlement Mechanism

Settlement of commodity future contracts is a little different from settlement of financial futures which are mostly cash settled. The possibility of physical settlement makes the process a little more complicated.

(i) Daily mark to market settlement

Daily mark to market settlement is done till the date of the contract expiry. This is done to take care of daily price fluctuations for all trades. All the open positions of the members are marked to market at the end of the day and the profit/ loss is determined as below:

- On the day of entering into the contract, it is the difference between the entry value and daily settlement price for that day.
- On any intervening days, when the member holds an open position, it is the difference between the daily settlement price for that day and the previous day's settlement price.
- On the expiry date if the member has an open position, it is the difference between the final settlement price and the previous day's settlement price.

The following explains the MTM for a member who buys one unit of December expiration Chilli contract at ₹ 6435 per quintal on December 15.

MTM on a long position in Chilli Futures

Date	Settlement Price	MTM
December 15	6320	-115
December 16	6250	-70
December 17	6312	+62
December 18	6310	-2
December 19	6315	+5

The unit of trading is 5 MT and each contract is for delivery of 5 MT. The member closes the position on December 19. The MTM profit/ loss per unit of trading show that the member makes a total loss of ₹ 120 per quintal of trading. So upon closing his position, he makes a total loss of ₹ 6000, i.e (5 x 120 x 10) on the long position taken by him. The MTM profit and loss is settled through pay in/ pay out on T+1 basis, T being the trade day.

(ii) Final settlement

On the date of expiry, the final settlement price is the closing price of the underlying commodity in the spot market on the date of expiry (last trading day) of the futures contract. The spot prices are collected from polling participants from base centre as well as other locations. The poll prices are bootstrapped and the mid-point of the two boot strapped prices is the final settlement price. The responsibility of settlement is on a trading cum clearing member for all trades done on his own account and his client's trades. A Professional Clearing Member is responsible for settling all the participants' trades which he has confirmed to the Exchange. Members are required to submit delivery information through delivery request window on the trader workstations provided by commodity exchange for all open positions for a commodity for all constituents individually. This information can be provided within the time notified by Exchange separately for each contracts. The commodity exchange on receipt of such information matches the information and arrives at a delivery position for a member for a commodity. A detailed report containing all matched and unmatched requests is provided to members through the extranet. Pursuant to regulations relating to submission of delivery information, failure to submit delivery information for open positions attracts penal charges as stipulated by the Commodity Exchange from time to time.

Example: A trader enters into a short futures contract to sell July Silver for Rs 40,000 per kilogram on the MCX. The size of the contract is 5 kilogram. The initial margin is Rs 20,000 and the maintenance margin is Rs. 15,000. What is the futures price above which there will be a margin call?

Solution:

There will be a margin call when the difference between the initial margin and the maintenance margin i.e. Rs. 20,000 - Rs. 15,000 = Rs. 5,000/- is lost from that account.

So a change of Rs. 5,000/5 = Rs. 1,000 per kilogram of future price will make a margin call.

Ans: When the price of Silver futures goes above Rs. 41,000/- trader would be asked to deposit the margin amount.

Example: A trader enters into a long futures contract to buy April Gold for Rs. 30,000 per 10 gram on the MCX. The size of the contract is 1000 grams. The initial margin is Rs. 6,000 and the maintenance margin is Rs. 4,000. What price change would lead to margin call? What futures price will allow Rs. 2,000 to be withdrawn from the margin account?

Solution:

A trader has entered into a long future contract and so if the price falls below the maintenance margin, then the trader is required to deposit that amount. In this case the margin amount available is Rs. 6,000- Rs. 4,000 = Rs. 2,000.

So a change of Rs. 2,000/1000grams = Rs. 2 per gram or Rs. 20 per 10 grams future price will make a margin call.

Therefore, if the price falls by Rs. 20 per 10 grams, the trader would be asked to deposit Rs. 2,000. Similarly, if the future price increases by Rs. 20 per 10 grams then a sum of Rs. 2,000 can be withdrawn from the margin account.

SETTLEMENT METHODS

Settlement of futures contracts on the commodity exchange can be done in two ways - by physical delivery of the underlying asset and by closing out open positions. All contracts materialising into deliveries are settled in a period as notified by the Exchange separately for each contract. The exact settlement day for each commodity is specified by the Exchange through circulars known as 'Settlement Calendar'.

(a) Physical delivery of the underlying asset

If the buyer/seller is interested in physical delivery of the underlying asset, he must complete the delivery marking for all the contracts within the time notified by the Exchange.

The following types of contracts are presently available for trading on the exchange Platform.

1. Compulsory Delivery
   – Staggered Delivery
   – Early Delivery
2. Seller's Right
3. Intention Matching

1. Compulsory Delivery Contract

Compulsory Delivery Contracts of Commodities are the contracts in which all the open positions on the expiry date need to be compulsorily settled through physical delivery.

On expiry of a compulsory delivery contract, all the sellers with open position shall give physical delivery of the commodity. That is, the sellers need to deliver the commodity and buyers need to accept the delivery. To allocate deliveries in the optimum location for clients, the members need to give delivery information for preferred location.

The information for delivery can be submitted during the trading hours of 3 trading days in advance of the expiry date and up to 6 p.m. on the last day of marking delivery intention. For example, for contracts expiring on the 20th of the month, delivery intentions window will be open from the 18th and will close on the 20th.Clients can submit delivery intentions up to the maximum of their open positions. In case the delivery intention is not marked the seller would tender delivery from the base location.

Members will be allowed to submit one-time warehouse preference (default location). They can give even multiple warehouse preferences. The same will be sent by the members to the Exchange. This preference will be applicable for all outstanding long and short client positions in that commodity. If the member does not mark any specific location, the default preference will be applied for all open positions. Members can change the default location preference on any day except the last 5 days before the expiry of the contract. For those members, who have not submitted the preference of the default location, delivery will be marked on the base location specified for the commodity.

After the trading hours on the expiry date, based on the available information, the delivery matching is done. All corresponding buyers with open position as matched by the process put in place by the Exchange shall be bound to settle his obligation by taking physical delivery. The deliveries are matched on the basis of open positions and delivery information received by the Exchange. In the event of default by the seller, penalty as may be prescribed by the Exchange from time to time would be levied. The sub-types of Compulsory Delivery Contracts are (i) Staggered Delivery (ii) Early Delivery.

2. Sellers Right Contract

In Seller's Right contracts, delivery obligation is created for all valid sell requests received by the Exchange. Simultaneously, the deliveries are allocated to the buyers with open positions on a random basis, irrespective of whether a buy request has been submitted or not. While allocating the deliveries, preference is given to those buyers who have submitted buy requests.

The information for delivery can be submitted during the trading hours of 3 trading days prior to 5 working days of expiry of contracts. For example, for contracts expiring on the 20th of the month, delivery intentions window will be open from the 13th and will close on the 15th. Clients can submit delivery intentions up to the maximum of their open positions. All open positions of those sellers who fail to provide delivery intention information for physical delivery shall be settled in cash.

In settling contracts that are physically deliverable, the clearing house:

– Assigns longs to shorts (no relationship to original counterparties)

– Provides a delivery venue

Successful matching of requests with respect to commodity and warehouse location results in delivery on settlement day. After completion of the matching process, clearing members are informed of the deliverable/ receivable positions.

3. Intention Matching Contract

The delivery position for intention matching contract would be arrived at by the Exchange based on the information to give/take delivery furnished by the seller and buyer as per the process put in place by the Exchange for effecting physical delivery. If the intentions of the buyers and sellers match, the respective positions would be settled by physical deliveries. The information for delivery can be submitted during the trading hours of 3 trading days prior to 5 working days of expiry of contracts. For example, for contracts expiring on the 20th of the month, delivery intentions window will be open from the 13th and will close on the 15th. Clients can submit delivery intentions up to the maximum of their open positions. On the expiry of the contract, all outstanding positions not resulting in physical delivery shall be closed out at the Final Settlement Price as announced by the Exchange.

(b) Closing out by offsetting positions

Most of the contracts are settled by closing out open positions. In closing out, the opposite transaction is effected to close out the original futures position. A buy contract is closed out by a sale and a sale contract is closed out by a buy. For example, an investor who took a long position in two gold futures contracts on January 30 at ₹16090 per 10 grams, can close his position by selling two gold futures contracts on February 13, at ₹15928. In this case, over the period of holding the position, he has suffered a loss of ₹162 per 10 grams. This loss would have been debited from his account over the holding period by way of MTM at the end of each day, and finally at the price that he closes his position, that is ₹15928, in this case.

(c) Cash settlement

In the case of intention matching contracts, if the trader does not want to take/ give physical delivery, all open positions held till the last day of trading are settled in cash at the final settlement price and with penalty in case of Sellers Right contract. Similarly any unmatched, rejected or excess intention is also settled in cash. When a contract is settled in cash, it is marked to the market at the end of the last trading day and all positions are declared closed. For example, Paul took a short position in five Silver 5kg futures contracts of July expiry on June 15 at ₹21500 per kg. At the end of 20th July, the last trading day of the contract, he continued to hold the open position, without announcing delivery intention. The closing spot price of silver on that day was ₹20500 per kg. This was the settlement price for his contract. Though Paul was holding a short position on silver, he did not have to actually deliver the underlying silver. The transaction was settled in cash and he earned profit of ₹ 5000 per trading lot of silver.

ENTITIES INVOLVED IN PHYSICAL SETTLEMENT

Physical settlement of commodities involves the following three entities - an accredited warehouse, registrar & transfer agent and an assayer.

Accredited Warehouse

The commodity exchange specifies accredited warehouses through which delivery of a specific commodity can be effected and which will facilitate for storage of commodities. For the services provided by them, warehouses charge a fee that constitutes storage and other charges such as insurance, assaying and handling charges or any other incidental charges. Following are the functions of an accredited warehouse:

1. Earmark separate storage area as specified by the Exchange for the purpose of storing commodities to be

delivered against deals made on the Exchange. The warehouses are required to meet the specifications prescribed by the Exchange for storage of commodities.

2. Ensure and co-ordinate the grading of the commodities received at the warehouse before they are stored.

3. Store commodities in line with their grade specifications and validity period and facilitate maintenance of identity. On expiry of such validity period of the grade for such commodities, the warehouse has to segregate such commodities and store them in a separate area so that the same are not mixed with commodities which are within the validity period as per the grade certificate issued by the approved assayers.

Approved Registrar and Transfer agents (R&T agents)

The Exchange specifies approved R&T agents through whom commodities can be dematerialized and who facilitate for dematerialization/rematerialization of commodities in the manner prescribed by the Exchange from time to time. The R&T agent performs the following functions:

1. Establishes connectivity with approved warehouses and supports them with physical infrastructure.

2. Verifies the information regarding the commodities accepted by the accredited warehouse and assigns the identification number (ISIN) allotted by the depository in line with the grade, validity period, warehouse location and expiry.

3. Further processes the information, and ensures the credit of commodity holding to the demat account of the constituent.

4. Ensures that the credit of commodities goes only to the demat account of the constituents held with the Exchange empanelled DPs.

5. On receiving a request for re-materialization (physical delivery) through the depository, arranges for issuance of authorisation to the relevant warehouse for the delivery of commodities.

R&T agents also maintain proper records of beneficiary position of constituents holding dematerialized commodities in warehouses and in the depository for a period and also as on a particular date. They are required to furnish the same to the Exchange as and when demanded by the Exchange. R&T agents also do the job of co-ordinating with DPs and warehouses for billing of charges for services rendered on periodic intervals. They also reconcile dematerialized commodities in the depository and physical commodities at the warehouses on periodic basis and co-ordinate with all parties concerned for the same.

Approved assayer

The Exchange specifies approved assayers through whom grading of commodities (received at approved warehouses for delivery against deals made on the Exchange) can be availed by the constituents of clearing members. Assayers perform the following functions:

1. Make available grading facilities to the constituents in respect of the specific commodities traded on the Exchange at specified warehouse. The assayer ensures that the grading to be done (in a certificate format prescribed by the Exchange) in respect of specific commodity is as per the norms specified by the Exchange in the respective contract specifications.

2. Grading certificate so issued by the assayer specifies the grade as well as the validity period up to which the commodities would retain the original grade, and the time up to which the commodities are fit for trading subject to environment changes at the warehouses.

INSTRUMENTS AVAILABLE FOR TRADING

Forward Contract

A forward contract is an agreement to buy or sell an asset on a specified date for a specified price. One of the parties to the contract assumes a long position and agrees to buy the underlying asset on a certain specified future date for a certain specified price. The other party assumes a short position and agrees to sell the asset on the same date for the same price. Other contract details like delivery date, price and quantity are negotiated bilaterally by the parties to the contract. The forward contracts are normally traded outside the exchanges. The salient features of forward contracts are:

1. They are bilateral contracts and hence exposed to counterparty risk.
2. Each contract is custom designed, and hence is unique in terms of contract size, expiration date and the asset type and quality.
3. The contract price is generally not available in public domain.
4. On the expiration date, the contract has to be settled by delivery of the asset.
5. If the party wishes to reverse the contract, it has to compulsorily go to the same counterparty, which often results in high prices being charged.

However, forward contracts in certain markets have become very standardized, as in the case of foreign exchange, thereby reducing transaction costs and increasing transactions volume. This process of standardization reaches its limit in the organized futures market.

Forward contracts are very useful in hedging and speculation. The classic hedging application would be that of an exporter who expects to receive payment in dollars three months later. He is exposed to the risk of exchange rate fluctuations. By using the currency forward market to sell dollars forward, he can lock on to a rate today and reduce his uncertainty. Similarly an importer who is required to make a payment in dollars two months hence can reduce his exposure to exchange rate fluctuations by buying dollars forward.

If a speculator has information or analysis, which forecasts an upturn in a price, then he can go long on the forward market instead of the cash market. The speculator would go long on the forward, wait for the price to rise, and then take a reversing transaction to book profits.

Limitations of Forward Markets

Forward markets world-wide are afflicted by several problems:

– Lack of centralization of trading,

– Illiquidity and

– Counterparty risk

In the first two of these, the basic problem is that of too much flexibility and generality. The forward market is like a real estate market in that any two consenting adults can form contracts against each other. This often makes them design terms of the deal which are very convenient in that specific situation, but makes the contracts non-tradable. Counterparty risk arises from the possibility of default by any one party to the transaction. When one of the two sides to the transaction declares bankruptcy, the other suffers. Even when forward markets trade standardized contracts, and hence avoid the problem of illiquidity, still the counterparty risk remains a very serious issue.

FUTURES

Futures markets were designed to solve the problems that exist in forward markets. A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. But unlike forward contracts, the futures contracts are standardized and exchange traded. To facilitate liquidity in the futures contracts, the exchange specifies certain standard features of the contract. It is a standardized contract with standard underlying instrument, a standard quantity and quality of the underlying instrument that can be delivered, (or which can be used for reference purposes in settlement) and a standard timing of such settlement. A futures contract may be offset prior to maturity by entering into an equal and opposite transaction.

The main standardized items in a futures contract are:

- Quantity of the underlying
- Quality of the underlying
- The date and the month of delivery
- The units of price quotation and minimum price change
- Delivery center

Distinction between Futures and Forward Contracts

Forward contracts are often confused with futures contracts. The confusion is primarily because both serve essentially the same economic functions of allocating risk in the presence of future price uncertainty. However, futures are a significant improvement over the forward contracts as they eliminate counterparty risk and offer more liquidity. This can be clearly understood with the following:

Futures	Forward
1. Trade on an Organised Exchange	1. OTC in nature
2. Standardized Contract terms	2. Customised Contract terms
3. Hence more liquid	3. Hence less liquid
4. Required Margin Payments	4. No Margin Payments
5. Follows daily settlement	5. Settlement happens at end of period

Futures Terminology

Spot price: The price at which an asset trades in the spot market.

Futures price: The price at which the futures contract trades in the futures market.

Contract cycle: The period over which a contract trades. The commodity futures contracts on the commodity exchange have one month, two months, three months etc (not more than a year) expiry cycles. For example: Most of the agri commodities futures contracts of NCDEX expire on the 20th day of the delivery month. Thus, a January expiration contract expires on the 20th of January and a February expiration contract ceases to exist for trading after the 20th of February. If 20th happens to be a holiday, the expiry date shall be the immediately preceding trading day of the Exchange, other than a Saturday. New contracts for agri commodities are introduced on the 10th of the month.

Expiry date: It is the date specified in the futures contract. This is the last day on which the contract will be traded, at the end of which it will cease to exist.

Delivery unit: The amount of asset that has to be delivered under one contract. For instance, the delivery unit for futures on Soybean on the NCDEX is 10 MT. The delivery unit for the Gold futures contract is 1 kg.

Basis: Basis is the difference between the futures price and the spot price. There will be a different basis for each delivery month for each contract. In a normal market, futures prices exceed spot prices. Generally, for commodities basis is defined as spot price -futures price. However, for financial assets the formula, future price -spot price, is commonly used.

Cost of carry: The relationship between futures prices and spot prices can be summarized in terms of what is known as the cost of carry. This measures the storage cost plus the interest that is paid to finance the asset.

Initial margin: The amount that must be deposited in the margin account at the time a futures contract is first entered into is known as initial margin.

Marking-to-market (MTM): In the futures market, at the end of each trading day, the margin account is adjusted to reflect the investor's gain or loss depending upon the futures closing price. This is called marking to market.

Maintenance margin: This is somewhat lower than the initial margin. This is set to ensure that the balance in the margin account never becomes negative. If the balance in the margin account falls below the maintenance margin, the investor receives a margin call and is expected to top up the margin account to the initial margin level before trading commences on the next day.

OPTIONS

Options are fundamentally different from forward and futures contracts. An option gives the holder of the option the right to do something. The holder does not have to exercise this right. In contrast, in a forward or futures contract, the two parties have committed themselves in doing something. Whereas it costs nothing except margin requirements to enter into a futures contract, the purchase of an option requires an up-front payment.

There are two basic types of options: call options and put options:

(i) Call option: A call option gives the holder the right but not the obligation to buy an asset by a certain date for a certain price.

(ii) Put option: A put option gives the holder the right but not the obligation to sell an asset by a certain date for a certain price.

Option Terminology

Commodity options: Commodity options are options with a commodity as the underlying. For instance, a gold options contract would give the holder the right to buy or sell a specified quantity of gold at the price specified in the contract.

Stock options: Stock options are options on individual stocks. Options currently trade on over 500 stocks in the United States. A contract gives the holder the right to buy or sell shares at the specified price.

Buyer of an option: The buyer of an option is the one who by paying the option premium buys the right but not the obligation to exercise his option on the seller/ writer.

Writer of an option: The writer of a call/ put option is the one who receives the option premium and is thereby obliged to sell/ buy the asset if the buyer exercises on him.

Option price: Option price is the price which the option buyer pays to the option seller. It is also referred to as the option premium.

Expiration date: The date specified in the options contract is known as the expiration date, the exercise date, the strike date or the maturity.

Strike price: The price specified in the options contract is known as the strike price or the exercise price.

American options: American options are options that can be exercised at any time upto the expiration date. Most exchange-traded options are American.

European options: European options are options that can be exercised only on the expiration date itself.

In-the-money option: An in-the-money (ITM) option is an option that would lead to a positive cash flow to the holder if it were exercised immediately. A call option on the index is said to be in-the- money when the current index stands at a level higher than the strike price (i.e. spot price > strike price). If the index is much higher than the strike price, the call is said to be deep ITM. In the case of a put, the put is ITM if the index is below the strike price.

At-the-money option: An at-the-money (ATM) option is an option that would lead to zero cash flow, if it were exercised immediately. An option on the index is at-the money when the current index equals the strike price (i.e. spot price = strike price)

Out-of-the-money option: An out-of-the-money (OTM) option is an option that would lead to a negative cash flow, if it were exercised immediately. A call option on the index is out-of-the-money when the current index stands at a level which is less than the strike price (i.e. spot price < strike price). If the index is much lower than the strike price, the call is said to be deep OTM. In the case of a put, the put is OTM if the index is above the strike price.

Intrinsic value of an option: The option premium can be broken down into two components - intrinsic value and time value. The intrinsic value of a call is the amount the option is ITM, if it is ITM. If the call is OTM, its intrinsic value is zero. Putting it another way, the intrinsic value of a call is Max [0; (St - K)] which means the intrinsic value of a call is the greater of 0 or (St - K). Similarly, the intrinsic value of a put is Max[0;K - St],i.e. the greater of 0 or (K - St). K is the strike price and St is the spot price.

Time value of an option: The time value of an option is the difference between its premium and its intrinsic value. Both calls and puts have time value. An option that is OTM or ATM has only time value. Usually, the maximum time value exists when the option is ATM. The longer the time to expiration, the greater is an option's time value, all else equal. At expiration, an option should have no time value.

USING COMMODITY EXCHANGES FOR HEDGING, SPECULATION AND ARBITRAGE

For a market to succeed, it must have all three kinds of participants - hedgers, speculators and arbitrageurs. The confluence of these participants ensures liquidity and efficient price discovery in the market. Commodity markets give opportunity for all three kinds of participants.

HEDGING

Many participants in the commodity futures market are hedgers. They use the futures market to reduce a particular risk that they face. This risk might relate to the price of wheat or oil or any other commodity that the person deals in. The classic hedging example is that of wheat farmer who wants to hedge the risk of fluctuations in the price of wheat around the time that his crop is ready for harvesting. By selling his crop forward, he obtains a hedge by locking in to a predetermined price. Hedging does not necessarily improve the financial outcome; What it does however is, that it makes the outcome more certain. Hedgers could be government institutions, private corporations like financial institutions, trading companies and even other participants in the value chain, for instance farmers, extractors, millers, processors etc., who are influenced by the commodity prices.

Basic Principles of Hedging

When an individual or a company decides to use the futures markets to hedge a risk, the objective is to take a position that neutralizes the risk as much as possible. Take the case of a company that knows that it will gain ₹1,00,000 for each 1 rupee increase in the price of a commodity over the next three months and will lose ₹1,00,000 for each 1 rupee decrease in the price of a commodity over the same period. To hedge, the company should take a short futures position that is designed to offset this risk. The futures position should lead to a loss of ₹1,00,000 for each 1 rupee increase in the price of the commodity over the next three months and a gain of ₹1,00,000 for each 1 rupee decrease in the price during this period. If the price of the commodity goes down, the gain on the futures position offsets the loss on the commodity. If the price of the commodity goes up, the loss on the futures position is offset by the gain on the commodity.

There are basically two kinds of hedges that can be taken. A company that wants to sell an asset at a particular time in the future can hedge by taking short futures position. This is called a short hedge. Similarly, a company that knows that it is due to buy an asset in the future can hedge by taking long futures position. This is known as long hedge.

Short Hedge

A short hedge is a hedge that requires a short position in futures contracts. A short hedge is appropriate when the hedger already owns the asset, or is likely to own the asset and expects to sell it at some time in the future. For example, a short hedge could be used by a cotton farmer who expects the cotton crop to be ready for sale in the next two months. A short hedge can also be used when the asset is not owned at the moment but is likely to be owned in the future. For example, an exporter who knows that he or she will receive a dollar payment three months later. He makes a gain if the dollar increases in value relative to the rupee and makes a loss if the dollar decreases in value relative to the rupee. A short futures position will give him the hedge he desires.

Example: Assume that today is the 15th of January and that a refined soy oil producer has just negotiated a contract to sell 10,000 Kgs of soy oil. It has been agreed that the price that will apply in the contract is the market price on the 15th April. The oil producer is therefore in a position where he will gain ₹10000 for each 1 rupee increase in the price of oil over the next three months and lose ₹10000 for each one rupee decrease in the price of oil during this period. Suppose the spot price for soy oil on January 15 is ₹450 per 10 Kgs and the April soy oil futures price on the commodity exchange e.g. NCDEX is ₹465 per 10 Kgs. The producer can hedge his exposure by selling 10,000 Kgs worth of April futures contracts (1 unit). If the oil producers closes his position on April 15, the effect of the strategy would be to lock in a price close to ₹465 per 10 Kgs. On April 15, the spot price can either be above ₹465 or below ₹465.

Case 1: The spot price is ₹ 455 per 10 Kgs. The company realises ₹4,55,000 under its sales contract. Because April is the delivery month for the futures contract, the futures price on April 15 should be very close to the spot price of ₹ 455 on that date. The company closes its short futures position at ₹ 455, making a gain of ₹465 - ₹455 = ₹10 per 10 Kgs, or ₹ 10,000 on its short futures position. The total amount realized from both the futures position and the sales contract is therefore about ₹ 465 per 10 Kgs, ₹4,65,000 in total.

Case 2: The spot price is ₹475 per 10 Kgs. The company realises ₹4,75,000 under its sales contract. Because April is the delivery month for the futures contract, the futures price on April 15 should be very close to the spot price of ₹475 on that date. The company closes its short futures position at ₹ 475, making a loss of ₹475 - ₹465 = ₹10 per 10 Kgs, or ₹ 10,000 on its short futures position. The total amount realized from both the futures position and the sales contract is therefore about ₹ 465 per 10 Kgs, ₹ 4,65,000 in total.

Long Hedge

Hedges that involve taking a long position in a futures contract are known as long hedges. A long hedge is appropriate when a company knows it will have to purchase a certain asset in the future and wants to lock in a price now.

Suppose that it is now January 15. A firm involved in industrial fabrication knows that it will require 300 kgs of silver on April 15 to meet a certain contract. The spot price of silver is ₹26800 per kg and the April silver futures price is ₹ 27300 per kg. A unit of trading is 30 kgs. The fabricator can hedge his position by taking a long position in ten units of futures on the NCDEX. If the fabricator closes his position on April 15, the effect of the strategy would be to lock in a price close to ₹ 27300 per kg. On April 15, the spot price can either be above ₹ 27300 or below ₹ 27300 per kg.

Case 1: The spot price is ₹ 27800 per kg. The fabricator pays ₹ 83,40,000 to buy the silver from the spot market. Because April is the delivery month for the futures contract, the futures price on April 15 should be very close to the spot price of ₹ 27800 on that date. The company closes its long futures position at ₹ 27800, making a gain of ₹27800 - ₹27300 = ₹500 per kg, or ₹ 1,50,000 on its long futures position. The effective cost of silver purchased works out to be about ₹ 27300 per Kg, or ₹81,90,000 in total.

Case 2: The spot price is ₹ 26900 per Kg. The fabricator pays ₹80,70,000 to buy the silver from the spot market. Because April is the delivery month for the futures contract, the futures price on April 15 should be very close to the spot price of ₹ 26900 on that date. The company closes its long futures position at ₹ 26900, making a loss of

₹27300 - ₹26900 = ₹400 per kg, or ₹1,20,000 on its long futures position. The effective cost of silver purchased works out to be about ₹ 27300 per Kg, or ₹81,90,000 in total.

Advantages of Hedging

Besides the basic advantage of risk management, hedging also has other advantages:

1. Hedging stretches the marketing period. For example, a livestock feeder does not have to wait until his cattle are ready to market before he can sell them. The futures market permits him to sell futures contracts to establish the approximate sale price at any time between the time he buys his calves for feeding and the time the fed cattle are ready to market, some four to six months later. He can take advantage of good prices even though the cattle are not ready for market.
2. Hedging protects inventory values. For example, a merchandiser with a large, unsold inventory can sell futures contracts that will protect the value of the inventory, even if the price of the commodity drops.
3. Hedging permits forward pricing of products. For example, a jewellery manufacturer can determine the cost for gold, silver or platinum by buying a futures contract, translate that to a price for the finished products, and make forward sales to stores at firm prices. Having made the forward sales, the manufacturer can use his capital to acquire only as much gold, silver, or platinum as may be needed to make the products that will fill its orders.

SPECULATION

An entity having an opinion on the price movements of a given commodity can speculate using the commodity market. While the basics of speculation apply to any market, speculating in commodities is not as simple as speculating on stocks in the financial market. For a speculator who thinks the shares of a given company will rise, it is easy to buy the shares and hold them for whatever duration he wants to. However, commodities are bulky products and come with all the costs and procedures of handling these products. The commodities futures markets provide speculators with an easy mechanism to speculate on the price of underlying commodities.

To trade commodity futures on the commodity exchange , a customer must open a futures trading account with a commodity derivatives broker. Buying futures simply involves putting in the margin money. This enables futures traders to take a position in the underlying commodity without having to actually hold that commodity. With the purchase of futures contract on a commodity, the holder essentially makes a legally binding promise or obligation to buy the underlying security at some point in the future (the expiration date of the contract). We look here at how the commodity futures markets can be used for speculation.

Speculation: Bullish Commodity, Buy Futures

Take the case of a speculator who has a view on the direction of the price movements of gold.If He knows that towards the end of the year due to festivals and the upcoming wedding season, the prices of gold are likely to rise, he would like to trade based on this view. Gold trades for ₹ 16000 per 10 gms in the spot market and he expects its price to go up in the next two-three months. How can he trade based on this belief? In the absence of a deferral product, he would have to buy gold and hold on to it. Suppose he buys a 1 kg of gold which costs him ₹ 16,00,000. Suppose further that his hunch proves correct and three months later gold trades at ₹ 17000 per 10 grams. He makes a profit of ₹ 1,00,000 on an investment of ₹ 16,00,000 for a period of three months. This works out to an annual return of about 25 percent.

Today a speculator can take exactly the same position on gold by using gold futures contracts. Let us see how this works. Gold trades at ₹ 16,000 per 10 gms and three-month gold futures trades at ₹ 16,650 per 10 gms. The unit of trading is 1 kg and the delivery unit for the gold futures contract on the commodity exchange is 1 kg. He buys one kg of gold futures which have a value of ₹ 16,65,000. Buying an asset in the futures market only require making margin payments. To take this position, suppose he pays a margin of ₹ 1,66,500. Three months later gold trades at ₹ 17,000 per 10 gms. On the day of expiration, the futures price converges to the spot price (else there would be a risk-free arbitrage opportunity). He closes his long futures position at ₹ 17,000 in the process making a profit of ₹ 35,000 on an initial margin investment of ₹ 1,66,500. This works out to an annual return of 85 percent. Because of the leverage they provide, commodity futures form an attractive tool for speculators.

