
STUDY MATERIAL

EXECUTIVE PROGRAMME

**CAPITAL MARKETS
AND
SECURITIES LAWS**

MODULE II
PAPER 6



**THE INSTITUTE OF
Company Secretaries of India**

IN PURSUIT OF PROFESSIONAL EXCELLENCE

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EXECUTIVE PROGRAMME

CAPITAL MARKETS AND SECURITIES LAWS

The Indian Capital market has grown exponentially in terms of resource mobilization, number of listed stocks, market capitalization, trading volumes, and investors' base. Along with this growth, the profiles of the investors, issuers and intermediaries have changed significantly. The market has witnessed a fundamental institutional change resulting in drastic reduction in transaction costs and significant improvement in efficiency, transparency and safety. The measures taken by SEBI such as, market determined allocation of resources, rolling settlement, sophisticated risk management and derivatives trading have greatly improved the framework and efficiency of trading and settlement, making the Indian capital market qualitatively comparable to many developed markets.

This study material has been published to aid the students in preparing for the Capital Market and Securities Laws paper of the CS Executive Programme. It is part of the educational kit and takes the students step by step through each phase of preparation stressing key concepts, pointers and procedures. Company Secretaryship being a professional course, the examination standards are set very high, with emphasis on knowledge of concepts, applications, procedures, for which sole reliance on the contents of this study material may not be enough. Besides, as per the Company Secretaries Regulations, 1982, students are expected to be conversant with the amendments to the laws made upto six months preceding the date of examination. The material may, therefore, be regarded as the basic material and must be read alongwith the original Bare Acts, Rules, Regulations, Academic Guidance etc. This study has been updated upto July, 2014.

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

In the event of any doubt, students may write to the Directorate of Academics 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.

This study material is based on those sections of the Companies Act, 2013 and the rules made there under which have been notified by the Government of India and came into force w.e.f. April 01, 2014 (Including amendments / clarifications / circulars issued there under upto June, 2014). In respect of sections of the Companies Act, 2013 which have not been notified, applicable sections of Companies Act, 1956 have been dealt with in the Study Material.

SYLLABUS

PAPER 6: CAPITAL MARKETS AND SECURITIES LAWS (100 Marks)

Level of Knowledge: Expert Knowledge

Objective: *To acquire knowledge and understanding of securities laws and the regulatory framework of capital markets.*

Contents:

Part A: Capital Markets (60 Marks)

1. Overview of Capital Market

- Indian Capital Market
- Authorities Governing Capital Markets in India
- Profile of Securities Market
- Securities Market Reforms and Regulatory Measures to Promote Investor Confidence
- Features of Developed Capital Market: IOSCO
- Overview of Depository System in India

2. Capital Market Instruments and Rating

- Capital Market Instruments: Equity, Debentures, Preference Shares, Sweat Equity, Non-Voting Shares, Share Warrants
- Pure, Hybrid and Derivatives
- Rating and Grading of Instruments: Concept, Scope and Significance, Regulatory Framework
- Rating Agencies in India, Rating Methodologies

3. Securities Market Intermediaries

- Primary Market and Secondary Market Intermediaries: Role and Functions, Merchant Bankers, Stock Brokers, Syndicate Members, Registrars, Underwriters, Bankers to an Issue, Portfolio Managers, Debenture Trustees, Foreign Institutional Investors, Depositories, Depositories Participants, Custodians, Credit Rating Agencies, Venture Capitalists

4. Market Infrastructure Institutions - Stock Exchanges

- Functions and Significance of Stock Exchanges
- Operations and Trading Mechanism of Stock Exchanges
- Settlement of Securities, Stock Market Indices, Risk Management, Surveillance Mechanism at Stock Exchanges, Straight through Processing
- Demutualization of Stock Exchanges
- SME Exchange

5. Debt Market

- Debt Market: Instruments, Listing, Primary and Secondary Segment

6. Money Market

- Growth of Money Market in India – Structure and Institutional Mechanism
- Money Market Instruments: Treasury Bills, Commercial Bills, Commercial Paper, Factoring Agreements & Discounting of Bill

7. Mutual Funds

- Mutual Fund: Introduction, Definitions, Schemes, Risks Involved, Setting Up of Mutual Funds, Role in Financial Market
- Advantage of Investment in Mutual Fund
- Concept of Trustee and Asset Management Company
- Legal & Regulatory Framework
- Offer Document, Accounting Valuation & Taxation
- Investment Management: Equity & Debt Portfolio, Measuring & Evaluating Mutual Fund Performance
- Investor's Rights and Obligations

8. Venture Capital

- Concept of Venture Capital
- Registration, Investment Conditions and Restrictions
- Foreign Venture Capital Investors
- Private Capital Funds

9. Collective Investment Schemes

- Regulatory Framework
- Restrictions on Business Activities
- Submission of Information and Documents
- Trustees and their Obligations

10. Resource Mobilization in International Capital Market

- Listing of Securities Issued Outside India
- Foreign Currency Convertible Bonds
- Global Depository Receipts
- American Depository Receipts
- External Commercial Borrowings
- Procedure for Issue of Various Instruments

11. Indian Depository Receipts

- Indian Depository Receipts: Procedure for Making Issue of IDRs, Conditions for Issue of IDRs, Listing of IDRs

Part B: Securities Laws (40 Marks)

12. Securities Contracts (Regulation) Act, 1956

13. SEBI Act, 1992

- Objective, Power and Functions of SEBI
- Securities Appellate Tribunal, Appeals, Appearance before SAT

14. Depositories Act, 1996

- Definitions, Setting up of Depository, its type, Role and Functions
- Depository Participants
- Admission of Securities
- Difference between Dematerialization & Rematerialisation
- Depository Process
- Inspection and Penalties
- Internal Audit and Concurrent Audit of Depository Participants

15. Issue and Listing of Securities

- Listing of Securities
- Issue of Capital and Disclosure Requirements (ICDR)
- Procedure for Issue of Various Types of Shares and Debentures
- Employee Stock Option Scheme and Employee Stock Purchase Scheme
- Delisting of Securities

16. Regulatory Framework relating to Securities Market Intermediaries

- Primary Market and Secondary Market Intermediaries: Role and Functions, Merchant Bankers, Stock Brokers, Syndicate Members, Registrars, Underwriters, Bankers to an Issue, Portfolio Managers, Debenture Trustees, Foreign Institutional Investors, Custodians, Credit Rating Agencies, Venture Capitalists

17. An Overview of Law relating to Insider Trading and Takeovers

LIST OF RECOMMENDED BOOKS

PAPER 6 : CAPITAL MARKETS AND SECURITIES LAWS

READINGS

1. E. Gordon & K. Natarajan : Capital Market in India; Himalaya Publishing House, Ramdoot, Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.
2. Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.
3. V.L. Iyer : SEBI Practice Manual; Taxman Allied Service (P) Ltd., 59/32, New Rohtak Road, New Delhi-110005.
4. M.Y. Khan : Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi – 110 002.
5. S. Suryanarayanan & V. Varadarajan : SEBI – Law, Practice & Procedure; Commercial Law Publishers (India) Pvt. Ltd., 151, Rajindra Market, Opp. Tis Hazari Court, Delhi - 110054
6. Mamta Bhargava : Compliances and Procedures under SEBI Law; Shreeji Publishers, 8/294, Sunder Vihar, New Delhi – 110 087
7. Taxmann : SEBI Manual
8. Asim Kumar Mishra : Venture Capital Financing in India; Shipra Publications, 115A, Vikas Marg, Shakarpur, Delhi-110092.
9. Shashi K Gupta : Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Nishja Aggarwal Ram Road, 24, Daryaganj, New Delhi -110002
Neeti Gupta
10. Vishal Saraogi : Capital Markets and Securities Laws simplified, Lawpoint Publication, 6C, R.N. Mukherjee Road, Kolkata-700001

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1. SEBI Annual Report : SEBI, Mumbai.
2. Indian Securities Market - A Review : NSE Yearly Publication
3. Website : www.sebi.gov.in
www.nseindia.com
www.bseindia.com
www.rbi.org.in
www.mca.gov.in

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, 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

PART A

1. Overview of Capital Market
2. Capital Market Instruments
3. Credit Rating and IPO Grading
4. Securities Market Intermediaries
5. Market Infrastructure Institutions - Stock Exchange Trading Mechanism
6. Debt Market
7. Money Market
8. Mutual Funds
9. Alternative Investment Fund
10. Collective Investment Schemes
11. Resource Mobilization in International Capital Market
12. Indian Depository Receipts

PART B

13. Regulatory Framework Governing Stock Exchanges
14. Securities and Exchange Board of India
15. Depositories
16. Listing and Delisting of Securities
17. Issue of Securities
18. Regulatory Framework relating to Securities Market Intermediaries
19. Insider Trading- An overview
20. Takeover Code- An Overview
21. Investor Protection

TEST PAPERS

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Lesson 1

Overview of Capital Market

LESSON OUTLINE

- Introduction
- Organisational Structure of Financial System
- Functions of Securities Market
- Securities Market and Economic Growth
- A Profile of Securities Market
- Market Regulations
- Securities Market Reforms and Regulatory Measures to promote Investor Confidence
- International Organisation of Securities Commission (IOSCO)
- Overview of Depository System in India
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

The Capital Market is a market for financial investments that are direct or indirect claims to capital. It embraces all forms of lending and borrowing, whether or not evidenced by the creation of a negotiable financial instrument. The Capital Market comprises the complex of institutions and mechanisms through which intermediate term funds and long term funds are pooled and made available to business, government and individuals. The Capital Market also encompasses the process by which securities already outstanding are transferred.

This lesson will enable the students to understand the basics of Capital Market, the major securities market reforms taken by SEBI, the role of IOSCO in securities market regulation and the overview of depository system in India.

INTRODUCTION

Every modern economy is based on a sound financial system which helps in production, capital and economic growth by encouraging savings habits, mobilising savings from households and other segments and allocating savings into productive usage such as trade, commerce, manufacture etc.

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

Various factors influence the capital market and its growth. These include level of savings in the household sector, taxation levels, health of economy, corporate performance, industrial trends and common patterns of living.

The strength of the economy is calibrated by different economic indicators like growth in GDP (Gross Domestic Product), Agricultural production, quantum and spread of rain fall, interest rates, inflation, position on balance of payments and balance of trade, levels of foreign exchange reserves and investments and growth in capital formation.

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

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

- (a) regulation of currency
- (b) banking functions
- (c) performance of agency services and custody of cash reserves
- (d) management of national reserves of international currency
- (e) credit control
- (f) administering national, fiscal and monetary policy to ensure stability of the economy
- (g) supply and deployment of funds for productive use
- (h) maintaining liquidity.

Long term growth of financial system is ensured through:

- (a) education of investors
- (b) giving autonomy to FIs to become efficient under competition
- (c) consolidation through mergers
- (d) facilitating entry of new institutions to add depth to the market
- (e) minimising regulatory measures and market segmentation.

ORGANISATIONAL STRUCTURE OF FINANCIAL SYSTEM

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

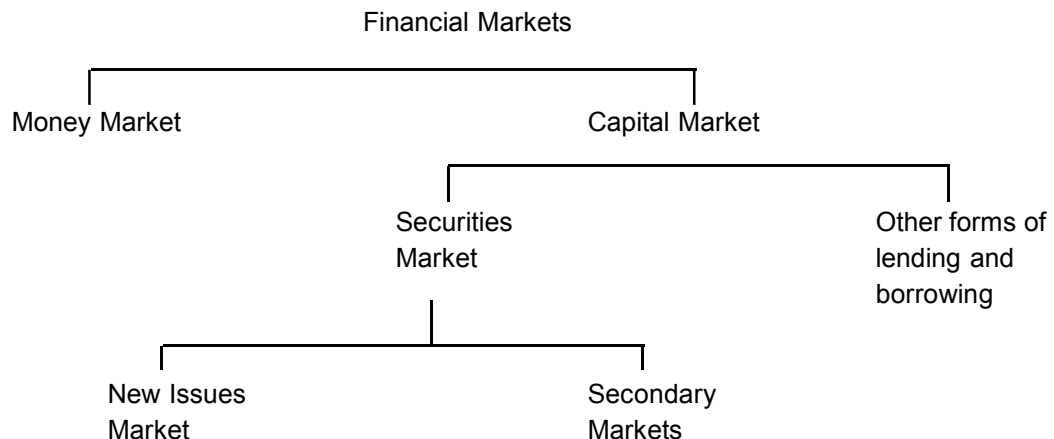
Constituents of Financial System

- Financial Markets
- Products
- Market participants

Financial Markets

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

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



Money Market

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

Capital Market

The Capital Market is a market for financial investments that are direct or indirect claims to capital. It is wider than the Securities Market and embraces all forms of lending and borrowing, whether or not evidenced by the creation of a negotiable financial instrument. The Capital Market comprises the complex of institutions and mechanisms through which intermediate term funds and long term funds are pooled and made available to business, government and individuals. The Capital Market also encompasses the process by which securities already outstanding are transferred.

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

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

NEED FOR CAPITAL MARKET

- Capital market plays an extremely important role in promoting and sustaining the growth of an economy.
- It is an important and efficient conduit to channel and mobilize funds to enterprises, both private and government.
- It provides an effective source of investment in the economy.
- It plays a critical role in mobilizing savings for investment in productive assets, with a view to enhancing a country's long-term growth prospects, and thus acts as a major catalyst in transforming the economy into a more efficient, innovative and competitive marketplace within the global arena.
- In addition to resource allocation, capital markets also provide a medium for risk management by allowing the diversification of risk in the economy.
- A well-functioning capital market tends to improve information quality as it plays a major role in encouraging the adoption of stronger corporate governance principles, thus supporting a trading environment, which is founded on integrity.
- Capital market has played a crucial role in supporting periods of technological progress and economic development throughout history.
- Among other things, liquid markets make it possible to obtain financing for capital-intensive projects with long gestation periods. This certainly held true during the industrial revolution in the 18th century and continues to apply even as we move towards the so-called "New Economy".
- Capital markets make it possible for companies to give shares to their employees via ESOPs.
- Capital markets provide a currency for acquisitions via share swaps.
- Capital markets provide an excellent route for disinvestments to take place.
- Venture Capital and Private Equity funds investing in unlisted companies get an exit option when the company gets listed on the capital markets
- The existence of deep and broad capital market is absolutely crucial in spurring the growth our country. An essential imperative for India has been to develop its capital market to provide alternative sources of funding for companies and in doing so, achieve more effective mobilisation of investors' savings. Capital market also provides a valuable source of external finance.

For a long time, the Indian market was considered too small to warrant much attention. However, this view has changed rapidly as vast amounts of both international and domestic investment have poured into our markets over the last decade. The Indian market is no longer viewed as a static universe but as a constantly evolving one providing attractive opportunities to the investing community.

FUNCTIONS OF THE CAPITAL MARKET

The major objectives of capital market are:

- To mobilize resources for investments.
- To facilitate buying and selling of securities.
- To facilitate the process of efficient price discovery.

- To facilitate settlement of transactions in accordance with the predetermined time schedules.