Speculation: Bearish Commodity, Sell Futures

Commodity futures can also be used by a speculator who believes that there is likely to be excess supply of a particular commodity in the near future and hence the prices are likely to see a fall. How can he trade based on this opinion? In the absence of a deferral product, there wasn't much he could do to profit from his opinion. Today all he needs to do is sell commodity futures.

Let us understand how this works:

Simple arbitrage ensures that the price of a futures contract on a commodity moves correspondingly with the price of the underlying commodity. If the commodity price rises, so will the futures price. If the commodity price falls, so will the futures price. Now take the case of the trader who expects to see a fall in the price of pepper. Suppose price of pepper is ₹14000 per quintal and he sells two pepper futures contract which is for delivery of 2 MT of pepper (1MT each). The value of the contract is ₹ 2,80,000. He pays a small margin on the same. Three months later, if his hunch was correct the price of pepper falls. So does the price of pepper futures. He can close out his short futures position at ₹13000 per quintal i.e. ₹ 2,60,000 making a profit of ₹ 20,000.

Speculation on the Basis:

The basis is the difference between the future price and spot price. As we know that on the maturity date of contract, the basis must be zero. Before maturity, however, the future price for later delivery may differ substantially from the current spot price.

If the assets and future contract are held till maturity, the hedger bears no risk. Risk is eliminated because the future price and the spot price at contract maturity must be equal: Gains and losses on the futures and the commodity positions will exactly cancel. However, if the contract and asset are to be liquidated early, before contract maturity, the hedger bear the basis risk, because the futures price and the spot price need not move in perfect lockstep at all times before the delivery date. In this case, gains and losses on the contract and the assets may not exactly offset each other.

Some speculators try to profit from movement in the basis. Rather than betting on the direction of the futures or spot price per se, they bet on the changes in the difference between the two. A long spot-short futures position will profit when the basis narrows.

Example:

Consider an investor holding 30 kilograms of silver, who is short one silver futures contract. Suppose that silver today sells for Rs. 40,000 per kilogram, and the futures price for June delivery is Rs. 40,500 per kilogram. Therefore, the basis currently is Rs. 500. Tomorrow, the spot price might increase to Rs. 41,000 per kilogram, while the futures price increases to Rs. 41,400 per kilogram, so the basis narrows to Rs. 400.

The investor's gains and losses are as follows.

Gain on holding of silver (per kilogram) = Rs. 41,000-Rs. 40,000 = Rs. 1000

Loss on silver futures position (per kilogram) = Rs. 41,400- Rs. 40,500 = Rs. 900

The net gain is the decrease in the basis, or Rs. 100 per kilogram.

ARBITRAGE

A central idea in modern economics is the law of one price. This states that in a competitive market, if two assets are equivalent from the point of view of risk and return, they should sell at the same price. If the price of the same asset is different in two markets, there will be operators who will buy in the market where the asset sells cheap and sell in the market where it is costly. This activity termed as arbitrage, involves the simultaneous purchase and sale of the same or essentially similar security in two different markets for advantageously different prices. The buying cheap and selling expensive continues till prices in the two markets reach an equilibrium.

Overpriced Commodity Futures: Buy Spot, Sell Futures

An arbitrageurs notices that gold futures seem overpriced. How can he cash in on this opportunity to earn risk less profits? Say for instance, gold trades for ₹ 1600 per gram in the spot market. Three month gold futures on the commodity exchange trade at ₹1685 per gram and seem overpriced. He could make risk less profit by entering into the following set of transactions.

On day one, borrow ₹ 1,60,05,100 at 6% per annum to cover the cost of buying and holding gold. Buy 10 kgs of gold on the cash/ spot market at ₹ 1,60,00,000. Pay ₹5100 (approx) as warehouse costs.

Simultaneously, sell 10 gold futures contract at ₹ 1,68,50,000.

Take delivery of the gold purchased and hold it for three months.

On the futures expiration date, the spot and the futures price converge. Now unwind the position.

Say gold closes at ₹ 1635 per gram in the spot market. Sell the gold for ₹ 1,63,50,000.

Futures position expires with profit of ₹ 5,00,000.

From the ₹ 1,68,50,000 held in hand, return the borrowed amount plus interest of ₹ 1,62,46,986.

The result is a risk less profit of ₹ 6,04,014.

If the cost of borrowing funds to buy the commodity is less than the arbitrage profit possible, it makes sense to arbitrage. This is termed as cash-and-carry arbitrage. Exploiting an arbitrage opportunity involves trading on the spot and futures market. In the real world, one has to build in the transactions costs into the arbitrage strategy.

Underpriced Commodity Futures: Buy Futures, Sell Spot

An arbitrageur notices that gold futures seem underpriced. How can he cash in on this opportunity to earn risk less profits? Say for instance, gold trades for ₹1600 per gram in the spot market. Three month gold futures on the commodity exchange trade at ₹ 1620 per gram and seem underpriced. If he happens to hold gold, he could make risk less profit by entering into the following set of transactions.

On day one, sell 10 kgs of gold in the spot market at ₹ 1,60,00,000.

Invest the ₹ 1,60,00,000 plus the ₹5100 saved by way of warehouse costs for three months 6%.

Simultaneously, buy three-month gold futures on NCDEX at ₹1,62,00,000.

Suppose the price of gold is ₹1635 per gram. On the futures expiration date, the spot and the futures price of gold converge. Now unwind the position.

The gold sales proceeds grow to ₹ 1,62,46,986.

The futures position expires with a profit of ₹ 1,50,000.

Buy back gold at ₹1,63,50,000 on the spot market.

The result is a risk less profit of ₹ 46,986.

When the futures price of a commodity appears underpriced in relation to its spot price, an opportunity for reverse cash and carry arbitrage arises. It is this arbitrage activity that ensures that the spot and futures prices stay in line with the cost-of-carry.

LESSON ROUND UP

– Commodity exchanges are defined as centers where futures trade is organized in a wider sense; it is taken to include any organized market place where trade is routed through one mechanism, allowing effective competition among buyers and among sellers.

– The year 2003 is a landmark in the history of commodity futures market witnessing the establishment and recognition of three new national exchanges National Commodity and Derivatives Exchange of India Ltd. (NCDEX), Multi Commodity Exchange of India Ltd (MCX) and National Multi Commodity Exchange of India Ltd. (NMCE)] with on-line trading and professional management.

– The Forward Markets Commission is a regulatory body for Commodity Markets in India.

– There are more than 20 recognised commodity futures exchanges in India under the purview of the Forward Markets Commission (FMC).

– Broadly, the participants in commodity market can be classified as Hedgers, Arbitrageurs and Speculators.

– An electronic trading system allows the trading members to enter orders with various conditions attached to them as per their requirements.

– Electronic spot exchanges is an emerging phenomenon in the country .These spot exchanges provide real time, online, transparent and vibrant spot platform for commodities.

– The Commodity Exchange membership is open to any person, association of persons, partnerships, co-operative societies, companies etc. that fulfills the eligibility criteria set by the Exchange.

– The settlement is done by closing out open positions, physical delivery or cash settlement. All these settlement functions are taken care of by an entity called clearing house or clearing corporation.

– Settlement of commodity futures contracts is a little different from settlement of financial futures which are mostly cash settled.

– Futures contracts have two types of settlements, the Mark-to-Market (MTM) settlement which happens on a continuous basis at the end of each day, and the final settlement which happens on the last trading day of the futures contract.

– Physical settlement of commodities involves the following three entities - an accredited warehouse, registrar & transfer agent and an assayer.

– There are various instruments available for trading on Commodity exchange like forward, future, options etc.

SELF TEST QUESTION

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

1. What is a Commodity Exchange? Briefly discuss the role of a Commodity Exchange.
2. Discuss about the various participants involved in Commodity Market.

3. What is an Electronic Spot Exchange? Explain the important functions performed by them.
4. Briefly explain about the various entities involved in physical settlement of commodities.
5. What is long hedge? Explain with the help of an example.

Lesson 12
Money Market

LESSON OUTLINE

- Introduction
- Features of Money Market
- Money Market vs. Capital Market
- Growth of Money Market
- Structure and Institutional Development
- Money Market Instruments
- Government Securities
- Gift edged (Govt.) Securities
- Call Money and Notice Money
- Term Money
- Bill Discounting
- Bill Rediscounting Scheme(BRD)
- Repurchase Agreements
- Banker's Acceptance
- Treasury Bills
- Certificate of Deposit
- Inter-Corporate Deposit
- Commercial Bills
- Commercial Paper
- Money Market Mutual Funds(MMMFs)
- Factoring
- Letter of Credit
- Bills of Exchange
- LESSON ROUND UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

The Money Market is a market for short term funds with maturity ranging from overnight to one year and includes instruments that are deemed to be close substitutes of money. The Money Market is a key component of the financial system as it is the fulcrum of the monetary operations conducted by the RBI in its pursuit of monetary policy objectives. As the Central Bank, RBI regulates the Money Market in India and injects liquidity in the banking system. Important institutions operating in the money market are central banks, commercial banks, acceptance house, non-banking financial institutions, bill brokers etc.

The objective of this lesson is to provide the students with basic understanding of Money Market, its distinct features, various instruments available in the Money Market, difference between Money Market and Capital Market, instruments used in financing import and export etc.

INTRODUCTION

The **money market** is where financial instruments with high liquidity and very short maturities are traded. It is used by participants as a means for borrowing and lending in the short term, with maturities that usually range from overnight to just under a year. Money Market instruments have the characteristics of liquidity (quick conversion into money), minimum transaction cost and no loss in value. Excess funds are deployed in the Money Market, which in turn is availed of to meet temporary shortages of cash and other obligations. Money Market provides access to providers and users of short-term funds to fulfill their investments and borrowings requirements respectively at an efficient market clearing price. It performs the crucial role of providing an equilibrating mechanism to even out short-term liquidity, surpluses and deficits and in the process, facilitates the conduct of monetary policy. The Money Market is one of the primary mechanism through which the Central Bank (RBI) influences liquidity and the general level of interest rates in an economy. The Bank's interventions to influence liquidity serve as a signaling-device for other segments of the financial system.

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

Though there are a few types of players in Money Market, the role and the level of participation by each type of player differs largely.

Government is an active player in the Money Market and in most of the economies; it constitutes the biggest borrower in this market. Both, Government securities (G-secs) and Treasury bill (T-bill) is a security issued by RBI on behalf of the Government of India to meet the latter's borrowing for financing fiscal deficit. Apart from functioning as a banker to the government, the central bank (RBI) also regulates the Money Market and issues guidelines to govern the Money Market operations.

Another dominant player in the Money Market is the banking industry. Banks mobilize deposits of savers in lending to investors of the economy. This process is known as credit creation. However, banks are not allowed to lend out the entire amount for extending credit for investment. In order to promote certain prudential norms for healthy banking practices, most of the developed economies require all commercial banks to maintain minimum liquid and cash reserves in form of Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) framed under the policies of central banks. The banks are required to ensure that these reserve requirements are met before directing deposits on their credit plans. If banks fall short of these statutory reserve requirements, the deficit amount can be raised using the Money Market.

Other institutional players like financial institutions, corporates, mutual funds (MFs), Foreign Institutional Investors (FIIs) etc. also transact in Money Market to fulfill their respective short term finance deficits and short falls. However, the degree of participation of these players depends largely on the regulations formulated by the regulating authorities in an economy. For instance, the level of participation of the FIIs in the Indian Money Market is restricted to investment in Government securities only.

FEATURES OF MONEY MARKET

The Money Market is a wholesale market where the volumes of transactions is very large and is settled on a daily basis. Trading in the Money Market is conducted over the telephone, followed by written confirmation through e-mails, texts from the borrowers and lenders.

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

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

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

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

Things You May Know

CRR : Cash Reserve Ratio is the cash parked by the banks in their specified account maintained with RBI.

SLR : Statutory Liquid Ratio is in the form of cash (book value), gold (current market value) and balances in unencumbered approved securities.

Base Rate: Base rate is the minimum rate set by the Reserve Bank of India below which banks are not allowed to lend to its customers.

MCLR (Marginal Cost of Funds based Lending Rate): The new methodology uses the marginal cost or latest cost conditions reflected in the interest rate given by the banks for obtaining funds (from deposits and while borrowing from RBI) while setting their lending rate.

MONEY MARKET Vs. CAPITAL MARKET

The Money Market possesses different operational features as compared to Capital Market. Money Market is distinguished from Capital Market on the basis of the maturity period, credit instruments and the institutions:

(i) Maturity Period: The Money Market deals in the lending and borrowing of short-term finance varying for one year or less, while the Capital Market deals in the lending and borrowing of long-term finance for more than one year.

(ii) Credit Instruments: The main credit instruments of the Money Market are Call Money, Treasury Bills, Commercial Bills, Commercial Papers, and Bills of Exchange. On the other hand, the main instruments used in the Capital Market are Stocks, Shares, Debentures, Bonds, Corporate Deposits etc.

(iii) Institutions: Important institutions operating in the Money Market are central banks, commercial banks, acceptance houses, non banking financial institutions, bill brokers, etc. Important institutions of the Capital Market are stock exchanges, commercial banks and non banking institutions, such as insurance companies, mortgage banks, etc.

(iv) Purpose of Loan: The Money Market meets the short-term credit needs of business: It provides working capital to the industrialists. The Capital Market, on the other hand, caters the long-term credit needs of the industrialists and provides fixed capital to buy land, machinery, etc.

(v) Risk and Liquidity: The degree of risk is small and that of liquidity is higher in the Money Market as compared to the higher risk and lower liquidity in the Capital Market.

(vi) Role of Central Bank: The central bank closely and directly has impact on the Money Market and its participants by framing its regulations and deciding various rates of interests that has impact on the parameters of an economy, while in case of Capital Market, Central Bank has an indirect link through other regulators like SEBI.

(vii) Market Regulation: In the Money Market, commercial banks are closely regulated. In the Capital Market, the institutions are not much regulated.

GROWTH OF MONEY MARKET

Post reforms period in India has witnessed tremendous growth of the Indian Money Markets. Banks and other financial institutions have been able to meet the high expectations of short term funding of important sectors like the industry, services and agriculture. Functioning under the regulation and control of the Reserve Bank of India (RBI), the Indian Money Market have also exhibited the required maturity and resilience over the years.

The organization and structure of the Money Market has undergone a sea change in the last decade in India.

This was accompanied by a growth in quantitative terms also.

Up to 1987, the Money Market consisted of 6 facets :

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

The market had 3 main deficiencies:

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

To set right these deficiencies, the recommendations of Chakravarthy Committee (1985) and the Vaghul Committee (1987) laid foundation for systematic development of the Indian Money Market. The implementation of the suggestions of the respective committees has widened and deepened the market considerably by increasing the number of participants and instruments and introducing market determined rates as against the then existing administered or volunteered interest rates.

Further, an active secondary market for dealings of Money Market instrument was created which positively impacted the liquidity of these instruments. For this purpose, the Discount and Finance House of India Limited (DFHI) was formed as an autonomous financial intermediary in April, 1988 to embellish the short-term liquidity imbalances and to develop an active secondary market for the trading of instruments of the Money Market. The DFHI plays the role of a market maker in Money Market instruments. With the relaxation of the regulatory framework and the arrival of new instruments and participants, DFHI occupies a key role in ushering a more active and de-regulated Money Market.

STRUCTURE AND INSTITUTIONAL DEVELOPMENT

The following diagram depicts the important segments and inter-relation in the Money Market:

Bankers' Acceptances Market	←→	Commercial Paper Market	←→	Treasury Bill Market	←→	Call Money Market

M O N E Y M A R K E T

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

The organized segment consists of the Reserve Bank of India, State Bank of India with its associate Banks, Public Sector Banks, Private Sector Commercial Banks including Foreign Banks, Regional Rural Banks, Non-Scheduled Commercial Banks, apart from Non-banking Financial Intermediaries such as LIC, GIC etc.

The unorganized segment essentially consists of indigenous bankers, money lenders and other non-bank financial intermediaries such as Chit Funds. The share of the unorganized sector in providing trade finance has greatly diminished after the Nationalization of Bank and expansion thereof into the length and breadth of the country.

Money Market

Organised Segment

RBI, SBI, Associate banks, Public Sector Banks,
Private Sector Commercial Banks,
Foreign banks, Regional Rural Banks,
Non Schedule Commercial Banks,
LIC, GIC, UTI etc.

Unorganised Segment

Indigenous Bankers, Money Lenders,
Non-bank financial intermediaries
such as chit funds.

MONEY MARKET INSTRUMENTS

Money Market instruments mainly include Government securities, securities issued by private sector and banking institutions –

- Government Securities
- Gilt-edged (Government) Securities
- Repo Market
- Money at Call and Short Notice
- Bills Rediscounting
- Money Market Mutual Funds
- Call Money Market and Short-term Deposit Market
- Treasury Bills
- Certificates of Deposits
- Inter-Corporate Deposits
- Commercial Bills
- Commercial Paper

GOVERNMENT SECURITIES

The Reserve Bank of India issues securities on behalf of the Government. The term Government Securities includes Central Government Securities, State Government Securities and Treasury Bills.

GILT-EDGED (GOVERNMENT) SECURITIES

Gilt edged Security also known as Government Securities are instruments issued by the government to borrow money from the market.

Depending upon the expiry date, government securities are divided into short term and long term securities. Short term government securities are Treasury bills. They have a maturity of less than one year. There are three main treasury bills in India – 91 day, 182 day and 364 day.

CALL MONEY AND NOTICE MONEY

Call Money is a Money Market instrument wherein funds are borrowed / lent for a tenor of one day overnight (excluding Sundays/holidays). Notice Money is a Money Market instrument, where the tenor is more than 1 day but less than 15 days. The borrower/lender must convey his intention to repay/recall the amount borrowed/lent with at least 24 hours notice.

Features

- Interest is calculated on Actual / 365 day basis.
- Interest payable to be rounded off to the nearest rupee.
- Interest on the amount borrowed/lent =

$$\frac{\text{Amount borrowed/lent *No. of days * Rate of Interest}}{365 * 100}$$

Settlement

The borrower of funds will collect the cheque and hand over the deposit receipt to the lender on the value date of the deal. On the due date, the lender will give back the deposit receipt to and collect the cheque from the borrower.

TERM MONEY

Money lent for a fixed tenor of 15 days or more is called Term Money.

Features

- Interest to be calculated on Actual / 365 day basis.
- Interest payable to be rounded off to the nearest rupee.
- Periodicity for payment of interest can be Quarterly/Half Yearly/on redemption, as agreed to at the time of the deal.
- Interest on the amount borrowed/lent =

$$\frac{\text{Amount borrowed/lent *No. of days * Rate of Interest}}{365 * 100}$$

- Premature cancellation after 14 days can be done by mutual consent on mutually agreed terms.
- No loan/overdraft can be granted against Term Money.

Settlement

The borrower of funds will collect the cheque and hand over the deposit receipt to the lender on the value date of the deal. On the due date, the lender will give back the deposit receipt to and collect the cheque from the borrower. In case the maturity of term money falls on a holiday, the repayment will be made on the next working day. Additional interest will be paid for such period on the amount borrowed (principal only) at the contracted rate.

BILL DISCOUNTING

Bill Discounting is a short tenure financing instrument for companies willing to discount their purchase / sales bills to get funds for the short run and as for the investors, it is a good instrument to park their spare funds for a very short duration.

Bills discounting is of two types:

1. Purchase bills discounting and

2. Sales bill discounting.

A purchase bill discounting means that the investor discounts the purchase bill of the company and pays the company, who in turn pay their supplier. The investor gets his money back from the company at the end of the discounting period.

A sales bills discounting means the investor discounts the sales bill of the company and pays directly to the company. The investor gets his return from the company at the end of the discounting period.

The funds generally required for this type of transaction start from ₹ 300,000 to upto ₹ 2 million. The tenure, generally, ranges from 60 days to upto 180 days.

Procedure of Bill Discounting

The procedure is that a broker will contact the investor with proposals to discount bills of different companies at different rates of discounting. The better companies command discounting rates of 13% to 15%, while the lesser known, by size and by safety, have to pay discounting rates of 17% to as high as 28%.

When an investor and the company agree to a particular bill discounting transaction, the following is what the company gives to the investor:

- The original copies of bills to be discounted;
- A hundi / promissory note;
- Post Dated Cheque (PDC).

The investor simply has to issue a cheque. The amount of cheque is arrived at after deducting the discount rate. The post-dated cheque that the company gives is of the full amount of the transaction. This can be better explained with an example as follows.

Company A wants to discount its purchase bill of ₹ 2,00,000 for a period of three months. Investor P agrees to do so at a discount rate of 21%. The deal is mutually agreed. Now, the investor will issue a cheque of ₹ 1,89,500. This figure is arrived at as follows:

= 200,000 x 21% x 3/12

Thus the investor gets his/her interest before the end of the period on discounting. The company on its part will issue a post-dated cheque of ₹2,00,000 for three months period.

Here the investor benefits in two ways:

He gets the interest element at the first day of issuing the cheque. i.e. he does not include that part in his cheque amount. Thus he can earn interest on this interest for a three-month period. Even a simple bank fixed deposit on it will earn @5% p.a. By investing ₹1,89,500 for three months, the investor earns ₹10,500 on it. A return of 22.16%.

Discount Rates

The rates depend on the following factors:

(i) The Broker: The broker has a good influence on the rates offered by companies. His relations with the company and the investor, do make a difference of a couple of percentage point in discounting rates.

(ii) Market Liquidity: Liquidity crunch in the market tends to hike up the rates even in the best of the companies. Since this instrument is a short tenure one, short-term changes in the market liquidity greatly affect the discount rates.

(iii) Volume/Value of Discounting: When the volume/value of discounting done by the investor is high, he is looking at security more than returns. The company on its part is looking at savings by way of reduced legal paper work and a higher amount of dedicated funds for a said period and hence on the whole reduced costs to the company.

(iv) Frequency: An investor who is regular bills discounter for the company may get upto 1% to 1.5% points higher interest rates than a new investor. As for the investor he is trying it out with a new company and will agree to a lesser rate to ensure safety.

(v) Company's finance resources: This is one of the biggest factors that decide the discount rates. A Public limited company generally tends to have a cheaper source of finance as against any other form of company. Working capital financing of companies to a large extent manipulates the rates the companies are willing to discount their bills at.

BILL REDISCOUNTING SCHEME (BRD)

Bill Rediscounting Scheme is the rediscounting of trade bills, which have already been purchased by /discounted with the bank by the customers. These trade bills arise out of supply of goods/services.

Features

- The banks normally rediscount the bills that have already been discounted with them or raise usance promissory notes in convenient lots and maturities and rediscount them.
- Rediscount of bills should be for a minimum period of 15 days and for a maximum period of 90 days.
- RBI has clarified to FIMMDA that in case a holiday is declared under the Negotiable Instruments Act, 1881, subsequent to the rediscounting of the bill, and the payment is to be made on the preceding working day (as per the Negotiable Instruments Act), such payment on the preceding working day would not be regarded as a violation of RBI's guidelines.
- Discount is calculated on Actual/365 day basis.
- The amount payable to the borrower is the principal amount less the discount/interest.
- While discounting a bill, the amount of discount is to be deducted at the time the bill is issued.
- The discount is rounded off to the nearest rupee.
- On maturity the borrower would repay the principal amount.

Example:

Transaction Amount : ₹ 10,00,00,000/- (Rupees Ten Crore)

(Principal amount)

No. of Days : 45 days

Rate of Discount : 10.25% p.a.

Discount :

$$\frac{\text{Transaction Amount * No . of days * Rate of interest/discount}}{365 * 100}$$

$$= \frac{10{,}00{,}00{,}000 * 45 * 10.25}{365 * 100}$$

= ₹ 12,63,699 (rounded off)

Amount payable: Transaction Amount – Discount/Interest

i.e. 10,00,00,000 - 12,63,699

i.e. ₹ 9,87,36,301/-

Amount to be repaid on maturity : ₹ 10,00,00,000/-

REPURCHASE AGREEMENTS

Repurchase transactions, called Repo or Reverse Repo are transactions or short term loans in which two parties agree to sell and repurchase the same security. They are usually used for overnight borrowing. Repo/ Reverse Repo transactions can be done only between the parties approved by RBI and in RBI approved securities viz. Government of India (GoI) and State Govt Securities, T-Bills, PSU Bonds, FI Bonds, Corporate Bonds etc. Under repurchase agreement the seller sells specified securities with an agreement to repurchase the same at a mutually decided future date and price. Similarly, the buyer purchases the securities with an agreement to resell the same to the seller on an agreed date at a predetermined price. Such a transaction is called a Repo when viewed from the perspective of the seller of the securities and Reverse Repo when viewed from the perspective of the buyer of the securities. Thus, whether a given agreement is termed as a Repo or Reverse Repo depends on which party initiated the transaction. The lender or buyer in a Repo is entitled to receive compensation for use of funds provided to the counterparty. Effectively the seller of the security borrows money for a period of time (Repo period) at a particular rate of interest mutually agreed with the buyer of the security who has lent the funds to the seller. The rate of interest agreed upon is called the Repo rate. The Repo rate is negotiated by the counterparties independently of the coupon rate or rates of the underlying securities and is influenced by overall Money Market conditions.

BANKER'S ACCEPTANCE

It is a short term credit investment created by a non financial firm and guaranteed by a bank to make payment. It is simply a bill of exchange drawn by a person and accepted by a bank. It is a buyer's promise to pay to the seller a certain specified amount at certain date. The same is guaranteed by the banker of the buyer in exchange for a claim on the goods as collateral. The person drawing the bill must have a good credit rating otherwise the Banker's Acceptance will not be tradable. The most common term for these instruments is 90 days. However, they can very from 30 days to180 days. For corporations, it acts as a negotiable time draft for financing imports, exports and other transactions in goods and is highly useful when the credit worthiness of the foreign trade party is unknown. The seller need not hold it until maturity and can sell off the same in secondary market at discount from the face value to liquidate its receivables.

TREASURY BILLS

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

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

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

Example

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

Funds Available as on 1.1.2014	₹ 200 crore
Deployment in a project	₹200 crore

As per the requirements

06.1.2014	₹ 50 crore
13.1.2014	₹ 20 crore
02.2.2014	₹ 30 crore
08.2.2014	₹ 100 crore

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

Option I

Invest the cash not required within 15 days in bank deposits. The party can invest a total of ₹ 130 crore only, since the balance ₹ 70 crores is required within the first 15 days.

Assuming a rate of return of 6% paid on bank deposits for a period of 31 to 45 days, the interest earned by the company works out to ₹ 76 lacs approximately.

Option II

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

There are four types of treasury bills :

(a) 14-day T bill

The Maturity is in 14 days. Its auction is on every Friday of every week. The notified amount for this auction is ₹ 100 crores.

(b) 91-day T bill

The Maturity is in 91 days. Its auction is on every Friday of every week. The notified amount for this auction is ₹ 100 crores.

(c) 182-day T bill

The Maturity is in 182 days. Its auction is on every alternate Wednesday (which is not a reporting week). The notified amount for this auction is ₹ 100 crores.

(d) 364-day T bill

The Maturity is in 364 days. Its auction is on every alternate Wednesday (which is a reporting week). The notified amount for this auction is ₹ 500 crores.

A considerable part of the government's borrowings is financed through T-bills of various maturities. Based on the bids received at the auctions, RBI decides the cut off yield and accepts all bids below this yield. The usual investors in these instruments are banks who invest not only to invest their short-term surpluses but also to get benefitted for maintaining the Statutory Liquid Ratio (SLR) requirements in T-bills is reckoned for the purpose of statutory reserves. FIIs so far have not been allowed to invest in this instrument.

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

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

Benefits of Investing in Treasury Bills

(a) No tax deducted at source

(b) Zero default risk being sovereign paper

(c) Highly liquid Money Market instrument

(d) Better returns especially in the short term

(e) Transparency

(f) Simplified settlement

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

Features of Treasury Bills

(a) Form

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

(b) Minimum Amount of Bids

Bids for treasury bills are to be made for a minimum amount of ₹ 10000/- only and in multiples thereof.

(c) Eligibility

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

(d) Repayment

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

(e) Availability

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

(f) Day Count

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

(g) Yield Calculation

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

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

Wherein Y = Discounted yield

P = Price

D = Days to maturity

Example

A co-operative bank wishes to buy 91 Days Treasury Bill on Oct. 12, 2013 which is maturing on Dec. 6, 2013. The rate quoted by seller is ₹ 99.1489 per ₹ 100 face values. The YTM can be calculated as following:

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

Yield to Maturity (YTM) = (100-99.1489) x 365 x 100/(99.1489*55) = 5.70%

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

Primary Market

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

Salient Features of the Auction Technique:

(a) The auction of treasury bills is done only at Reserve Bank of India, Mumbai.

(b) Bids are to be submitted on Negotiated Dealing System (NDS) by 2:30 PM on Wednesday. If Wednesday happens to be a holiday then bids are to be submitted on previous day (Tuesday).

(c) Bids are submitted in terms of price per ₹100. For example, a bid for 91-day Treasury bill auction could be for ₹ 97.50 for per unit of T-bill of face valuer of ₹100.

(d) Auction committee of Reserve Bank of India decides the cut-off price and results are announced on the same day.

(e) Bids above the cut-off price receive full allotment. Bids at cut-off price may receive full or partial allotment and bids below the cut-off price are rejected.

Things You May Know

Negotiated Dealing System

An electronic trading platform, operated by the RBI, used to facilitate the exchange of Government Securities and other Money Market instruments. The Negotiated Dealing System is also responsible for hosting new issues of Government Securities.

Secondary Market

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

Types of Auction

There are two types of auction for treasury bills:

(i) Multiple Price Based or French Auction: Under this method, all bids equal to or above the cut-off price are accepted. However, the bidder has to obtain the treasury bills at the price quoted by him. This method is followed in the case of 364 days treasury bills and is valid only for competitive bidders.

(ii) Uniform Price Based or Dutch Auction: Under this system, all the bids equal to or above the cut-off price are accepted at the cut- off level. However, unlike the Multiple Price based method, the bidder obtains the treasury bills at the cut-off price and not the price quoted by him. This method is applicable in the case of 91 days treasury bills only. The system of Dutch auction has been done away with by the RBI w.e.f 08.12.2002 for 91 day T Bill.

What is Dutch auction?

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

What is French Auction?

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

CERTIFICATES OF DEPOSITS

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

Eligibility

CDs can be issued by:

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

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

Aggregate Amount

The amount of CDs allowed to be issued by:

(i) Banks: varying according to the requirements keeping in limits the CRR and SLR requirements as stipulated by RBI.

(ii) Financial Institutions: may issue CDs within the overall umbrella limit fixed by RBI. As per the prevailing guidelines issued by RBI, an FI can issue CDs together with other instruments viz., term money, term deposits, commercial papers and inter corporate deposits, not exceeding 100 per cent of its net owned funds, as per the latest audited balance sheet.

Minimum Size of Issue and Denominations

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

Maturity

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

Discount/Coupon Rate

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

Reserve Requirements

Banks have to maintain the appropriate reserve requirements, i.e., Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR), on the issue price of the CDs.

Transferability

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

Trades In CDs

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

Format Of CDs

Banks/FIs should issue CDs only in the dematerialised form. However, according to the Depositories Act, 1996, investors have the option to seek certificate in physical form. Accordingly, if the investor insists on physical certificate, the bank/FI may inform to Monetary Policy Department, Reserve Bank of India about such instances separately. **Further, issuance of CD will attract stamp duty**. There will be no grace period for repayment of CDs. If the maturity date happens to be holiday, the issuing bank should make payment on the immediate preceding working day. Banks/FIs may, therefore, so fix the period of deposit that the maturity date does not coincide with a holiday to avoid loss of discount / interest rate.

Security Aspect

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

Payment of Certificate

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

Issue of Duplicate Certificates

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

(a) A notice is required to be given in at least one local newspaper;

(b) Lapse of a reasonable period (say 15 days) from the date of the notice in the newspaper; and

(c) Execution of an indemnity bond by the investor to the satisfaction of the issuer of CD.

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

Accounting

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

INTER-CORPORATE DEPOSITS

Apart from CDs, corporates also have access to another market called the Inter Corporate Deposits (ICD) market. An ICD is an unsecured loan extended by one corporate to another. Existing mainly as a refuge for low rated corporates, this market allows corporates with surplus funds to lend to other corporates facing shortage of funds. Another aspect of this market is that the better-rated corporates can borrow from the banking system and lend in this market to make speculative profits. As the cost of funds for a corporate in much higher than that of a bank, thus, the rates in this market are higher than those in the other markets. ICDs are unsecured, and hence the risk inherent is high. The ICD market is an unorganised market with very less information available publicly about transaction details.

COMMERCIAL BILLS

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

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

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

COMMERCIAL PAPER

Commercial Paper (CP) is an unsecured Money Market instrument issued in the form of a promissory note. CP, as a privately placed instrument, was introduced in India in 1990 with a view to enable highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors. Subsequently, primary dealers (PDs), and all-India financial institutions were also permitted to issue CP to enable them to meet their short-term funding requirements for their operations. The Guidelines for issue of CP are presently governed by various directives issued by the Reserve Bank of India, as amended from time to time.

The guidelines for issue of CP are given below:

Eligible issuers of CP

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

A corporate would be eligible to issue CP provided:

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

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

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

(i) Rating Requirements

All eligible participants shall obtain credit rating for issuance of CP from any one of the SEBI registered Credit Rating Agencies. The minimum credit rating shall be 'A3' as per rating symbol and definition prescribed by SEBI. The issuers shall ensure at the time of issuance of the CP that the rating so obtained is current and has not fallen due for review.

(ii) Maturity

CP can be issued for maturities between a minimum of 7 days and a maximum of up to one year from the date of issue. The maturity date of the CP should not go beyond the date up to which the credit rating of the issuer is valid.

(iii) Denominations

CP can be issued in denominations of ₹5 lakh and multiples thereof. The amount invested by a single investor should not be less than ₹5 lakh (face value).

(iv) Limits and the Amount of Issue of CP

The aggregate amount of CP from an issuer shall be within the limit as approved by its Board of Directors or the quantum indicated by the CRA for the specified rating, whichever is lower. Banks and FIs will, however, have the flexibility to fix working capital limits, duly taking into account the resource pattern of company's financing, including CPs.

The total amount of CP proposed to be issued should be raised within a period of two weeks from the date on which the issuer opens the issue for subscription. CP may be issued on a single date or in parts on different dates provided that in the latter case, each CP shall have the same maturity date. Every issue of CP, including renewal, should be treated as a fresh issue.

(v) Issuing and Paying Agent (IPA)

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

(vi) Investment in CP

CP may be issued to individuals, banking companies, other corporate bodies (registered or incorporated in India) and unincorporated bodies, Non-Resident Indians and Foreign Institutional Investors (FIIs). However, investment by FIIs would be within the limits set for them by SEBI.

(vii) Trading in CP

All OTC trades in CP shall be reported within 15 minutes of the trade to the Fixed Income Money Market and Derivatives Association of India (FIMMDA) reporting platform.

(viii) Mode of Issuance

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

(ix) Preference for Dematerialisation

While option is available to both issuers and subscribers to issue/hold CP in dematerialised or physical form, issuers and subscribers are encouraged to opt for dematerialised form of issue/holding. However, banks, FIs and PDs are required to make fresh investments and hold CP only in dematerialised form.

(x) Payment of CP

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

PROCEDURE FOR ISSUANCE

Every issuer must appoint an IPA for issuance of CP. The issuer should disclose to the potential investors, its financial position as per the standard market practice. After the exchange of deal confirmation between the investor and the issuer, issuing company shall issue physical certificates to the investor or arrange for crediting the CP to the investor's account with a depository. Investors shall be given a copy of IPA certificate to the effect that the issuer has a valid agreement with the IPA and documents are in order.

Role and Responsibilities

The role and responsibilities of issuer, IPA and CRA are set out below:

(a) Issuer

With the simplification in the procedures for issuance of CP, issuers would now have greater flexibility. However, they have to ensure that the guidelines and procedures laid down for CP issuance are strictly adhered to.

(b) Issuing and Paying Agent (IPA)

(i) The IPA would ensure that the issuer has the minimum credit rating as stipulated by RBI and the amount mobilised through issuance of CP is within the quantum indicated by CRA for the specified rating or as approved by its Board of Directors, whichever is lower.

(ii) The IPA has to verify all the documents submitted by the issuer, viz., copy of board resolution, signatures of authorised executants (when CP in physical form) and issue a certificate to this effect.

(iii) Certified copies of original documents, verified by the IPA, should be held in the custody of IPA.

(iv) All scheduled banks, acting as the IPAs should submit the data pertaining to CP issuances on the Online Returns Filing System (ORFS) module of the RBI within two days from the date of issuance of CP.

(c) CRA

(i) The CRA shall be abide by the Code of Conduct prescribed by the SEBI for CRAs for undertaking rating of Capital Market instruments shall be applicable to CRAs for rating CPs.

(ii) The CRAs would henceforth have the discretion to determine the validity period of the rating depending upon its perception about the strength of the issuer. Accordingly, they shall, at the time of rating, clearly indicate the date when the rating is due for review.

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

The amount of CDs allowed to be issued by:

- **(i) Banks:** varying according to the requirements keeping in limits the CRR and SLR requirements as stipulated by RBI.
- **(ii) Financial Institutions:** may issue CDs within the overall umbrella limit fixed by RBI. As per the prevailing guidelines issued by RBI, an FI can issue CDs together with other instruments viz., term money, term deposits, commercial papers and inter corporate deposits, not exceeding 100 per cent of its net owned funds, as per the latest audited balance sheet.

MONEY MARKET MUTUAL FUNDS (MMFS)

One of the recent development in the sphere of Money Market is the establishment of Money Market Mutual Funds, the guidelines of which have been prescribed by the Reserve Bank of India. Money Market Mutual Funds (MMFs) can be set up by the banks and public financial institutions. There can also be Money Market Deposit Account (MMDAs).

- **(a) Limit :** The limit for raising resources under the MMMF scheme should not exceed 2% of the sponsoring bank's fortnightly average aggregate deposits. If the limit is less than `50 crores for any bank, it may join with some other bank and jointly set up MMMF. In the case of public financial institutions, the limit should not exceed 2% of the long-term domestic borrowings as indicated in the latest available audited balance sheets.
- **(b) Eligibility :** MMMFs are primarily intended for individuals investors including NRIs who may invest on a non-repatirable basis. MMMFs would be free to determine the minimum size of the investment by a single investor.
- **(c) Minimum rate of return** : There is no guaranteed minimum rate of return.
- **(d) Lock-in-period** : The minimum lock in period would be 46 days.
- **(e) Deployment of capital** : The resources mobilized by MMMFs should be invested exclusively in various Money Market instruments.
- **(f) Money Market Mutual Fund investment limits :**
  - (i) Treasury bills and dated government securities having an unexpired maturity upto one year – Minimum 25%.
  - (ii) Call/notice money – Minimum 30%.
  - (iii) Commercial Paper – Maximum 15%. The exposure to CP issued by an individual company should not be more than 3%.
  - (iv) Commercial bills accepted/co-accepted by Banks – Maximum 20%.
  - (v) Certificate of deposits – No limit.

FACTORING

Factoring is a financial transaction where an entity sells its receivables to a third party called a 'factor', at discounted prices. Factoring is a financial option for the management of receivables. In simple definition it is the conversion of credit sales into cash. In factoring, a financial institution (factor) buys the accounts receivable of a company (Client) and pays up to 80%(rarely up to 90%) of the amount immediately on formation of agreement. Factoring company pays the remaining amount (Balance 20%-finance cost-operating cost) to the client when the customer pays the debt. Collection of debt from the customer is done either by the factor or the client depending upon the type of factoring. The account receivable in factoring can either be for a product or service. Examples : factoring against goods purchased, factoring for construction services (usually for government contracts where the government body is capable of paying back the debt in the stipulated period of factoring. Contractors submit invoices to get cash instantly), factoring against medical insurance etc.

Parties in Factoring

The factoring transaction involves three parties:

(i) The Seller, who has produced the goods/services and raised the invoice.

(ii) The Buyer, the consumer of goods/services and the party to pay.

(iii) The Factor, the financial institution that advances the portion of funds to the seller.

FACTORING PROCESS

The steps involved in factoring are listed below:

(i) The seller interacts with the funding specialist/broker and explains the funding needs.

(ii) The broker prepares a preliminary client profile form and submits to the appropriate funder for consideration.

(iii) Once both parties agree that factoring is possible, the broker puts the seller in direct contact with the funder to ask/answer any additional questions and to negotiate a customized factoring agreement, which will meet the needs of all concerned.

(iv) At this point, the seller may be asked to remit a fee with formal application to cover the legal research costs, which will be incurred during "due diligence". This is the process by which the buyer's credit worthiness is evaluated through background checks, using national database services.

(v) During the next several days, the funder completes the "due diligence" process on the seller, further verifies invoices and acknowledges any liens, UCC filings, judgments or other recorded encumbrances on the seller's accounts receivables.

(vi) The seller is advised of the facility and is asked to advise the buyers of the Factor by letter and submit an acknowledged copy of the same to the Factor for records.

(vii) A detailed sanction letter is given to the seller and their acceptance on the same taken, with the required signatories. (Authorized signatories would be mentioned in the "Signing Authorities" section of the Proposal presented by seller).

(viii) Sanction terms must contain the following.

  (a) All Facilities covered under the sanction.

  (b) The period for which the sanction is valid

  (c) When the Facility comes into effect e.g. (if Facility is dated 1/07/2014, it can state that invoices raised from or after 15/07/2014 only would be Factored).

  (d) Who the authorized signatories are for signing invoices for factoring.

  (e) The limits.

  (f) The seller has to advise the buyer of the Factoring agreement.

  (g) Copy of such advice acknowledged by the buyer should be submitted to them Factor. Buyer's consent is not required to decide on the Factor.

(viii) The discounting rates, charges fixed.

(ix) In case of discounts given by the seller to the buyer, which value would be financed by the factor (since the factored amount should never exceed the amount actually payable by buyer).

(x) Usually within 7 to 10 days of the initial contact with the factor, agreements are signed, customers are notified, Uniform Commercial Code (UCC) forms filed and the first advance is forwarded to the company. This advance can vary between 70 - 80% of the face value of the invoices being factored. In the construction industry, the advances may be in the range of 60 - 70%. The remaining amount is called the "reserve" which is held by the factor until the invoices are paid. The factor then deducts his fee and returns the remaining funds to the seller.

(xi) The seller performs services or delivers products, thus creating an invoice.

(xii) The seller sends or faxes a copy of the invoice directly to the factor.

(xiii) The funder verifies the invoice and the advance is sent to the seller as per the agreement with the factor. In certain cases, the funder wires the funds to the seller's account for an additional fee.

(xiv) The buyer pays the factor. The factor then returns any remaining reserve, minus the fee, which has been predetermined in the negotiated agreement.

Advantages for the Seller

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

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

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

– Interest rates are not as high as normal discounting.

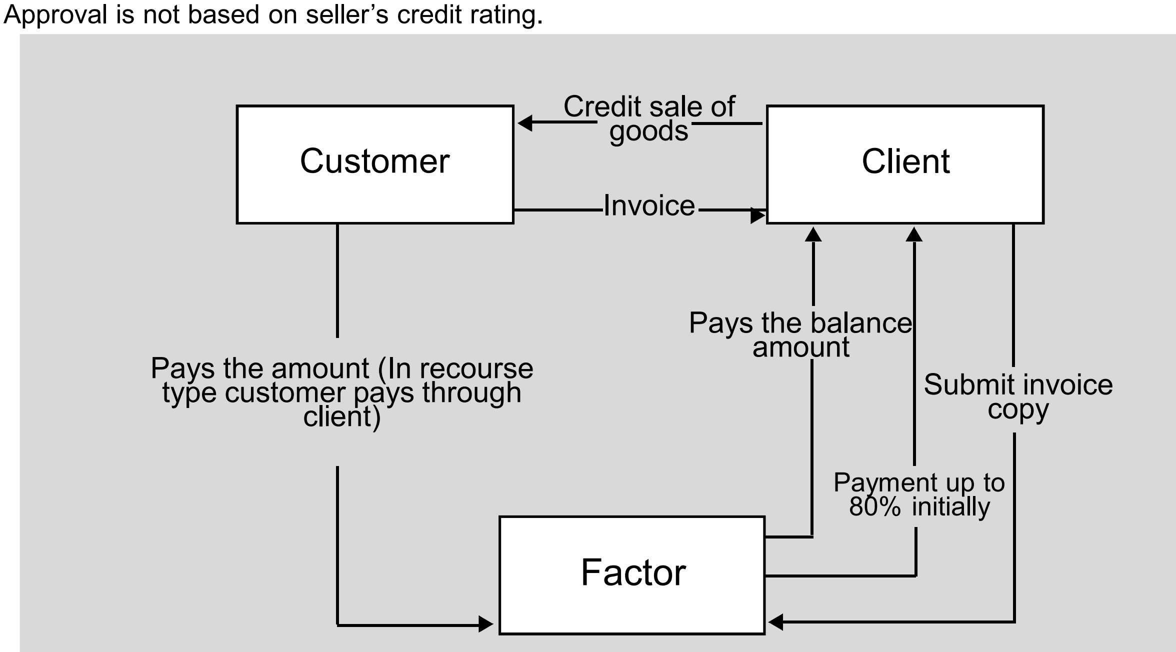
– Increased cash flow to meet payroll.

– Immediate funding arrangements.

– No additional debt is incurred on balance sheet.

– Other assets are not encumbered.

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



TYPES OF FACTORING

Factoring

- Full Factoring
- Recourse Factoring
- Maturity Factoring
- Advance Factoring
- Undisclosed Factoring
- Invoice Discounting

Non-Recourse or Full factoring

Under this type of factoring, the bank takes all the risk and bear all the loss in case of debts becoming bad debts.

Recourse Factoring

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

Maturity Factoring

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

Advance Factoring

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

Undisclosed Factoring

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

Invoice Discounting

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

Example/Case:

Under an advance factoring arrangement XYZ Ltd has agreed to advance a sum of Rs 14 lakh against the receivables purchased from ABC ltd. The factoring agreement provides for an advance payment of 80% of the value of factored receivables and for guaranteed payment after three months from the date of purchasing the receivables. The Advance carries a rate of interest of 16% per annum compounded quarterly and the factoring commission is 1.5% of the value of the receivables. Both the interest and commission are collected upfront.

a) Compute the amount actually made to ABC ltd.

b) Calculate the effective cost of funds made available to ABC Ltd.

c) Assume that the interest is collected in arrear and the commission is collected in advance. Calculate the effective cost of funds made available to ABC.

Sol:

a)	Value of factored receivable (14/0.8) (Rs lakh)	17.50
	Maximum Permissible advance (Rs lakh)	14
	Less commission@1.5% (17.5*0.015) (Rs lakh)	0.26
	Less Discount charge (14*0.16*90/360) (Rs lakh)	0.56
	Funds available to ABC (Rs lakh)	13.18

b) Discount charge expressed as a percentage of funds made available to ABC (0.56/13.18)*100 = 4.25%

Effective rate of interest is 4.25% per quarter.

Annualized rate of return = $\{(1.0425)^4 - 1\}*100$ =18.11%

c)	Maximum Advance (Rs lakh)	14
	Less Commission payable upfront (Rs lakh)	0.26
	Funds available to ABC (Rs lakh)	13.74
	Interest charge collected in arrears (14*0.16*90/360) (Rs lakh)	0.56

Discount charge expressed as a percentage of funds made available to ABC (0.56/13.74)*100 = 4.08%

Annualized interest cost = $\{(1.0408)^4 - 1\}*100$ = 17.35%

LETTER OF CREDIT

A letter of credit is a written understanding given by the buyer's bank (the issuing bank) on behalf of and at the request of its customer (the applicant) routed through the agency of a bank in the seller's country (advising bank) to the seller beneficiary that it (issuing bank) guarantees to pay the seller for the goods within a specified time provided that the conditions laid down in documentary credit are fully satisfied.

Reasons for using LC

In international trade, buyer and seller being located in different countries may not know each other well. The two countries will have different legal systems, currencies, trade and exchange regulations. Due to this fact both the Buyer and Seller, need some conditions to be fulfilled, to suit their requirements, before releasing the payments and goods respectively. The buyer and seller want the following:-

(a) Seller would want:

- (i) To be paid as soon as he ships the goods.
- (ii) An assurance that he will be paid by the buyer or his bank as per contractual obligations.
- (iii) Convenience of receiving payments in his own country.

(b) Buyer would want:

- (i) To pay for the goods only after they are shipped by the seller.
- (ii) An assurance that seller will ship the goods ordered for and deliver them in time.

BASIC FORMS OF LCS

Basic forms of LCs are enumerated below:-

(a) Revocable letter of credit.

(b) Irrevocable letter of credit.

(c) Confirmed letter of credit.

(d) Revolving letter of credit

(a) Revocable Letter of Credit.

A revocable letter of credit is one which may be amended or cancelled by the issuing bank at any moment without prior notice to the beneficiary. Therefore, such a type of letter of credit does not give complete sense of security to the beneficiary. However when the revocable letter of credit is made available at a branch of a bank concerned, the notice of amendment or cancellation is effective only upon receipt of such notice. If such a bank has undertaken liability (i.e. Paid, negotiated or accepted) against documents, which appear on the face of it to be in conformity with the terms and conditions of the credit before notice of amendment/cancellation, then the issuing Bank is bound to reimburse such a bank. If the letter of credit is silent as to whether it is revocable or irrevocable, the credit is deemed as IRREVOCABLE.

(b) Irrevocable Letter of Credit

When the issuing Bank gives a definite, absolute and irrevocable undertaking to honour its obligations, provided the beneficiary complies with all the terms and conditions such a credit is known as an irrevocable letter of credit. That means that the letter of credit cannot be amended, cancelled or revoked without the consent of the parties to the letter of credit. This gives the beneficiary definite protection.

(c) Confirmed Letter of Credit

A confirmed letter of credit is one when another Bank in the beneficiary's country adds its confirmation at the request of the issuing Bank. This undertaking of the confirming Bank to pay/negotiate/accept is in addition to the undertaking of the issuing bank. This is an added protection to the beneficiary. This is not to be agreed as it undermines the credibility of our Nationalized Banks.

(d) Revolving Letter of Credit

In such credits, the amount is restored, after it has been utilized, to the original amount. Such credits are used when the buyer is to receive partial shipment of goods at specific intervals for a long duration. It can be cumulative or noncumulative in nature. It avoids opening letter of credit for each and every consignment.

WORKING MECHANISM

The following is a step-by-step description of a typical Letter of Credit transaction:

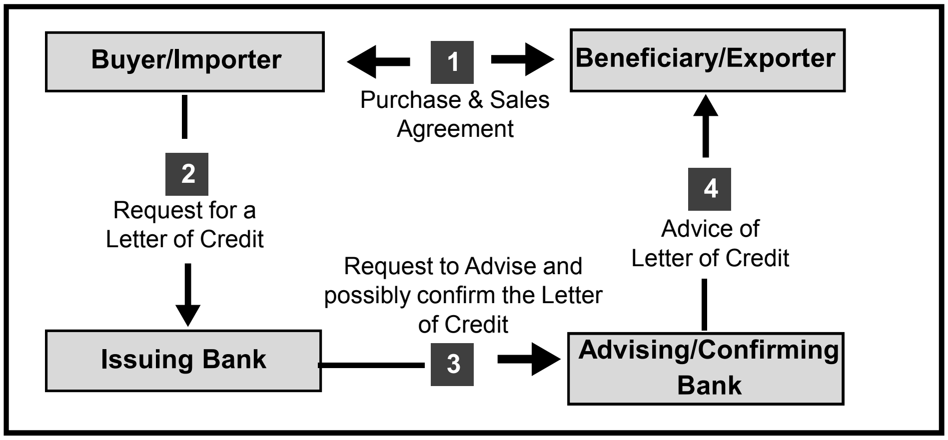
1. An Importer (Buyer) and Exporter (Seller) agree on a purchase and sale of goods where payment is made by Letter of Credit.

2. The Importer completes an application requesting its bank (Issuing Bank) to issue a Letter of Credit in favour of the Exporter. It is important to note that the Importer must have a line of credit with the Issuing Bank in order to request that a Letter of Credit be issued.

3. The Issuing Bank issues the Letter of Credit and sends it to the Advising Bank by telecommunication or registered mail in accordance with the Importer's instructions. A request may be included for the Advising Bank to add its confirmation. The Advising Bank is typically located in the country where the Exporter carries on business and may be the Exporter's bank but it does not have be.

4. The Advising Bank will verify the Letter of Credit for authenticity and send a copy to the Exporter.

Issuance of Letter of Credit



5. The Exporter examines the Letter of Credit to ensure:

(a) it corresponds to the terms and conditions in the purchase and sale agreement;

(b) documents stipulated in the Letter of Credit can be produced; and

(c) the terms and conditions of the Letter of Credit may be fulfilled.

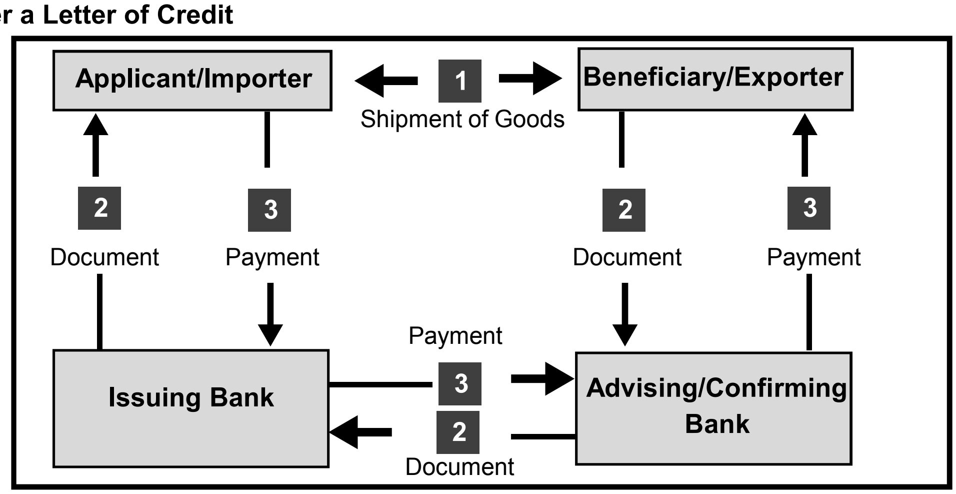
6. If the Exporter is unable to comply with any term or condition of the Letter of Credit or if the Letter of Credit differs from the purchase and sale agreement, the Exporter should immediately notify the Importer and request an amendment to the Letter of Credit.

7. When all parties agree to the amendments, they are incorporated into the terms of the Letter of Credit and advised to the Exporter through the Advising Bank.

8. The Exporter arranges for shipment of the goods, prepares and/or obtains the documents specified in the Letter of Credit and makes demand under the Letter of Credit by presenting the documents within the stated period and before the expiry date to the "available with" Bank. This may be the Advising/Confirming Bank. That bank checks the documents against the Letter of Credit and forwards them to the Issuing Bank. The drawing is negotiated, paid or accepted as the case may be.

9. The Issuing Bank examines the documents to ensure they comply with the Letter of Credit terms and conditions. The Issuing Bank obtains payment from the Importer for payment already made to the "available with" or the Confirming Bank.

Payment under a Letter of Credit



BILL OF EXCHANGE

The Negotiable Instruments Act, 1881, defines the Bill of Exchange as "an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument."

There are five important parties to a Bill of Exchange:

(i) **The Drawer** : The drawer is the person who has issued the bill. The drawer is the creditor to whom the money is owned.

(ii) **The Drawee** : The drawee is the person to whom the bill is addressed or against whom the bill is drawn. In other words, the drawee is the debtor who owes money to the drawer, the creditors.

(iii) **The Payee** : The payee is the person to whom the bill is payable. The bill can be drawn payable to the drawee or his Bank.

(iv) **The Endorser** : The endorser of a bill is the person who has placed his name and signature at the back of the bill signifying that he has obtained title to the bill and payment is due to him on his own account or on account of the original payee.

(v) **The Endorsee** : The endorsee is the person to whom the bill is endorsed. The endorsee can obtained payment from the drawee.

There are the following important types of Bill of Exchange :

(i) **Sight Bill of Exchange** : A sight or demand Bill of Exchange is one which is required to be paid by the draweee immediately on presentation of the Bill.

(ii) **Usance Bill of Exchange** : In case of the usance or time Bill of Exchange, there is maturity period called the tenor, and the payment is to be made only on the maturity of the bill.

Generally speaking, the due date of payment of the usance bill is calculated from the date of presentation or sighting of the bill by the drawee. Such a bill is called after sight usance bill. But sometimes the date of maturity is calculated from the date of drawing of the bill. Such a bill is known as after date usance bill.

(iii) **Clean Bill of Exchange** : A Bill of Exchange not accompanied by the relative shipping documents is known as a clean Bill of Exchange. In respect of the clean Bill of Exchange, the documents are sent to the consignee directly, and he can take delivery of the goods on their arrival at the port of destination.

(iv) **Documentary Bill of Exchange** : A documentary Bill of Exchange is a Bill of Exchange accompanied by the relative shipping documents such as the bill of lading, marine insurance policy, commercial invoice, certificate of origin, etc. The documents accompanying the bill are delivered to the importer by the bank only upon either acceptance or payment of the bill. The former is called documents against acceptance and the latter is called documents against payment. It is the documentary Bill of Exchange that is commonly used in foreign trade transactions.

Upon shipment of the goods, the exporter may draw a bill of exchange on the importer or, more frequently, on bank acting for the importer. The exporter usually draws the bill payable to his own order, or to that of his bank. He then endorses the bill and sells it to, or discounts it at, his bank. In this way the exporter receives his money immediately upon the shipment of the goods. The bank sends the bill and the documents to its foreign branch or correspondent bank which, upon arrival, promptly notifies the importer and presents the bill to him for payment or acceptance. Until the importer has accented the bill or made arrangements for payments he cannot receive the bill of lading, which is his title to the goods.

FIMMDA

FIMMDA stands for The Fixed Income Money Market and Derivatives Association of India (FIMMDA). It is an Association of Commercial Banks, Financial Institutions and Primary Dealers. FIMMDA is a voluntary market body for the bond, Money And Derivatives Markets.

Objectives of FIMMDA

- To function as the principal interface with the regulators on various issues that impact the functioning of these markets.
- To undertake developmental activities, such as, introduction of benchmark rates and new derivatives instruments, etc.
- To provide training and development support to dealers and support personnel at member institutions.
- To adopt/develop international standard practices and a code of conduct in the above fields of activity.
- To devise standardized best market practices.
- To function as an arbitrator for disputes, if any, between member institutions.
- To develop standardized sets of documentation.
- To assume any other relevant role facilitating smooth and orderly functioning of the said markets.

FOREIGN EXCHANGE DEALER'S ASSOCIATION OF INDIA

Foreign Exchange Dealer's Association of India (FEDAI) was set up in 1958 as an Association of banks dealing in foreign exchange in India (typically called Authorised Dealers - ADs) as a self regulatory body and is incorporated under Section 8 of The Companies Act, 2013. It's major activities include framing of rules governing the conduct of inter-bank foreign exchange business among banks vis-à-vis public and liaison with RBI for reforms and development of forex market.