Securities Market

The Securities Market, refers to the markets for those financial instruments/claims/obligations that are commonly and readily transferable by sale. The Securities Market has two inter-dependent and inseparable segments, the new issues (primary) market and the stock (secondary) market.

Primary Market

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

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

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

Secondary Market

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

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

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

This secondary market has further two components, First, the spot market where securities are traded for immediate delivery and payment, The other is futures market where the securities are traded for future delivery and payment. Another variant is the options market where securities are traded for conditional future delivery. Generally, two types of options are traded in the options market. A put option permits the owner to sell a security to the writer of the option at a pre-determined price before a certain date, while a call option permits the buyer to purchase a security from the writer of the option at a particular price before a certain date.

Products and Market Participants

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

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funds. These demand for and supply of securities and funds determine, under competitive market conditions in goods and securities market, the prices of securities.

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

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

FUNCTIONS OF SECURITIES MARKET

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

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

Takeaways

Securities Market –

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

The liquidity, the market confers and the yield promised or anticipated on security ownership may be sufficiently

great to attract net savings of income which would otherwise have been consumed. Net savings may also occur because of other attractive features of security ownership, e.g. the possibility of capital gain or protection of savings against inflation.

A developed Securities Market enables all individuals, no matter how limited their means, to share the increased wealth provided by competitive private enterprises. The Securities Market allows individuals who can not carry an activity in its entirety within their resources to invest whatever is individually possible and preferred in that activity carried on by an enterprise. Conversely, individuals who can not begin an enterprise, they can attract enough investment from others to make a start. In both cases individuals who contribute to the investment made in the enterprise share the fruits. The Securities Market, by allowing an individual to diversify risk among many ventures to offset gains and losses, increases the likelihood of long-term, overall success.

SECURITIES MARKET AND ECONOMIC GROWTH

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

It is reasonable to expect savings and capital accumulation and formation to respond favourably to developments in securities market. The provision of even simple securities decouples individual acts of saving from those of investment over both time and space and thus allows savings to occur without the need for a concomitant act of investment. If economic units rely entirely on self-finance, investment is constrained in two ways: by the ability and willingness of any unit to save, and by its ability and willingness to invest. The unequal distribution of entrepreneurial talents and risk taking proclivities in any economy means that at one extreme there are some whose investment plans may be frustrated for want of enough savings, while at the other end, there are those who do not need to consume all their incomes but who are too inert to save or too cautious to invest the surplus productively. For the economy as a whole, productive investment may thus fall short of its potential level. In these circumstances, the securities market provides a bridge between ultimate savers and ultimate investors and creates the opportunity to put the savings of the cautious at the disposal of the enterprising, thus promising to raise the total level of investment and hence of growth. The indivisibility or lumpiness of many potentially profitable but large investments reinforces this argument. These are commonly beyond the financing capacity of any single economic unit but may be supported if the investor can gather and combine the savings of many. Moreover, the availability of yield bearing securities makes present consumption more expensive relative to future consumption and, therefore, people might be induced to consume less today. The composition of savings may also change with fewer saving being held in the form of idle money or unproductive durable assets, simply because more divisible and liquid assets are available.

International Linkage

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

Improved Investment Allocation

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

Standardised products and reduction in costs

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

Developmental benefits

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

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

PROFILE OF SECURITIES MARKET

Equity and Debt Issue

During February 2014, ₹ 4,860 crore were mobilised in the primary market (equity and debt issues) by way of ten issues and ₹ 777 crore were mobilised through nine equity issues. The cumulative amount mobilised for the financial year 2013-14, so far, stood at ₹ 44,903 crore through 72 issues as against ₹ 29,788 crore raised through 49 issues during the corresponding period of 2012-13.

Dematerialized Accounts

The total number of investor accounts was 130.7 lakh at NSDL and 87.3 lakh at CDSL at the end of February 2014. The number of investor accounts in February 2014 decreased by 0.3 percent and 0.2 percent over the previous month at NSDL and CDSL respectively. A comparison with February 2013 showed there was an increase in the number of investor accounts to the extent of 3.8 percent at NSDL and 5.4 percent at CDSL.

QIPs Listed at BSE and NSE

During February 2014, there were two QIP issues for ₹ 8,113 crore as compared to one QIP issue for ₹ 67 crore in January 2014. The cumulative amount mobilised through QIP route during 2013-14 stood at ₹ 13,663 crore through seventeen issues.

Preferential Allotments Listed at BSE and NSE

There were 21 preferential allotments (₹ 686 crore) listed at BSE and NSE during February 2014. The cumulative mobilised amount for the financial year 2013-14 so far, stood at ₹ 44,045 crore through 372 preferential allotments (of which 153 allotments amounting ₹ 39,804 crore were listed at both BSE and NSE).

Resource Mobilisation by Mutual Funds

During February 2014, mutual funds saw a net inflow of ₹ 3,403 crore (of which ₹ 2,231 crore inflow was into private sector mutual funds while public sector mutual funds saw inflow of ₹ 1,171 crore) as compared to a net inflow of ₹ 83,533 crore (of which ₹ 71,270 crore inflow was into private sector mutual funds while public sector mutual funds saw inflow of ₹ 12,263 crore) during January 2014. During the financial year 2013-14 so far, mutual funds net mobilised ₹ 1,63,033 crore as compared to ₹ 1,84,585 crore mobilized in corresponding period of 2012-13.

Investments by Mutual Fund

Mutual Funds made net investment of ₹ 60,669 crore in the secondary market in February 2014. Mutual funds sold ₹ 1,345 crore in equity in February 2014. Mutual Funds invested ₹ 62,015 crore in debt market in February 2014. As on February 28, 2014 there were a total of 1,538 schemes under mutual funds of which Income/Debt oriented schemes were 1,089 (70.8 percent), Growth/equity oriented schemes were 353 (23.0 percent), Exchange Traded Funds were 39 schemes (2.5 percent), Balanced schemes were 30 (2.0 percent) and Fund of Funds investing Overseas schemes were 27 (1.8 percent). The number of schemes at the end of 2012-13 was 1,294 of which Income/Debt oriented schemes were 857 (66.2 percent), Growth/equity oriented scheme were 347 (26.8 percent), Exchange Traded Funds were 37 schemes (2.9 percent), Balanced schemes were 32 (2.5 percent) and Fund of Funds investing Overseas schemes were 21 (1.6 percent)

Corporate Bond Market

During February 2014, there were 733 trades with a value of ₹ 6,171 crore reported on BSE. At NSE, 1,187 trades were reported in February 2014 with a trading value of ₹ 11,811 crore. Further, 2,349 trades with a value of ₹ 27,773 crore were reported to FIMMDA in February 2014 as against 3,498 trades with a value of ₹ 52,496 crore in January 2014.

Investment by Foreign Institutional Investors

There was a net inflow of ₹ 12,741 crore in February 2014 by Foreign Institutional Investors (FIIs) compared to inflow of ₹ 13,323 crore in January 2014. FIIs bought ₹ 1,404 crore in equity in February 2014 as compared to ₹ 714 crore bought in January 2014 while they bought ₹ 11,337 crore in debt market in February 2014 as compared to ₹ 12,609 crore bought in January 2014. The asset under custody of FIIs at the end of February 2014 stands at ₹ 14,73,802 crore, out of which the value of participatory notes including PNs on derivatives is ₹ 1,72,738 crore, constituting 11.7 percent of the total asset under custody of FIIs.

MARKET REGULATION

It is important to ensure smooth working of capital market, as it is the arena for the players associated with the economic growth of the country. Various laws have been passed from time to time to meet this objective. The financial market in India was highly segmented until the initiation of reforms in 1992-93 on account of a variety of regulations and administered prices including barriers to entry. The reform process was initiated with the establishment of Securities and Exchange Board of India.

The main legislations governing the Capital Market are:–

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

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2. The Securities Contracts (Regulation) Act, 1956, SC(R)A which regulates transactions in securities through control over stock exchanges.
3. The Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities.
4. The Companies Act, 2013, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities and disclosures to be made in public issues.

SEBI ACT, 1992

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

SECURITIES CONTRACTS (REGULATION) ACT, 1956

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

DEPOSITORIES ACT, 1996

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

COMPANIES ACT, 2013

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

SECURITIES MARKET REFORMS & REGULATORY MEASURES TO PROMOTE INVESTOR CONFIDENCE

SEBI has come a long way since its inception as an institution regulating the Indian Capital Markets. It has

initiated a lot of reforms to make the market more safer for investors. The following are the major policy initiatives taken by SEBI since its inception.

- **Control over Issue of Capital:** A major initiative of liberalisation was the repeal of the Capital Issues (Control) Act, 1947 in May 1992. In the interest of investors, SEBI issued Disclosure and Investor Protection (DIP) guidelines. The guidelines allow issuers, complying with the eligibility criteria, to issue securities at market determined rates. The market moved from merit based to disclosure based regulation.
- **Establishment of Regulator:** A major initiative of regulation was, establishment of a statutory autonomous agency, called SEBI, to provide reassurance that it is safe to undertake transactions in securities.
- **Screen Based Trading:** A major developmental initiative was a nation-wide on-line fully-automated screen based trading system (SBTS) where a member can punch into the computer quantities of securities and the prices at which he likes to transact and the transaction is executed as soon as it finds a matching sale or buy order from a counter party.
- **Risk management:** A number of measures were taken to manage the risks in the market so that the participants are safe and market integrity is protected. The trading cycle varied from 14 days for specified securities to 30 days for others and settlement took another fortnight. Rolling settlement on T+5 basis was introduced in phases. All scrips moved to rolling settlement from December 2001. T+5 gave way to T+3 from April 2002 and T+2 from April 2003.
- **Depositories Act:** The earlier settlement system gave rise to settlement risk. This was due to the time taken for settlement and due to the physical movement of paper. Further, the transfer of shares in favour of the purchaser by the company also consumed considerable amount of time. To obviate these problems, the Depositories Act, 1996 was passed to provide for the establishment of depositories in securities.
- **Derivatives:** To assist market participants to manage risks better through hedging, speculation and arbitrage, SC(R)A was amended in 1995 to lift the ban on options in securities.
- **Settlement Guarantee:** A variety of measures were taken to address the risk in the market. Clearing corporations emerged to assume counter party risk. Trade and settlement guarantee funds were set up to guarantee settlement of trades irrespective of default by brokers. These funds provide full novation and work as central counter party. The Exchanges /clearing corporations monitor the positions of the brokers on real time basis. The securities market moved from T+3 settlement period to T+2 rolling settlement with effect from April 1, 2003. Further, straight through processing has been made mandatory for all institutional trades executed on the stock exchange.
- **Securities Market Awareness:** In January 2003, SEBI launched a nation-wide Securities Market Awareness Campaign that aims at educating investors about the risks associated with the market as well as the rights and obligations of investors.
- **Green Shoe Option-** As a stabilization tool for post listing price of newly issued shares, SEBI has introduced the green shoe option facility in IPOs.
- **Securities Lending and Borrowing-** A clearing corporation/clearing house, after registration with SEBI, under the SEBI scheme for Securities Lending and Borrowing, as an approved intermediary, may borrow securities for meeting shortfalls in settlement, on behalf of the members.
- **Corporate Governance -** To improve the standards of corporate governance, SEBI amended Clause 49 of the Listing Agreement. The major changes in the new Clause 49 include amendments/additions to provisions relating to definition of independent directors, strengthening the responsibilities of audit

committees, improving quality of financial disclosures, including those pertaining to related party transactions and proceeds from public/rights/preferential issues, requiring Boards to adopt formal code of conduct, requiring CEO/CFO certification of financial statements and improving disclosures to shareholders. Certain non-mandatory clauses like whistle blower policy and restriction of the term of independent directors have also been included.

- **Debt Listing Agreement-** In order to further develop the corporate debt market, SEBI prescribed a model debenture listing agreement for all debenture securities issued by an issuer irrespective of the mode of issuance.
- **Gold Exchange Traded Funds in India-** Pursuant to the announcement made by the Honourable Finance Minister in his Budget Speech for 2005-06, SEBI appointed a Committee for the introduction of Gold Exchange Traded Fund (GETF) in India. Based on the recommendations of the said Committee, the SEBI (Mutual Funds) Regulations, 1996 were amended and notification was issued on January 12, 2006 permitting mutual funds to introduce GETFs in India subject to certain investment restrictions.
- **Guidelines for Issue of Indian Depository Receipts (IDRs)-** SEBI issued Guidelines on disclosures and related requirements for companies desirous of issuing IDRs in India. SEBI also prescribed the listing agreement for entities issuing IDRs.
- **Grading of Initial Public Offerings (IPOs)-** Grading of all IPOs was made mandatory. The grading would be done by credit rating agencies, registered with SEBI. It would be mandatory to obtain grading from at least one credit rating agency. The grading would be disclosed in the prospectus, abridged prospectus and in every advertisement for IPOs.
- **Introduction of Fast Track Issuances-** To enable compliant listed companies to access Indian primary market in a time effective manner through follow-on public offerings and rights issues, SEBI introduced fast track issue mechanism. To make the issuance process fast, the earlier requirement of filing draft offer documents was amended and the need to file draft offer documents with SEBI and the stock exchanges was done away with.
- **Mandatory Requirement of Permanent Account Number (PAN) for All Transactions in the Securities Market-** SEBI stipulated that PAN would be the sole identification number for all participants in the securities market, irrespective of the amount of transaction with effect from July 02, 2007. The objective was to strengthen the 'Know Your Client' (KYC) norms through a single identification number for all participants in the securities market for facilitating sound audit trail.
- **Corporate Debt Market-** In order to develop a sound corporate debt market in India, SEBI took a number of policy initiatives with respect to the following areas: (i) setting up of reporting platforms for corporate bonds, (ii) setting up of trading platform for corporate bonds, (iii) issues pertaining to trading in corporate bonds, (iv) making amendments to the listing agreement for debentures, (v) issuing securitised debt instruments regulations, (vi) evolving policy guidelines on debenture trustees, (vii) introducing Repos in corporate bonds, (viii) facilitating setting up of quote dissemination platforms, (ix) simplifying corporate bond issuance norms and (x) framing of draft issue and listing regulations for corporate bonds.
- **Setting up of SME Exchange-** SEBI decided to put in place a framework for setting up of new exchange or separate platform of existing stock exchange having nationwide terminals for SME. In order to operationalise the said framework, necessary changes have been made to applicable regulations, circulars etc. As per the framework, market making has been made mandatory in respect of all scrips listed and traded on SME exchange.