Presently some of the functions of FEDAI are as follows:

- Guidelines and Rules for Forex Business.
- Training of Bank Personnel in the areas of Foreign Exchange Business.
- Accreditation of Forex Brokers
- Advising/Assisting member banks in settling issues/matters in their dealings.
- Represent member banks on Government/Reserve Bank of India/Other Bodies.
- Announcement of daily and periodical rates to member banks.

Due to continuing integration of the global financial markets and increased pace of de-regulation, the role of self-regulatory organizations like FEDAI has also transformed. In such an environment, FEDAI plays a catalytic role for smooth functioning of the markets through closer co-ordination with the RBI, other organizations like FIMMDA, the Forex Association of India and various market participants. FEDAI also maximizes the benefits derived from synergies of member banks through innovation in areas like new customized products, bench marking against international standards on accounting, market practices, risk management systems, etc.

LESSON ROUND UP

- The Money Market is a Market for dealing in monetory assets of short term nature. The Money Market functions as a wholesale debt market for low-risk, highly liquid, short term instruments.
- Government is an active player in the Money Market and in most of the economies; it constitutes the biggest borrower in this market.
- The Money Market possesses different operational features as compared to Capital Market. Money Market is distinguished from Capital Market on the basis of the maturity period, credit instruments and the institutions.
- The Indian Money Market consists of two types of segments: an organized segment and an unorganized segment.
- The Reserve Bank of India issues securities on behalf of the Government. The term Government Securities includes Central Government Securities, State Government Securities and Treasury Bills.
- Call Money is a Money Market instrument wherein funds are borrowed / lent for a tenor of one ay/ overnight (excluding Sundays/holidays).
- Money lent for a fixed tenor of 15 days or more is called Term Money.
- Bill discounting is a short tenure financing instrument for companies willing to discount their purchase / sales bills to get funds for the short run and as for the investors in them, it is a good instrument to park their spare funds for a very short duration.
- Repurchase transactions, called Repo or Reverse Repo are transactions or short term loans in which two parties agree to sell and repurchase the same security.
- Treasury Bills are Money Market instruments issued by RBI to finance the short term requirements of the Government of India.
- Certificate of Deposits (CDs) is a negotiable Money Market instrument and issued in dematerialised form or as Usance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period.
- An Inter Corporate Deposits (ICD) is an unsecured loan extended by one corporate to another. Existing mainly as a refuge for low rated corporates, this market allows corporates with surplus funds to lend to other corporates facing shortage of funds.
- Commercial bills are basically negotiable instruments accepted by buyers for goods or services obtained by them on credit.
- Commercial Paper (CP) is an unsecured Money Market instrument issued in the form of a promissory note.
- One of the recent development in the sphere of Money Market is the establishment of Money Market Mutual Funds, the guidelines of which have been prescribed by the Reserve Bank of India. Money Market Mutual Funds (MMFs) can be set up by the banks and public financial institutions.
- Factoring is a financial transaction where an entity sells its receivables to a third party called a ‘factor’, at discounted prices. Factoring is a financial option for the management of receivables.
- A Letter of Credit is a written understanding given by the buyer’s bank (the issuing bank) on behalf of and at the request of its customer (the applicant) routed through the agency of a bank in the seller’s country (advising bank) to the seller beneficiary that it (issuing bank) guarantees to pay the seller for the goods within a specified time provided that the conditions laid down in documentary credit are fully satisfied.

– The Negotiable Instruments Act, 1881, defines the Bill of Exchange as "an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument."

SELF TEST QUESTIONS

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

1. Briefly discuss about Call money and Notice Money Market.
2. Explain Treasury Bills as an effective Cash Management product and state how yield of Treasury Bill is calculated.
3. What is Banker's Acceptance? Discuss.
4. Explain briefly about Money Market Mutual funds.
5. How credit transaction takes place in a Letter of Credit? Explain with step wise description.
6. Discuss the various objective of FIMMDA.

Lesson 13
Insider Trading

LESSON OUTLINE

- Introduction
- Provisions of Companies Act, 2013 relating to insider trading
- SEBI (Prohibition of Insider Trading) Regulations, 2015
- Salient features
- Important Definitions
- Major Terms under SEBI (PIT) Regulations, 2015
- Restriction on Communication and Trading by Insiders
- Disclosure of Trading by Insiders
- Code of Fair Conduct and Disclosure
- Penalties for Contravention
- The Model Code of Conduct
- Role of CS under SEBI (PIT) Regulations, 2015
- LESSON ROUND UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

In simple terms 'Insider Trading' is buying or selling a security, in breach of a fiduciary duty or related relationship of trust, and confidence, while in possession of material and non-public information about the security. Insider trading can be illegal or legal depending on when the insider makes the trade. It is illegal when the material information is still non-public; trading while having special knowledge is unfair to other investors who don't have access to such knowledge. Therefore, preventing such transactions is one of the 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 Compliance Officer of the company plays an important role in preventing and regulating Insider Trading by the implementation of policies and procedures and over all supervision in this regard.

This lesson will enable the students to have the basic understanding of the Insider Trading, the Regulations prevailing in India, the disclosures required to be made 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 etc.

INTRODUCTION

Meaning and Definition of Insider Trading

Insider trading is defined as a malpractice wherein trade of a company's securities is undertaken by people who by virtue of their work have access to the otherwise nonpublic information which can be crucial for making investment decisions.

Example: When insiders, e.g. key employees or executives who have access to the strategic information about the company, use the same for trading in the company's stocks or securities, it is called insider trading and is highly discouraged by the Securities and Exchange Board of India to promote fair trading in the market for the benefit of the common investor.

Insider trading is an unfair practice, wherein the other stock holders are at a great disadvantage due to lack of important insider non-public information. However, in certain cases if the information has been made public, in a way that all concerned investors have access to it that will not be a case of illegal insider trading.

Insider trading can be legal or illegal depending on if the information used to base the trade is public.

Individuals who engage in illegal insider trading attempt to benefit from trades based on information about a company not yet made public. *For example*, an executive of Company ABC Limited who purchases shares of the company based on a pending merger announcement is engaging in illegal insider trading.

However, once Company ABC Limited has announced the merger publicly, insiders may legally trade the shares based on the information.

Insider Trading : A Legal Backdrop

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 history of Insider Trading in India relates back to the 1940's with the formulation of government committees such as the Thomas Committee 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 late 80's and early 90's and came to be known and observed extensively in the Indian Securities market. The rapidly advancing Indian Securities market requiring 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. Therefore with a view to remove the lacunae existing in the Regulations of 1992, the amendment has been made in Insider Trading Regulationss known as the SEBI (Prohibition of Insider Trading) Regulations, 1992.

The regulations of 1992 seemed to be more punitive in nature. The 2002 (Amended) which came to be regulations on the other hand are preventive in nature. The amendment requires all the listed companies, market intermediaries and advisers to follow the new regulations and also take steps in advance to prevent the practice of insider trading.

Now a big step taken forward by introduction of the insider trading provisions in the Companies Act, 2013 itself. As per the Companies Act, 2013 provisions it prohibits directors and key managerial personnel from purchasing call and put options of shares of the company, its holding company and its subsidiary and associate companies as if such person is reasonably expected to have access to price-sensitive information (being information which, if published, is likely to affect the price of the company's securities).

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. While the Companies Act, 1956 was silent on the provisions relating to insider trading, the Companies Act, 2013 on the other hand, lays down provisions relating to prohibition of insider trading with respect to all companies This is a step towards harmonization between the 2013 Act and the SEBI Act; more specifically for listed companies; Any person who violates the clause will be punished with a cash fine or imprisonment or both.

SEBI notified (Settlement of Administrative and Civil Proceedings) Regulations, 2014 vide its circular dated 09 January, 2014. Under these regulations, defaults involving insider trading and communication of unpublished price sensitive information are kept out of the purview of the scope of these regulations, i.e. a specified proceeding cannot be settled for insider trading default.

SEBI (Prohibition of Insider Trading) Regulations, 2015

Further, owing to the enactment of Companies Act, 2013 and to strengthen the regulation over Insider Trading, The Securities and Exchange Board of India ("SEBI") finally notified the SEBI (Prohibition of Insider Trading Regulations) 2015 ("Regulations") on January 15, 2015 replacing the two-decade old insider trading norms in India. The Regulations are based on the recommendations made by an 18 member committee ("Committee") constituted by SEBI under the chairmanship of Justice N.K. Sodhi, former Chief Justice of the High Courts of Kerala and Karnataka, which were approved by the SEBI Board in its meeting held on November 19, 2014 ("Board Meeting"). Please click on this link for our hotline on the Committee recommendations as well as a comparative study of the draft Regulations vis-à-vis the SEBI (Prohibition of Insider Trading) Regulations of 1992 ("1992 Regulations"). Our hotline on the Board Meeting is also available here. Although the Committee recommendations have substantially been incorporated in the Regulations, certain provisions have been left out/amended in the Regulations.

In November, 2014, India's market capitalization crossed USD 1.6 trillion, making it world's ninth largest economy by market capitalization1. SEBI has been constantly focused on developing and regulating the Indian capital market to boost the investors' confidence to maintain this momentum. The 1992 Regulations had considerable inadequacies in terms of their drafting, interpretation and outreach and over time, SEBI had introduced several amendments to certain provisions of the 1992 Regulations to fill in the lacunae. However, a need was felt to systematically review and provide a more robust and efficient mechanism in line with the global norms and standards to curb insider trading in India. Thus, the Regulations are formulated in order to put in place a framework for prohibition of insider trading in securities and to strengthen the legal framework. Therefore, in year 2015, The SEBI (Prohibition of Insider Trading) Regulations 2015 has been put in place by the Government of India.

PROVISIONS RELATING TO INSIDER TRADING IN COMPANIES ACT, 2013

Section 195 of the Companies Act, 2013 deals with the provisions on prohibition on insider trading of securities, which is as under:

Sub-section (1) lays down that no person including any director or key managerial personnel shall enter into insider trading:

Provided that nothing contained in this sub-section shall apply to any communication required in the ordinary course of business or profession or employment or under any law.

(a) "insider trading" means –

(i) an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company, or

(ii) an act of counselling about, procuring or communicating directly or indirectly any non- public price sensitive information to any person;

(b) "price-sensitive information" means any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the company.

Sub-section (2) provides that If any person contravenes the provisions of this section, he shall be punishable with imprisonment for a term which may extend to five years or with fine which shall not be less than five 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, or with both.

THE SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS 2015

INTRODUCTION

Fraudulent securities transactions or insider trading is one of the run-of-the-mill corporate phenomena today and as the number of episodes of manipulation of company securities' information was increasing at an alarming rate, it had become imperative to review the extant rules and regulations on the subject. Not much time has passed since the chief Indian Capital Market regulator, SEBI was accorded some extra teeth to prosecute and punish the offenders involved in Insider Trading.

On 15th January, 2015, Securities Exchange Board of India notified "Prohibition of Insider Trading Regulations, 2015" in exercise of its wide ranging powers conferred by Section 30 of the Securities and Exchange Board of India Act, 1992 read with S. 11(2) (g), S. 12 A (d) and S. 12 A (e) of the Securities and Exchange Board of India Act, 1992. It is also trite to cite Section 195 of Companies Act, 2013 here which provides that, "No person including any director or KMP of Company shall enter into insider trading." With these new regulations coming into force, the two decade old predecessor law i.e. SEBI (Prohibition of Insider Trading) Regulations, 1992 was repealed with subsequent effect on 15th May, 2015.

The new regulations reinforce framework for prohibition of securities fraud. The new regulation consists of five chapters and two Schedules whereas the previous regulation had four chapters and three schedules.

Five chapters notified under Chapters under SEBI (Prohibition of Insider Trading) Regulation, 2015 are –

Chapter – I: Preliminary;

Chapter – II: Restrictions on Communication and Trading by Insider;

Chapter – III: Disclosures of Trading by Insider;

Chapter – IV: Codes of Fair Disclosure and Conduct and

Chapter – V: Miscellaneous

APPLICABILITY OF THE REGULATIONS

The recently framed insider trading has been given a wide application and they are extended to securities listed and proposed to be listed on stock exchanges. This is an expansion from the 1992 Regulations which only applied with respect to companies that were listed. Additionally, the Regulations also strengthen the definition of who an 'insider' is. The scope of 'connected persons' under the Regulations has been widened to include persons associated with the company in a contractual, fiduciary or employment relationship or having direct or indirect access to unpublished price-sensitive information. Further, under the Regulations, the criteria for what constitutes 'unpublished price sensitive information' would be whether the information is 'generally available' or not. The definition of 'unpublished price sensitive information' has been extended to both a company and securities.

SALIENT FEATURES OF THE REGULATIONS

The newly fangledSEBI Regulations on the Prohibition of Insider Trading has no doubt sketched a stricter and more focused regulatory regime. Further, more comprehensively it has put in place a much resilientand efficiently enforceable regulatory framework for prevention of Insider Trading in India. Though the provisions of this regulation including the penalties imposed under the Companies Act, 2013 and the SEBI Act, 1992 for non-compliance and contravention of these Regulations are enormous; yet major distinguishing feature of the SEBI (Prohibition of Insider Trading) 2015 could be analysed as below:

1. There shall be prohibition on all designated persons for exercise of ESOPs during the trading window closure period and there shall be prohibition on all designated persons for exercise of ESOPs for six months after sale of shares, and vice versa.
2. There shall be no contra trade even in case of ESOP.
3. The Regulations prescribe that every employee shall disclose to the Company (Compliance Officer) details of the trade within 2 trading days of the transaction, if the value of securities traded in one or a series of transactions in any calendar quarter exceeds Rs.10 lakhs. The disclosures shall include those relating to trading by immediate relatives and by any other person for whom the trading decisions are taken.
4. A designated person who buys or sells any number of securities of the company shall not enter into an opposite transaction i.e. sell or buy respectively any number of securities of the Company during the next six months following the prior transaction.
5. A new concept of trading plans has been introduced in India for an insider under the Regulations.
6. If any Designated Person or his/her immediate relative(s) intend(s) to trade in securities exceeding market value of INR 42 lakhs during a calendar month, then he/she should apply to the Compliance Officer for pre-clearance, even during the period when the window is open.
7. The trading window shall be closed for adopting and considering financial results and other Unpublished Price Sensitive Information (UPSI) matters.
8. 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. Moreover, the designated persons and their immediate relatives shall not trade in securities when the trading window is closed.

DEFINITION

2 (1) (b) "Board" means the Securities and Exchange Board of India.

2 (1) (c) "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.

2 (1) (d) "Connected Person" means,-(i) any person who is or has during the six months prior to the concerned act been associated with a company, directly or indirectly, in any capacity including by reason of frequent communication with its officers or by being in any contractual, fiduciary or employment relationship or by being a director, officer or an employee of the company or holds any position including a professional or business relationship between himself and the company whether temporary or permanent, that allows such person, directly or indirectly, access to unpublished price sensitive information or is reasonably expected to allow such access.

(ii) Without prejudice to the generality of the foregoing, the persons falling within the following categories shall be deemed to be connected persons unless the contrary is established:

(a) An immediate relative of connected persons specified in clause (i); or

(b) A holding company or associate company or subsidiary company; or

(c) An intermediary as specified in section 12 of the Act or an employee or director thereof; or

(d) An investment company, trustee company, asset management company oran 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 the Board; 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.

Under these regulations, it is intended that a connected person is one who has a connection with the company that is expected to put him in possession of unpublished price sensitive information. Immediate relatives and other categories of persons specified above are also presumed to be connected persons but such a presumption is a deeming legal fiction and is rebuttable. This definition is also intended to bring into its ambit persons who may not seemingly occupy any position in a company but are in regular touch with the company and its officers and are involved in the know of the company's operations. It is intended to bring within its ambit those who would have access to or could access unpublished price sensitive information about any company or class of companies by virtue of any connection that would put them in possession of unpublished price sensitive information.

The new SEBI regulations widened the scope of "connected person", to cover all associated with a company, directly or indirectly. Even this includes, a professional or business relationship, that allows such person, directly or indirectly, access to unpublished price sensitive information ('UPSI') or is reasonably expected to allow such access. Further, SEBI has provided 10 categories of connected persons who shall be deemed to be connected persons unless contrary is established. It includes, an immediate relatives, a holding / associate / subsidiary company, an intermediary / an employee / director thereof, an investment company, trustee company, asset management company / an employee / director thereof; an official of stock exchange / of clearing house / corporation; a member of board of trustees of a mutual fund / member of board of directors of asset management company of mutual fund / is an employee thereof; a member of board of directors or an employee, of a public financial institution as defined in section 2 (72) of the Companies Act, 2013; an official or an employee of a self-regulatory organization recognized or authorized by the Board; a banker of the company; a concern, firm, trust, HUF, company / association of persons wherein a director of a company / his immediate relative / banker of the company, has more than 10% of holding / interest.

With the new definition of connected persons, it is clear for corporates that a connected person means anyone who has a connection with company that is expected to put him in possession of UPSI. As a result, the Corporates shall have to have up-to-date list of all such persons presumed to be connected. It would be a herculean task for Company Secretaries ('CS') to collect such information from all departments and keep the list of such persons ready from time to time. However, Corporates shall have to gear-up and ensure that such list is prepared and up-dated, in order to avoid unwarranted situations.

2 (1) (e) "Generally Available Information" means information that is accessible to the public on a non-discriminatory basis.

Under the regulation, it is intended to define what constitutes generally available information so that it is easier to crystallize and appreciate the meaning of unpublished price sensitive information. For example, the Information published on the website of a stock exchange, would ordinarily be considered generally available.

2 (1) (f) "Immediate Relative" means a spouse of a person, and includes parent, sibling, and child of such person or of the spouse, any of whom is either dependent financially on such person, or consults such person in taking decisions relating to trading in securities.

Under the rebuttable presumption, the immediate relatives of a "connected person" too become connected persons for purposes of these regulations.

2 (1) (g) "Insider" means any person who is:

(i) A connected person; or

(ii) In possession of or having access to unpublished price sensitive information.

With reference to the definition of generally available information provided under the regulation, it is intended that anyone in possession of or having access to unpublished price sensitive information should be considered an "insider" regardless of how one came in possession of or had access to such information. Various circumstances are provided for such a person to demonstrate that he has not indulged in insider trading. Therefore, this definition is intended to bring within its reach any person who is in receipt of or has access to unpublished price sensitive information. The onus of showing that a certain person was in possession of or had access to unpublished price sensitive information at the time of trading would, therefore, be on the person levelling the charge after which the person who has traded when in possession of or having access to unpublished price sensitive information may demonstrate that he was not in such possession or that he has not traded or he could not access or that his trading when in possession of such information was squarely covered by the exonerating circumstances.

2 (1) (l) "Trading" means and includes subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, deal in any securities, and "trade" shall be construed accordingly.

It is to be noted that Under the parliamentary mandate, since the Section 12A (e) and Section 15G of the Act employs the term 'dealing in securities', it is intended to widely define the term "trading" to include dealing. Such a construction is intended to curb the activities based on unpublished price sensitive information which are strictly not buying, selling or subscribing, such as pledging etc. when in possession of unpublished price sensitive information.

2 (1) (m)"Trading Day" means a day on which the recognized stock exchanges are open for trading.

2 (1) (n) "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.

It is intended that information relating to a company or securities, that is not generally available would be unpublished price sensitive information if it is likely to materially affect the price upon coming into the public domain. The types of matters that would ordinarily give rise to unpublished price sensitive information have been listed above to give illustrative guidance of unpublished price sensitive information.

Words and expressions used and not defined in these regulations but defined in the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Securities Contracts (Regulation) Act, 1956 (42 of 1956), the Depositories Act, 1996 (22 of 1996) or the Companies Act, 2013 (18 of 2013) and rules and regulations made thereunder shall have the meanings respectively assigned to them in those legislation.

MAJOR TERMS UNDER SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

What is an Insider Trading?

Insider Trading is an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal any securities of the company, by an insider, when in possession of any non-public price sensitive information.

In India, Insider Trading is regulated by SEBI (Prohibition of Insider Trading) Regulations, 2015.

Who is an insider?

Insider means any person who is a connected person or who is in possession or has access to unpublished price sensitive information. "Connected person" includes employees of the company, directors and their relatives, bankers, officials of stock exchanges etc.

What is unpublished price sensitive information (UPSI)?

UPSI is any information, relating to a company or its securities, directly or indirectly, that is not generally available and which upon becoming generally available, is likely to materially affect the price of the securities.

What is Trading window?

Trading window is the period during which Insiders (Designated persons) and their relatives can trade in the securities of the company.

The trading window is closed when insiders are expected to be in possession of unpublished price sensitive information. Insiders (Designated persons) and their relatives cannot trade in the securities of the company during the trading window close period. For example: Prior to declaration of financial results, mergers/ demergers etc. and for a minimum period of 48 hours after the information becomes publicly available.

What is a pre-clearance?

Preclearance is seeking approval from the compliance office before trading in the securities of the company. All insiders trading in the securities of the company need to apply to the compliance officer and take a permission to trade. This preclearance is valid for a maximum period of 7 days. The insider has to execute the trade within 7 days of receiving the preclearance.

What is a contra trade?

An insider trading in securities cannot execute an opposite transaction within 6 months or such period as mentioned in the Code of Conduct. For example: If an insider has purchased shares on say 1 Jan 2015, shares cannot be sold until 30 June 2015. If the insider sells shares before 30 June 2015, the profits from such trade shall be paid to the Investor Protection and Education Fund.

Disclosure Requirements as an Insider

An insider is required to submit details of holdings of self and relatives within 7 days of joining or being categorized as an insider (Initial disclosures).

On an ongoing basis, an insider has to submit disclosures when the traded value in the securities of the company, for self and relatives, during a calendar quarter exceeds the threshold limit which is currently 10 lacs (Continuous disclosures). This is a stock exchange reporting requirement.

What is a Trading Plan?

An insider can formulate a trading plan and get it approved from the compliance officer. This trading plan shall set out either the value of trades to be effected or the number of securities being purchased. Once a trading plan has commenced, the insider shall have to compulsorily trade based on the approved plan without deviating from it or executing any trade outside the scope of the trading plan.

RESTRICTION ON COMMUNICATION AND TRADING BY INSIDERS

Chapter II of the SEBI (Prohibition of Insider Trading) Regulation, 2015 imposes restrictions on Communication and Trading by Insiders Communication or procurement of Unpublished Price Sensitive Information except where such communication is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations.

Multiple restrictions have been placed i.e.

(i) Prohibition on communication of unpublished price sensitive information

(ii) Procurement of unpublished price sensitive information and

(iii) Trading in securities when in possession of unpublished price sensitive information.

The 1992 Regulations prohibited ‘dealing’ in securities when in possession of unpublished price sensitive information, amongst others; the expression ‘dealing’ has been replaced with ‘trading’ in securities. Under the Regulations, the definition of ‘trading’ has been kept wide. It must be noted that the 1992 Regulations placed no restrictions on the ‘procurement’ of unpublished price sensitive information by other persons.

Sub section (1) of Section 3 prohibits any insider from communicating, providing or allowing any access to any unpublished price sensitive information, relating to a company or securities listed or proposed to be listed, to any person including other insiders.

In this regard, it is worth to note that this provision is intended to cast an obligation on all insiders who are essentially persons in possession of unpublished price sensitive information to handle such information with care and to deal with the information with them when transacting their business strictly on a need-to-know basis. It is also intended to lead to organizations developing practices based on need-to-know principles for treatment of information in their possession.

Sub section (2) of Section 3 prohibits from procurement or communication by any insider of unpublished price sensitive information, relating to a company or securities listed or proposed to be listed.

This provision is intended to impose a prohibition on unlawfully procuring possession of unpublished price sensitive information. Inducement and procurement of unpublished price sensitive information not in furtherance of one's legitimate duties and discharge of obligations would be illegal under this provision.

Conditions of procuring Unpublished Price Sensitive Information in Public

Unpublished Price Sensitive Information may be communicated, provided, allowed access to or procured, in connection with a transaction that would:-

(i) Entail an obligation to make an open offer under takeover regulations

(ii) Where the Board of Directors of the company are of informed opinion that the proposed transaction is in the best interests of the company and the information relating to the same is disseminated at least two trading days prior to the proposed transaction.

Trading when in possession of Unpublished Price Sensitive Information

Insiders shall not trade in securities that are listed or proposed to be listed on a stock exchange when they are in possession of unpublished price sensitive information except in the following circumstances:

(i) Transaction is an off-market inter-se transfer between promoters who were in possession of the unpublished price-sensitive information without being in a breach of regulation 3 and both parties had made a conscious and informed trade decision;

(ii) In case of non-individual insiders:-

   (a) The individuals who were in possession of such UPSI 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

   (b) Appropriate and adequate arrangements were in place to ensure that these regulations are not violated and no UPSI was communicated by the individuals processing the information to the individuals taking trading decisions and there is no evidence of such arrangements having been breached.

   (iii) The trades were pursuant to a trading plan set up in accordance to Section 5 of SEBI (PIT) Regulations, 2015.

The provision clearly states that where a person who has traded in securities has been in possession of UPSI his trades would be presumed to have been motivated by the knowledge and awareness of such information in his possession. The reasons for which he trades or the purposes to which he applies the proceeds of the transactions are not intended to be relevant for determining whether a person has violated the regulation. He traded when in possession of UPSI is what would need to be demonstrated at the outset to bring a charge. Once this is established it would be open to the insider to prove his innocence by demonstrating the circumstances mentioned in the provision, failing which he would have violated the prohibition.

Section 4(2) states that in case of connected persons the onus of establishing that they were not in possession of UPSI shall be on such connected persons and in other cases, the onus would be on the Board.

Section 4(3) states that the Board may specify such standards and requirements, from time to time, as it may deem necessary for the purpose of these regulations.

The provisions in the Regulations aim at curbing trading in the stock market on biasness. Trade curb on the basis of USPI by an insider within the meaning of the Regulations is the aim of the Regulations.

Trading Plans

The concept of trading plan has been introduced in India by virtue of SEBI (Prohibition of Insider Trading) Regulations, 2015. In every company there are persons holding key managerial positions or promoters who may perpetually in possession of unpublished price sensitive information (UPSI). For such person, it is impossible to trade in the securities of the Company as these persons are always involved in decision making and thus have access to UPSI. Trading plans provide such persons opportunity to trade in the securities of the company without compromising the prohibitions imposed under PIT Regulations. It is a mechanism which entails monetizing of securities by insiders on a regular basis who may otherwise be unable to trade in the securities of the company.

Section 5 of the regulation requires that an insider shall be entitled to formulate a trading plan and present it to the compliance officer for approval and public disclosure pursuant to which trades may be carried out on his behalf in accordance with such plan.

This provision intends to give an option to persons who may be perpetually in possession of unpublished price sensitive information and enabling them to trade in securities in a compliant manner. This provision would enable the formulation of a trading plan by an insider to enable him to plan for trades to be executed in future. By doing so, the insider who is in possession of unpublished price sensitive information and formulated a Trading Plan approved by the Compliance Officer subsequently would not be prohibited from execution of such trades as per the trading plan approved by the Compliance Officer on such stand that he/she had pre-decided the trade even before such unpublished price sensitive information available to them.

The Trading plan shall comply with the requirements as follows:

i. It shall be submitted for a minimum period of 12 months.

ii. No Overlapping of plan with the existing plan submitted by Insider

iii. 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.

iv. Trading can only commence only after 6 months from public disclosure of plan.

v. No trading between 20th day prior to closure of financial period and 2nd trading day after disclosure of financial results.

vi. Compliance Officer to approve the plan.

vii. Section 5 (4) provides that 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 formulations of the plan and such information has not become generally available at the time of the commencement of implementation.)

viii. Section 5 (5) entails that upon approval of the trading plan, the compliance officer shall notify the plan to the stock exchanges on which the securities are listed.

Review of Trading Plan

Section 5 (3) provides thatthe compliance officer shall review the trading plan to assess whether the plan would have any potential for violation of these regulations and shall be entitled to seek such express undertakings as may be necessary to enable such assessment and to approve and monitor the implementation of the plan.

Under this section, it is worth to note that the compliance officer would have to review and approve the plan. For doing so, he may need the insider to declare that he is not in possession of unpublished price sensitive information or that he would ensure that any unpublished price sensitive information in his possession becomes generally available before he commences executing his trades. Once satisfied, he may approve the trading plan, which would then have to be implemented in accordance with these regulations.

DISCLOSURE OF TRADING BY INSIDERS

Chapter – III of the Regulation deals with disclosures of the trading details by insiders. Section 6 states that insiders are required to disclose the trading details to the authorities. It further states that the disclosures to be made by any person under this section shall include those relating to trading by such person's immediate relatives, and by any other person for whom such person takes trading decisions.

It is intended that disclosure of trades would need to be of not only those executed by the person concerned but also by the immediate relatives and of other persons for whom the person concerned takes trading decisions.

These regulations are primarily aimed at preventing abuse by trading when in possession of unpublished price sensitive information and therefore, what matters is whether the person who takes trading decisions is in possession of such information rather than whether the person who has title to the trades is in such possession.

Section 6 (4) states the disclosures made shall be maintained by the company, for a minimum period of five years, in such form as may be specified.

Typically, disclosure is mandated at two levels;

i) One is the immediate disclosure of any material information and

ii) The other is the disclosure of transactions undertaken.

Initial Disclosure

Initial Disclosures are required to be made by every promoter, key managerial personnel ('KMP') and director of every company whose securities are listed on any recognized stock exchange. It shall disclose person's holding of securities of the company as on the date of these regulations taking effect, to the company within 30 days of these regulations taking effect;

Further, every such person shall make similar disclosures within 7 days of assuming such position.

Continuous Disclosure

Under continual disclosures, every promoter, employee and director of every company shall disclose to the company the number of such securities acquired or disposed of within 2 trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of Rs. 10 Lacs or such other value as may be specified from time to time.

For example, a listed company may ask that a management consultant who would advise it on corporate strategy and would need to review unpublished price sensitive information, should make disclosures of his trades to the company.

CODE OF FAIR DISCLOSURE AND CONDUCT

Chapter – IV of the Regulation provides the listed companies, market intermediaries and other persons handing the Unpublished Price Sensitive Information to strictly follow the code of fair disclosure and conduct issued by the respective authorities.

Code for Fair Disclosure

Section 8 of the regulation clearly intends to require every company whose securities are listed on stock exchanges to formulate a stated framework and policy for fair disclosure of events and occurrences that could impact price discovery in the market for its securities. Principles such as, equality of access to information, publication of policies such as those on dividend, inorganic growth pursuits, calls and meetings with analysts, publication of transcripts of such calls and meetings, and the like are set out in the schedule A of the Regulation.

Section 8 (2) further states that 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 of Fair Disclosure for purposes of Code of Practices and Procedures for Fair Disclosure of Unpublished Price Sensitive Information [As per Annexure – A of SEBI (Prohibition of Insider Trading) Regulation, 2015]

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 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.

Code of Conduct

Section 9 (1) of the regulation clearly states that every company whose securities are listed on stock exchanges and every market intermediary registered with SEBI is mandatorily required to formulate a code of conduct governing trading by its employees. The standards set out in the schedule B are required to be addressed by such code of conduct.

Section 9 (2) further clearly intends to mandate persons other than listed companies and market intermediaries that are required to handle unpublished price sensitive information to formulate a code of conduct governing trading in securities by their employees. These entities include professional firms such as auditors, accountancy firms, law firms, analysts, consultants etc., assisting or advising listed companies, market intermediaries and other capital market participants. Even entities that normally operate outside the capital market may handle unpublished price sensitive information. ***This Provision would mandate all of them to formulate a code of conduct as per the minimum standards prescribed in Schedule B of the regulation.***

Designation of Compliance Officer:

For the purpose of Code of Conduct and its mandatory compliance, Section 9 (3) of the regulation entails that 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 to Regulate, Monitor and Report Trading by Insiders[As per Annexure B of SEBI (Prohibition of Insider Trading) Regulation, 2015]

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. The code of conduct shall contain norms for appropriate Chinese Walls procedures, and processes for permitting any designated person to “cross the wall”.
3. 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. 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.
4. 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. 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. Designated persons and their immediate relatives shall not trade in securities when the trading window is closed.
5. 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. 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.
6. When the trading window is open, trading by designated persons shall be subject to preclearance 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.
7. 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 preclearance of trades.
8. 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. He shall also have regard to whether any such declaration is reasonably capable of being rendered inaccurate.

9. 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.
10. 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 the Board for credit to the Investor Protection and Education Fund administered by the Board under the Act.
11. 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.
12. Without prejudice to the power of the Board under the Act, 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 under sub-regulation (1) and sub-regulation (2) of regulation 9, for the contravention of the code of conduct.
13. The code of conduct shall specify that in case it is observed by the persons required to formulate a code of conduct under sub-regulation (1) and sub-regulation (2) of regulation 9, that there has been a violation of these regulations, they shall inform the Board promptly.

PENALTIES FOR CONTRAVENTION

Section 10 of the Regulation states that any contravention of these regulations shall be dealt with by the Board in accordance with the SEBI Act, 1992.

The SEBI Act talked about two classes of penalties:

Imprisonment: Section 24 of SEBI Act even goes to the extent of imprisonment up to 10 years or fine up to Rs. 25 Crore, or both, for any offences pertaining to contravention of the provisions of the Act.

Section 24 of SEBI Act, 1992 reads as under:

Offences: (1) Without prejudice to any award of penalty by the adjudicating officer under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations made thereunder, he shall be punishable with imprisonment for a term which may extend to 121[ten years, or with fine, which may extend to twenty-five crore rupees or with both]. (2) If any person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to [ten years, or with fine, which may extend to twenty-five crore rupees or with both]

Fine: Section 15G of the Act imposes penalty of at least Rs10 Lacs, which may extend to Rs. 25 Crore or three times of profits made out of insider trading, whichever is higher.

Section 15 G of SEBI Act, 1992 reads as under:

Penalty for insider trading: If any insider who,— (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, 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].

MODEL CODE OF CONDUCT FOR PREVENTION OF INSIDER TRADING

COMPLIANCE OFFICER

The Board of the Company shall appoint the any senior officer as accordance to section 2(1)(c) as the Compliance Officer to ensure compliance and for effective implementation of the Regulations and also this Code across the Company.

The Compliance Officer shall report to the board of directors of the Company 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.

The Compliance Officer shall be responsible for setting forth the 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 Company.

In the performance of his/her duties, the Compliance Officer shall have access to all information and documents relating to the Securities of the Company.

In the event ofthe office of the designated Compliance Officer falling vacant till such time asuccessor is appointed, the Managing Director shall, in the interim period act as the Compliance Officer.

In order to discharge his/her functions effectively, the Compliance Officer shall be adequately empowered and provided with adequate manpower and infrastructure to effectively discharge his/her function. In the performance of his/her duties, the Compliance Officer shall have access to all information and documents relating to the Securities of the Company.

The Compliance Officer shall act as the focal point for dealings with SEBI in connection with all matters relating to the compliance and effective implementation of the Regulations and this Code.

Duties of the Compliance Officer

The Compliance Officer shall be responsible for:

1. Setting forth policies in relation to the implementation of the Code and the Regulations in consultation with the Board/Audit Committee.
2. Prescribing procedures for various activities referred to in the Code.
3. Compliance with the policies and procedures referred hereinabove.
4. Monitoring adherence to the rules for the preservation of UPSI.
5. Grant of pre-trading approvals to the Designated Persons for trading in
6. the Company‘s Securities by them/their Immediate Relatives and monitoring of such trading.
7. Implementation of this Code under the general supervision of the Audit Committee and the overall supervision of the Board of the Company.

The Compliance Officer shall maintain a record (either manual or in electronic form) of the Designated Persons and their Immediate Relatives and changes thereto from time-to-time.

The Compliance Officer shall assist all the Designated Persons in addressing any clarifications regarding the Regulations and this Code.

The Compliance Officer shall place status reports before the Chairman of the Audit Committee, detailing Trading in the Securities by the Designated

Persons along with the documents that such persons had executed in accordance with the pre-trading procedure prescribed under the Code on a quarterly basis.

PRESERVATION OF UNPUBLISHED PRICE SENSITIVE INFORMATION

All information shall be handled within the Company 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.

Unpublished price sensitive information may be communicated, provided, allowed access to or procured, in connection with a transaction which entails:

- an 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; or
- not attracting the obligation to make an open offer under the takeover regulations but 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 two trading days prior to the proposed transaction being effected in such form as the Board of Directors may determine.

However, the Board of Directors shall require the parties to execute agreements to contract confidentiality and non-disclosure obligations on the part of such parties and such parties shall keep information so received confidential, except for the limited purpose and shall not otherwise trade in securities of the Company when in possession of unpublished price sensitive information.

Need to know basis - Price Sensitive Information of the Company is to be handled on a "need to know" basis i.e. should be disclosed only to those within the Company who need the information to discharge their duty and whose possession of such information will not give rise to a conflict of interest or apprehension of misuse of the information. All non-public information directly received by any employee should immediately be reported to the head of the department.

Limited access to confidential information - All manual files containing confidential information shall be kept secure. All Computer files must have adequate security.

PREVENTION OF MISUSE OF UNPUBLISHED PRICE SENSITIVE INFORMATION

No insider shall

- Trade in Securities of the Company either on their own behalf or on behalf of any other person when in possession of any unpublished price sensitive information; or
- Communicate, provide or allow access to any unpublished price sensitive information, relating to a company or securities listed or proposed to be listed, to any person including other insiders except where such communication is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations.

TRADING PLAN

An insider shall be entitled to formulate a trading plan and present it to the compliance officer for approval and public disclosure pursuant to which trades may be carried out on his behalf in accordance with such plan.

Trading Plan shall:

(i) not entail commencement of trading on behalf of the insider earlier than six months from the public disclosure of the plan;

(ii) not entail trading for the period between the twentieth trading day prior to the last day of any financial period for which results are required to be announced by the issuer of the securities and the second trading day after the disclosure of such financial results;

(iii) entail trading for a period of not less than twelve months;

(iv) not entail overlap of any period for which another trading plan is already in existence;

(v) 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; and

(vi) not entail trading in securities for market abuse.

The Compliance Officer shall consider the Trading Plan made as above and shall approve it forthwith. However, he shall be entitled to take expressed undertakings as may be necessary to enable such assessment and to approve and monitor the implementation of the plan as per provisions of the Regulations.

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.

However, the implementation of the trading plan shall not be commenced, if at the time of formulation of the plan, the Insider is in possession of any unpublished price sensitive information and the said information has not become generally available at the time of the commencement of implementation. The commencement of the Plan shall be deferred until such unpublished price sensitive information becomes generally available information. Further, the Insider shall also not be allowed to deal in securities of the Company, if the date of trading in securities of the Company, as per the approved Trading Plan, coincides with the date of closure of Trading Window announced by the Compliance Officer.

Upon approval of the trading plan, the compliance officer shall notify the plan to the stock exchanges on which the securities are listed.

TRADING WINDOW

The trading window shall be, inter alia, closed 7 days prior to and during the time the unpublished price sensitive information is published.

The Compliance Officer shall intimate the closure of trading window to all the designated employees of the Company when he 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.

The Compliance Officer after taking into account various factors including the unpublished price sensitive information in question becoming generally available and being capable of assimilation by the market, shall decide the timing for re-opening of the trading window, however in any event it shall not be earlier than forty-eight hours after the information becomes generally available.

Other than the period(s) for which the Trading Window is closed as specified hereinabove, the same shall remain open for dealing in the Securities of the Company.

PRE CLEARANCE OF TRADE IN SECURITIES

All the persons covered by the Code who propose to acquire/sell Securities of the Company which are more than Rs. 10 Lacs in value or 50,000 shares or 1% of the total shareholding or voting rights, whichever is lower, should pre-clear the transaction.However, no designated person shall be entitled to 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 and hence he shall not be allowed to trade. The pre-dealing procedure shall be hereunder:

– A Designated Person shall make a pre-clearance application to the Compliance Officer in the prescribed format Form 1 along with an undertaking stating that he/she has not contravened the provision of this Code.

– If any person covered by the Code,obtained any Price Sensitive Information after executing the undertaking but prior to transacting in Securities of the Company, he/she shall inform the Compliance Officer and refrain from dealing in Securities of the Company.

– All the persons covered by the Code shall execute their order **within 7 Days of pre clearance of trade.** If the transaction is not executed within 7 Days of such clearance, fresh approval of the Compliance Officer is required.

All Designated Persons shall conduct their dealings in the securities of the Company only in the “Valid Trading Window” period and shall not enter into “Contra Trade” i.e. opposite or reverse transactions, in the securities of the Company during the next six months following the prior transaction. The Compliance Officer is 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 the Board for credit to the Investor Protection and Education Fund administered by the Board under the Act. When the trading window is closed, the Specified Persons shall not trade in the Company’s securities in such period.

In the case of subscription in the primary market (initial public offers), the above mentioned entities shall hold their investments for a minimum period of 30 days. The holding period would commence when the securities are actually allotted.

In case the sale of securities is necessitated by personal emergency the holding period may be waived by the Compliance Officer after recording in writing his reasons in this regard. The application for the waiver of the minimum period of holding of the securities shall be made by the employee in Form 2 annexed to this Code.

DISCLOSURE REQUIREMENTS

Initial Disclosure

Every Promoter, Key Managerial Personnel and Director of the Company and any other person for whom such person takes trading decisions shall disclose his holding of securities of the Company as on the date of these regulations taking effect, within 30 days in Form A;

Every person on appointment as a Key Managerial Personnel or a Director of the Company or Designated Employee or upon becoming a Promoter shall disclose his holding of securities of the Company and any other person for whom such person takes trading decisions as on the date of appointment or becoming a promoter, to the Company within seven days of such appointment or becoming a Promoter in Form B**.**

Continual Disclosure

Every Promoter, Designated Employee and director of Company and any other person for whom such person takes trading decisions shall disclose to the Company the number of such securities acquired or disposed of within two trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of ten lakh rupees or such other value as may be specified by the Compliance Officer from time to time in Form C.

Disclosure by the Company to the Stock Exchange(s)

The Company shall within 2 Working days the receipt of disclosures as mentioned as aforesaid, discloses to all Stock Exchanges on which the securities of the Company are listed, the information received as aforesaid.

General Provision

The Compliance Officer shall maintain records of all the declarations in the appropriate form given by the directors/ designated employees for a minimum period of five years.

The Compliance Officer shall place before the Managing Director / Chief Executive Officer or a committee specified by the company, on a monthly basis all the details of the dealing in the securities by the employees / director / officer of the company and the accompanying documents that such persons had executed under the pre-dealing procedure as envisaged in this code.

PENALTIES

Every Designated Person shall be individually responsible for complying with the provisions of the Code (including to the extent the provisions hereof are applicable to his/her dependents).

Any Designated Person who trades in securities or communicates any information for trading in securities, in contravention of this Code may be penalised and appropriate action may be taken by the Company. The penalties will be as per the Securities Contract (Regulation) Act, 1956.

The action by the Company shall not preclude SEBI and other authorities from taking any action in case of violation of SEBI (Prohibition of Insider Trading) Regulations, 2015. In case the SEBI Regulations or any Statutory Provisions are more stringent than those contained in the Code, the SEBI Regulations / Statutory Provisions will prevail.

ROLE OF COMPANY SECRETARY UNDER SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

By virtue of the SEBI (PIT) Regulation, 2015, a Company Secretary has following responsibilities to perform:

1. To ensure overall compliance of the Regulations.
2. To administer and implement Code of Fair Disclosure and Code of Conduct.
3. To review, approval and monitoring the Designated Persons' Trading Plans –
4. To file submission to stock exchanges.
5. To conduct Periodic reporting to the Board of Directors and Audit Committee.
6. To identify and review list of designated persons under internal code ofconduct with guidance by the Board.
7. To notify closure and re-open of Trading Window –
8. To monitor the trading by employees and connected persons.
9. Pre-clearance of trades.
10. To provide relaxation from mandatory 6 months holding period to the Insiders inexceptional circumstances.
11. To maintenance of records for a period of five years.
12. To ensure clarifications and guidance to the insiders.
13. To adopt appropriate measures for prevention of leakage of UPSI.

14. To stipulate various formats under the Code :
    - Preclearance of Trades
    - Reporting of trades by Insiders or Decisions not to trade after securing pre- clearance
15. To maintain following registers
    - Register of Insiders
    - Register of Preclearance
    - Register of forms (A, B, C, D) submitted to stock exchanges
16. To secure board approval for due diligence on the Companies
17. To reporting of non-compliance to the Board / audit committee and SEBI

LESSON ROUND UP

- An Insider cannot trade when he is in possession of Unpublished Price Sensitive Information (UPSI).
- An Insider cannot communicate UPSI except of legitimatepurpose, duties and legal obligations.
- An Insider in possession with UPSI can opt for trading plan only after take approval from Compliance officer.
- The Regulation are applicable on the Connected persons too which are defined as any person who is or has during the six months prior to the concerned act been associated with a company, directly or indirectly, in any capacity thereto.
- In case of trading by Connected Person, the burden of proof will be oncconnected persons to establish theywere not in possession of UPSI at the time of trading.In other cases, onus of proof is on SEBI
- The regulation covers the designated persons and relatives too
- Regulation requires for the Initial Disclosures as well as Continuous Disclosure
- Continuous disclosure for trade of above Rs.10 Lakhs
- The Insiders cannot trade during closure of trading window. They shall take pre-clearance for trades above Rs.10 Lakhs
- Under the Regulation, one is required to comply with Insider Code of Conduct.
- Board of the Company has to formulate the Code of Fair disclosure and Code of Conduct.
- Compliance officer has a duty to implement the Code and report the contravention in any to the Authorities.
- Companies are required to communicate the formulation of Codes to Stock Exchanges as per the SEBI Circular dated May 11, 2015.
- Companies required to upload the Code of Fair Disclosure on the website of the Company.
- Companies to seek initial disclosures from Promoter, Director, KMP and other vital officers in the possession of UPSI
- Companies to create mechanisms and procedures for Initial Disclosure and Continual Disclosures from.
- Companies may determine any other disclosures required from Connectedperson
- Companies to implement the code and create communication andawareness, training with regard to the SEBI (Prohibition of Insider Trading) Regulation, 2015.

– There shall be prohibition on all designated persons for exercise of ESOPs during the trading window closure period and there shall be prohibition on all designated persons for exercise of ESOPs for six months after sale of shares, and vice versa.

– There shall be no contra trade even in case of ESOP.

– The Regulations prescribe that every employee shall disclose to the Company (Compliance Officer) details of the trade within 2 trading days of the transaction, if the value of securities traded in one or a series of transactions in any calendar quarter exceeds Rs.10 lakhs. The disclosures shall include those relating to trading by immediate relatives and by any other person for whom the trading decisions are taken.

– A designated person who buys or sells any number of securities of the company shall not enter into an opposite transaction i.e. sell or buy respectively any number of securities of the Company during the next six months following the prior transaction.

– A new concept of trading plans has been introduced in India for an insider under the Regulations.

– If any Designated Person or his/her immediate relative(s) intend(s) to trade in securities exceeding market value of Rs. 42 lakhs during a calendar month, then he/she should apply to the Compliance Officer for pre-clearance, even during the period when the window is open.

– The trading window shall be closed for adopting and considering financial results and other Unpublished Price Sensitive Information (UPSI) matters.

– 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. Moreover, the designated persons and their immediate relatives shall not trade in securities when the trading window is closed.

– The penalties for the contravention of SEBI (PIT) Regulation, 2015 are imposed under the Companies Act, 2013 and the SEBI Act, 1992 for non-compliance and contravention of these Regulations which are quite huge.

SELF TEST QUESTIONS

1. What do you mean by Insider Trading? Discuss the rules and regulations prohibiting Insider Trading in India.
2. Discuss the role of Compliance Officer under the SEBI (Prohibition of Insider Trading) Regulation, 2015
3. What are the Penalties for Insider Trading under the SEBI Act, 1992?
4. What is Trading Plan and Trading Window? Discuss
5. What are the Disclosure requirement under SEBI (Prohibition of Insider Trading) Regulation, 2015? Discuss in detail.
6. Discuss the role of Company Secretary under SEBI (Prohibition of Insider Trading) Regulation, 2015.
7. What is Code of Fair Disclosure and Code of Conduct under SEBI (Prohibition of Insider Trading) Regulation, 2015?
8. Write a summary note on SEBI (Prohibition of Insider Trading) Regulation, 2015.

Lesson 14

Substantial Acquisition of Shares and Takeovers

LESSON OUTLINE

- Introduction
- Important Definitions
- Trigger Point for making an open offer by an acquirer
- Open Offer
- Open Offer Process
- Public Announcement
- Offer Price
- Provision of Escrow
- Mode of Payment
- Disclosures
- Exemptions
- Case Study
- LESSON ROUND UP
- SELF TEST QUESTIONS

LEARNING OBJECTIVES

Industrialization, Liberalization and the opening of Indian economy have created enormous opportunities for the growth of development of Indian Economy including the opportunities for International Mergers and Acquisitions. This has led the transformation of entire business scenario at parity. This new instrument of M&A, though proved to be beneficial for growth, yet has also created a need for some regulations to protect the interest of investors, especially in case of widely held companies. Accordingly, SEBI came out with SEBI Takeover Regulations, 1994 which was later substituted by SEBI Takeover Regulations, 1997 and then replaced by SEBI Takeover Regulations, 2011. The regulations were duely amended with their first Amendment in 2013 & second Amendment in 2016

SEBI Takeover Regulations plays a major role in regulating, directing and driving acquisition and restructuring exercises of listed companies in India. The regulations have been developed to enshrine the interest of various concerned entities viz. by facilitating a guide to corporate sector in exploiting the business opportunities by way of acquisitions without prejudicing the interest of investors and by providing an instrument to investors to ensure that their funds vests in the same hands in which they have been bestowed.

The objective of this lesson is to give an insight into SEBI Takeover Regulations, 2011 along with their recent amendments. This lesson will also help the students to understand the key concepts of the Takeover Regulations in our country.

INTRODUCTION

The globalization and initiation of various economic reforms in India during early nineties opened up the opportunities for International Mergers and Acquisitions and began the process of transformation of entire business scenario. To compete at the world platform, the scale of businesses in India was needed to be increased. This new weapon of M&A in the armory of corporate, though proved to be beneficial for growth, also created a need for some regulations to protect the interest of investors, especially in case of widely held companies, so that the process of M&A is used to develop the securities market and not to sabotage it.

Accordingly, in the year 1994, SEBI came out with SEBI Takeover Regulations, 1994 which was later substituted by SEBI Takeover Regulations, 1997.

SEBI Takeover Regulations plays a major role in driving the acquisition and restructuring exercises of listed companies of India. The regulations have been developed to enshrine the interest of various concerned entities viz. by facilitating a guide to corporate sector in exploiting the business opportunities by way of acquisitions without prejudicing the interest of investors and by providing an instrument to investors to ensure that their funds vests in the same hands in which they have been bestowed with.

With a view to be aligned with the changing business scenario of market behaviour, the SEBI Takeover Regulations, 1997 have been amended a number of times to address the changing business. To review the SEBI Takeover Regulations, 1997, SEBI constituted an expert committee, Takeover Regulations Advisory Committee (or TRAC) under the chairmanship of Late Sh. C. Achuthan which released its report on July 19, 2010. Finally, on September 23, 2011, SEBI has notified the much awaited New Takeover Regulations i.e. SEBI (Substantial Acquisitions of Shares and Takeovers) Regulations, 2011 that came into force on the 30th day from the date of their publication in the Official Gazette i.e. w.e.f. October 22, 2011.

SEBI (SAST) Regulations, 2011 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. These Regulations 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.

To align the need of changes in the business pattern towards M&A, these regulations were further amended in 2013 & 2016.

In reference with the recent amendments in the SEBI (SAST) Regulation 2011 in year 2013 and 2016, it is noteworthy that these regulations shall apply to direct and indirect acquisition of shares or voting rights in, or control over Target Company. Provided that 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, on the institutional trading platform of a recognised stock exchange.

It is note-worthy that these regulations shall apply to direct as well as indirect acquisition of shares or voting rights in or control over the target company.

What is Takeover and Substantial Acquisition of Shares ?

When an "Acquirer" takes over the control of the "Target Company", it is termed as Takeover. When an acquirer acquires "substantial quantity of shares or voting rights" of the Target Company, it results into substantial acquisition of shares.

IMPORTANT DEFINITIONS

To understand the concept of the takeover code, it would be pertinent understand some major of the Cod e definitions:

Acquirer – 2(1)(a)

"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 – 2(1)(b)

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

Control – 2(1)(c)

"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.

Provided that 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.

Convertible Security – 2(1)(f)

Convertible security means a security which is convertible into or exchangeable with equity shares of the issuer at a later date, with or without the option of the holder of the security, and includes convertible debt instruments and convertible preference shares.

Disinvestment – 2(1)(g)

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.

Enterprise Value – 2(1)(h)

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 – 2(1)(j)

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 per cent of the total number of shares of such class of the target company.

Provided that 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.

Identified Date – 2(1)(k)

"Identified date" means the date falling on the tenth working day prior to the commencement of the tendering period, for the purposes of determining the shareholders to whom the letter of offer shall be sent.

Listing Agreement – 2(1)(m)

Listing Agreement means the agreement with the stock exchange governing the conditions of listing of shares of the target company.

Manager to Open Offer – 2(1)(n)

Manager to the Open Offer means a merchant banker referred to in regulation 12. Regulation 12 says that a merchant banker registered with the Board and appointed the acquirer prior to making a public announcement, who is not an associate of the acquirer will act and known as the manager to the open offer. Further for the purposes of this regulation the term associate has the same meaning as in the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992.

Maximum Permissible Non-Public Shareholding – 2(1)(o)

Maximum Permissible Non-Public Shareholding means such percentage shareholding in the target company excluding the minimum public shareholding required under the Securities Contracts (Regulation) Rules, 1957;

Offer Period – 2(1)(p)

"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 – 2(1)(q)

"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;
- (iv) promoters and members of the promoter group;
- (v) immediate relatives;
- (vi) a mutual fund, its sponsor, trustees, trustee company, and asset management company;
- (vii) a collective investment scheme and its collective investment management company, trustees and trustee company;
- (viii) a venture capital fund and its sponsor, trustees, trustee company and asset management company;
- (viiia) an alternative investment and its sponsor, trustees, trusty company and manager;
- (ix) omitted by the SEBI (FPI) Regulations, 2014;
- (x) a merchant banker and its client, who is an acquirer;
- (xi) a portfolio manager and its client, who is an acquirer;
- (xii) 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:

Provided that this sub-clause 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;

(xiii) 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:

Provided that nothing contained in this sub-clause shall apply to holding of units of mutual funds registered with SEBI.

Explanation to Regulation 2(1)(q)

For the purposes of this clause – associate of a person means, – (a) any immediate relative of such person; (b) trusts of which such person or his immediate relative is a trustee; (c) partnership firm in which such person or his immediate relative is a partner; and (d) members of Hindu undivided families of which such person is a coparcener.

Shares – 2(1)(v)

Shares means shares in the equity share capital of a target company carrying voting rights, and includes any security which entitles the holder thereof to exercise voting rights.

Explanation : For the purpose of this clause shares will include all depository receipts carrying an entitlement to exercise voting rights in the target company.

Target Company – 2(1)(z)

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 – 2(1)(za)

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" – 2(1)(zb)

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

$$\text{Volume weighted Average Market Price} = \frac{X1*Y1+X2*Y2+X3*Y3\ldots\ldots\ldots}{X1+X2+X3\ldots\ldots\ldots\ldots\ldots..}$$

"Volume weighted average price" – 2(1)(zc)

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

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

Weighted Average Number of Total Shares – 2(1)(zd)

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-weighing factor.

Wilful Defaulter 2(1)(ze) (Inserted by the SEBI (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2016, w.e.f. 25-05-2016**)**

Wilful Defaulter means any person who is categorized as a wilful defaulter by any bank or financial institution or consortium thereof, in accordance with the guidelines on wilful defaulters issued by the Reserve Bank of India and includes any person whose director, promoter or partner is categorized as such.

SUBSTANTIAL ACQUISITION OF SHARES OR VOTING RIGHTS

Regulation 3 under Chapter II of the SEBI (SAST) Regulation, 2011 describes a detailed procedure for the Substantial acquisition of shares or voting rights.

Regulation 3(1) says that no acquirer shall acquire shares or voting rights in a target company which taken together with shares or voting rights, if any, held by him and by persons acting in concert with him in such target company, entitle them to exercise twenty-five per cent or more of the voting rights in such target company **unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations.**

Further, regulation 3(2) regulates the acquisition by acquire together with person acting in concert. The regulation clearly says that no acquirer, who together with persons acting in concert with him, has acquired and holds in accordance with these regulations shares or voting rights in a target company entitling them to exercise twenty-five per cent or more of the voting rights in the target company but less than the maximum permissible non-public shareholding, **shall acquire within any financial year additional shares or voting rights in such target company entitling them to exercise more than five per cent of the voting rights**, unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations.

Provided that such acquirer shall not be entitled to acquire or enter into any agreement to acquire shares or voting rights exceeding such number of shares as would take the aggregate shareholding pursuant to the acquisition above the maximum permissible non-public shareholding.

For purposes of determining the quantum of acquisition of additional voting rights under this sub-regulation,

(i) Gross acquisitions alone shall be taken into account regardless of any intermittent fall in shareholding or voting rights whether owing to disposal of shares held or dilution of voting rights owing to fresh issue of shares by the target company.

(ii) In the case of acquisition of shares by way of issue of new shares by the target company or where the target company has made an issue of new shares in any given financial year, the difference between the pre-allotment and the post-allotment percentage voting rights shall be regarded as the quantum of additional acquisition.

Obligation to Make Open Offer:

Regulation 3 (3) says that for the purposes of sub-regulation (1) and sub-regulation (2), acquisition of shares by any person wherein the shareholding of such person acquiring shares exceeds the stipulated thresholds, such individual is under a mandatory obligation to make an open offer for acquiring shares of the target company irrespective of the fact that there is a change in the aggregate shareholding with persons acting in concert.

Exemption:

As per Regulation 3 (4), which is inserted by the SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2016, w.e.f. 17-02-2016, it is clear that nothing contained in this regulation shall apply to acquisition of shares or voting rights of a company by the promoters or shareholders in control, in terms of the provisions of Chapter VI-A of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

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.