- SEBI made ASBA bid-cum application forms available for download and printing, from websites of the Stock Exchanges which provide electronic interface for ASBA facility i.e. Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). The ASBA forms so downloaded should have a unique application number and can be used for making ASBA applications in public issues.
- In order to develop the primary market for securitized debt instruments in India, SEBI notified the Securities and Exchange Board of India (Public offer and Listing of Securitised Debt Instruments) Regulations, 2008. The regulations provide for a framework for issuance and listing of securitized debt instruments by a Special Purpose Distinct Entity (SPDE).
- SEBI has commenced processing of investor grievances against the intermediaries in a centralized web-based complaints redressal system, 'SCORES' at <http://scores.gov.in/Admin>.
- Facility of e-voting by shareholders enabled on July 13, 2012.
- **Business Responsibility Reports-** SEBI inserted Clause 55 in the Equity Listing Agreement, mandating inclusion of Business Responsibility Reports ("BR reports") as part of the Annual Reports for listed entities in line with the 'National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business' issued by the Ministry of Corporate Affairs.
- SEBI notified the SEBI (Foreign Portfolio Investors) Regulations 2014 (FPI Regulations) on January 07, 2014 to simplify compliance requirements and have uniform guidelines for various categories of Foreign Portfolio Investors (FPIs) like Foreign Institutional Investors (FIIs) including their sub-accounts, if any and Qualified Foreign Investors (QFIs).
- With the objectives to align with the provisions of the Companies Act, 2013, to adopt best practices on corporate governance and to make the corporate governance framework more effective, SEBI revised clause 49 of the listing agreement with effect from October 01, 2014.

The details regarding various initiatives of SEBI are covered separately at respective places in the Study Material.

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

BACKGROUND

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

In 1984, securities regulators from France, Indonesia, Korea and the United Kingdom were the first agencies to join the organization from outside the Americas. The IOSCO Annual Conference in July 1986, held in Paris, was the first to take place outside of the western hemisphere. It was decided at this meeting to create a permanent General Secretariat for IOSCO.

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

IOSCO provides comprehensive technical assistance to its members, in particular those which regulate emerging securities markets.

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In 1998, IOSCO adopted a comprehensive set of Objectives and Principles of Securities Regulation (IOSCO Principles), which is recognized as the international regulatory benchmarks for all securities markets. In 2003, the organization endorsed a comprehensive methodology (IOSCO Principles Assessment Methodology) that enables an objective assessment of the level of implementation of the IOSCO Principles in the jurisdictions of its members and the development of practical action plans to correct identified deficiencies.

In 2002, IOSCO adopted a multilateral memorandum of understanding (IOSCO MMoU) designed to facilitate cross-border enforcement and exchange of information among international securities regulators.

Then in 2005, IOSCO endorsed the IOSCO MMoU as the benchmark for international cooperation among securities regulators and set-out clear strategic objectives to expand the network of IOSCO MMoU signatories by 2010. It approved as an operational priority the effective implementation - in particular within its membership - of the IOSCO Principles and of the IOSCO MMoU, which are considered primary instruments in facilitating cross-border cooperation, reducing global systemic risk, protecting investors and ensuring fair and efficient securities markets. **The Securities and Exchange Board of India is also a signatory to IOSCO MMoU.**

IOSCO OBJECTIVE OF SECURITIES REGULATION

There are three objectives of securities regulation –

- (i) protecting investors;
- (ii) ensuring that markets are fair, efficient and transparent;
- (iii) reducing systemic risk

MEMBERSHIP

CATEGORIES

There are three categories of membership within IOSCO which are designed to the different approaches to securities markets regulation while also ensuring that those with an interest in the regulation of securities markets are also involved in the debate on securities market issues.

The three categories are:

- Ordinary;
- Associate; and
- Affiliate.

ORDINARY

This category is open to a securities commission, or a similar government or statutory regulatory body that has primary responsibility for securities regulation in its jurisdiction.

If there is no governmental, or statutory, regulatory body in a jurisdiction then a self-regulatory body, such as a stock exchange, in that jurisdiction is eligible for ordinary membership of IOSCO. However, the ordinary membership of a self-regulatory body admitted to IOSCO will lapse if a governmental regulatory body from the same jurisdiction becomes the ordinary member for that jurisdiction.

Ordinary members each have one vote in the Presidents Committee, which meets yearly at the Annual Conference.

ASSOCIATE

The following bodies can apply to become associate members of the organization:

1. a public regulatory body with jurisdiction in the subdivisions of a jurisdiction if the national regulatory body is already an ordinary member; and
2. any other eligible body with an appropriate responsibility for securities regulation.

A self regulatory body is not eligible for associate membership.

Associate members do not have the right to vote and are also precluded from membership of the IOSCO Board; however they are members of the Presidents Committee.

AFFILIATE

A self-regulatory body (SRO), or an international body, with an appropriate interest in securities regulation is eligible for this category of membership.

Affiliate members do not have a vote, are not eligible for the IOSCO Board and are not members of the Presidents Committee. SROs affiliate members form the SRO Consultative Committee.

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

The MMoU sets an international benchmark for cross-border co-operation critical to combating violations of securities and derivatives laws.

What is it?

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

The MMoU itself sets out the specific requirements for what information can be exchanged and how it is to be exchanged: legal ability to compel information; types of information that can be compelled; legal ability to share information; and permissible uses of information.

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

OVER VIEW OF DEPOSITORY SYSTEM IN INDIA

A depository is an organisation which holds securities (like shares, debentures, bonds, government securities, mutual fund units etc.) of investors in electronic form at the request of the investors through a registered Depository Participant. India has adopted the Depository System for securities trading in which book entry is done electronically and no paper is involved. The physical form of securities is extinguished and shares or securities are held in an electronic form.

KEY FEATURES OF THE DEPOSITORY SYSTEM IN INDIA

1. Multi-Depository System: The depository model adopted in India provides for a competitive multi-depository system. There can be various entities providing depository services. A depository should be a company formed under the Company Act, 2013 and should have been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992. Presently, there are two depositories registered with SEBI, namely:

- National Securities Depository Limited (NSDL), and
- Central Depository Service Limited (CDSL)

2. Depository services through depository participants: The depositories can provide their services to investors through their agents called depository participants. These agents are appointed subject to the conditions

prescribed under Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 and other applicable conditions.

3. Dematerialisation: The model adopted in India provides for dematerialisation of securities. This is a significant step in the direction of achieving a completely paper-free securities market. Dematerialization is a process by which physical certificates of an investor are converted into electronic form and credited to the account of the depository participant.

4. Fungibility: The securities held in dematerialized form do not bear any notable feature like distinctive number, folio number or certificate number. Once shares get dematerialized, they lose their identity in terms of share certificate, distinctive numbers and folio numbers. Thus all securities in the same class are identical and interchangeable. For example, all equity shares in the class of fully paid up shares are interchangeable.

5. Registered Owner/ Beneficial Owner: In the depository system, the ownership of securities dematerialized is bifurcated between Registered Owner and Beneficial Owner. According to the Depositories Act, 1996 'Registered Owner' means a depository whose name is entered as such in the register of the issuer. A 'Beneficial Owner' means a person whose name is recorded as such with the depository. Though the securities are registered in the name of the depository actually holding them, the rights, benefits and liabilities in respect of the securities held by the depository remain with the beneficial owner. For the securities dematerialized, NSDL/CDSL is the Registered Owner in the books of the issuer; but ownership rights and liabilities rest with Beneficial Owner. All the rights, duties and liabilities underlying the security are on the beneficial owner of the security.

6. Free Transferability of shares: Transfer of shares held in dematerialized form takes place freely through electronic book-entry system.

LESSON ROUND UP

- The Securities Market refers to the markets for those financial instruments/ claims/obligations that are commonly and readily transferable by sale.
- The Securities Market has two inter-dependent and inseparable segments, the new issues (primary) market and the stock (secondary) market.
- The primary market provides the channel for sale of new securities, while the secondary market deals in securities previously issued.
- The four main legislations governing the securities market are: the SEBI Act, 1992; the Companies Act, 2013; the Securities Contracts (Regulation) Act, 1956 and the Depositories Act, 1996.
- Today IOSCO is recognized as the international standard setter for securities markets. Its membership regulates more than 95% of the world's securities markets and it is the primary international cooperative forum for securities market regulatory agencies.
- India has adopted the Depository System for securities trading in which book entry is done electronically and no paper is involved.

GLOSSARY

Boom

A condition of the market denoting increased activity with rising prices and higher volume of business resulting from greater demand of securities. It is a state where enlarged business, both investment and speculative, has been taking place for a sufficiently reasonable period of time.

Corporate Governance

The way in which companies run themselves, in particular the way in which they are accountable to those who have a vested interest in their performance, especially their shareholders.

Lesson 2

Capital Market Instruments

LESSON OUTLINE

- Introduction
- Classification of Instruments
- Equity Shares
- Shares with Differential Voting Rights
- Preference Shares
- Fully Convertible Cumulative Preference Share (Equipref)
- Debentures
- Sweat Equity Shares
- Secured Premium Notes
- Equity Shares with detachable warrants
- Dual Option Warrants
- Debt Instruments with Debt Warrants
- Debt for Equity Swap
- Different types of Bonds & Notes
- Global Depository Receipts
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- Hedge Funds
- Exchange Traded Funds
- Fund of Funds
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

Financial instruments innovation has been a continuous and integral part of growth of the capital markets. A variety of factors such as fluctuation in interest rate, volatility in price, change in tax structures and regulatory changes etc. plays an important part in financial innovation.

In finance, innovation involves adapting and improvising on existing products and concepts. Advances emerge initially as either products (such as derivatives, high-yield corporate bonds, and mortgage-backed securities) or processes (such as pricing mechanisms, trading platforms, and means and methods for distributing securities). By moving funds or enabling investors to pool funds, these tools increase liquidity to facilitate the sale and purchase of goods or the management of risks in markets and enterprises.

In general, it refers to the creating and marketing of new types of securities by the issuers for raising funds from the investor. A financial instrument is a combination of characteristics such as promised yield, liquidity, maturity period, security and risk.

Keeping this in view this lesson is designed to enable the students to understand the various instruments available in the capital market, their features and classification etc.

INTRODUCTION

Financial Instruments that are used for raising capital resources in the capital market are known as capital market instruments. The capital market instruments are usually used by the Government, Corporations and Companies. The instruments used by the corporate sector to raise funds are selected on the basis of – (i) investor preference for a given instrument, (ii) the regulatory framework, which regulate the issue of security.

Factors effecting the preferences for choosing any instruments :

For issuers	For investor
Cost	Return
Post Tax Cost of Capital	Tax on return received
Servicing	Yield
Debt-equity ratio and debt service capabilities	Risk reward ratio
Ceding the control in case of equity	Gaining the control in case of equity
Company Law, SEBI Regulations etc	Marketable and liquidity

The corporate sector and financial/investment institutions have been issuing new instruments to attract investors. However, the range of instruments used is still very narrow. In current market scenario Companies are issuing Non-Convertible redeemable debenture to raise funds from the markets. The attraction for the instrument for both the corporate sector and the investor lies in – (a) the investor gets a high return (b) the issue involves lower post-tax cost of capital, and redemption with in 3 to 5 years time. These instruments are listed on stock exchanges, which give them liquidity. Mannapuram Finance Limited, Muthoot Finance Limited, India Infoline Finance Limited etc are the example of such Companies who have raised the funds through this route

CLASSIFICATION OF INSTRUMENTS

Hybrid Instruments

Hybrid instruments are those which are created by combining the features of equity with bond, preference and equity etc. Examples of Hybrid instruments are: Convertible preference shares, Cumulative convertible preference shares, convertible debentures, non convertible debentures with equity warrants, partly convertible debentures, partly convertible debentures with Khokha (buy-back arrangement), Optionally convertible debenture, warrants convertible into debentures or shares, secured premium notes with warrants etc.

Pure Instruments

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

Derivatives Instruments

Derivatives are contracts which derive their values from the value of one or more of other assets (known as underlying assets). The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the underlying asset. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes. Some of the most commonly traded derivatives are futures, forward, options and swaps.

EQUITY SHARES

Equity shares, commonly referred to as ordinary share also represents the form of fractional ownership in which

a shareholder, as a fractional owner, undertakes the maximum entrepreneurial risk associated with a business venture. The holder of such shares is the member of the company and has voting rights.

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

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

Important characteristics of equity shares are given below :

Equity shares, have voting rights at all general meetings of the company. These votes have the affect of the controlling the management of the company.

Equity shares have the right to share the profits of the company in the form of dividend (cash) and bonus shares.

However even equity shareholders cannot demand declaration of dividend by the company which is left to the discretion of the Board of Directors.

When the company is wound up, payment towards the equity share capital will be made to the respective shareholders only after payment of the claims of all the creditors and the preference share capital.

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

- (a) The right to vote on every resolution placed before the company – (Section 47)
- (b) The rights to subscribe to shares at the time of further issue of capital by the company (Preemptive Right) – (Section 62)
- (c) Right to appoint proxy to attend and vote at the meeting on his behalf – (Section 105)
- (d) Right to receive copy of annual accounts of the Company – (Section 136)
- (e) Right to receive notice of the meeting of members – (Section 101)
- (f) Right to inspection of various statutory registers maintained by the company.
- (g) Right to requisition extraordinary general meeting of the company – (Section 100)

SHARES WITH DIFFERENTIAL VOTING RIGHTS

Section 43(a)(ii) of the Companies Act, 2013, authorized equity share capital with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed by the Government.

Rule 4 of Companies (Share Capital and Debentures) Rules, 2014 prescribes the following conditions for issue of DVRs :

- (a) the articles of association of the company authorizes the issue of shares with differential rights;
- (b) the issue of shares is authorized by a special resolution passed at a general meeting of the shareholders. Where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot or a poll at a general meeting;
- (c) the shares with differential rights shall not exceed twenty-six percent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;

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- (d) the company having consistent track record of distributable profit for the last three years;
- (e) the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;
- (f) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;
- (g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or state level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;
- (h) the company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, Securities and Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act under which such companies being regulated by sectoral regulators.
- (i) The explanatory statement to be annexed to the notice of the general meeting should contain the disclosures as mentioned in the rules
- (j) The Board of Directors shall disclose in the Board's Report for the financial year in which the issue of equity shares with differential rights was completed, the as mentioned in the rules

The holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.
- (k) The company shall not convert its existing share capital with voting rights into equity share capital carrying differential voting rights and *vice-versa*.

PREFERENCE SHARES

According to explanation (ii) to Section 43 of Companies Act, 2013 "preference share capital", with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to –

- (a) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
 - (b) repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;
- (iii) capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:–
- (a) that in respect of dividends, in addition to the preferential rights to the amounts specified in sub-clause (a) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;
 - (b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in sub-clause (b) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

In simple terms, the preference shares are those shares which have rights of preference over equity shares in the case of distribution of dividend and distribution of surplus in the case of winding up. They generally carry a fixed rate of dividend and redeemable after specific period of time. According to Section 55 of the Companies Act, 2013, a Company cannot issue preference shares which are irredeemable.

The following kinds of preference shares are issued by the companies:

- Cumulative preference shares
- Non-cumulative preference shares
- Convertible preference shares
- Redeemable preference shares
- Participating preference share
- Non participating preference shares

CUMULATIVE PREFERENCE SHARES

In the case of this type of preference share the dividend payable every year becomes a first claim while declaring dividend by the company. In case the company does not have adequate profit or for some reason the company does not want to pay preference dividend, it gets accumulated for being paid subsequently. Such arrears of preference dividend will be carried forward and paid out of the profits of the subsequent years, before payment of equity dividend. However, if a company goes into the liquidation no arrears of preference dividend will be payable unless the Articles of Association of the issuing company contains a specific provision to make such payment even in winding up.

NON-CUMULATIVE PREFERENCE SHARES

In the case of these 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 some times referred to as quasi equity shares in common parlance. Companies may even charge a premium as part of the terms of conversion of preference shares, as they do sometimes while converting debentures into equity shares.

REDEEMABLE PREFERENCE SHARES

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 issue 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 subject to condition mentioned in rule 9 and 10 of the Companies (Share Capital and Debenture) Rules, 2014.

PARTICIPATING PREFERENCE SHARES

Preference shareholders are not entitled to dividend more than what has been indicated as part of the terms of issue, even in a year in which the company has made huge profits. Subject to provision in the terms of issue these shares can be entitled to participate in the surplus profits left, after payment of dividend to the preference and the equity shareholders to the extent provided therein. Subject to provisions in the terms of issue such preference shares can be entitled even to bonus shares.

NON PARTICIPATING PREFERENCE SHARES

Unless the terms of issue indicate specifically otherwise, all preference shares are to be regarded as non-participating preference shares.

FULLY CONVERTIBLE CUMULATIVE PREFERENCE SHARE (EQUIPREF)

This instrument is in two parts A & B. Part A is convertible into equity shares automatically and compulsorily on the date of allotment without any application by the allottee, and Part B is redeemed at par/ converted into equity after a lock in period at the option of the investor, at a price 30% lower than the average market price. The dividend is given only for part B shares.

DEBENTURES

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

Debenture is a document evidencing a debt or acknowledging it and any document which fulfills either of these conditions is a debenture.

The important features of a debenture are:

1. It is issued by a company as a certificate of indebtedness.
2. It usually indicates the date of redemption and also provides for the repayment of principal and payment of interest at specified date or dates.
3. It usually creates a charge on the undertaking or the assets of the company. In such a case the lenders of money to the company enjoy better protection as secured creditors, i.e. if the company does not pay interest or repay principal amount, the lenders may either directly or through the debenture trustees bring action against the company to realise their dues by sale of the assets/undertaking earmarked as security for the debt.
4. Debentures holders does not have any voting rights.
5. Compulsory payment of interest. The interest on debenture is payable irrespective of whether there are profits made or not.

TYPES OF DEBENTURES

(a) Naked or unsecured debentures

Debentures of this kind do not carry any charge on the assets of the company. The holders of such debentures do not therefore have the right to attach particular property by way of security as to repayment of principal or interest.

(b) Secured debentures

Debentures that are secured by a mortgage of the whole or part of the assets of the company are called

mortgage debentures or secured debentures. Debenture trustees are appointed in whose favour securities are created and which hold the assets on behalf of the debenture holders. In case of default debenture trustee has the rights to sell the securities and pay the amount to holders.

(c) Redeemable debentures

Debentures that are redeemable on expiry of certain period are called redeemable debentures

(d) Perpetual debentures

If the debentures are issued subject to redemption on the happening of specified events which may not happen for an indefinite period, e.g. winding up, they are called perpetual debentures.

(e) Bearer debentures

Such debentures are payable to bearer and are transferable by mere delivery. The name of the debenture holder is not registered in the books of the company, but the holder is entitled to claim interest and principal as and when due. A bonafide transferee for value is not affected by the defect in the title of the transferor.

(f) Registered debentures

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

CATEGORIES OF DEBENTURES

Based on convertibility, debentures can be classified under three categories:

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

FULLY CONVERTIBLE DEBENTURES

These are converted into equity shares of the company with or without premium as per the terms of the issue, on the expiry of specified period or periods. If the conversion is to take place at or after eighteen months from the date of allotment but before 36 months, the conversion is optional on the part of the debenture holders in terms of SEBI ICDR Regulations. Interest will be payable on these debentures upto the date of conversion as per transfer issue.

NON CONVERTIBLE DEBENTURES (NCDs)

These debentures do not carry the option of conversion into equity shares and are therefore redeemed on the expiry of the specified period or periods.

PARTLY CONVERTIBLE DEBENTURES (PCDs)

These may consist of two kinds namely -convertible and non-convertible. The convertible portion is to be converted into equity shares at the expiry of specified period. However, the non convertible portion is redeemed at the expiry of the stipulated period. If the conversion takes place at or after 18 months, the conversion is optional at the discretion of the debenture holder.

BASIC FEATURES OF CONVERTIBLE DEBENTURES

- 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 are listed on the stock exchanges to assure liquidity to the holders. However, even today debt instruments are not actively traded in Indian stock exchanges.

ADVANTAGES OF CONVERTIBLE DEBENTURES

The advantages of convertible debentures to the company are –

1. Capitalisation of interest cost till the date of commissioning of the project is allowed in accordance with accounting principle. If the conversion of the debentures is duly linked with the commissioning of the project the entire interest cost can be capitalised, without charging the interest to profit & loss account and pulling down the profits of the company.
2. Convertible debentures carry lower interest as compared to the rate charged by the Banks and Financial Institutions.
3. From the point of view of the debt equity ratio the convertible part of the debentures is treated as equity by financial institutions. The company is thus enabled to have a high degree of flexibility in financing its future projects.
4. Equity capital gets increased after each conversion, facilitating easier servicing of equity by payment of dividend.
5. Tax benefits are higher as interest on debentures is allowed as a deduction in computation of taxable income of the company. Additionally a company having a proven track record and future earning potential will be able to charge reasonable premium at the time of conversion.
6. In the case of term loans from FIs and Banks they usually impose many conditions on management including placing their representative on the board. In the case of convertible debentures there is thus a greater degree of autonomy for the companies.

The advantages of the convertible debentures to the investors are –

1. The investor is assured of a fixed return by way of interest on the debentures till conversion. On conversion into equity the investor becomes entitled to receive dividend declared on equity shares. The advantage to the investor is that he receives a fixed return on his investment by way of interest even during the gestation period and project implementation period.

2. As price of equity shares tends to rise on completion of the project of the company, the investor gets value appreciation on his investment, if converted into equity.
3. In most cases, debentures carry security with a charge on all or a part of movable/immovable properties of the company. This assures prompt payment of principal and interest by invoking the assistance of a debenture trustee. However in terms of SEBI Regulations where the debentures have a maturity period of 18 months or less it is mandatory for the company to create security on the debentures.
4. A fair amount of liquidity is enjoyed by convertible debentures listed on the stock exchanges depending on the track record of the companies. Even if debentures are not traded as actively as equity shares, convertible debentures of good companies command reasonable liquidity. Where a debenture has several parts, each part of the convertible debentures can be traded separately or in full on the stock exchanges.
5. The following options are available to the investor who has bought convertible debentures issued in several parts:
 - (a) To sell all the parts immediately on allotment;
 - (b) To sell one or more parts and retain other or others till conversion and to obtain equity shares for retention or sale.

DISTINCTION BETWEEN FULLY CONVERTIBLE AND PARTLY CONVERTIBLE DEBENTURES

<i>Characteristics</i>	<i>Partly convertible debentures</i>	<i>Fully convertible debentures</i>
Suitability	Better suited for companies with established track record	Better suited for companies without established track record
Capital base	Relatively lower equity capital on conversion of debentures	Higher equity capital on conversion of debentures
Flexibility in financing	Favourable debt equity ratio	Highly favourable debt equity ratio
Classification for debt-equity ratio computation	Convertible portion classified as 'equity' and non-convertible portion as 'debt'	Classified as equity for debt-equity computation
Popularity	Not so popular with investors	Highly popular with investors
Servicing of equity	Relatively lesser burden of equity servicing	Higher burden of servicing of equity

In the case of partly convertible debentures, debenture redemption reserve has to be created for 50% of the face value of the non-convertible portion. The facility of buy-back is also permissible in respect of non-convertible portion of debentures.

In contrast no reserve for debenture redemption is required for fully convertible debentures nor are buy-back arrangements permissible.

Sometimes companies issue zero interest fully convertible debentures. In this case, investors are not paid any interest till the date of conversion or upto the notified date, after which they are converted into shares. For the investor the investment amount is lower and cost of conversion also is less. Further this helps them as a means of tax planning since interest which is otherwise taxable is not paid. The capital appreciation at the time of conversion is treated as capital gains where tax rate is less. Companies also prefer this instrument because they are able to avoid payment of interest.

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.

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

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. It combines the feature of both debt and equity. During the lock in period no interest is paid. The holder has an option to sell back the SPN to the company at par value after the lock in period. If the holder exercises this option, no interest/premium is paid on redemption. In case the holder keeps it further, he is repaid the principal amount along with the additional interest/premium on redemption in installments as per the terms of issue. The conversion of detachable warrants into equity has to be done within the specified time. TISCO took the lead in July, 1992 by making a mega rights issue of equity shares and secured premium notes aggregating to ₹ 1,212 crores.

The terms of the SPN were so formulated that the return on investment was treated as capital gain and not regular income. Consequently, the rate of tax applicable was lower.

EQUITY SHARES WITH DETACHABLE WARRANTS

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

DUAL OPTION WARRANTS

Dual option warrants are designed to provide the buyer with good potential of capital appreciation and limited downside risk. Dual option warrants may be used to sell equity shares in different markets. For example, equity shares or debentures may be issued with two warrants - one warrant giving right to the purchaser to be allotted one equity share at the end of a certain period and another warrant with a debt or preference share option.

DEBT INSTRUMENTS WITH DEBT WARRANTS

Debt instruments may be issued with debt warrants which give the holder the option to invest in additional debt on the same terms within the period specified in the warrant. This instrument is beneficial to the investors in periods of falling interest rates when the holder can exercise the debt warrant option and hold additional debt at interest rates above market rates.

DEBT FOR EQUITY SWAP

These instruments give an offer to the debt holders to exchange the debt for equity shares of the company.

The issuers offering debt for equity swaps are interested in increasing equity capital by improving their debt-equity ratios and enhancing their debt issuing capacity. They reduce their interest burden and replace it with dividend burden which is payable at the discretion of the issuer. However, the issuer faces the risk of dilution of earnings per share by a sharp rise in the equity. In addition, dividends are not tax deductible.

From the investors' point of view, there is potential gain from rise in the value of the equity shares. The potential rise in price of equity shares may or may not materialize.

Variations of this instrument are mortgage backed securities that split the monthly payment from underlying mortgages into two parts -each receiving a specified portion of the principal payments and a different specified portion of the interest payments.

INDEXED RATE NOTES

In indexed rate notes, the interest rate fixation is postponed till the actual date of placement, rather than fixing it on the date of the commitment. The interest rate is computed on the date of take down at the then prevailing private placement rates, using a formula based on the index such as the 182 days treasury bill yield rates. These instruments are beneficial to a company in a high interest rate environment, if the interest rates are expected to decline between the date of commitment and the date of takedown.

EXTENDABLE NOTES

Extendable notes are issued for 10 years with flexibility to the issuer to review the interest rate every two years. The interest rate is adjusted every two years to reflect the then prevailing market conditions by trying the interest rate to a spread over a bond index such as two years treasury notes. Depending on the specific terms of the extendable bond, the bond holder and/or bond issuer may have one or more opportunities to defer the repayment of the bond's principal, during which time interest payments continue to be paid. Additionally, the bond holder or issuer may have the option to exchange the bond for one with a longer maturity, at an equal or higher rate of

interest. Because these bonds contain an option to extend the maturity period, a feature that adds value to the bond, extendable bonds sell at a higher price than non-extendable bonds

LEVEL PAY FLOATING RATE

Level pay floating rate notes are issued for a long period of time say 20 years, with adjustment in interest rate every five years. These notes provide for level payments for time intervals during the term of the note, with periodic interest adjustments tied to an index, and adjustments to the principal balance to reflect the difference between the portion of the payment allocable to interest and the amount of floating rate interest actually incurred. Maximum limits on upward adjustments to principal are specified at the outset to protect the lender from runaway floating exposure. The level pay note has the advantage to the issuer of having a predictable level of debt service for a period of years, thereby avoiding the uncertainties of floating debt on cash flows during that time.

ZERO COUPON CONVERTIBLE NOTES

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

The investor gains in the event of appreciation in the value of the equity shares. Even if the appreciation does not materialize, the investor has the benefit of a steady stream of implied income. If the instrument is issued with put option, the investor can resell the securities to the investor.

DEEP DISCOUNT BOND

IDBI and SIDBI had issued this instrument. For a deep discount price of ₹ 2,700/- in IDBI the investor got a bond with the face value of ₹ 1,00,000. The bond appreciates to its face value over the maturity period of 25 years. Alternatively, the investor can withdraw from the investment periodically after 5 years. The capital appreciation is charged to tax at capital gains rate which is lower than normal income tax rate. The deep discount bond is considered a safe, solid and liquid instrument and assigned the best rating by CRISIL.

DISASTER BONDS

These are issued by companies and institutions to share the risk and expand the capital to link investors return with the size of insurer losses. The bigger the losses, the smaller the return and vice-versa. The coupon rate and the principal of the bonds are decided by the occurrence of the casualty of disaster and by the possibility of borrower defaults.

OPTION BONDS

This instrument covers those cumulative and non-cumulative bonds where interest is payable on maturity or periodically and redemption premium is offered to attract investors.

EASY EXIT BONDS

This instrument covers both bonds which provide liquidity and an easy exit route to the investor by way of redemption or buy back where investors can get ready encashment in case of need to withdraw before maturity.

PAY IN KIND BONDS

This refers to bonds wherein interest for the first three to five years is paid through issue of additional bonds, which are called baby bonds as they are derived from parent bond.

SPLIT COUPON DEBENTURES

This instrument is issued at a discounted price and interest accrues in the first two years for subsequent payment in cash. This instrument helps better management of cash outflows in a new project depending upon cash generating capacity.

FLOATING RATE BONDS AND NOTES

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

Some of the above instruments have been used selectively by companies and institutions recently to raise funds.

CLIP AND STRIP BONDS

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

In structuring a coupon note issue, a conventional current coupon bond is sold to the investor. The streams of coupon payments are stripped away and the principal amount of bond is sold as a deep discount bond. The gain to the investor is difference between the purchase price and the par value. The coupon streams are sold like zero coupon bonds where the investor pays discount for it and receives the payment at a lower rate.

DUAL CONVERTIBLE BONDS

A dual convertible bond is convertible into either equity shares or fixed interest rate debentures/preference shares at the option of the lender. Depending on the prospects of the project during the conversion period, the lender may exercise either of the options. The fixed interest rate debenture may have certain additional features including higher rate of interest distinct from the original debt instrument.

STEPPED COUPON BONDS

Under stepped coupon bonds, the interest rate is stepped up or down during the tenure of the bond. The main advantage to the investor is the attraction of higher rate of interest in case of general rise in interest rates.

INDUSTRIAL REVENUE BONDS

Industrial revenue bonds are issued by financial institutions in connection with the development or purchase of industrial facilities. These may become attractive if certain income-tax and wealth-tax concessions are offered.

The bond proceeds could be used to purchase or a construct facilities which are subsequently leased or sold to the company. The institution acts as a conduit of funds between the lenders and the company in order to take advantage of tax benefits enjoyed by the institutions.

COMMODITY BONDS

Commodity bonds are bonds issued to share the risk and profitability of future commodity prices with the investor. For example, petro bonds, silver bonds, gold bonds and coal bonds.