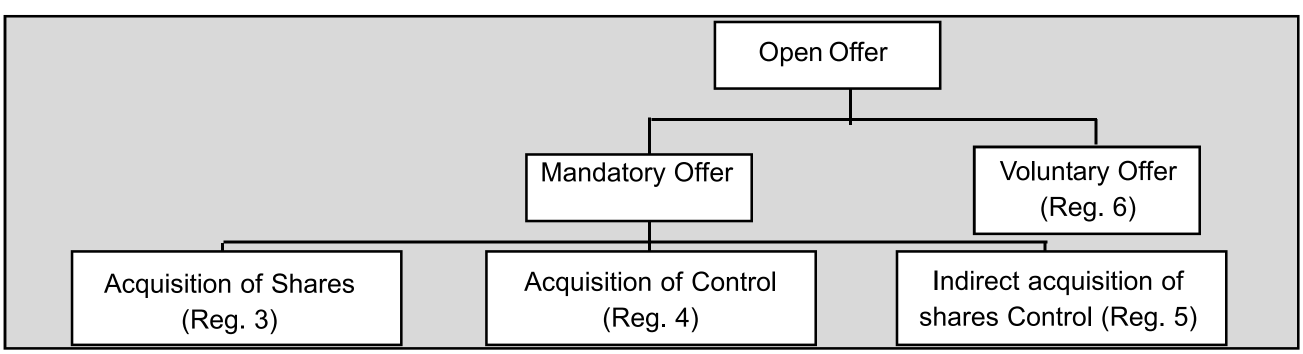
For Example

Name	Pre Holding	Creeping Acuisition	Post Holding	Applicability of SEBI Takeover Regulations, 2011
A	23%	3%	26%	Open Offer Obligations
B	7%	2%	9%	–

On analysis of the above Table, it can be seen that although the acquisition made by promoters as a group is within the creeping acquisition limit, however, pursuant to the above acquisition of shares, the shareholding of A is increased beyond 25% of the total voting rights of the Target Company. Accordingly, in terms of SEBI Takeover Regulations, 2011, the above acquisition of shares by A would result into triggering the open offer obligations.

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 provides 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 that the Acquirer to give an open offer to the shareholders of Target Company on the acquisition of shares or voting rights entitling the Acquirer along with the Persons Acting in Concert with him to exercise 25% or more voting rights in the Target Company.

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)]

The most important point to be noted here is that 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)]

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]

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**

  (i) 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.

  (ii) 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.

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.

Delisting Offer

This new regulation of Delisting Offer has been introduced under the SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2015, w.e.f. 24-03-2015.

The Regulation 5A (1) clearly states that Notwithstanding anything contained in these regulations, in the event the acquirer makes a public announcement of an open offer for acquiring shares of a target company in terms of regulations 3, 4 or 5, he may delist the company in accordance with provisions of the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009:

Provided that the acquirer shall have declared upfront his intention to so delist at the time of making the detailed public statement.

When the Delisting Offer is Unsuccessful

Further the regulation 5A (2) clarifies that Where an offer made under sub-regulation (1) is not successful,-

(i) on account of non–receipt of prior approval of shareholders in terms of clause (b) of sub-regulation (1) of regulation 8 of Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009; or

(ii) in terms of regulation 17 of Securities and Exchange Board of India (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 sub-regulation (1) of regulation 16 of Securities and Exchange Boardof India (Delisting of Equity Shares) Regulations, 2009,

The acquirer shall make an announcement within two 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.

Regulation 5A (3) specifies that in the event of the failure of the delisting offer made under sub-regulation (1), the acquirer, through the manager to the open offer, shall within five working days from the date of the announcement under sub-regulation (2), file with the Board, a draft of the letter of offer as specified in sub-regulation (1) of regulation 16 and shall comply with all other applicable provisions of these regulations:

Provided that the offer price shall stand enhanced by an amount equal to asum determined at the rate of ten per cent per annum for the period betweenthe scheduled date of payment of consideration to the shareholders and theactual date of payment of consideration to the shareholders Explanation: For the purpose of this sub-regulation, scheduled date shall bethe date on which the payment of consideration ought to have been made tothe shareholders in terms of the timelines in these regulations.

Competing Offer

Regulation 5A (4) states that where a competing offer is made in terms of sub-regulation (1) ofregulation 20,-

(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 terms of sub-regulation (1) of regulation 20, in all the newspapers in which the detailed public statement was made.

Protection of Shareholders' Interest in case of Delisting Offer

Regulation 5A (5) states that Shareholders who have tendered shares in acceptance of the offer made undersub regulation (1), shall be entitled to withdraw such shares tendered, within 10 working days from the date of the announcement under sub-regulation(2) .

Further regulation 5A (6) clarifies that Shareholders who have not tendered their shares in acceptance of the offer made under sub-regulation (1) shall be entitled to tender their shares inacceptance of the offer made under these regulations.

Restrictions on Wilful Defaulter

This provision restricting wilful defaulters to make open offer has been inserted by Inserted by the SEBI (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2016, w.e.f. 25-05-2016.

Regulation 6A states that notwithstanding anything contained in these regulations, no person who is a wilful defaulter shall 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 under these regulations:

Provided that this regulation shall not prohibit the wilful defaulter from making a competing offer in accordance with regulation 20 of these regulations upon any other person making an open offer for acquiring shares of the target company.

OPEN OFFER PROCESS

These Regulations provides certain triggering events wherein the Acquirer is required to give Open Offer to the shareholders of the Target Company to provide them exit opportunity. The objective behind giving opportunity to the shareholders of the Target Company is to safeguard their interest in the event of change in management and control of the Target Company or where the promoters desires to consolidate their shareholding to the maximum permissible level. The whole process of Open Offer is divided into three parts:

1. Pre Open Offer
2. During the Open Offer
3. Post Open Offer

Pre Open Offer

1. **Triggering Event**: The process of open offer starts from the date of happening of triggering event itself. The triggering event may be signing of Share Purchase Agreement or actual acquisition of shares from the market or the Board Meeting held for considering the preferential issue of Equity Shares or acquisition of control over Company. Thus as soon as the intention of acquirer to acquire the shares of Target Company beyond the prescribed threshold limits is expressed clearly, the process of Takeover Offer is initiated provided the acquisition is not exempted under regulation 10 of these regulations.

2. **Appointment of Merchant Banker**: As soon as the triggering event happens as mentioned above, the acquirer is required to appoint a Merchant Banker registered with SEBI, who is responsible for executing the entire open offer process. [Regulation 12]

3. **Public Announcement**: A Public Announcement shall be made to concerned stock Exchange, SEBI and Target Company.

4. **Escrow Account**: The Acquirer shall open an escrow account atleast two working days prior to the date of detailed public statement and deposit an amount aggregating to 25% of the consideration on first ‘ 500 crore and additional amount of 10% on the balance consideration. [Regulation 17(1)].

5. **Publication of Detailed Public Statement**: A Detailed Public Statement shall be made by the Acquirer within 5 working days from the date of Public Announcement. Such detailed public statement is required to be published in all editions of any one English national daily with wide circulation, any one Hindi national daily with wide circulation, and any one regional language daily with wide circulation at the place where the registered office of the Target Company is situated and one regional language daily at the place of the stock exchange where the maximum volume of trading in the shares of the Target Company are recorded during the sixty trading days preceding the date of the public announcement. [Regulation 13(4) read with Regulation 14(3)]

6. **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 statement along with a non-refundable fee. [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)]

7. **Identified Date:** The Acquirer shall fix a date for determining the names of the shareholders to whom the letter of offer would be send which shall be a date falling on the tenth working day prior to the commencement of the tendering period. [Regulation 2(1) (l)]

8. **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 on the identified date, and to the custodian of shares underlying depository receipts of the Target 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. [Regulation 18(2)]

9. **Upward Revision:** The Acquirer is allowed to make upward revision to the Offer Price and the number of shares sought to be acquired under the Open Offer, at any time prior to the commencement of last three working days before the initiation of the tendering period. [Regulation 18(4)]

10. **Recommendation by the Independent Directors**: On the receipt of detailed public statement, the Board of Directors of the Target Company shall constitute a committee of Independent Directors to provide reasoned recommendations on the Open Offer to the shareholders of the Target Company and such recommendations shall be published 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 a copy of the same shall also be sent to SEBI, all Stock Exchanges where the shares of the Target Company are listed and to Manager to the Offer. [Regulation 26 (6) and (7)]

11. **Tendering Period:** The tendering period shall start not later than 12 working days from the date of receipt of comments from SEBI and shall remain open for 10 working days. [Regulation 18(8)]

During the Offer

1. **Disclosure during Offer Period**: The acquirer shall disclose during the offer period every acquisition made by the acquirer or persons acting in concert with him of any shares of the Target Company to each of the stock exchanges on which the shares of the Target Company are listed and to the Target Company at its registered office within twenty-four hours of such acquisition. . [Regulation 18(6)]

2. **Restriction on Acquisition of Shares:** The acquirer and persons acting in concert with him shall not acquire or sell any shares of the Target Company during the period between three working days prior to the commencement of the tendering period and until the expiry of the tendering period. [Proviso of Regulation 18(6)]

Post Open Offer

1. **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)]

2. **Post offer Advertisement:** The acquirer shall issue a post offer advertisement in such form as may be specified within five working days after the offer period, giving details including aggregate number of shares tendered, accepted, date of payment of consideration. [Regulation 18 (12)]

3. **Report to SEBI by Manager to the Offer:** The manager to the Open Offer shall file a report with SEBI within fifteen working days from the expiry of the tendering period, in such form as may be specified, confirming status of completion of various Open Offer requirements. [Regulation 27 (7)]

4. **Restriction on acquisition**: The acquirer shall not acquire any shares of the Target Company for a period of 26 weeks after the tendering period at a price higher than the offer price paid except by way

of another Open Offer, or SEBI Delisting Regulations, or open market purchases made in the ordinary course on the stock exchanges, not being negotiated acquisition of shares of the Target Company whether by way of bulk deals, block deals or in any other form. [Regulation 8(10)]

ACTIVITY CHART FOR OPEN OFFER

S. No.	Particulars	Timeline (Legal)
1.	Public announcement through notice to Stock Exchange	X
2.	Opening of Bank Escrow & Securities Escrow	X+2 Working Days
3.	Deposit of Escrow Amount in Escrow A/c	
4.	Detailed Public Statement in Newspaper	X+5 Working Days
5.	Draft letter of offer to be submitted to SEBI and sent to Target Company	X+10 Working Days
6.	Receipt of comments from SEBI on draft letter of offer	X+25 Working Days
7.	Identified date for determining name of shareholders to whom the letter of offer should be sent	X+27 Working Days
8.	Dispatch of the Letter of Offer to shareholder	X+32 Working Days
9.	Upward revision in offer	X+33 Working Days
10.	Comments on the offer by independent directors of Target Company	X+34 Working Days
11.	Issue of advertisement announcing the schedule of activities for open offer	X+36 Working Days
12.	Date of opening of offer	X+37 Working Days
13.	Date of closing of offer	X+46 Working Days
14.	Payment of Consideration	X+56 Working Days
15.	Filing of report to SEBI by Merchant Banker	X+61 Working Days

(This is the minimum timeline as prescribed under SEBI Takeover Regulations, 2011)

Withdrawal of Open Offer

Regulation 23 provides the rules for the withdrawal of Open Offer. It states that an open offer for acquiring shares once made shall not be withdrawn in general.

The open offer can be withdrawn 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, and such agreement is rescinded, subject to such conditions having been specifically disclosed in the detailed public statement and the letter of offer; or

(d) Such circumstances as in the opinion of the Board, merit withdrawal.

Explanation. – For the purposes of clause (d) of sub-regulation (1), the Board shall pass a reasoned order permitting withdrawal, and such order shall be hosted by the Board on its official website.

Provided that 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.

Post Withdrawal Requirements

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) The Board;

(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

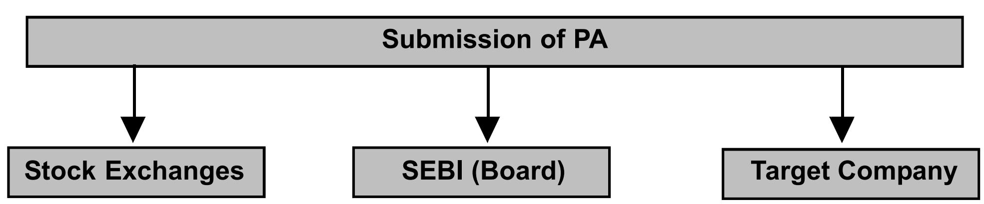
(iii) The target company at its registered office.

PUBLIC ANNOUNCEMENT

SEBI (SAST) Regulation, 2011 (SAST Regulations) provides that whenever an Acquirer acquires the shares or voting rights of the Target Company in excess of the limits prescribed under Regulation 3 and 4, then the Acquirer is required to make an Open Offer to the shareholder of the Target Company. During the process of an Open Offer, the Acquirer is required to give Public Announcement and publish Detailed Public Statement. Regulation 14 of SAST Regulations prescribed the manner in which Public Announcement and Detailed Public Statement is to be made.

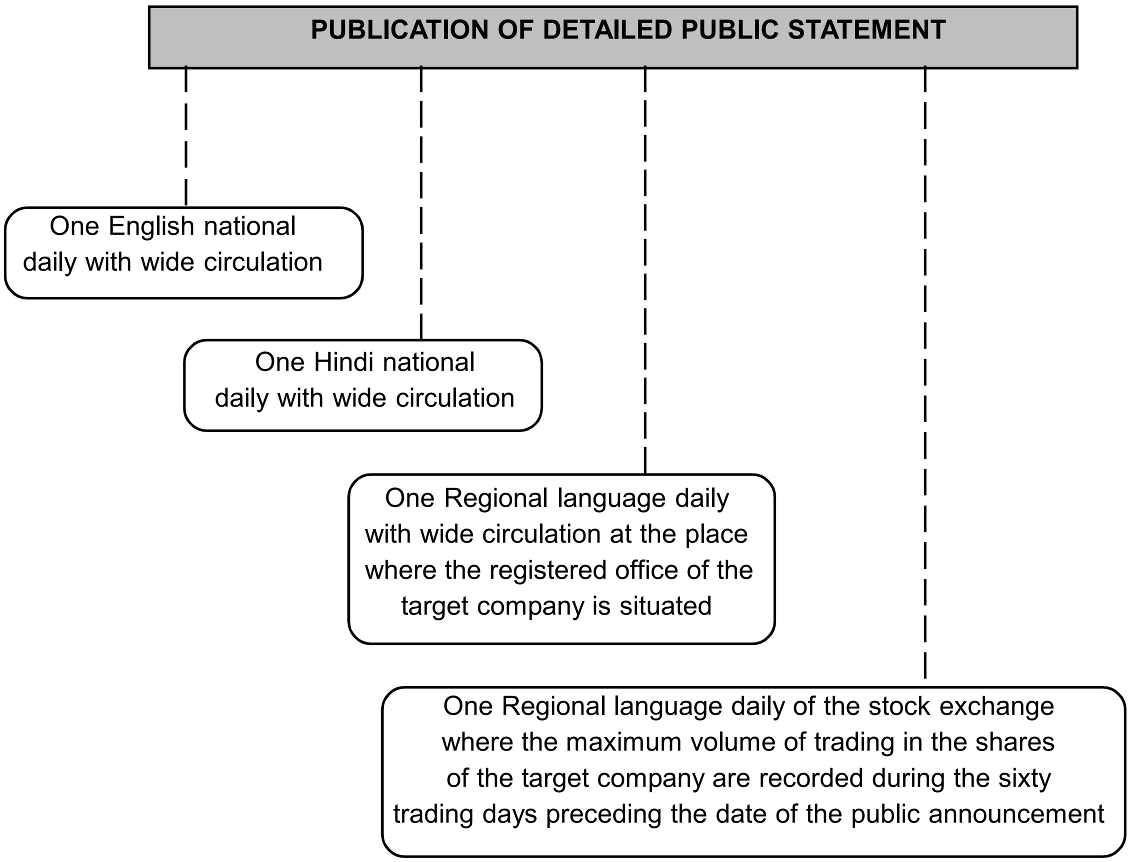
Submission of Public Announcement (PA)

Within the time specified under Regulation 13 of SAST Regulations, 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.



Publication and Submission of Detailed Public Statement

A detailed public statement shall be published by the acquirer through the manager to the open offer not later than five working days of the public announcement in the following newspaper:



Simultaneously with the publication in the newspaper, a copy of the same shall be sent to:

1. SEBI
2. All the Stock Exchanges on which the shares of the Target Company are listed; and
3. The Target Company at its registered office.

Contents of Public Announcement and Detailed Public Statement

The public announcement shall contain such information as may be specified, including the following-

(a) name and identity of the acquirer and persons acting in concert with him;

(b) name and identity of the sellers, if any;

(c) nature of the proposed acquisition such as purchase of shares or allotment of shares, or any other means of acquisition of shares or voting rights in, or control over the target company;

(d) the consideration for the proposed acquisition that attracted the obligation to make an open offer for acquiring shares, and the price per share, if any;

(e) the offer price, and mode of payment of consideration; and

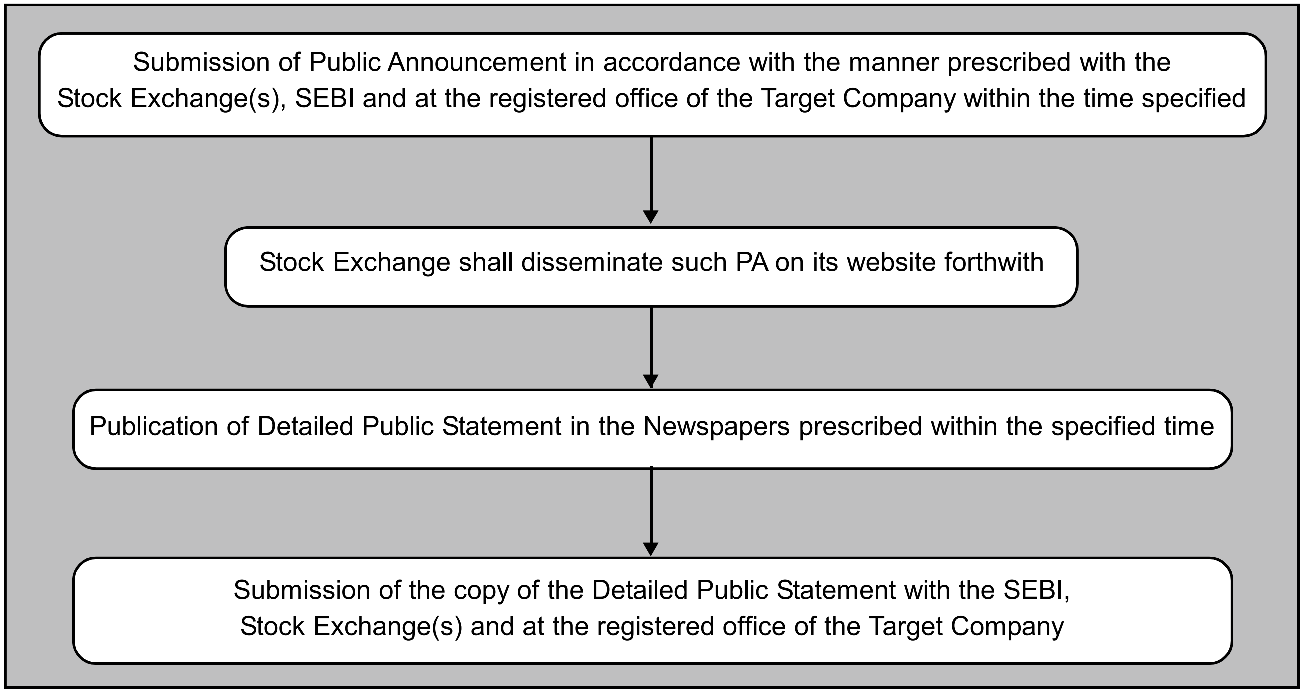
(f) offer size, and conditions as to minimum level of acceptances, if any.

The detailed public statement pursuant to the public announcement shall contain such information as may be specified in order to enable shareholders to make an informed decision with reference to the open offer.

NOTE: The public announcement of the open offer, the detailed public statement, and any other statement, advertisement, circular, brochure, publicity material or letter of offer issued in relation to the acquisition

of shares under these regulations shall not omit any relevant information, or contain any misleading information.

Procedure of Filing PA and DPS



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 PA;
- Highest price paid 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 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.

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:

Sl.	**Consideration payable**	**Escrow Amount No. under the Open Offer**
(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.

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

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.

Regulation No.	Triggering Point	To and by whom	Time Period
EVENT BASED DISCLOSURES			
29(1)	Acquisition of 5% or more shares or voting rights	To the Target Company and Stock Exchange by the Acquirer	Within 2 working days of: (a) Receipt of intimation of allotment of shares; or (b) The acquisition of shares or voting rights.
29(2)	Acquirer already holding 5% or more shares or voting rights, On acquisition/ disposal of 2% or more shares or voting rights.	To the Target Company and Stock Exchange by the Acquirer/Seller	Within 2 working days of such acquisition/disposal.
CONTINUAL DISCLOSURES			
30(1)	Any person holding 25% or more shares or voting rights	Target Company & Stock Exchange by such person	Within 7 working days from the end of each financial year
30(2)	Promoter /Person having control over the Target Company	Target Company & Stock Exchange by Promoter	Within 7 working days from the end of each financial year
DISCLOSURE OF PLEDGED/ENCUMBERED SHARES			
31(1)	On the encumbrance of shares by the promoter or person acting in Concert with him	Target Company & Stock Exchange by the promote	Within 7 working days from the date of creation of encumbrance
31(2)	On the invocation of or release of such encumbrance by the promoter	Target Company & Stock Exchange by the promoter	Within 7 working days from the date of invocation of encumbrance

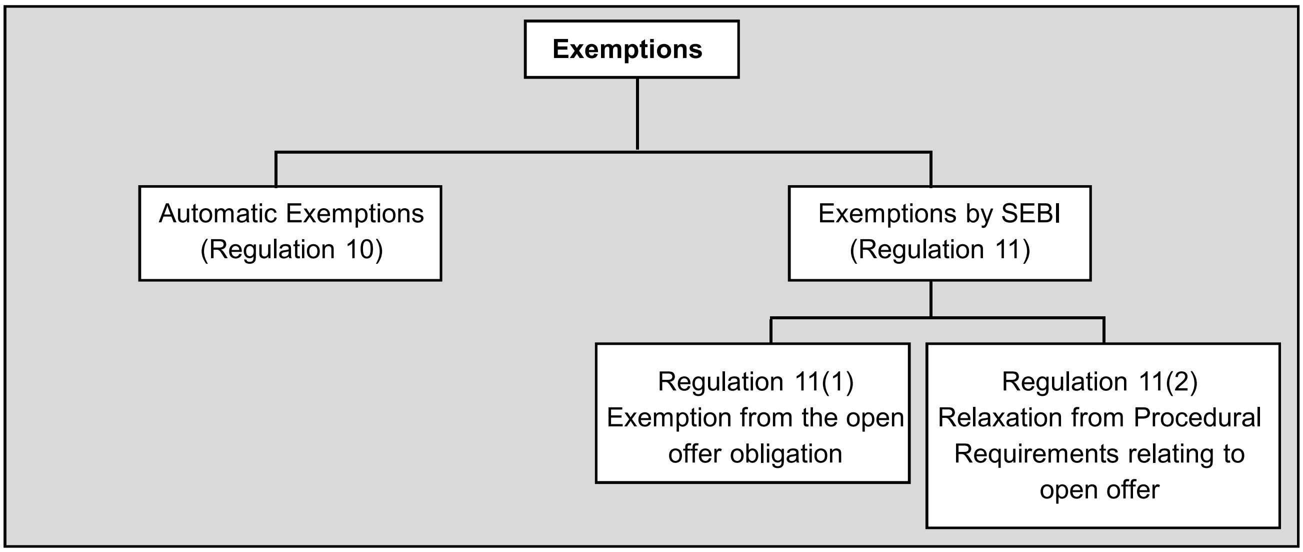
Points to Remember

The important point to be noted here is that the acquisition and holding of any convertible security shall also be regarded as shares and disclosures of such acquisition and holdings is also to be made accordingly.

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.



REGULATION 10 - AUTOMATIC EXEMPTIONS

Some of the important exemptions provided therein Regulation 10 along with their conditions for exemption are 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 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 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.

(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 sub-section (2) of section 47 of the Companies Act, 2013.

(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 under regulation 3.

(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 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 sub-regulation (1) of regulation 3 within ninety days from the date of the closure of the sad buy back offer.

(4) The following acquisitions shall be exempt from the obligation to make an open offer under sub-regulation (2) of regulation 3, –

(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 fulfillment 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 trading days 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 buyback, 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

(iii) 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 the Board, by promoters of the target company pursuant to an agreement between such venture capital 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 twenty five thousand by way of a , banker's cheque or demand draft payable in Mumbai in favour of SEBI.

REGULATION 11 – EXEMPTION BY SEBI

Regulation 11(1) 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 ₹ 50,000 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.

Regulation 11(2) provides that the acquirer may also be granted the relaxation from the procedural requirements relating to Open Offer by SEBI on an application being made in writing by the Target Company giving the details of the proposed acquisition and grounds on which the relaxation is sought alongwith duly sworn affidavit. The purpose and intent of regulations is to safeguard the interest of investor and not to act as an impediment in the furtherance of their interest.

The SEBI has been given the power to relax the procedural requirements under Chapter III and IV, subject to such conditions as it deems fit on being satisfied that:

I. The Central Government or State Government or any other regulatory authority has removed the Board of Directors of the Target Company and has appointed new directors to hold office as directors under any law for the time being in force if:

   (a) such Board of Directors has devised a plan which provides transparent, open, and competitive process for acquisition of shares or voting rights or control over the Target Company to secure the smooth and continued operation of the target company in the interests of all stakeholders of the target company and such plan does not further the interests of any particular acquirer;

   (b) The conditions and requirements of the competitive process are reasonable and fair;

   (c) The process adopted by the Board provides for details including the time when the public offer would be made, completed and the manner in which the change in control would be effected;

II. The provisions of Chapter III and Chapter IV are likely to act as impediment to implementation of the plan of the Target Company and exemption from strict compliance with one or more of such provisions are in interest of public, investors and the securities market.

Procedure for filing the application under Regulation 11

File an application with SEBI supported by duly sworn affidavit giving the details of the proposed acquisition and the grounds on which the exemption has been sought along with non-refundable fee of ₹ 50,000 by way of a banker's cheque or demand draft payable in Mumbai in favour of SEBI

↓

SEBI may constitute a panel of experts to make recommendations on the application made under Regulation 11(1)

↓

SEBI will give reasonable opportunity of being heard to the concerned parties

↓

After considering the recommendation of the panel and giving the reasonable opportunity of being heard to the concerned parties, SEBI shall pass an order giving the reasons for accepting or rejecting the applications as expeditiously as possible

↓

SEBI shall publish the order passed by it on its official website

Case Study

The following is the information of Company ABC Limited Listed on National Stock Exchange (NSE) :

(a) The paid up equity share capital of the company is Rs. 11,50,00,000 comprising of 1,15,00,000 Equity Shares of Rs. 10 each

(b) The Promoters of the company viz. Mr. Narayanan members, relatives, associate companies are holding 60,12,166 equity shares, representing 52.25% of the total paid up capital of the company as 31.03.2011.

(c) The Promoters intend to acquire further 15% (575000 shares) of total share capital of the company under regulation 3(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (hereinafter referred as "Takeover Regulations") in the financial year 2013-14.

(d) Further, they are desirous of increasing their holding by further 5% shares (5,75,000) in each financial year 2014-15, 2015-16, 2016-17 in terms of the regulations without making any public announcement, by way of purchase from open market in normal segment on the Stock Exchange.

(e) The sad acquisitions shall also not be through bulk/block deal/negotiated deal or preferential allotment.

In light of the above informations explain the following:

(a) Can the promoters of the company acquire additional 5% (575000 shares) during the financial year 2013-14 as per regulation 3(2) of the Takeover Regulation?

(b) Can the promoters further acquire 5% additional shares as per regulation 3(2) of the Takeover Regulations in each financial year 2014-15, 2015-16 and 2016-17 till reaching the level 75% of the share capital of the company.

Answer :

The regulation 3(2) of the SEBI (Takeover) Regulations, 2011 provides for. exemption from making a public announcement subject to the following conditions:

(a) The shareholding of the Acquirer is between 25% of the total shares or voting lights of the company and the "maximum permissible non-public share holding limit."

(b) pursuant to the acquisition, to the shareholding of the Acquirer should not breach the maximum public shareholding limit,

(c) For calculating the acquisition limit of 5% of shares or voting rights, as specified under regulation 3(2) of the Takeover Reputations, only gross acquisitions shall be taken into account. Any intermittent fail, in shareholding owing to disposal of shares by the acquirer or dilution of shareholding on account of fresh issue of share capital shall be ignored.

(d) In case the acquisition has taken place by way of issue of new shares of the target company or where the target company has issued has shares during a financial year, the difference between the pre-allotment and post-allotment voting rights shall be taken in to account for calculating the acquisition limit under regulation 3(2) of the Takeover Regulations.

Further the Promoters of the company are currently holding 52,28% shares in the company, which is within the eligible limit as stated at point 4(a) above. Further, the promoters want to increase their shareholding by 5% in each of the financial year 2011-12, 2012-13, 2013-14 and 2014-15, The precise query of the applicant is whether Promoters of the company are allowed to acquire 5% of shares only once, or tie facility to acquire 5% of shares is available for every financial year.

The language "any financial year" mentioned in regulation 3(2) of the Takeover Regulations should be read as "every financial year". Therefore, the Promoters of the company are eligible to acquire upto 5% of shares of the company every financial year without attracting the obligation to make a public announcement as provided under regulations 3(2) of Takeover Regulations, subject to the fulfillment of other conditions mentioned therein.

LESSON ROUND UP

- SEBI (Substantial Acquisitions of Shares and Takeovers) Regulations, 2011, 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 Regulations, 1997 stand repealed from October 22, 2011, i.e. the date on which SEBI (SAST) Regulations, 2011 come into force.
- SEBI (SAST) 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.

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 Takeover Regulations, 2011?
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. Discuss briefly the conditions for the withdrwal of open offer in detail.