A petro bond may carry a fixed rate of interest with part of the face value of the bonds denominated in barrels of oil. There would be a floor in the face value of the bond. In view of the upside profit potential in oil prices, the interest rate could be lower than the market rate of interest. These bonds may be issued for decontrolled items.

CARROT AND STICK BOND

Another variation of the above instrument is the carrot and stick bond. The carrot is the lower than normal conversion premium i.e. the premium over the present market price of the equity shares is fixed at a reasonable level so that the price of the equity shares need not increase significantly to make conversion practical. The stick

is the issuer's right to call the issue at a specified premium if the price of the equity shares is traded above a specified percentage of the conversion price.

CAPITAL INDEXED BONDS

Capital indexed bonds are inflation-protection securities. Such bonds, therefore, provide good hedge against inflation risk. The benefits do extend beyond hedging. Capital index bonds can be used as a market indicator for inflation expectation. This will help investors take a more intelligent decision on their current consumption. Finally, the spot yield curve can be better constructed based on the real yields.

Inflation risk: A nominal bond is exposed to high inflation risk. This is the risk that inflation will increase, leading to increase in interest rate. Essentially then, inflation risk is a sub-component of interest rate risk. A capital indexed bonds lowers the interest rate risk by neutralizing the inflation risk.

The effectiveness of the hedge will, however, depend on the appropriateness of the inflation index. The purpose of issuing capital indexed bonds will not be fully served if the RBI were to use the Wholesale Price Index (WPI) or the Retail Price Index (RPI) as the index for inflation. The reason is that these indices do not adequately capture inflation as it affects the investors, especially the retail class.

If banks are protected against inflation risk, they may, perhaps, pass on the benefits in the form of higher interest rate to the retail investors. That, in turn, provides retail investors a higher cushion against inflation risk. In such cases, more the inflation index is aligned to price levels affecting retail consumption, better the hedge.

Inflation expectation: Investors buy bonds by postponing their current consumption. There is, therefore, a trade-off between investment and consumption. To make an intelligent decision between these two states of nature, investors need an indicator to measure inflation expectations. At present, due to lack of adequate measures, we assume that inflation expectation is the same as current inflation. If actual inflation were higher in the future, the investment decision may be unattractive. It is, therefore, important to proxy inflation expectation. A capital indexed bond helps in this regard.

If the RBI were to issue capital indexed bonds across the yield curve, we will have real yields for each maturity sector. We already have nominal yields as well for these sectors. The difference between the nominal and the real yields is a proxy for inflation expectation.

Inflation indexed bonds or Inflation Indexed National Savings Securities

India recently launched a new kind of bond to give individual investors some protection against inflation. The new bonds, officially called the Inflation Indexed National Savings Securities.

Unlike a traditional bond where the interest rate is fixed, in the inflation-linked bonds, the government will pay an interest of 1.5% per year above the rate of inflation as measured by the Consumer Price Index.

The interest rate will be reset every six months, to reflect any changes in inflation.

These bonds aren't a great deal for investors who are in higher income-tax brackets, because the interest on the bonds is taxable as income. After taxes, the returns on these bonds will be lower than inflation.

Tax Free Bonds

Specified Companies issue Tax free bonds. The interest paid on this bonds are tax free in the hand of investor.

GLOBAL DEPOSITORY RECEIPTS

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 of the Companies Act, 2013 authorizes a company to issue Global Depository Receipts after following the conditions as prescribed in Companies (Issue of Global Depository Receipts) Rules, 2014.

It is a form of depository receipt or certificate created by the Overseas Depository Bank outside India denominated in dollar and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company. In simple words, it is basically a negotiable instrument denominated in US dollars. It is traded in Europe or the US or both. After getting approval from the Ministry of Finance and completing other formalities, a company issues rupee denominated shares in the name of depository which delivers these shares to its local custodian bank, the holder on records, thus depository. The depository then issues dollar denominated depository receipts (or GDR) against the shares registered with it. Generally one GDR is equivalent to one or more (rupee denominated) shares. It is traded like any other dollar denominated security in the foreign markets, in addition to equity financing (as GDR represents equity) over debt financing. GDR issue also possesses merits like less issue formalities, less administrative works as regards dividend payment, information dissemination, annual general meeting etc. as the issuer deal only with a single shareholder, the depository; easy availability of foreign exchange and no foreign exchange risk. Besides issuing companies, foreign investors especially FIIs also get advantage of investing in the Indian companies without getting registration with SEBI, relief from cumbersome settlement and delivery procedures, adequate liquidity (as GDR is as liquid as the shares of the company in its home market) and generally higher returns. In fact, GDR holders enjoy all economic benefits of the underlying shares but have none of the corporate rights like right to vote.

FOREIGN CURRENCY CONVERTIBLE BOND (FCCB)

A Foreign Currency Convertible Bond (FCCB) is a quasi debt instrument which is issued by any corporate entity, international agency or sovereign state to the investors all over the world. They are denominated in any freely convertible foreign currency. Euro Convertible Bonds are usually issued as unsecured obligation of the borrowers. FCCBs represent equity linked debt security which can be converted into shares or into depository receipts. The investors of FCCBs has the option to convert it into equity normally in accordance with pre-determined formula and sometimes also at a pre-determined exchange rate. The investor also has the option to retain the bond. The FCCBs by virtue of convertibility offers to issuer a privilege of lower interest cost than that of similar non convertible debt instrument. By issuing these bonds, a company can also avoid any dilution in earnings per share that a further issue of equity might cause whereas such a security still can be traded on the basis of underlying equity value. The agreement providing for the issuance of FCCBs normally carry less restrictive covenants as they relate to the issuer. Further, FCCBs can be marketed conveniently and the issuer company can expect that the number of its shares will not increase until investors see improved earnings and prices for its common stock. Like GDRs, FCCBs are also freely tradeable and the issuer has no control over the transfer mechanism and cannot be even aware of ultimate beneficiary. The Finance Ministry vide Notification dated 20.6.1994 stated that w.e.f. this date FCCBs will be considered an approved instrument of accessing external commercial borrowings. The terms and conditions normally applicable to commercial borrowing would be binding on convertible bonds. This would include restrictions on end-use, import of capital goods and minimum maturity for bonds. Priority for accessibility to this facility would be given to firms with good forex earnings record or potential.

INDIAN DEPOSITORY RECEIPTS

According to Section 2(48) of the Companies Act, 2013 “Indian Depository Receipt” means any instrument in the form of a depository receipt created by a domestic depository in India and authorised by a company incorporated outside India making an issue of such depository receipts;

Section 390 of the Companies Act, 2013 and rule 13 of Companies (Registration of Foreign Companies) Rules, 2014 lays down the procedure for issue of Indian Depository Receipts.

Apart from this a company has to comply with Chapter X and XA of SEBI (ICDR) Regulations, 2009 to issue IDRs or a rights issue of IDRs.

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

In an IDR, foreign companies would issue shares, to a domestic (Indian) depository, which would in turn issue depository receipts to investors in India. The actual shares underlying the IDRs would be held by an Overseas Custodian, which shall authorize the Indian depository to issue the IDRs. To that extent, IDRs are derivative instruments because they derive their value from the underlying shares. Standard Chartered PLC is only company to offer IDR in the Indian market.

Benefits to the stakeholders

Issuing Companies: Any foreign company listed in its home country and satisfying the eligibility criteria can issue IDRs. A company which has significant businesses in India can increase its value through IDRs by breaking down market segmentations, reaching trapped pools of liquidity, achieving international shareholder base and improving its brand's presence through global visibility.

Investors: IDRs can lead to better portfolio management and diversification for investor by giving them a chance to buy into the stocks of reputed companies abroad.

TRACKING STOCKS

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

A tracking stock is a special type of stock issued by a publicly held company to track the value of one segment of that company. By issuing a tracking stock, the different segments of the company can be valued differently by investors. Tracking stocks are generally issued by a parent company in order to create a financial vehicle that tracks the performance of a particular division or subsidiary. When a parent company issues a tracking stock, all revenues and expenses of the applicable division are separated from the parent company's financial statements and bound to the tracking stock. Often this is done to separate a high-growth division from large losses shown by the financial statements of the parent company. The parent company and its shareholders, however, still control operations of the subsidiary.

Tracking stock carries dividend rights tied to the performance of a targeted division without transferring ownership or control over divisional assets. In contrast to a spin-off or an equity carve-out, the parent retains full control, allowing it to enjoy any operating synergies, or economies of scale in administration or finance.

Shareholders of tracking stocks have a financial interest only in that unit or division of the company. Unlike the common stock of the company itself, a tracking stock usually has limited or no voting rights. In the event of a company's liquidation, tracking stock shareholders typically do not have a legal claim on the company's assets. If a tracking stock pays dividends, the amounts paid depends on the performance of the business unit or division. But not all tracking stocks pay dividends.

A company has many good reasons to issue a tracking stock for one of its subsidiaries (as opposed to spinning it off to shareholders).

- (i) First, the company keeps control over the subsidiary (although they don't get all the profit), but all revenues and expenses of the division are separated from the parent company's financial statements and attributed to tracking stock. This is often done to separate a high growth division with large losses from the financial statements of the parent company.
- (ii) Second, they might be able to lower their costs of obtaining capital by getting a better credit rating.

- (iii) Third, the businesses can share marketing, administrative support functions, etc.
- (iv) Finally, if the tracking stock shoots up, the parent company can make acquisitions and pay in stock of subsidiary instead of cash.

When a tracking stock is issued, the company can choose to sell it to the markets (i.e., via an initial public offering) or to distribute new shares to existing shareholders. Either way, the newly tracked business segment gets a longer lease, but can still run back to the parent company in tough times.

ADVANTAGES OF TRACKING STOCK

A key advantage of tracking stock is that it offers divisional managers a degree of decision-making authority that might otherwise be unattainable, given top management's reluctance to dilute its control over the division's assets. The practical effect should be to enhance job satisfaction for divisional managers, thus reducing retention risk and also increasing the company's responsiveness to changing market conditions. Also, investors have more direct access to the specific businesses of the parent, which can be highly useful in the case of a diversified company. Another possible reason for the growing popularity of trackers is that trackers allow mainstream companies to exploit the dual stock market pricing between conventional and high-tech or Internet businesses. By creating tracked business units, conventional businesses too can benefit from the pricing frenzy.

DISADVANTAGES OF TRACKING STOCK

For investors, tracking stocks can be of a mixed bag. Like regular stocks, tracking stockholders are entitled to dividends paid out by the subsidiaries issuing the tracking stock. Yet the holders of tracking stocks do not have ownership in the company, instead, at-times tracking stock shareholders vote on issues affecting the corporate parent, not the subsidiary whose stocks they own. Another downside is the fact that the board of directors of the tracking-stock subsidiary is often put in place by the parent company and is not elected by tracking stock shareholders, which would cause conflicts of interests.

The tracking stocks are highly skeptical also. Shareholders have limited voting rights, if any, and they cannot elect their own boards. Moreover, if the parent company falls on hard times, conflict could develop between the shareholders of a tracked division, especially if it continues to do well, and the shareholders of the parent company. The potential for such conflict could affect the performance of the tracking stock.

Another important drawback with tracking stock is that it can dramatically increase the potential for conflict and litigation over accounting policy. It is because the owners of the tracking stock have rights only over dividends, and dividend payouts are driven by the recognition of divisional profits, the arguments over profit recognition are almost sure to arise whenever tracking stock investors are disappointed in their returns. They will surely be tempted to accuse corporate management of adopting policies that deliberately understate their profits.

MORTGAGE BACKED SECURITIES

These securities assure a fixed return which is derived from the performance of the specific assets. They are issued with a maturity period of 3 to 10 years and backed by pooled assets like mortgages, credit card receivables, etc. There is a commitment from the loan originator and/or intermediary institution to ensure a minimum yield on maturity.

FEATURES OF ASSETS TO BE SECURITISED

The assets to be securitized shall have the following features:

- (a) The cash flows generated from the assets should be received periodically in accordance with a pre-determined schedule.
- (b) The actual cash flows generated from the assets should be predictable.
- (c) The assets should be large in number and total value to be issued in securitized form.

- (d) The assets should be sufficiently similar in nature to enable pooling of their cash flows.
- (e) The assets should be marketable.

Advantages of Asset backed Securities to Issuer

- (a) The issuer can generate cash from the assets immediately enabling funds to be redeployed in other projects.
- (b) The issuer may be able to improve balance sheet ratios by excluding the original assets and the securities created by the assets from the balance sheet by suitable structuring of the transaction.

Advantages of Asset backed Securities to Investor

These instruments have a relatively low credit risk since the securities are backed by good quality collateral and offer a higher yield than Government securities.

FUTURES

Futures is a contract between two parties to buy or sell a underlying asset of standardized quantity and quality for a price agreed upon today with delivery and payment occurring at a specified future date. Underlying assets for the purpose include equities, foreign exchange, interest bearing securities and commodities. The idea behind financial futures contract is to transfer future changes in security prices from one party in the contract to the other. It offers a means to manage risk in participating financial market. Futures basically transfer value rather than create it. It is a means for reducing risk or assuming risk in the hope of profit. Every futures contract entered into has two side willing buyer and a willing seller. If one side of contract makes a profit, the other side must make a loss. All futures market participants taken together can neither lose nor gain the futures market is a zero sum game.

OPTIONS

An option contract conveys the right, but not the obligation, to buy or sell a specific security or commodity at specified price within a specified period of time. The right to buy is referred to as a call option whereas the right to sell is known as a put option. An option contract comprises of its type a put or call, underlying security or commodity expiry date, strike price at which it may be exercised.

Option provides the investor with the opportunity to hedge investments in the underlying shares and share portfolios and can thus reduce the overall risk related to the investments significantly. Generally two type of options namely :

- European option – an option that may only be exercised on expiration.
- American option – an option that may be exercised on any trading day on or before expiry.

Term one should know

- **Long Position** – A position showing a purchase or a greater number of purchase than sales in anticipation of a rise in prices. A long position can be closed out through the sale of an equivalent amount.
- **Short Position** – In futures, the short has sold the commodity or security for future delivery; in options, the short has sold the call or put and is obligated to take a futures position if he or she is assigned for exercise.

HEDGE FUNDS

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

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 an 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

Hedge Fund and Other Pooled Investment Vehicles

Hedge funds are sometimes called as ‘rich man’s mutual fund’. In addition, other unregistered investment pools, such as venture capital funds, private equity funds and commodity pools, are sometimes referred to as hedge funds. Although all of these investment vehicles are similar in that they accept investors’ money and generally invest it on a collective basis, they also have characteristics that distinguish them from hedge funds.

Mutual Fund or Registered Investment Companies

In many ways, hedge funds are similar to mutual funds. Both entities issue units or securities to investors, hold pools of securities to diversify investment, have professional asset manager and may, at times, have similar investment strategies. At the same time, they also differ in a number of ways. Mutual funds are registered with securities markets regulator and are subject to the provisions of the relevant regulations such as, offer/issue of units/securities, disclosure and reporting requirement, valuation for the purpose of computation of NAV, conflict of interest issue and limit leverage. Hedge funds are not required to be registered and therefore, are not subject to similar regulatory provisions.

Private Equity Fund

A private equity fund, like a hedge fund, is an unregistered investment vehicle in which investors pool money to invest. Private equity funds concentrate their investments in unregistered (and typically illiquid) securities. Like hedge funds, private equity funds also rely on the exemption from registration of the offer and sale of their securities. The investors in private equity funds and hedge funds typically include high net worth individuals and families, pension funds, endowments, banks and insurance companies. Private equity funds, however, differ from hedge funds in terms of the manner in which contribution to the investment pool is made by the investors. Private equity investors typically commit to invest a certain amount of money with the fund over the life of the fund, and make their contributions in response to “capital calls” from the fund’s general partner. Private equity funds are long term investments, provide for liquidation at the end of the term specified in the fund’s governing documents and offer little, if any, opportunities for investors to redeem their investments. A private equity fund may distribute cash to its investors when it sells its portfolio investment, or it may distribute the securities of a portfolio company.

Venture Capital Fund

Venture capital pools are similar to hedge funds or private equity; they attract the same class of investors. Venture capital funds, however, invest in the start-up or early stages of a company. Unlike hedge fund advisors, general partners of venture capital funds often play an active role in the companies in which the funds invest. In contrast to a hedge fund, which may hold an investment in a portfolio security for an indefinite period based on market events and conditions, a venture capital fund typically seeks to liquidate its investment once the value of the company increases above the value of the investments.

Commodity Pool

Commodity pools are investment trusts, syndicates or similar enterprises that are operated for the purpose of trading commodity futures. The investment concentration in commodity futures distinguishes commodity pools from hedge funds.

DOMESTIC AND OFFSHORE HEDGE FUND

Domestic Hedge Fund

Domestic hedge funds are usually organized (in USA) as limited partnerships to accommodate investors that are subject to U.S. income taxation. The fund's sponsor typically is the general partner and investment adviser. Hedge funds may also take the form of limited liability companies (LLC) or business trusts. LLPs, LLCs and business trusts are generally not separately taxed and, as a result, income is taxed only at the level of the individual investors. Each of three firms also limits investors liability; LLCs offer the additional benefit of limited liability for fund advisors (general partners).

Offshore Hedge Fund

Offshore hedge funds are typically organized as corporations in countries such as the Cayman Islands, British Virgin Islands, the Bahamas, Panama, The Netherlands Antilles or Bermuda. Offshore funds generally attract investments of U.S. tax exempt entities, such as pension funds, charitable trusts, foundations and endowments, as well as non-U.S. residents. U.S. tax-exempt investors favour investments in offshore hedge funds because they may be subject to taxation if they invest in domestic limited partnership hedge funds.

Market Benefits of Hedge Funds

<i>A Taxonomy of Hedge Fund Strategies</i>	
<i>Strategy</i>	<i>Description</i>
Directional Trading	Based upon speculation of market direction in multiple asset classes. Both model-based systems and subjective judgment are used to make trading decisions.
Relative Value	Focus on spread relationships between pricing components of financial assets. Market risk is kept to minimum and many managers use leverage to enhance returns.
Specialist Credit	Based around lending to credit sensitive issuers. Funds in this strategy conduct a high level of due diligence in order to identify relatively inexpensive securities.
Stock Selection	Combine long and short positions, primarily in equities, in order to exploit under and overvalued securities. Market exposure can vary substantially.

Hedge funds can provide benefits to financial markets by contributing to market efficiency and enhance liquidity. Many hedge fund advisors take speculative trading positions on behalf of their managed hedge funds based extensive research about the true value or future value of a security. They may also use short term trading strategies to exploit perceived mis-pricings of securities. Because securities markets are dynamic, the result of such trading is that market prices of securities will move toward their true value. Trading on behalf of hedge funds can thus bring price information to the securities markets, which can translate into market price efficiency. Hedge funds also provide liquidity to the capital markets by participating in the market.

Hedge funds play an important role in a financial system where various risks are distributed across a variety of innovative financial instruments. They often assume risks by serving as ready counter parties to entities that wish to hedge risks. For example, hedge funds are buyers and sellers of certain derivatives, such as securitised financial instruments, that provide a mechanism for banks and other creditors to un-bundle the risks involved in real economic activity. By actively participating in the secondary market for these instruments, hedge funds can help such entities to reduce or manage their own risks because a portion of the financial risks are shifted to investors in the form of these tradable financial instruments. By reallocating financial risks, this market activity provides the added benefit of lowering the financing costs shouldered by other sectors of the economy. The absence of hedge funds from these markets could lead to fewer risk management choices and a higher cost of

capital. Hedge fund can also serve as an important risk management tool for investors by providing valuable portfolio diversification. Hedge fund strategies are typically designed to protect investment principal. Hedge funds frequently use investment instruments (e.g. derivatives) and techniques (e.g. short selling) to hedge against market risk and construct a conservative investment portfolio – one designed to preserve wealth.

In addition, hedge funds investment performance can exhibit low correlation to that of traditional investments in the equity and fixed income markets. Institutional investors have used hedge funds to diversify their investments based on this historic low correlation with overall market activity.

EXCHANGE TRADED FUNDS

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

In short, they are similar to index mutual funds but are traded more like a stock. As their name implies, Exchange Traded Funds represent a basket of securities that are traded on an exchange. Gold ETFs are most popular among other ETFs, physical gold is kept as underlying security. As with all investment products, exchange traded funds have their share of advantages and disadvantages.

<i>Advantages of Exchange Traded Funds</i>	<i>Disadvantages of Exchange Traded Funds</i>
ETFs can be bought and sold throughout the trading day, allowing intraday trading - which is rare with mutual funds.	Commissions - like stocks, trading exchange traded funds are an extra cost.
Traders have the ability to short or buy ETFs on margin.	Only institutions and the extremely wealthy can deal directly with ETF. Companies must buy through a broker.
Low annual expenses rival the cheapest mutual funds.	Unlike mutual funds, ETFs don't necessarily trade at the net asset values of their underlying holdings, meaning an ETF could potentially trade above or below the value of the underlying portfolios.

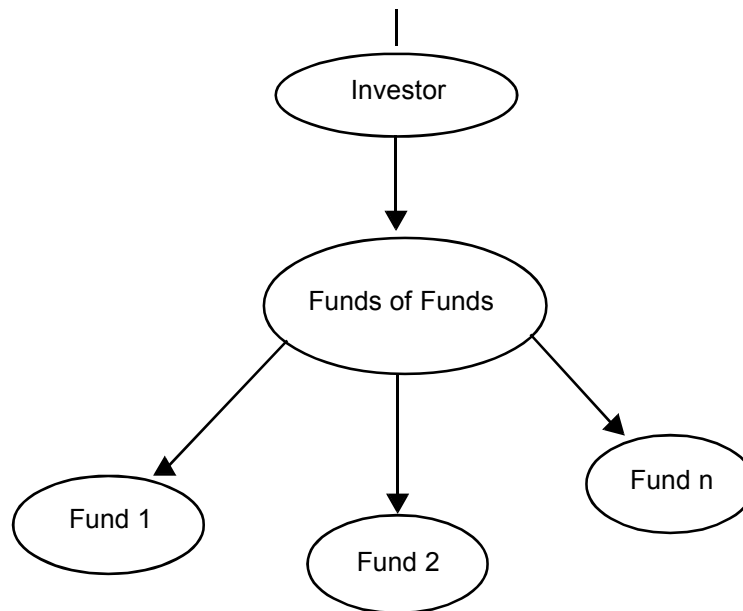
FUND OF FUNDS (FOFS)

Fund of funds (FoFs) is a mutual fund scheme, which invests in the schemes of same mutual funds or other mutual funds, instead of investing in securities. These funds can invest in equity oriented, debt oriented and liquid schemes or sector specific schemes. Depending on the investment style of the fund managers, fund of funds schemes can be broadly classified into:

Sector specific funds: Such type of funds invest in different sectors of the economy and thus hedge themselves against the under performance of any sector by taking the advantage from the rise in another sector.

Asset allocation funds: These funds diversify investment by holding several different asset classes at the same time. By varying the stocks to bonds proportion, the fund endeavors to endow the investors, with an appropriate asset allocation in different stages of their lives. They are also known as life cycle funds.

A Typical Fund of Funds



BENEFITS OF FUND OF FUNDS SCHEME

Diversification

As a fund of funds invests in the schemes of other funds, it provides a greater degree of diversification.

Uncomplicated

Instead of investing in different stocks/units of mutual funds and keeping a track record of all of them, it will be much easier to invest in and track only one fund, which in turn invests in other mutual funds.

Cheap

While entering into the capital markets it is difficult to diversify because of limited funds. Fund of funds provide an opportunity to go for diversification with comparatively limited amounts.

Risk

Investors can trim down the risk by choosing this route. Because of diversification, even if one stock/scheme is not performing well risk level comes down.

Expertise of Various Managers

As in the case of schemes of mutual funds, fund of funds scheme also work under the due diligence of a fund manager. This gives the scheme additional expertise as compared to other mutual funds schemes. These schemes also provide access to information which may be difficult to obtain for an investor on a case by case basis.

DISADVANTAGES OF FUND OF FUNDS SCHEME

However, just like any other investment, fund of funds is not free from shortcomings. Few of the disadvantages are specified below.

Additional Fees

The more diversified the fund is, the greater the likelihood that the investor will incur an incentive fee on one or more of the constituent managers, regardless of overall FoF performance.

Associated Risks

Risks associated with all the underlying funds get added at this level. Following are the type of risks associated with fund of funds scheme.

Management Risks

Every fund manager has a particular style of diversification. This diversification style will be in perfect correlation with the number of managers involved. The views of a manager may be altogether different from the market.

Operational Risks

Due diligence of a scheme in itself gives rise to operational risks. Continuous monitoring is required for knowing about performance of the funds, any possibility of a fraud and to know about the investment style of the funds and any desirable or undesirable changes in it.

Qualitative Risks

These include risks associated with the management environment of the fund such as organizational structure, infrastructure, investment process, operational issues etc.

Regulations in India

The fund of funds scheme was introduced in the Indian market by making suitable amendments in SEBI (Mutual Funds) (Amendment) Regulations, 2003.

LESSON ROUND UP

- Instruments can be classified into three categories viz. Pure, Hybrid and Derivatives.
- 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.
- Owners of preference shares are entitled to a fixed dividend or dividend calculated at a fixed rate to be paid regularly before dividend can be paid in respect of equity shares.
- Debenture includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not.
- Sweat equity share is an instrument permitted to be issued by specified Indian companies, under Section 2(88) of Companies Act, 2013.
- A Tracking stock is a type of common stock that “tracks” or depends on the financial performance of a specific business unit or operating division of a company, rather than the operations of the company as a whole.
- GDR is a form of depository receipt or certificate created by the Overseas Depository Bank outside India denominated in dollar and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company.
- Derivatives are contracts which derive their values from the value of one or more of other assets (known as underlying assets).
- Future is a contract to buy or sell an underlying financial instrument at a specified future date at a price when the contract is entered.

- An option contract conveys the right to buy or sell a specific security or commodity at specified price within a specified period of time.
- Private equity fund is an unregistered investment vehicle in which investors pool money to invest.

GLOSSARY

At-the-Money Option	Term used to describe an option or a warrant with an exercise price equal to the current market price of the underlying asset.
Coupon Rate	The interest rate stated on the face of coupon.
Hedge	An asset, liability or financial commitment that protects against adverse changes, in the value of or cash flows from another investment or liability. An unhedged investment or liability is called an “exposure”. A perfectly matched hedge will gain in value what the underlying expense loses or lose what the underlying exposure gains.
Premium	If an investor buys a security for a price above its evaluate value at a maturity he has paid a premium for it.
Forward Contract	An agreement for the future delivery of the underlying commodity or security at a specified price at the end of a designated period of time. Unlike a future contract, a forward contract is traded over the counter and its terms are negotiated individually. There is no clearing house for forward contracts, and the secondary market may be non-existent or thin.
Hypothecation	Pledging assets against a loan. The ownership of the asset or the income from the asset is not transferred, except that in default of repayment of loan the asset may be sold to realize its value. Brokers will accept shares as collateral for loans to finance purchase of shares or to cover short sales.

SELF TEST QUESTION

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

1. State and explain in brief about various new capital market instruments in Indian Securities Market.
2. Give a comparative view of various types of preference shares prevalent in the market.
3. Dwell upon the features and advantages of convertible debentures. Distinguish between fully and partly convertible debentures.
4. What is Exchange Traded Funds (ETFs)? Briefly discuss the advantages and disadvantages of ETFs.
5. Write short notes on –
 - (a) Sweat Equity Shares
 - (b) Mortgage Backed Securities
 - (c) Derivatives
 - (d) Pure and Hybrid Instruments

Lesson 3

Credit Rating & IPO Grading

LESSON OUTLINE

- Introduction
- Concept & Overview
- Purposes
- Uses of Credit Rating
- Factors for Success of a Rating System
- Important Issues in Credit Rating
- Rating Methodologies
- Rating Process
- Regulatory Framework
- SEBI (Credit Rating Agencies) Regulations, 1999
- Transparency and Disclosure Norms for CRAs
- Internal Audit of CRAs
- Rating Symbols & Definitions
- IPO Grading
- Lesson Round-Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

Credit Rating is a symbolic indication of the current opinion regarding the relative capability of a corporate entity to service its debt obligations in time with reference to the instrument being rated. It enables the investor to differentiate between debt instruments on the basis of their underlying credit quality. In determining a rating, both qualitative and quantitative analyses are employed. The judgment is qualitative in nature and the role of the quantitative analysis is to help make the best possible overall qualitative judgment or opinion.

This lesson is designed to give a comprehensive, regulatory framework of Credit Rating Agencies (CRAs). After going through this lesson the student will be able to understand the concept, uses, purpose, rating methodologies of CRAs, the provisions stipulated in the regulations, guideline relating to CRAs, basic understanding of IPO grading, Internal Audit of CRA by a Practicing Company Secretary etc.

INTRODUCTION

Credit rating, in general sense, is the evaluation of the credit worthiness of an individual or of a business concern or of an instrument of a business based on relevant factors indicating ability and willingness to pay obligations as well as net worth.

'Encyclopedia of Banking & Finance' by Charles J. Woelfel states that a credit rating is a letter or number used by a mercantile or other agency in reports and credit rating books to denote the ability and disposition of various businesses (individual, proprietorship, partnership or corporation) to meet their financial obligations. It also states that ratings are used as a guide to the investment quality of bonds and stocks, based on security of principal and interest (or dividends), earning power, mortgage position, market history and marketability.

Credit ratings establish a link between risk and return. An investor or any other interested person uses the rating to assess the risk-level and compares the offered rate of return with his expected rate of return.

EVOLUTION OF CREDIT RATING

The first Mercantile Credit Agency was established in New York in 1841. Its first rating guide was published in 1859 by Robert Dun. Another similar agency was set up by John Bradstreet which published its rating guide in 1857. These two agencies were merged to form Dun and Bradstreet in 1933 which acquired Moody's Investor Service in 1962. Moody's was founded by Moody in 1900. The other world renowned rating agency namely Standard and Poor was created in 1941 by merging the Standard Statistics Company and Poor's Publishing Company which had their origin earlier.