REPORT OF THE COMMITTEES ON CAPITAL MARKET

INTRODUCTION

The Capital Market is a dynamic market and ever evolving. To keep pace with the developments of Capital Market in the country, the Government regularly comes up with a consultative process to collate the views of market experts and various stakeholders through the respective regulators towards formulation of industry friendly regulatory prescriptions. In this line various Committees had been formed from time to time by the Government to deal with particular areas or issues or concern which is outdated and crying for reform. The Committee carries out research, investigation, empirical study and analyse the objective for which it is established. After completion of its rigorous task assigned to it by the Government through the respective regulator, the Committee formed an opinion and prepare a fair and unbiased report in line with the domestic as well as international development/practice which suit the Indian situation, meet the stakeholder expectations and can be effectively applied to various development schemes which would bolster the Indian Economy and the general public will get benefits. The gist of Recommendation of some of the eminent Committees of recent origin has been discussed below for the easy understanding of the students.

REPORT OF FINANCIAL SECTOR LEGISLATIVE REFORMS COMMISSION

Financial Sector Legislative Reforms Commission (FSLRC) was set up by the Indian Government in pursuance of the announcement made in Union Budget 2010-11, to help rewriting and harmonizing the financial sector legislation, rules and regulations so as to address the contemporaneous requirements of the sector. The resolution notifying the FSLRC was issued on March 24, 2011. FSLRC had a two year term. The Commission was chaired by Supreme Court Justice (Retired) B. N. Srikrishna, and had ten members with expertise in the fields of finance, economics, law and other relevant fields. The secretariat was placed at National Institute of Public Finance and Policy (NIPFP). Secretariat consisted of a Secretary at the level of Joint Secretary to the Government of India and other officials and support staff.

The establishment of the FSLRC is the result of a realisation that the institutional foundation (laws and organizations) of the financial sector in India needs to be looked afresh to assess its soundness for addressing the emerging requirements in a rapidly changing world. Today, India has over 60 Acts and multiple Rules/ Regulations that govern the financial sector. Many of them have been written several decades back. For example, the RBI Act and the Insurance Act are of 1934 and 1938 vintage respectively and the Securities Contract Regulation Act, which governs securities transactions, was legislated in 1956 when derivatives and statutory regulators were unknown in the financial system. A Large number of amendments were, therefore, made in these Acts and regulations at different points of time to address various needs. But these have also resulted in their fragmentation, often adding to the ambiguity and complexity of regulations in the financial sector.

The Financial Sector Legislative Reforms Commission (FSLRC), constituted by the Ministry of Finance was asked to comprehensively review and redraw the legislations governing India's financial system. According to the FSLRC, the current regulatory architecture is fragmented and is fraught with regulatory gaps, overlaps, inconsistencies and arbitrage. To address this, the FSLRC submitted its report to the Ministry of Finance on March 22, 2013, containing an analysis of the current regulatory architecture and a draft Indian Financial Code to replace the bulk of the existing financial laws which is summarised as below.

The Draft Indian Financial Code

The draft Code is a non-sectoral, principles-based law bringing together laws governing different sectors of the financial system. It addresses nine components, which the FSLRC believes any financial legal framework should address:

Consumer protection: Regulators should ensure that financial firms are doing enough for consumer protection.

The draft Code establishes certain basic rights for all financial consumers and creates a single unified Financial Redressal Agency (FRA) to serve any aggrieved consumer across sectors. In addition, the FSLRC considers competition an important aspect of consumer protection and envisages a detailed mechanism for co-operation between regulators and the Competition Commission.

Micro-prudential regulation: Regulators should monitor and reduce the failure probability of a financial firm. The draft Code specifies five powers for micro-prudential regulation: regulation of entry, regulation of risk-taking, regulation of loss absorption, regulation of governance and management, and monitoring/supervision.

Resolution: In cases of financial failure, firms should be swiftly and sufficiently wound up with the interests of small customers. A unified resolution corporation, dealing with various financial firms, should be created to intervene when a firm is close to failure. The resolution corporation would charge a fee to all firms based on the probability of failure.

Capital controls: While the FSLRC does not hold a view on the sequencing and timing of capital account liberalisation, any capital controls should be implemented on sound footing with regards to public administration and law. The FSLRC sees the Ministry of Finance creating the 'rules' for inbound capital flows and the RBI creating the 'regulations' for outbound capital flows. All capital controls would be implemented by the RBI.

Systemic risk: Regulators should undertake interventions to reduce the systemic risk for the entire financial system. The FSLRC envisages establishing the Financial Stability and Development Council (FSDC) as a statutory agency taking a leadership role in minimizing systemic risk.

Development and redistribution: Developing market infrastructure and process would be the responsibility of the regulator while redistribution policies would be under the purview of the Ministry of Finance.

Monetary policy: The law should establish accountability mechanisms for monetary policy. The Ministry of Finance would define a quantitative target that can be monitored while the RBI will be empowered with various tools to pursue this target. An executive Monetary Policy Committee (MPC) would be established to decide on how to exercise the RBI's powers.

Public debt management: The draft Code establishes a specialised framework for public debt management with a strategy for long run low-cost financing. The FSLRC proposes a single agency to manage government debt.

Contracts, trading and market abuse: The draft Code establishes the legal foundations for contracts, property and securities markets.

Regulators

With respect to regulators, the FSLRC stresses the need for both independence and accountability. The draft Code adopts ownership neutrality whereby the regulatory and supervisory treatment of a financial firm is the same whether it is a private or public company.

The draft Code seeks to move away from the current sector-wise regulation to a system where the RBI regulates the banking and payments system and a Unified Financial Agency subsumes existing regulators like SEBI, IRDA, PFRDA and FMC, to regulate the rest of the financial markets.

Regulators will have an empowered board with a precise selection-cum-search process for appointment of members. The members of a regulatory board can be divided into four categories: the chairperson, executive members, non-executive members and Government nominees. In addition, there is a general framework for establishing advisory councils to support the board. All regulatory agencies will be funded completely by fees charged to the financial system. Finally, the FSLRC envisages a unified Financial Sector Appellate Tribunal (FSAT), subsuming the existing Securities Appellate Tribunal (SAT), to hear all appeals in finance.

The following chart provides an outline of the FSLRC's proposed regulatory architecture.

Present	Proposed	Functions
RBI	RBI	Monetary policy regulation and supervision of banks; regulation and supervision of payments system.
SEBI FMC IRDA PFRDA	United financial agency (UFA)	Regulation and supervision of all non-bank and payments related markets
Securities Appellate Tribunal (SAT)	FSAT	Hear appeals against RBI, the UFA and FRA.
Deposit Insurance and Credit Guarantee Corporation (DICGC)	Resolution Corporation	Resolution work across the entire financial system
Financial Stability Development Council (FSDC)	FSDC	Statutory agency for systemic risk and development.
New entities	Debt Management Agency	An independent debt management agency.
	Financial Redressal Agency	Consumer complaints.

Report of the Takeover Regulations Advisory Committee under the Chairmanship of Mr. C. Achuthan

The SEBI Act, 1992 expressly mandated SEBI to regulate substantial acquisition of shares and takeovers by suitable measures. Accordingly, SEBI provided a legal framework by making the Takeover Regulations of 1994, which came into force on November 4, 1994.

In November 1995, SEBI appointed a committee to review the Takeover Regulations of 1994 under the chairmanship of Justice P.N. Bhagwati (the Bhagwati Committee). The said committee submitted its report in January 1997. Taking into consideration its recommendations, the Takeover Regulations of 1997 were notified by SEBI on February 20, 1997, repealing the Takeover Regulations of 1994. These regulations were periodically amended in response to events and developments in the marketplace, regulatory and judicial rulings as well as evolving global practices as considered appropriate. In 2001, a review of the Takeover Regulations of 1997 was carried out by a reconstituted committee chaired by Justice P.N. Bhagwati. The reconstituted Bhagwati committee submitted its report in May 2002. Based on the same, further amendments were made to the Takeover Regulations of 1997.

There has been a steady increase in corporate restructuring by Indian companies to adapt to the evolving competitive landscape. Taking into consideration the growing level of M&A activity in India, the increasing sophistication of takeover market, the decade-long regulatory experience and various judicial pronouncements, it was felt necessary to review the Takeover Regulations of 1997. Accordingly, SEBI on September 4, 2009, constituted a multi-disciplinary expert committee, Takeover Regulations Advisory Committee (TRAC) under the chairmanship of Mr. C. Achuthan, to examine the existing Takeover Code which related to substantial acquisitions and takeovers of Indian listed companies. The Committee framed the Takeover Regulations keeping in view the interest of public shareholders on one side and that of the Strategic Investors, Private Equity Players, Target Company and Promoters on the other side.

On 28th July 2011, SEBI took certain key decisions on takeover regulations based on the recommendations of TRAC. Some of the notable decisions involve increasing the initial open offer trigger threshold, increasing the mandatory open offer size and determination of the open offer price.

Summary of Key Recommendations of the Committee

Considering the substantive changes recommended upon review of the existing law governing substantial acquisition of the shares and takeovers, the Committee has recommended comprehensive reform of the regulations. Some of the main recommendations of the Committee alongwith the Provisions of Takeover Regulations, 1997 provisions are summarized below:

Summary of Recommendations of the Achuthan Committee and the Provisions in the Takeover Regulations, 1997

S.No.	Issue	Provisions of the Takeover Regulations, 1997	Committee Recommendations
1.	Offer Size and Minimum Public Shareholding Requirement		
	– Offer Size	On acquisition resulting in triggering regulations 10, 11& 12, the acquirer is mandatorily required to make an open offer for a minimum of 20% of the voting capital (reckoned as on the 15th day after closure of the offer).	– Every open offer pursuant to a substantial acquisition of shares in, or change of control over a target company under the Takeover Regulations ought to be for every share held by all the shareholders of the target company, as on the expected date of the close of the tendering period.
	– Minimum Public Shareholding Requirement	If the acquisition made pursuant to an open offer results in the public shareholding in the target company falling below the minimum level required as per the listing agreement, the acquirer shall take necessary steps to facilitate compliance with the relevant provisions thereof, within the time period specified therein.	– Holders of equity linked instruments eligible to be converted into equity shares prior to the aforementioned date may do so and tender their equity shares in the open offer. – The target Company should stand delisted, should the acquirer have stated its intention to delist the target company and the response to the open offer is such that the acquirer's shareholding crosses the delisting threshold. – In the event the shares of the target company stand delisted pursuant to the open offer, every shareholder who has not tendered an acceptance of the open offer shall be entitled to require the acquirer to acquire his shares at the offer price at any time within a period of twelve months from the fifteenth day on which the shares are delisted from the stock exchanges. This exit window would also be available to the holders of all equity- linked instruments in the company. The company and the acquirer shall

			take necessary steps to facilitate the provisions of an option to such holders to accelerate the conversion/vesting of such instruments during the period of this exit window. – Should the acquirer's shareholding and the delisting threshold, such acquirer be given an option to proportionately reduced would be those under the open offer, the agreement (if any) and immediate past purchases (except acquisitions due to allotments by the target company). Such reductions would enable the acquirer not to breach the maximum permissible non-public shareholding.
2	Thresholds for Open Offers		
	– Initial Threshold	If an acquirer acquirers or agrees to acquire shares or voting rights such that his voting rights exceed 15% of the voting capital of the target company, he is required to make an open offer.	– Initial acquisition threshold for a mandatory open offer be raised to 25% of the voting capital of the target company.
	– Creeping Acquisitions	If an acquirer already holds more than 15% but less than 55%, he may acquire additional shares carrying not more than 5% of the voting rights within a financial year without having to make an open offer. If holding is above 55% but less than 75%, a one time allowance to increase their shareholding by 5% through market purchases or pursuant to a Buy back by the target Company, without having to make a open offer, has been permitted, provided that post acquisition holding of acquirer does not go beyond 75%.	– An acquirer holding 25 % or more voting rights in a target company is allowed to acquire additional voting rights in the target company up to 5 % within a financial year, without making an open offer.

	– Voluntary Offers	Consolidation of shareholding by an acquirer who is desirous of maximizing his shareholding without breaching the minimum public shareholding requirements. The offer size for an open offer under this provision is the lower of 20% or the maximum permissible acquisition without breaching the minimum public shareholding requirement.	– Acquirers collectively holding shares entitling them to exercise 25% or more voting rights in the target company may voluntarily make an open offer to consolidate their shareholdings. – The Committee proposed a minimum open offer size of 10% consistent with the rationale of consolidation option outside the creeping route. Voluntary offers should not, however, be of a size that could lead to breach of the maximum permissible on-public shareholding.
3.	Control	Control shall 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 their shareholding or management rights or shareholder agreements or voting agreements or in any other manner.	– Definition of "Control" be modified to include "ability" in addition to "right" to appoint majority of the directors or to control the management or policy decisions would constitute control. – A director or officer of the target company would not be regarded as being in control merely by virtue of holding such position.
4.	Offer Price	Provides the parameters to be considered for determining the minimum offer price depending on whether or not the shares of the target company are "frequently traded" (shares which have annualized trading volume of 5% or more of the listed share capital during a period of 6 calendar months preceding the month in which the public announcement is made). For "infrequently traded" shares, the Takeover Regulations require the computation of the offer price on the basis of financial parameters such as return on net worth, industry price-earnings multiples and the like,	– The minimum offer price for direct acquisitions should be the highest of: (a) The highest negotiated price per share of the target company for any acquisition under the agreement attracting the obligation to make a public announcement of an open offer. (b) The volume- weighted average price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him during the fifty-two weeks immediately preceding the date of the public announcement ; and (c) the highest price paid or payable for any acquisition,

		apart from any price actually paid by the acquirer or persons acting in concert during the look back period, or in the transactions that triggers the open offer obligation. The Takeover Regulations also require addition to the open offer price, of any amount paid towards non-compete fee in excess of 25% of the open offer price.	whether by the acquirer or by any person acting in concert with him during the twenty-six weeks immediately preceding the date of the public announcement; and (d) The volume- weighted average market price, for frequently traded shares, during 60 trading days immediately preceding the date of the public announcement, computed based on market prices on the stock exchange where the shares of the company are most frequently traded during the period. – Frequently traded shares having a trading volume of 10% or more of the total number of the shares during a period of 12 calendar months preceeding the month in which the public announcement is made. – Clause relating to non-compete fee be deleted from the Takeover Regulations, and any considerations paid in any form inclusive of all ancillary and collateral agreements shall form part of the negotiated price.
5.	Indirect Acquisitions – Trigger for indirect acquisitions	The acquirer has to make an open offer for shares of the target company when there is direct or indirect change of control of the target company irrespective of any direct acquisition of shares of the target company. The regulations also provide for deferment of open offer obligations till consummation of the original transaction.	– Irrespective of whether the target company is material to the parent transaction, open offer obligations have to be triggered. Where a change in control over the target company occurs, shareholders of the target company ought to rightfully get an adequate exit opportunity.
	– Timing and offer Price	In case of indirect acquisition of shares or change of control, a public announcement may be	– Where the proportionate net asset value, or the sales turnover, or the market

		made by the acquirer at any time from the date of the initial announcement of the intention to acquire or entering in to the acquisition agreement, until completion of three months after the consummation of such acquisition or change in control or restructuring of the parent or the company holding shares of or control over the target company. Takeover Regulations currently do not differentiate between open offers arising due to direct acquisitions vis-a-vis indirect acquisitions for computation of offer price and the same offer price formula prescribed for direct acquisitions is used for indirect acquisitions as well, and the practice is to compute the offer price as of the date of the announcement of primary acquisition and as of the date of the public announcement for the target company, whichever is higher.	capitalization of the indirectly-acquired listed company represents more than 80 % of the net asset value, sales turnover or the deal value for the parent business or company, the acquirer must specify the value of the stake in the Indian company and the basis of such valuation that would have been factored in, and the Takeover Regulations would treat such acquisitions as if they were direct acquisitions in all respects. – For indirectly acquired target companies, the minimum offer price ought to be the highest of: (a) The highest negotiated price per share, if any, of the target company for any acquisition under the agreement attracting the obligation to make a public announcement of an open offer; i. Where the proportionate net asset value, or the sales turnover, or the market capitalization of the indirectly acquired listed company represents more than 15 % of the net asset value, or the sales turnover, or the deal value for the parent business or company, the acquirer shall be required to compute and disclose the per share value of the target company taken into account for the acquisition of the parent business or company and the basis of such valuation. ii. Where the proportionate net asset value, or the sales turnover, or the market capitalization of the indirectly acquired listed company represents less than 15 % of the net asset value, or the sales turnover, or the deal value for the parent business or company, the acquirer shall not be necessarily

			required to make the computation as above, but to factor in the same if the same has been carried out. (b) The volume-weighted average price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him during the fifty-two weeks immediately preceding the date on which the intention or the decision to make the primary acquisition was announced in the public domain or any agreement was entered into; (c) The highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him during the twenty-six weeks immediately preceding the date on which the intention or the decision to make the primary acquisition was announced in the public domain or any agreement was entered into ; and The highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him between the date on which the intention or the decision to make the primary acquisition was announced in the public domain or any agreement was entered into and the date of the public announcement; – For frequently traded shares, the volume-weighted average market price on the stock exchange for a period of 60 trading days preceding the date on which the intention or the decision to make the primary acquisition was announced in the public domain or any agreement was entered into, as traded on the stock exchange where the maximum volume of trading in the shares of the target company

			are recorded during such period. – The price offered as of the date of public announcement (to be calculated as detailed above) shall have to be increased by 10 % per annum for the period between the announcement of primary acquisition and date on which the detailed public statement is actually made. – For transactions where the proportionate net asset value, or the sales turnover, or the market capitalization of the indirectly-acquired listed company represents more than 80 % of the net asset value, sales turnover or the deal value for the parent business or company, the public announcement be made on the earlier of the date on which the intention or the decision to make the primary acquisition was announced in the public domain or any agreement was entered into. In all other cases, the public announcement can be made within four business days of such date, and in such cases the detailed public statement should be issued within five business days of the consummation of the primary acquisition.
6.	Withdrawl of Open Offer	No open offer, once made, shall be withdrawn except under the following circumstances: (a) the statutory approval(s) required have been refused; (b) the sole acquirer, being a natural person, has died; (c) Such circumstances as in the opinion of SEBI merit withdrawal.	In addition to the grounds currently existing, an open offer may be withdrawn where 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, and such agreement is rescinded, subject to such conditions having been disclosed in the detailed public statement and the letter of offer.

7.	Competing Offer	Provide the opportunity to any person other than the acquirer to make a competing offer within 21 days of the public announcement of the first offer. Also provide that any competitive offer by an acquirer shall be for such number of shares which, when taken together with shares held by him shall be at least equal to the holding of the first bidder including the number of shares for which the present offer by the first bidder has been made.	– A competing offer may be made within 15 business days from the date of the original detailed public statement instead of 21 calendar days from the date of the original public announcement. No further offer should be allowed to be made after the expiry of the said period of 15 business days until the completion of all the competing offers. – An open offer made by a competing acquirer shall not be regarded as a voluntary open offer and therefore all provisions of Takeover Regulations, including relating to offer size, shall apply accordingly. – An acquirer who has made a competing offer, shall be entitled to acquire the shares acquired by the other competing acquirers in their respective competing open offers within 21 business days of the expiry of the offer period without attracting an obligation to make another open offer. – An acquisition mentioned above shall not be made at a price exceeding the offer price in the competing offer made by the acquirer who buys shares in such transaction. Moreover, such an acquisition ought not to take the shareholding of the acquirer beyond the maximum permissible non-public shareholding limit. – Other Recommendations: a. During the pendency of competing offers, no appointment of additional directors ought to be made on the board of directors of the target company. b. The ability of an acquirer to proportionately reduce his acquisitions such that the holding does not exceed the maximum

			permissible non-public shareholding ought not to be available where competing offers are underway. This is critical to ensure that competing acquirers compete on an identical end-objective and shareholders are truly able to compare them on the offer price. c. Unless the open offer first made is an open offer conditional as to the minimum level of acceptances, no open offer made by a competing acquirer may be conditional as to the minimum level of acceptances. d. The schedule of activities and the tendering period for all competing offers shall be carried out with identical timelines and the dates for tendering shares shall be revised to the dates for tendering shares in acceptance of the competing offer last made.
8.	Obligation of the Traget Company – Material Actions	The target company shall not, during the offer period sell, transfer, encumber or otherwise dispose of assets of the company or its subsidiaries or enter into any material contracts.	– The Committee recommends retaining restrictions on the target company during the offer period from carrying out material transactions outside the ordinary course of business except with the consent of the shareholders through a special resolution. The Committee recommends that such restrictions would also cover the subsidiaries of the target company, and such actions in respect of subsidiaries would also require approval of the shareholders of the target company.
9.	Composition of the Board	Till the offer formalities are completed, the target company shall be precluded from inducting any person or person nominated by the acquirer or	– The acquirer or persons acting in concert with him may be represented on the board only after the expiry of a period of 15 business days from the date of

		belonging to his group into the board of the target company other than in cases, where acquirer deposits full consideration in an escrow account.	the detailed public statement and provided the entire consideration payable under the open offer is cases, where acquirer deposits full consideration in an escrow account. Deposited in cash in the escrow account required under the Takeover Regulations and the offer is not subject to any conditions other than regulatory approvals. – If a competing offer is made, there ought to be no appointments of directors during the offer period, and only casual vacancies arising out of death or incapacitation may be filled with prior approval of shareholders.
10.	Timelines for the Open Offer process	The Committee discussed the current timelines for an open offer under the existing Takeover Regulations and reviewed the same with a view to shorten the timelines.	– A short public announcement should be made on the same date as the date of transaction which triggered the open offer through a notice to the Stock Exchange, followed by a detailed public statement within 5 business days of the public announcement. – Post submission of draft letter of offer, all timelines are dependent on issue of comments by SEBI, thus the Committee recommends to link timelines (post submission of draft letter of offer) to the date of receipt of SEBI comments on the draft letter of offer. – The letter of offer should be sent to the most recent set of shareholders. Therefore, the Committee recommends that date for reckoning the shareholders to whom the letter of offer shall be sent should be ten business days prior to commencement of the tendering period. – Most shareholders tender their shares on the last few days of

			the offer period, after the date of final revision in price has been carried out, and hence the initial part of the offer period is virtually redundant. Hence, the overall time frame of the tendering period has been reduced to ten business days, and the last date for upward revision of offer price has been moved up to three business days prior to commencement of the tendering period. – Since the last date of upward revision is prior to the opening of the open offer, shareholders are expected to be in receipt of all information to enable them to decide on the open offer. Therefore, there is no requirement to permit withdrawal of shares tendered in response to the open offer. This would also make the process more efficient. – The acquirer shall issue an advertisement, 1 business day prior to the opening of the tendering period announcing the schedule and procedure for tendering acceptances. – The entire open offer process from the public announcement to the payment of consideration can now be done within fifty seven business days. – The committee also recommended revised timelines and activity chart for an open offer pursuant to a direct acquisition.
11.	Mode of payment	Offer consideration shall be payable either : (a) by way of cash; (b) by issue, exchange and, or transfer of shares (other than preference shares) of acquirer company, if the person seeking to acquire	– The offer price may be paid in the form of cash or securities like shares, convertibles, secured debt instruments of the acquirer or of persons acting in concert with him or a combination of these modes. – To ensure that the equity shares

		the shares is a listed body corporate; or (c) by issue, exchange and, or transfer of secured instruments of acquirer company with a minimum A' grade rating from a Credit Rating Agency registered with the Board; or (d) a combination of clause (a), (b) or (c).	given in consideration for the open offer are liquid, eligibility conditions have been stipulated. – If shares of the target company carrying more than 10% voting rights have been acquired for cash in the preceding 52 weeks, shareholders to whom the open offer is made may opt to receive the offer price only in cash.
12.	Exemption from open offer obilgations	The Takeover Regulations currently provide for fourteen categories of transactions which are exempted from the requirement to make an open offer subject to satisfying the conditions specified therein, if any, without the need to seek SEBI's approval for the same. Further, for the transactions that are not covered in the aforesaid fourteen categories, an application can be made for seeking exemption from SEBI. Such applications are referred to a takeover panel for its recommendations. SEBI considers the recommendations received and passes an appropriate order.	– The Committee has classified the exemptions on the basis of the specific charging provisions which deal with the obligation to make an open offer, and has sought to distinguish between acquisitions involving change in control and those involving only consolidation of shareholding. The deliberations in brief and the recommendations of the Committee on the same are discussed below under separate heads.
13.	Recommendation by the independent directors of the Target Company	The Board of Directors of the Target Company may, if they so desire, send their unbiased comments and recommendations on the offer(s) to the shareholders, keeping in mind the fiduciary responsibility of the directors to the shareholders.	– Independent directors on the Board of Directors of the target company ought to make a reasoned recommendation on the open offer. – For the making of such recommendation, the board of the target company ought to appoint a committee of independent directors with freedom to consult and engage external advisors such as merchant bankers, chartered accountants and lawyers at the expense of the target company.

			– Such committee of independent directors ought to make a reasoned recommendation and such recommendation ought to be sent to all the stock exchanges where the shares of the target company are listed and be published in the same newspapers where the relevant detailed public statement of the open offer was published.
14.	Obligations of the Acquirer – Disposal of assets of the Target Company	Where the acquirer has not stated his intention to dispose of or otherwise encumber any assets of the target company except in the ordinary course of business of the target company, the acquirer shall be debarred from disposing of or otherwise encumbering the assets of the target company for a period of 2 years from the date of closure of the public offer.	– Unless acquirer has declared an intention in the detailed public statement and the letter of offer, the acquirer shall be debarred from alienating any material assets of the target company (including its subsidiaries) for a period of two years after the offer period. However, where such alienation is necessary despite no such intention having been expressed by the acquirer, the target company shall require a special resolution passed by the shareholders by way of a postal ballot.
15.	Obligations of the Merchant Banker	The merchant banker shall ensure compliance of the Takeover Regulations and any other laws or rules as may be applicable in this regard and provide other specific obligations under Regulations 24 of the Takeover Regulations, 1997.	– The merchant banker would be expected to demonstrate the application of due skill, care and diligence in the discharge of professional duties cast on him and the obligations of the merchant banker ought to be construed accordingly. – It is perhaps likely that despite following best practices and full application of diligence, skill and care, an acquirer could end up defaulting under the Takeover Regulations. In such circumstances, the Committee believes that, in the least, the expectation from a merchant banker would be a demonstration of the bona fide efforts undertaken

16.	Disclosure Obligations	The current Takeover Regulations obligate any acquirer who crosses the specified thresholds to disclose at every stage his aggregate shareholding or voting right to the company concerned and to the stock exchanges where shares of the company are listed. It also obligates a promoter / majority shareholder to annually disclose to the company and the concerned stock exchange regarding the number and percentage of shares or voting rights held by him along with PACs.	by him in professionally and diligently discharging the role envisaged for the merchant banker under the regulations. – The acquirer promoter / shareholders shall be asked to disclose their acquisition on periodic as well as transaction specific basis upon crossing the limits specified therein to the Stock Exchange. – Such disclosures shall be of the aggregated shareholding and voting rights of the acquirer and every person acting in concert with him. – The acquisition and holding of any security or instrument that would entitle the acquirer to receive shares in the target company, including warrants and convertible debentures, shall also be required to be disclosed.
17.	Present Tax Regime	An open offer transaction is considered akin to an off-market deal.	– There is a need to bring parity in the tax treatment given to the shareholders who tender their shares in an open offer and those who are selling the same in the open market. SEBI may like to suitably take up this issue with the concerned authorities in the Government.

On September 23, 2011, SEBI notified the New Takeover Regulations i.e. SEBI (Substantial Acquisitions of Shares and Takeovers) Regulations, 2011 that came into force w.e.f. October 22, 2011.

REPORT OF JUSTICE DHANUKA COMMITTEE ON SECURITIES LAWS

On 28th February, 1997, SEBI had appointed a Committee under the Chairmanship of Justice D.R. Dhanuka, former judge of the High Court of Bombay to examine areas of deficiency in the SEBI Act,1992, SC(R) Act,1956 and the Depositories Act,1996 to suggest the amendments to the provisions of the SEBI Act,1992; SC(R) Act,1956, Depositories Act,1996 with a view to enable SEBI to regulate and develop the Securities Market and protect the interests of investors and to examine the provisions of the Companies Act,1956 and to make recommendations for amendments in the Companies Act in order to enable SEBI to better regulate issue of capital, listing of securities, transfer of securities and to protect the interests of investors.

Executive Summary of Principal Recommendations

Part - I A: Pertaining to Draft Securities Bill and Draft Depositories (Amendment) Act 1998.

1. Consolidation of Securities Contracts (Regulation) Act, 1956 and SEBI Act 1992 into a composite securities legislation and consequent repeal of SCR Act and SEBI Act. SEBI should be the sole regulatory agency for securities market, including in relation to certain provisions in the Companies Act.

2. Several additional provisions introduced in the consolidated Securities Act so as to provide for the statutory basis for regulation of a number of aspects relating to the Securities Market. Some of these features are referred below:

2.1 - Long arm jurisdiction provided so as to make the Act applicable to an entity outside India dealing directly or indirectly in securities in India.

2.2 - Several new definitions including that of "derivatives" "fraudulent and unfair trade practices", "insider trading", "intermediaries", "issuer", "mutual fund", "offer documents", "private placement", "qualified institutional investors", "self regulatory organsiations" and "venture capital funds" have been statutorily introduced.

The insertion of definition of "qualified institutional investor" enables identification of a class of "qualified institutional investors" who may be subject to a more liberal, enabling regulation regime. This would be particularly relevant in the context of private placements.

Provision has been made for comprehensive definition of "securities". This now includes derivatives, plantation companies, time shares, securitised instruments, etc.

Some existing definitions, have also been modified to make the same more comprehensive. Insertion / modifications of these definitions will provide the basis for promoting of trading in "derivatives", statutory regulation and punishment of insider trading and fraudulent and unfair trade practices as also, regulations of private placements.

The same also includes regulation of issuer and improving disclosure standards to be followed by the issuer.

3. Powers and functions of SEBI rationalised. Provision is made for power to issue general and special directions including those for enforcement of such directions and recovery of money as arrears of land revenue.