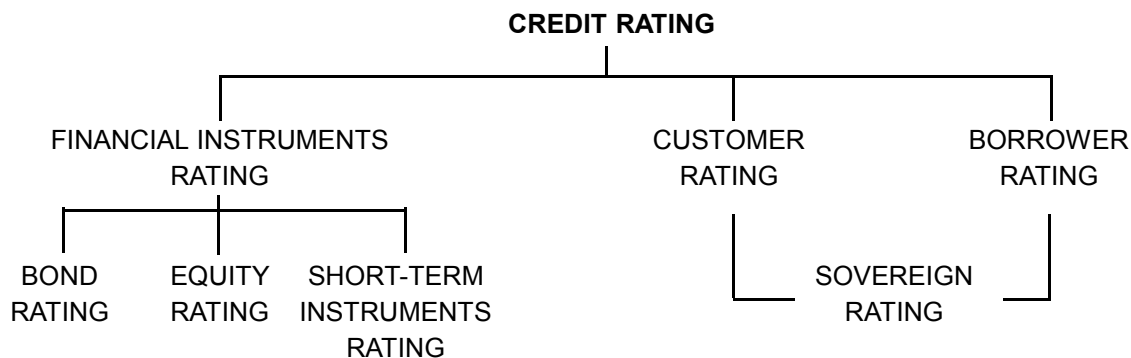
In India CRISIL (Credit Rating and Information Services (India) Limited) was set up as the first credit rating agency in 1987. This was followed by ICRA Limited (Investment Information and Credit Rating Agency of India Limited) in 1991 and CARE (Credit Analyses and Research Limited) in 1994 and then in 1999 Fitch Rating India Pvt. Ltd. now known as India Ratings and Research Pvt. Ltd., Brickwork Rating Pvt. Ltd. in 2008 and SMERA (SME Rating Agency of India Limited) in 2011. All these Six credit rating agencies are registered with the SEBI.

CONCEPT & OVERVIEW

Credit Rating is a symbolic indication of the current opinion regarding the relative capability of a corporate entity to service its debt obligations in time with reference to the instrument being rated. It enables the investor to differentiate between debt instruments on the basis of their underlying credit quality. To facilitate simple and easy understanding, credit rating is expressed in alphabetical or alphanumeric symbols.

A rating is specific to a debt instrument and is intended to grade different such instruments in terms of credit risk and ability of the company to service the debt obligations as per terms of contract namely - principal as well as interest. A rating is neither a general purpose evaluation of a corporate entity, nor an over all assessment of the credit risk likely to be involved in all the debts contracted or to be contracted by such entity.

Though credit rating is considered more relevant for gradation of debt securities, it can be applied for other purposes also. The diagram below depicts various types of credit ratings:



PURPOSES

The various instruments which can be rated may be –

- Credit rating does not bound the investor to decide whether to hold or sell an instrument as it does not take into consideration factors such as market prices, personal risk preferences and other consideration which may influence an investment decision. It does not create any fiduciary relationship between the rating agency and the user of the rating. A credit rating agency does not perform an audit but relies on information provided by the issuer and collected by the analysts from different sources hence it does not guarantee the completeness or accuracy of the information on which the rating is based.
- Long-term/Medium-term debt obligations such as debentures, bonds, preference shares or project finance debts are considered long-term and debts ranging from 1 to 3 years like fixed deposits are considered medium-term;
- Short-term debt obligations - the period involved is one year or less and cover money market instruments such as commercial paper, credit notes, cash certificates etc.;
- Equity Grading and Assessment, structured obligations, municipal bonds, mutual fund schemes, plantation schemes, real estate projects, infrastructure related debts, ADR, GDR issues, bank securities etc.

In determining a rating, both qualitative and quantitative analyses are employed. The judgment is qualitative in nature and the role of the quantitative analysis is to help make the best possible overall qualitative judgment or opinion. The reliability of the rating depends on the validity of the criteria and the quality of analysis.

The quality of credit rating mainly depends upon the quality of the rating agency and rating elements also. The agency should have good reputation, personal competence, independence, qualified and experienced staff.

USES OF CREDIT RATING

Credit rating is extremely important as it not only plays a role in investor protection but also benefits industry as a whole in terms of direct mobilization of savings from individuals. Rating also provide a marketing tool to the company and its investment bankers in placing company's debt obligations with a investor base that is aware of, and comfortable with, the level of risk. Ratings also encourage discipline amongst corporate borrowers to improve their financial structure and operating risks to obtain a better rating for their debt obligations and thereby lower the cost of borrowing. Companies those get a lower rating are forewarned, as it were and have the freedom, if they desire, to take steps on their financial or business risks and thereby improve their standing in the market.

The need for reliable information in channelization of the resources to the most productive uses can hardly be overemphasized. Relevant and reliable information helps the investors to arrive at their investment decisions. These include offer documents of the issuers, research reports of market intermediaries and media reports. In the developed markets, credit rating agencies have also come to occupy a leading position as information providers along with rating of financial instruments. Particularly for the credit related opinions in respect of debt related instruments, such agencies offer independent opinions which are objective, well researched and credible.

Credit rating is useful to investors, issuers, intermediaries and regulators.

For Investors

The main purpose of credit rating is to communicate to the investors the relative ranking of the default loss probability for a given fixed income investment, in comparison with other rated instruments. In a way it is essentially an

information service. In the absence of professional credit rating, the investor has to largely depend on his familiarity with the names of promoters or collaborators of a company issuing debt instruments. This is not a reliable method. Credit rating by skilled, competent and credible professionals eliminates or at least minimizes the role of name recognition and replaces it with a well researched and properly analyzed opinion. This method provides a low cost supplement to investors. Large investors use information provided by rating agencies such as upgrades and downgrades and alter their portfolio mix by operating in the secondary market. Investors also use the industry reports, corporate reports, seminars and open access provided by the credit rating agencies.

For Issuers

The market places immense faith in opinion of credit rating agencies, hence the issuers also depend on their critical analysis. This enables the issuers of highly rated instruments to access the market even during adverse market conditions. Credit rating provides a basis for determining the additional return (over and above a risk free return) which investors must get in order to be compensated for the additional risk that they bear. The difference in price leads to significant cost savings in the case of highly rated instruments.

For Intermediaries

Rating is useful to Intermediaries such as merchant bankers for planning, pricing, underwriting and placement of the issues. Intermediaries like brokers and dealers in securities use rating as an input for monitoring risk exposures. Merchant bankers also use credit rating for pre-packaging issues by way of asset securitization/structured obligations.

For Regulators

The Reserve Bank of India (RBI) prescribes a number of regulatory uses of ratings. The RBI requires that a NBFC must have minimum investment grade credit rating if it intends to accept public deposits. As per money market regulations of the RBI, a corporate must get an issue of CP rated and can issue such paper subject to a minimum rating. SEBI has also stipulated that ratings are compulsory for all public issue of debentures. SEBI has also made mandatory for acceptance of public deposit by Collective Investment Schemes.

FACTORS FOR SUCCESS OF A RATING SYSTEM

- Credible and independent structure and procedures;
- Objectivity and impartiality of opinions;
- Analytical research, integrity and consistency;
- Professionalism and industry related expertise;
- Confidentiality;
- Timeliness of rating review and announcement of changes;

Ability to reach wide range of investors by means of press reports, print or electronic media and investor oriented research services.

IMPORTANT ISSUES IN CREDIT RATING

Investments and Speculative Grades

Debt instrument rated 'BBB' & above are classified as investment grade ratings. Instruments that are rated 'BB' and below are classified as speculative grade ratings. Rating agencies do not recommend or indicate the rating levels of instruments up to which one should or should not invest.

Surveillance

The rating published by credit rating agencies is subjected to a continuous surveillance during the life of the instrument or so long as any amount is outstanding against the specific instrument. The frequency of surveillance may range between quarterly or yearly. A formal and extensive written review is taken at least once in a year but where some

specific concern arises about the industry or the issuing entity, the review is taken up immediately. Where the rating agency justified may change the rating by upgradation or downgradation depending on the likely impact of changing circumstances on the debt servicing capability of the issuer. In other cases, the rating is retained at the same level.

Credit Watch

When a major deviation from the expected trends of the issuers business occurs, or when an event has taken place, it creates an impact on the debt servicing capability of the issuer and warrants a rating change, the rating agency may put such ratings under credit watch till the exact impact of such unanticipated development is analyzed and decision is taken regarding the rating change. The credit watch listing may also specify positive or negative outlooks. It should be noted that being under credit watch does not necessarily mean that there would be a rating change.

Ownership as a rating consideration

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

Rating agency keeps the information provided by the issuer confidential and completes the rating within 2 to 4 weeks. Once the rating is assigned, it is communicated to the issuer, who is given an opportunity to make one request for a review, only in case fresh facts or clarifications become relevant. After these are considered, the final rating is assigned. In India, the issuer has the option of not accepting the assigned rate in which case the rating is not disclosed by the rating agency. However, if the rating is accepted, it comes under the surveillance process of the concerned agency.

RATING METHODOLOGIES

RATING OF MANUFACTURING COMPANIES

The factors generally considered for rating of manufacturing companies are as under:

Industry Risk

It is defined as the strength of the industry within the economy and relativity to the economic trends. It is evaluated on the basis of factors like business cyclicity, earnings volatility, growth prospects, demand - supply projections, entry barriers and extent of competition and nature and extent of regulation.

Company's industry and market position

The company's sales position in its major fields and its historical background of its market position is analyzed along with ability to sustain/increase market shares; brand strengths and position; price leadership and distribution and marketing strengths/weaknesses.

Operating efficiencies

Ability to control costs, productivity efficiencies relative to others, labour relationship, extent of forward and backward integration, access to raw materials/markets, and technology.

Accounting Quality

Financial statements are adjusted for non-standard accounting treatments. Overall evaluation of the accounting policies employed and the extent to which they understate or overstate financial performance and position. These include analysis of auditor's qualifications, revenue recognition, depreciation policy, inventory evaluation, funding for pension liabilities, undervalued assets etc.

Financial flexibility

Evaluation of the company's financing needs, plans and alternatives, its flexibility to accomplish its financing programmes under stress without damaging creditworthiness.

Earnings protection

The key measurements which indicate the basic long term earnings power of the company including return on capital, profit margins, earnings from various business segments, sources of future earnings growth, coverage ratios etc.

Financial leverage

Relative usage of debt and levels of debt appropriate to different types of businesses, utilization of long and short term sources of funds, management of working capital.

Cash flow adequacy

It is the relationship of cash flows to leverage and the ability to internally meet all cash needs of the business. It measures the magnitude and variability of future cash flows relative to debt servicing obligations and other commitments such as group company funding, BIFR packages and contingent liabilities. This analysis goes into the inherent protective factors for expected cash flows of the company and the sensitivity of these cash flows to changes in variables like raw material costs and selling prices.

Management evaluation

The record of achievement in operations and financial results, strategic and financial planning, commitment, consistency and credibility, overall quality of management, line of succession, strength of middle management and organization structure and its linkage with the operating environment and management strategies.

RATING OF FINANCIAL SERVICES COMPANIES

The rating methodology for non-banking financial services companies is based on CAMELS model encompassing, Capital adequacy, Asset quality, Management, Earnings, Liquidity and Sensitivity to Market Risk. The nature and accessibility of funding sources is also considered.

RATING OF STRUCTURED OBLIGATIONS/ASSET SECURITISATION

Structured borrowing arrangements are entered into by companies for various reasons. However, the most important one is that less credit worthy instruments or corporates are able to tap sources of funds at a more advantageous borrowing rate by offering a variety of credit enhancements.

The process of converting loans or receivables into negotiable instruments is known as securitization. These negotiable instruments are then sold to investors; they are secured by the underlying assets and have other credit enhancements. Securitization transforms illiquid assets like the renewable portfolio on the balance sheet of a lender into a marketable security.

The principal credit risk in asset backed financing is potential impairment of cash flows due to the assets becoming defaulting on repayments or turning into a loss. The main factors considered for credit rating are the overall risk profile and monitoring and collection procedures of the issuer; the quality of the assets being securitized; the process of selection of the asset pool to be securitized; the characteristics of the pool and the cash flows from it based on the past record of its behaviour. The possible credit loss and other deficiencies of the pool in terms of timing and quantum of cash flows are analyzed and the extent and nature of credit enhancement is then determined.

Other important considerations in a securitization transaction are the legal and tax structure and the ability and willingness of the services and trustee to manage and maintain control on assets and payment streams from them.

RATING PROCESS

Rating process refers to the typical practices and procedures which a rating agency follows to gather information for evaluating the credit risk of specific issuers and issues, to analyze and conclude on the appropriate rating to monitor the credit quality of the rated issuer or security over time, deciding on timely changes in ratings, as and when companies' fundamentals change and to keep investors and the market players informed. All these are

interrelated and on going processes. The general principals followed all over the world are the same. The rating agencies in India have adopted the methodology of the major international credit rating agencies.

The rating process begins with the receipt of a mandate from the issuer company. The next step is to form analytical teams with sectoral skills.

Information gathering/analysis

For the basic research, obtain credit related data, both statistical and qualitative, from a multitude of sources like annual reports, prospectus, industry/sectoral economic data, government reports, news reports, discussions with industry/ regulatory/other circles. Statistical data bases are developed over time to enable comparability across major issuer categories.

Meetings with Management

Meetings are held with key operating personnel of the company covering broadly the background, history, organisational structure, operating performance, financial management and topics of special relevance to the company's future. The central focus of all discussions is the same with analysts looking for information that will help them to understand the issuer's ability to generate cash from operations to meet debt obligations over the next several years. It is the management's opportunity to explain the company's business and financial strategies. Finally, a meeting with top management is held, where apart from corporate strategy and philosophy, key issues relevant to the rating are discussed. A plant visit with the major manufacturing/work centres and project sites is invariably undertaken.

In India, credit rating agencies do not undertake unsolicited ratings merely based on published information of the company. The quality of credit rating will greatly improve with privileged information obtained from the companies by credit rating agencies. It is possible to have two agencies to do the rating for a particular issue and the findings may even vary, because rating is a matter of perceptions. But generally the findings will not be varying widely.

The ratings can be published by the agency only after approval and with the permission of the issuer. Subsequent changes emerging out of the monitoring by the credit rating agency will be published even if such changes are not found acceptable to the issuers. The issuer may appeal on the findings of an agency. In such a case the agency will undertake a review and thereafter indicate its final decision. Unless the rating agency has overlooked critical information at the first stage, chances of the rating being changed on appeal will be rare.

There is no system yet to rate the rating agency. Informed public opinion is the touch stone on which the rating companies are being assessed. The success of a rating agency is measured by the quality, consistency and integrity and the record of acceptance in the market. The rating is always about a particular issue and not generally about the issuer.