3.1 Scope of SEBI's powers to issue directions, is expressly extended also to investors or any other person, rather than merely intermediaries.

4. Statutory provision is made for restriction of professionals practicing in the securities market including advocates, chartered accountants also who act as experts if they are found to be guilty of malpractices. This is without prejudice to the Advocates Act as the autonomy of the bar and the Chartered Accountant Act is maintained and is in furtherance of the strong desire of the Committee to encourage raising of professional standards and creation of a larger force of securities market professionals.

5. A new Chapter for recognition and regulations of self regulatory organisations is inserted. The encouragement of self regulatory organisations and the statutory regulation thereof are the key recommendations of this Committee.

5.1 The right to carry on business as intermediary has been linked to membership of an SRO.

6. The scope of recognition and regulation of stock exchange, also a form of SRO has now been rationalised.

6.1 The definition of stock exchange has been extended to include "exchanges promoted by other exchanges."

6.2 Concept of "territoriality" with reference to recognition of exchanges has been abandoned. SEBI's approval for additional trading floors will still be required.

6.3 In case of supersession of the governing board, some members may continue till reconstitution of new governing body.

7. Strict provisions made for the regulation of the issuer, particularly, in relation to issue of securities and disclosure standards.

8. Consequential provisions are prescribed for mis-statement in terms of civil and criminal consequences.

9. Non company issuers are also to be included in the regulatory net.

10. Parallel action under the SEBI Act can be also taken in case of mis-statements in offer documents and action is not confined to mis-statement in prospectus, under Companies Act.

11. Provision has been made for establishment of a clearing corporation and the regulation thereof.

12. Provision has been made for recovery of the listing fees. Directors or persons in management are personally liable for payment of listing fees which can be recovered as land revenue from the issuer, management in case of default.

13. Parameters are prescribed for delisting of securities. Voluntary de-listing to be permitted by stock exchanges and SEBI only with the consent of the prescribed majority of the shareholders and also upon specific conditions.

14. Provisions regarding contracts and options in securities are streamlined.

14.1 Hence, dealing in securities may take place in any of three ways.

(1) through members of the stock exchange

(2) spot delivery contracts

(3) special exceptions such as repos in Government securities, securities of private companies, private shareholder agreement, deliveries as per takeover code, etc. These may take place other than through members of stock exchanges and not necessarily as spot delivery contracts.

15. The business of spot deliveries to be strictly regulated. Hence, share shoppes to be prohibited unless licensed.

16. Compulsory dematerialisation for new issue of securities exceeding rupees 10 crores in value.

17. UTI to be regulated as a Mutual Fund notwithstanding the provisions of UTI Act, 1963.

18. New Chapter inserted for empowering SEBI and its officials for Investigation and Enforcement on lines of other economic legislations including powers, examination of persons, search and seizure, etc.

19. Provision inserted to take approver, evidence and to offer consequential immunity for prosecution.

20. To prevent abuse of power necessary safeguards for prevention of vexatious searches, draconian exercise of powers provided for. SEBI to follow settled principles of administrative law subject to judicial review.

21. Provisions as to penalty and adjudication are rationalised.

22. New categories of penalties for mis-statement in offer documents and other documents. In relation to offences of insider trading and unfair trade practices, persons who knowingly benefit are also liable for penalty.

23. Provisions related to a single Appellate Authority i.e. Securities Appellate Tribunal has been rationalised.

24. Power to make rules and regulations, rationalised in the new context.

25. Intermediaries to hold securities or funds of investor as trustee pending executions of contract.

Part I B: Dematerialisation / Depositories Act, 1996 - Amendments

26. Issuer not to resile or withdraw from agreement with depository after dematerlisation of its securities.

27.Option to issuer to enter into agreement with anyone of the depository in case of several depositories.

28.Nomination facility to the beneficial owner in respect of dematerialised security.

29.In case of pledge of dematerialised securities, the provisions of Contract Act not to be applicable.

30.Bankers Book Evidence Act, 1879 applicable also to the statement issued by “participant”.

31.Depository to indemnify the beneficial owner only for its own negligence and fraud and not generally.

32.Contravention of direction of the Board is made punishable.

33.Appeal to lie to Securities Appellate Tribunal from the order of the Board.

34.Jurisdiction of Consumer Forum barred in relation to dispute relating to dematerialised securities.

35.Depository Act to override memorandum and articles of association of companies.

36.Exemption from stamp duty in respect of issue and transfer of dematerialised security.

37.Participants to hold securities of beneficial owner as trustee pending dematerialisation .

*Special problems - Plantation companies

PART II - PERTAINING TO WORKING DRAFT OF COMPANIES BILL, 1997

– Definition of the expression “security” be restructured. The expressions “derivative” and “option in securities” can be more appropriately defined in SC(R) Act.

– As per the Working Draft Report, only Part III is proposed to be administered by SEBI. It is recommended that all the provisions relating to listed companies in so far as they relate to subject matter of capital market and issuance or dealing in securities wherever found in Companies Act be administered by SEBI. SEBI should be the sole authority for framing regulations in relation to the subjects entrusted to it under the new legislation.

– Provisions relating to prospectus, shelf-prospectus and red herring prospectus require several modifications.

– Private Placement should be regulated. Broad parameters should be laid down in the Act. Details to be determined by SEBI.

– Provisions made in the Working Draft for buy back of securities require several modifications.

(i) The provision for buy-back should be restricted to “shares” only.

(ii) The company should not be allowed to utilise proceeds of “prior issue” for purpose of “buy-back”.

(iii) The company should be allowed to re-issue the shares which are bought back, subject to safeguards and stipulations which may be laid down.

(iv) Implications relating to insider trading to be considered.

– Penal provisions of the Act be made deterrent.

– Listing period be reduced from 10 weeks to 30 days. It should not be mandatory to have the securities listed on the regional stock exchange.

– Clauses 94-98 of the Working Draft require several amendments. SEBI may be authorised by the Act to frame regulations relating to transfer of securities of listed companies, etc.

– Obtaining of duplicate share certificate and issue thereof as a result of fraud or collusion be made a serious criminal offence.

– If a person is found guilty of contravening the provisions of SEBI Act, SC(R) Act or depository Act, or is penalised by the adjudicating officer under the SEBI Act, he should be disqualified from becoming the director of the company. The Committee has formulated amendments.

- Securities audit be made compulsory.
- Monetary penalty concept be introduced so that investors can seek remedy of claiming compensation, damages, etc.
- In order to enhance corporate democracy, the concept of Postal Ballot to be introduced to enable shareholders to vote through postal ballot.
- The blank transfer deeds should not be permitted.
- SEBI should have power of inspection of books of accounts, records of the listed companies.
- Rights issue with right of renounciation be treated as public issue.
- Printing of share certificates be regulated and technical standards to be prescribed.
- Verification of transfer deeds by companies on payment of nominal fees before lodgment of certificate of transfer.
- Company's right to refuse transfer limited to be limited to violation of SEBI Act and regulations, or any other law and not on "sufficient cause" as presently prescribed under section 111A.
- The concept of deemed public company be reintroduced. Section 43A of existing Act is a useful provision in the Act and it should not be deleted.
- The Reserve Bank of India should have power to freeze voting rights in respect of "shares under transfer" concerning Banking Companies pending consideration of Application for Acknowledgment. If the shares of a Banking Company are transferred in violation of Banking Regulation Act, 1949 or the circulars / guidelines issued by Reserve Bank having the force of law, the Reserve Bank should have locus standii to apply to Company Law Board for rectification of Register on par with SEBI and other authorities.
- Companies making initial public offer of securities for a sum of ₹10 crores or more to be issued only in dematerialised form through a depository.

Recommendation for Issue of an Ordinance for Moving of an Urgent Bill To Curb The Growing Evil Emanating From Collective Investment Schemes

The Government of India issued press release dated 18/11/1997 that the Collective Investment Schemes based on issuing instruments like Agro Bonds, Plantation Bonds, etc. are within the purview of SEBI Act,1992 and particularly the provisions of law contained in Section 11(2)(c) of the SEBI Act. The said sub-clause was incorporated in the Act by the Securities Laws (Amendment) Act, 1995 with effect from 25/1/1995 for "Collective Investment Schemes".

Section 11(1) of the Act provides that it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market by such measures as it deems fit. Section 11(2)(c) of the said Act provides that the generality from the provisions, the measure referred to therein may provide for restructuring and regulating the working of venture capital funds and collective investment schemes, including mutual funds.

SEBI was facing writ petitions in the Hon'ble Courts where content of one writ petition is that the plantation companies, etc. are not within the jurisdiction of SEBI in as much as such companies do not operate in the securities market and the bonds issued by such companies do not constitute securities.

The Committee was of the view that as a measure of the abundant caution, clarificatory provision should be made in the new legislation restructuring the definition of securities so as to specifically provide that Agro Bonds, Plantation Bonds, etc. be expressly included in definition of the expression securities. The existing definition of the expression "securities" contained in Section 2(h) of Securities Contracts (Regulation) Act,1956 is an inclusive definition and the same definition has been adopted in SEBI Act,1992 by Section 2(i) thereof.

The clarificatory definition of the expression security should not indicate any change in law as such but should in terms clarify and provide that the collective investment schemes were within the range of the definition of the expression securities and whatever be the nature of document issued by these companies, these documents would constitute securities. The Committee had prepared draft of an extensive definition of the expression "security" for being included in the proposed Securities Act, 1998. Above draft of a consolidated legislation was prepared by the Committee after holding about 22 meetings. In the draft-Bill of the securities, the definition of securities was widened. The committee was of the view that the said definition be taken into consideration by the authorities concerned while drafting new legislation in the form of an Ordinance or the Bill as may be deemed fit.

The Committee made a few suggestions / recommendations indicating the nature of powers, duties and obligations to be conferred on the regulatory body for giving better protection to investors whose interests are in jeopardy. A list of such provisions is particularly indicated hereinafter.

1. Power of making enquiry and investigation. Thus, the power to issue summons and record statements of individuals, suspected of fraud and malpractices - power to search the premises, to seize the records - power to appoint a Chartered Accountant or any other officer to take inspection of the records of the company concerned.

2. Power to take-over the management of the entity concerned for a limited duration.

3. Power to appoint Chairman or additional directors as Government nominees or as SEBI nominees with special obligations to protect the interest of the investors and make report to the authorities including authority to perform Bank Accounts.

4. Power to make inventory inspection of the assets of the company. Appointment of receiver or freeze assets of the company including Bank Accounts where the regulatory authority has reason that the company is indulging in activities prejudicial in the interest of the investors or is dealing with the assets in a manner prejudicial or manipulating in activities in accordance with law.

5. Power to prosecute the manipulators and persons who are prima - facie suspected fraud after investigation.

6. Power to issue directions including directives in respect of freezing the assets of the company and such other directions as are deemed necessary in the interest of the investors.

7. In case the company or the unit is found insolvent or the interests of the investors are in jeopardy or it is prima-facie deemed just and equitable to seek winding up of such companies to make necessary applications for winding up of the company.

PROFESSIONAL PROGRAMME

CAPITAL, COMMODITY AND MONEY MARKET

PP-CC&MM

Open Book Examination in Elective Subjects (Paper - 9) in Module-III of Professional Programme (New Syllabus) Examination

Professional Programme (New Syllabus) offers five elective subjects in Module III, as mentioned herein below, out of which a student has to opt only one subject to study and qualify that suits his aptitude, interest, ability and career goal:

1. Banking Law and Practice
2. Capital, Commodity and Money Market
3. Insurance Law and Practice
4. Intellectual Property Rights-Law and Practice
5. International Business -Laws and Practices.

There is Open Book Examination (OBE) in all the above five elective subjects from June 2014 onwards. However, in all other subjects/modules of Professional Programme (New Syllabus), students would continue to be examined as per traditional pattern of examinations.

This is to inculcate and develop skills of creative thinking, problem solving and decision making amongst students of its Professional Programme and to assess their analytical ability, real understanding of facts and concepts and mastery to apply, rather than to simply recall replicate and reproduce concepts and principles in the examination.

In OBE, the candidates are allowed to consult their study material, class notes, textbooks, Bare Acts and other relevant papers, while attempting answers, as per the requirement of questions. The emphasis throughout is in assessing the students' understanding of the subject, applying their minds, rather than the ability to memorise large texts or rules or law.

Unlike a conventional/typical examination, which assesses how much information candiates have been able to store in their minds, the success in this type of examination depends on the candidate's ability to understand the question, identify inherent issues, application of various techniques, laws, principles, etc. while solving answers with the help of supporting reference material.

Broad pattern of Question Paper for OBE is as follows:

- Each question paper would contain **Six** questions carrying 100 marks
- Question No.1 will be of 50 marks based on case study ranging between 3000-4000 words.
- Question No.2 will be of 30 marks based on study of regulatory framework related to the subject.
- Question No.3-6 will be of 5 marks each covering important topics of the syllabus.

Candidates are not allowed to consult their fellow examinees or exchange their study material/notes, *etc.* with each other in the examination hall.

Candidates are prohibited to bring in any electronic devices, such as laptop, tab, I pad, palmtop, mobile phone, or any other electronic device/ gadget at the examination hall/room. However, they are permitted to use their own battery operated noiseless and cordless pocket calculator with not more than six functions, twelve digits and two memories.

PROFESSIONAL PROGRAMME EXAMINATION (NEW SYLLABUS)

ELECTIVE PAPER 9.2 – CAPITAL, COMMODITY AND MONEY MARKET

PRACTICE TEST PAPER

OPEN BOOK EXAMINATION

Time allowed: 3 hours *Max Marks: 100*

Attempt all questions. All questions are compulsory.

Question No. 1

Suppose that the following order has been passed by a Whole-time Member of SEBI.

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM:............., WHOLE TIME MEMBER

IN THE MATTER STE LTD In respect of M/s ROSE (Prop. GHANA)

SEBI Registration No. INB ....(PAN:.....................)

Sub-broker of XYZ Ltd.

Date of hearing: September 19, 2011

Appearances

For Noticee: Mr. Amit, Advocate

For SEBI: Mr. Mahesh, Deputy General Manager Ms. Sasmita, Deputy Legal Adviser

ORDER

Under Regulation 28(2) read with Regulation 38 (2) of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008

1. Securities and Exchange Board of India (hereinafter referred to as 'SEBI') conducted an investigation in the trading in the scrip of M/s STE Limited (hereinafter referred to as 'STEL' / 'Company') during the period from January 01, 2002 to July 31, 2002. The shares of STEL are listed on Bombay Stock Exchange (hereinafter referred to as 'BSE') and Ahmedabad Stock Exchange (hereinafter referred to as 'ASE'). Investigations, inter alia, revealed that STEL, which had a paid up capital of Rs.3,60,00,000 comprising 36 lakh shares, issued additional shares to the tune of 3 crores on a preferential basis to certain entities . These shares were issued by STEL to the shareholders of two companies, namely M/s. ABC Ltd. (hereinafter referred to as 'ABC') and M/s. PQR Ltd (hereinafter referred to as 'PQR') on swap basis. The shares of STEL so allotted were fraudulently dematerialized using an in-principle listing approval from ASE. Further, it was seen that immediately prior to allotment, several fictitious demat accounts were opened using forged and fictitious documents. The shares allotted on preferential basis were found to have been transferred, in some instances, to such fictitious accounts. Following this, the said shares were routed through various entities and finally offloaded onto unsuspecting investors at BSE, even though BSE had refused listing permission for these additional shares.

2. Pursuant to the said investigation, it was alleged that one of the entities, viz., M/s ROSE (hereinafter referred to as 'ROSE'/ 'the noticee'), received unlisted shares of STEL from various entities in off market transactions and thereafter transferred these shares to brokers who then offloaded the unlisted shares on the market.

3. Based on the findings of investigation, SEBI initiated enquiry proceedings as against the noticee in terms of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as 'Enquiry Regulations'), by appointing an Enquiry Officer under Regulation 5(1) of Enquiry Regulations vide order dated April 7, 2008 to enquire into the alleged violation of the provisions of Regulations 3, 4(b),(c) and 6(a) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 1995 (hereinafter referred to as 'PFUTP Regulations, 1995') read with Regulations 3(a), (c), (d), 4(1), (2) (a) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 2003 (hereinafter referred to as 'PFUTP Regulations, 2003') and Clauses A(1), (2) and D (1), (4) and (5) of Code of Conduct as stipulated in Schedule II under Regulation 15 of the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 (hereinafter referred to as 'Brokers Regulations'). As the Enquiry Regulations were repealed with the notification of SEBI (Intermediaries) Regulations, 2008, the Enquiry Officer/ Designated Authority (hereinafter referred to as the 'Enquiry Officer') submitted his Report dated November 23, 2009, in terms of Regulation 27 of SEBI (Intermediaries) Regulations, 2008, recommending thereby that the certificate of registration of the noticee be suspended for a period of six months.

4. Subsequently notices dated December 29, 2009 and June 09, 2010 (hereinafter referred to as the 'SCN') under Regulation 28 of SEBI (Intermediaries) Regulations, 2008, were issued to the noticee, asking it to show cause as to why action as recommended by the Enquiry Officer or a higher penalty should not be imposed on the noticee. The noticee was advised to reply to the SCN, within twenty one days from the date of receipt thereof. It was also informed that in case of failure, it would be presumed that it had no explanation to offer and SEBI shall be free to take such action in the manner as it deemed fit. A copy of the Enquiry Report was also forwarded to the noticee along with the SCN.

5. An opportunity of personal hearing was granted to the noticee before me on December 16, 2010. However, the noticee did not appear for the said hearing citing health reasons. The noticee replied to the SCN vide letter dated December 22, 2010. Subsequently, one more opportunity of hearing was granted to the noticee on September 19, 2011. On the scheduled date, Mr Amit, Advocate, appeared before me as the authorized representative of M/s ROSE and made submissions. The noticee has, *inter alia,* submitted as under:

(i) The noticee was holding these shares in trust for the allottees.

(ii) The shares were not unlisted shares.

6. I have carefully considered the Enquiry Report, the SCN issued to the noticee along with the submissions of the noticee and other material available on record. Thus, the issue that arises for my consideration is whether the noticee had violated Regulations 3, 4(b),(c), and 6 (a) of PFUTP Regulations, 1995 read with Regulations 3(a), (c), (d) and 4(1), (2) (a) of PFUTP Regulations, 2003 and Clauses A(1), (2) and D (1), (4) and (5) of the Code of Conduct as stipulated in Schedule II under Regulation 15 of the Brokers Regulations.

7. I note that the paid up capital of the company as on January 1, 2002 was Rs.33,60,00,000/- (3,36,00,000 shares of Rs.10/-). The above capital of the company consisted of 3,00,00,000 shares allotted on a preferential basis (swap for consideration other than cash). The shares of the preferential allotment remained unlisted at BSE. Hence, the submission of the noticee that the shares were not unlisted is without merit.

8. I note that the major brokers/sub brokers and their clients who had traded during the investigation period are as under:

Member Broker	Sub-Broker	Major Ultimate Client	Gross Purchase		Gross Sales	
			Shares	**%**	**Shares**	**%**
PLI Pvt. Ltd.		Karan	285053	0.59	14927712	31.21
		Nitin			1988023	4.13
		Yatindra			3454658	7.18
		YC Corporation			274313	0.57
	Total Trading by broker		296023	0.62%	20691706	43.00%
XYZLtd.	Vasu	ROSE			892000	1.85
	JamBhai	Sunil			2003700	4.16
	ROSE	Nitin	31928	0.07	49982	0.10
		ROSE(GHANA)	34948	0.076	38054	0.076
	Total trading by broker		518930	1.08%	3305629	6.87%
Sampark	SPF(Prop: Pankaj)	Hitendra	10000	0.02	260500	0.54
		Farooq	1004011	2.09	1004976	2.09
		KC Corporation		0.00	1050000	2.18
		Trading account	1071504	2.23	1091952	2.27
		Nitin	146314	0.30	812586	1.69
	Total trading by broker		2529550	5.26%	4452659	9.25%
Imtiaz		Total 273 clients.	10827004	22.50%	6555277	13.62%
Total traded quantity			48116275	100%	48116275	100%

9. As it was observed that a few clients who were the major sellers had sold more than the listed capital of the company, while their purchases were comparatively less as stated above, demat accounts of these clients including Karan, Nitin, Yatindra, ROSE and Sunil, KC Corporation were analyzed to find out the source of their acquisition. Analysis of their demat statements revealed the following:

(i) The preferential allottees had dematerialised the shares they had received in the allotments and had transferred these shares to Rinku and GHANA (proprietor of M/s ROSE, the noticee herein).

(ii) Rinku was holding 5 lakh shares from the preferential allotment and further received 71,81,980 shares from the preferential allottees of ABC Ltd. and 1,90,00,000 shares (on a single day) from the allottees of PQR Ltd.

(iii) Rinku transferred 2,33,72,565 shares to GHANA. GHANA also received 11,09,556 shares from some of the other preferential allottees in the scrip during the Investigation period.

10. Subsequently, the noticee delivered these shares to the brokers/sub brokers, details of which are stated below. The shares were sold in the market by these brokers/ subbrokers.

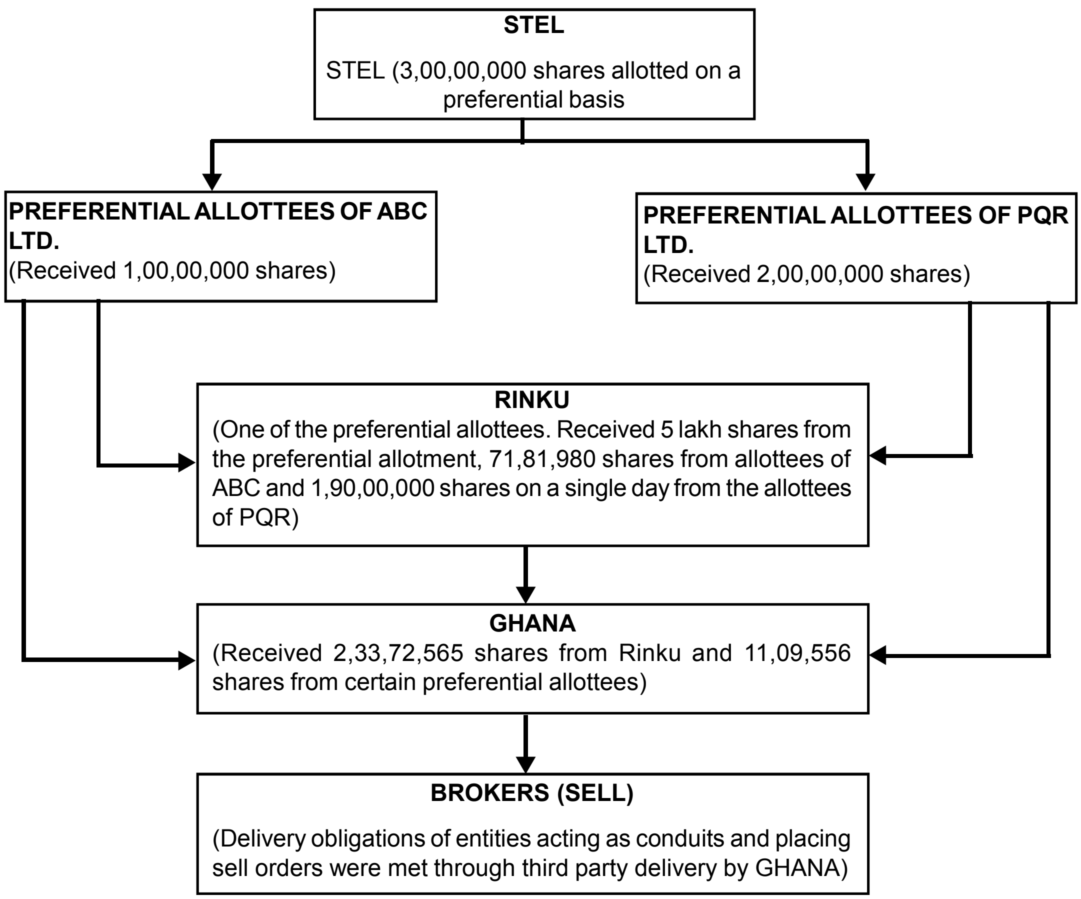
Name of the Broker/sub-broker	No of shares
PLI Pvt. Ltd	2,05,34,963
XYZ Ltd.	20,00,000
SPF	12,68,286

The aforesaid shares were unlisted. Thus, it is alleged that the noticee aided and abetted the allottees in off loading the shares which they received in the preferential allotment.

11. I note that none of the aforementioned entities who traded in the scrip, except GHANA (proprietor of M/s ROSE), had received any shares through off- market transfers, nor had they delivered any shares to the respective brokers. Their delivery obligations were met through third party delivery by Shri GHANA (ROSE).

12. The scheme of manipulation in the scrip of STEL can be represented diagrammatically as under:

13. Thus, I note from the above that the noticee was part of the manipulation in the scrip of STEL as it received shares from the allottees in the preferential allotment through off- market and subsequently transferred to the brokers/sub-brokers for sale through the market.



14. I further note that SPF, one of the entities to whom the noticee transferred the unlisted shares, is related to the noticee. While the noticee has denied that Pankaj, the proprietor of SPF is his cousin, I note that the telephone No.......... registered in the name of ROSE, is allotted to the address .... I note that this is the same address as that of SPF.

15. I also note that 1,83,957 shares were sold by M/s PLI Pvt. Ltd. On behalf of ROSE as client, but contract notes were issued in the name of Mr. Karan. The noticee, during the proceedings before the Enquiry Officer, admitted that the transaction was on behalf of Mr. Karan, and submitted that the same was due to an error and has been rectified.

16. From the above, I find that the noticee has not only received the shares in off market from Rinku and other preferential allottees but also transferred the same to PLI Pvt Ltd., XYZ Ltd. and SPF, who in turn sold them in the market. By doing so, the noticee has aided and abetted the preferential allottees, brokers/sub-brokers and clients in offloading the unlisted shares in the market.

17. In view of the facts and circumstances of the case, the violation of Regulations 3, 4(b), 4(c), 6(a) of PFUTP Regulations, 1995 read with Regulation 3(a),(c),(d) 4(1),(2)(a) of PFUTP Regulations, 2003 and Clauses A(1)(2) and D (1) (4) (5) of Code of Conduct for Stock Brokers as stipulated in Schedule II under Regulation 15 of the Brokers Regulations stands established.

18. Therefore, taking into consideration the facts and circumstances of the case, I, in exercise of the powers conferred upon me in terms of Section 19 of the Securities and Exchange Board of India Act, 1992 read with Regulation 28(2) of Securities and Exchange Board of India (Intermediaries) Regulations, 2008, hereby state that the certificate of registration of the noticee, **M/s ROSE (Prop. GHANA) (SEBI Registration No. ....) (PAN: ....)** be suspended for a period of six (6) months from the date of this order.

19. This order shall come into effect on expiry of 21 days from the date of this order.

Place:

Date: Whole Time Member

SEBI

Draft an appeal to Securities Appellate Tribunal under Section 15T of the SEBI Act, 1992 against this order in about 1500 words.

(*50 Marks*)

Question No. 2

M/s ABC Limited (Target Company) a public limited company listed at NSE and BSE, has total paid up capital of Rs. 13,41,43,160/- comprising of 13,41,43,160 equity shares of Rs 1/-each. The promoter of the Target Company is a body corporate i.e. GB Private Limited (GBPL) (unlisted company) and holding 75% equity share capital of Target Company and balance shareholding is held by Indian Public. The promoters of GBPL are M/s GI Private Limited (GIPL) holding 90% shareholding of GBPL. The total shareholding of M/s GIPL is held by other three bodies corporate i.e. M/s AH Private Limited (AHPL), M/s AI Private Limited (AIPL) and M/s DR Private Limited (DRPL). The individuals are holding majority shareholdings of all these three bodies corporate viz. AHPL, AIPL and DRPL. Mrs. Jain is holding 21.57%, 24.92% and 28.40% equity stakes in AHPL, AIPL and DRPL respectively. Mrs. Malhotra is holding 23.53%, 19.93 % and 28.40 % stakes in AHPL, AIPL and DRPL respectively. Mrs. Malhotra and Mrs. Jain together with the Person Acting in Concert, who are their relatives, are in control of AHPL, AIPL and DRPL. In the light of the above, explain the following:

(i) Whether the transfer of all the shares by Mrs. Jain and Mrs. Malhotra in unlisted companies i.e. AHPL, AIPL and DRPL by way of gift to their immediate relative i.e. brother (who is not directly or indirectly part of the promoter group of target company of share holder of any of the unlisted holding company) shall attract the provisions of SEBI (SAST) Regulations, 2011? If the answer is yes, explain with detailed provisions which are attracted.

(ii) Whether the above said transfer of shares by Mrs. Jain and Mrs. Malhotra in unlisted companies i.e. AHPL, AIPL and DRPL by way of gift to their immediate relative i.e. brother shall be eligible for exemption under the SEBI (SAST) Regulations, 2011? If yes, then subject to which regulation it can claim exemption?

(iii) Whether for the above said transfer, the individual promoters of AHPL, AIPL and DRPL i.e. Mrs. Jain and Mrs. Malhotra and their brother will be deemed to be qualifying person s for claiming exemption?

(*30 marks*)

Question No. 3

Hedging has generally proved to be one of the most popular techniques for risk management, it is imperative to test its efficiency, and estimate its effectiveness as a risk management tool in a quantitative manner. How does various future contracts traded in commodity markets of India improves hedging efficiency? (*5 Marks*)

Question No. 4

Money market mutual funds are the lowest-risk variety of mutual funds, but they aren't risk-free. Discuss.

(*5 Marks*)

Question No. 5

Write a short note on how commodity derivative market has helped in price discovery and price risk management.

(*5 Marks*)

Question No. 6

Compare the settlement mechanism of Capital and Commodity Market.

(*5 Marks*)