REGULATORY FRAMEWORK

SEBI (CREDIT RATING AGENCIES) REGULATIONS, 1999

SEBI regulations for Credit Rating Agencies (CRAs) cover rating of securities only and not rating of fixed deposits, foreign exchange, country ratings, real estates etc. CRAs can be promoted by public financial institutions, scheduled commercial banks, foreign banks operating in India, foreign credit rating agencies recognised in the country of their incorporation, having at least five years experience in rating, or any company or a body corporate having continuous net worth of minimum ₹100 crore for the previous five years. CRAs would be required to have a minimum net worth of ₹ 5 crore. A CRA can not rate a security issued by its promoter. No Chairman, Director or Employee of the promoters shall be Chairman, Director or Employee of CRA or its rating committee. A CRA can not rate securities issued by any borrower, subsidiary, an associate promoter of CRA, if there are common Chairman, Directors and Employees between the CRA or its rating committee and these entities. A CRA can not rate a security issued by its associate or subsidiary if the CRA or its rating committee has a Chairman, Director or Employee who is also a Chairman, Director or Employee of any such entity. CRAs would have to carry out periodic reviews of the ratings given during the lifetime of the rated instrument. For ensuring that corporates

provide correct/ adequate information to CRAs, a clause would be incorporated in the listing agreement of the stock exchanges requiring the companies to co-operate with the rating agencies in giving correct and adequate information. Issuers coming out with a public/rights issue of debt securities would be required to incorporate an undertaking in the offer documents promising necessary co-operation with the rating agency in providing true and adequate information.

Registration of Credit Rating Agencies

Any person proposing to commence any activity as a credit rating agency should make an application to SEBI for the grant of a certificate of registration for the purpose. Any person, who before the said date carrying on any activity as a credit rating agency, should make an application to SEBI for the grant of a certificate within a period of three months from such date. However SEBI may, where it is of the opinion that it is necessary to do so, for reasons to be recorded in writing, extend the said period upto a maximum of six months from such date. An application for the grant of a certificate should be made to SEBI accompanied by a non-refundable specified application fee. Any person who fails to make an application for the grant of a certificate within the period specified in that sub-regulation, ceases to carry on rating activity.

Promoter of Credit Rating Agency

SEBI should not consider an application unless the applicant is promoted by a person belonging to any of the following categories, namely:

- (i) a public financial institution;
- (ii) a scheduled commercial bank;
- (iii) a foreign bank operating in India with the approval of the Reserve Bank of India;
- (iv) a foreign credit rating agency 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, of its promoter has at any time in the past been convicted of any offence involving moral turpitude or any economic offence;
- (h) the applicant has, in its employment, persons having adequate professional and other relevant experience to the satisfaction of the 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 consider necessary, for the purpose of processing of the application. SEBI if so desires, may ask the applicant or its authorised representative to appear before SEBI for personal representation in connection with the grant of a certificate.

Grant of Certificate

SEBI grants a certificate after getting satisfied that the applicant is eligible for the grant of a certificate of registration. The grant of certificate of registration should be subject to the payment of the specified registration fee in the manner prescribed.

Conditions of Certificate

The certificate granted is subject to the condition that the credit rating agency should comply with the provisions of the Act, the regulations made thereunder and the guidelines, directives, circulars and instructions issued by SEBI from time to time on the subject of credit rating. The credit rating agency should forthwith inform SEBI in writing where any information or particulars furnished to SEBI by a credit rating agency is found to be false or misleading in any material particular; or has undergone change subsequently to its furnishing at the time of the application for a certificate. The period of validity of certificate of registration shall be three years.

Renewal of Certificate

A credit rating agency, if it desires renewal of the certificate granted to it, should make to SEBI an application for the renewal of the certificate of registration. An application for renewal of certificate of registration shall be accompanied by a non-refundable application fee as prescribed in Second Schedule of the Regulations. Schedule II provides for the following fees:

Application fee	—	₹ 50,000/-
Registration fee for grant of certificate	—	₹ 5,00,000/-
Renewal fees	—	₹ 10,00,000/-

Such application should be made not less than three months before expiry of the period of validity of the certificate in the manner specified. The application for renewal should be accompanied by a renewal fee as specified and should be dealt in the same manner as if it were an application for the grant of a fresh certificate.

Procedure where Certificate is not granted

SEBI may reject the application if after considering an application is of the opinion that a certificate should not be granted or renewed, after giving the applicant a reasonable opportunity of being heard. The decision of SEBI not to grant or not to renew the certificate should be communicated by SEBI to the applicant within a period of thirty days of such decision, stating the grounds of the decision. Any applicant aggrieved by the decision of SEBI rejecting his application may, within a period of thirty days from the date of receipt by him of the communication apply to SEBI in writing for re-consideration of such decision. Where an application for re-consideration is made, SEBI should consider the application and communicate to the applicant its decision in writing, as soon as may be.

Effect of Refusal to Grant Certificate

An applicant whose application for the grant of a certificate has been rejected should not undertake any rating activity. An applicant, whose application for the grant of a certificate has been rejected by SEBI, should on and from the date of the receipt of the communication ceases to carry on any rating activity. If SEBI is satisfied that it is in the interest of the investors, it may permit the credit rating agency to complete the rating assignments already entered into by it, during the pendency of the application or period of validity of the certificate. SEBI in order to protect the 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 Code of Conduct as per SEBI Regulations:

- (1) A credit rating agency in the conduct of its business should observe high standards of integrity and fairness in all its dealings with its clients.
- (2) A credit rating agency should fulfill 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 to all the stock exchanges where the said securities are listed.

Procedure for Review of Rating

Every credit rating agency should carry out periodic review of all published ratings during the lifetime of the

securities. If the client does not co-operate with the credit rating agency so as to enable the credit rating agency to comply with its obligations, the credit rating agency should carry out the review on the basis of the best available information.

However, it has been provided that if owing to such lack of co-operation, a rating has been based on the best available information, the credit rating agency should disclose to the investors the fact that the rating is so based. A credit rating agency should not withdraw a rating so long as the obligations under the security rated by it are outstanding, except where the company whose security is rated is wound up or merged or amalgamated with another company.

Internal Procedures to be Framed

Credit rating agency should frame appropriate procedures and systems for monitoring the trading of securities by its employees in the securities of its clients, in order to prevent contravention of SEBI (Insider Trading) Regulations, 1992; SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 2003; and other laws relevant to trading of securities.

Disclosure of Rating Definitions

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

Submission of Information

In case any information is called by SEBI from a credit rating agency including any report relating to its activities, the credit rating agency is required to furnish such information to SEBI within a period specified or if no such period is specified, then within a reasonable time. It should also furnish to SEBI, copies of its balance sheet and profit and loss account at the close of each accounting period,

Every credit rating agency is required to comply with such guidelines, directives, circulars and instructions as issued by SEBI from time to time.

Appointment of Compliance Officer

It is under an obligation to appoint a compliance officer who will be responsible for monitoring the compliance of the Act, Rules and Regulations, notifications, guidelines, instructions etc issued by SEBI or the Central Government. The compliance officer should immediately and independently report to SEBI any non-compliance observed by him.

Maintenance of Books of Accounts Records, etc.

Credit rating agency should keep and maintain, for a minimum period of five years, the following books of accounts, records and documents, namely:

- (i) copy of its balance sheet, as on the end of each accounting period;
- (ii) a copy of its profit and loss account for each accounting period;
- (iii) a copy of the auditor's report on its accounts for each accounting period.
- (iv) a copy of the agreement entered into, with each client;
- (v) information supplied by each of the clients;
- (vi) correspondence with each client;

- (vii) ratings assigned to various securities including upgradation and down gradation (if any) of the ratings so assigned;
- (viii) rating notes considered by the rating committee;
- (ix) record of decisions of the rating committee;
- (x) letter assigning rating;
- (xi) particulars of fees charged for rating and such other records as SEBI may specify from time to time.

Credit rating agency is required to intimate to SEBI, the place where the books of account, records and documents required to be maintained under these regulations are being maintained.

Steps on Auditor's Report

Credit rating agency should within two month's from the date of the auditor's report, take steps to rectify the deficiencies if any, made out in the auditor's report, in so far as they relate to the activity of rating of securities.

Confidentiality

Every credit rating agency shall treat, as confidential, information supplied to it by the client and no credit rating agency shall disclose the same to any other person, except where such disclosure is required under any law.

Rating Process

Credit rating agency should specify the rating process and file a copy of the same with SEBI for record and also file with SEBI any modifications or additions made therein from time to time. It should in all cases follow a proper rating process. Credit rating agency is required to have professional rating committees, comprising members who are adequately qualified and knowledgeable to assign a rating. All rating decisions, including the decisions regarding changes in rating, should be taken by the rating committee. Credit rating agency should be staffed by analysts qualified to carry out a rating assignment. Credit rating agency should inform SEBI about new rating instruments or symbols introduced by it. Credit rating agency, while rating a security should exercise due diligence in order to ensure that the rating given by the credit rating agency is fair and appropriate. A credit rating agency should not rate securities issued by it. Rating definition, as well as the structure for a particular rating product, should not be changed by a credit rating agency, without prior information to SEBI. A credit rating agency should disclose to the concerned stock exchange through press release and websites for general investors, the rating assigned to the securities of a client, after periodic review, including changes in rating, if any.

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. No credit rating agency should rate a security issued by an entity, which is a borrower of its promoter or a subsidiary of its promoter or an associate of its promoter, if there are common Chairman, Directors between credit rating agency and these entities, there are common employees, there are common Chairman, Directors, Employees on the rating committee. No credit rating agency should rate a security issued by its associate or subsidiary, if the credit rating agency or its rating committee has a Chairman, director or employee who is also a Chairman, director or employee of any such entity. However, these conditions do not apply to securities whose rating has been already done by a credit rating agency before the commencement of these regulations, and such securities may, subject to the provisions of the other Chapters of these regulations, continue to be rated, without the need to comply with the restrictions imposed by the regulations.

Procedure for Inspection and Investigation

SEBI can appoint one or more persons as inspecting officers, to undertake inspection or investigation of the

books of account, records and documents of the credit rating agencies, for any of the purposes specified in the regulations. The purposes referred to in regulation should be to ascertain whether the books of account, records and documents are being maintained properly, to ascertain whether the provisions of the Act and these regulations are being complied with, to investigate into complaints received from investors, clients or any other person on any matter having a bearing on activities of the credit rating agency and in the interest of the securities market or in the interest of investors. The inspections ordered by SEBI should not ordinarily go into an examination of the appropriateness of the assigned ratings on the merits. Inspections to judge the appropriateness of the ratings may be ordered by SEBI, only in case of complaints which are serious in nature to be carried out either by the officers of SEBI or independent experts with relevant experience or combination of both.

Notice of Inspection or Investigation

SEBI shall give ten days written notice to the credit rating agency before ordering an inspection or investigation. SEBI in the interest of the investors may order in writing, direct that the inspection or investigation of the affairs of the credit rating agency to be taken up without such notice. During the course of an inspection or investigation, the credit rating agency against whom the inspection or investigation is being carried out should be bound to discharge all its obligations as provided in this regulation.

Obligations of Credit Rating Agency

It should be the duty of credit rating agency whose affairs are being inspected or investigated, and of every director, officer or employee thereof, to produce to the inspecting or investigating officer such books, accounts and other documents in its or his custody or control and furnish him with such statements and information relating to its rating activities, as the inspecting officer may require within such reasonable period as may be specified by the officer. The credit rating agency should allow the inspecting officer to have reasonable access to the premises occupied by such credit rating agency or by any other person on its behalf and extend to the inspecting officer reasonable facility for examining any books, records, documents and computer data in the possession of the credit rating agency and to provide copies of documents or other materials which, in the opinion of the inspecting officer, are relevant for the purposes of the inspection or investigation, as the case may be. The inspecting officer, in the course of inspection or investigation, should be entitled to examine, or record the statements, of any officer, director or employee of the credit rating agency for the purposes connected with the inspection or investigation. Every director, officer or employee of the credit rating agency is bound to render to the inspecting officer all assistance in connection with the inspection or investigation which the inspecting officer may reasonably require.

The inspecting officer should as soon as possible, on completion of the inspection or investigation, submit a report to SEBI. However if directed to do so by SEBI, he may submit an interim report. SEBI after considering the inspection report or the interim report referred to in regulation communicate the findings of the inspecting officer to the credit rating agency and give it a reasonable opportunity of being heard in the matter. SEBI may call upon the credit rating agency on receipt of the explanation, if any to take such measures as it may deem fit in the interest of the securities market and for due compliance with the provisions of the Act and the regulations.

ACTION IN CASE OF DEFAULT

A credit rating agency which –

- (a) fails to comply with any condition subject to which a certificate has been granted;
- (b) contravenes any of the provisions of the Act or these regulations or any other regulations made under the Act; shall be dealt with in the manner provided under Chapter V of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

Who regulates a rating agency?

The capital market regulator regulates rating agencies in most regions. In India, the Securities and Exchange Board of India (SEBI), regulates the credit rating agencies.

TRANSPARENCY & DISCLOSURE NORMS FOR CREDIT RATING AGENCIES

Recent events in global financial system have underlined the pivotal role that credit ratings play. Effective use of credit ratings by the users is crucially dependent upon quality and quantity of disclosures made by the Credit Rating Agencies (CRAs). There have been widespread consultations on the issue both globally and within India and several documents have been prepared. In the wake of the above and in order to impart higher credibility to the processes and procedures associated with the credit rating, SEBI in consultation with the CRAs, prescribed the following transparency and disclosure norms for the CRAs:

Rating Process

A CRA shall keep the following records in support of each credit rating and review / surveillance thereof:

- The important factors underlying the credit rating and sensitivity of such credit rating to changes in these factors;
- Summary of discussions with the issuer, its management, auditors and bankers which have a bearing on the credit rating;
- Decisions of the rating committee(s), including voting details and notes of dissent, if any, by any member of the rating committee, and
- If a quantitative model is a substantial component of the credit rating process, the rationale for any material difference between the credit rating implied by the model and the credit rating actually assigned.

These records should be maintained till five years after maturity of instruments and be made available to auditors and regulatory bodies when sought by them.

Default Studies

The CRA, should publish information about the historical default rates of CRA rating categories and whether the default rates of these categories have changed over time, so that the public can understand the historical performance of each category and if and how rating categories have changed, and be able to draw quality comparisons among ratings given by different CRAs. The default rates shall be calculated in the following manner:

- One Year Default Rate is the weighted average of default rates of all possible 1 year static pools in the 5-year period.
- Cumulative Default Rate: The cumulative default rate (CDR) represents the likelihood of an entity that was rated at the beginning of any multi-year period defaulting at any time during the multi-year period. Three-year cumulative default rate shall be computed as: Three-year CDR for rating category X = No. of issuers which defaulted over the three-year period / No. of issuers outstanding at the beginning of the three-year period.

Here,

Static Pool: Non-defaulted ratings that were outstanding at the beginning of any period.

Default: Non-payment of interest or principal amount in full on the pre-agreed date. A

CRA shall recognize default at the first instance of delay in servicing of interest or principal on the rated debt instrument.

Default Rate:	The number of defaults among rated entities in the static pool as a percentage of the total number of entities in the static pool.
Averaging:	All averaging across static pools for default rate computations must be based on the weighted average method where the weights are the number of ratings in each static period.

Dealing with Conflict of Interest

A CRA shall formulate the policies and internal codes for dealing with the conflict of interests. A CRA shall ensure that its analysts do not participate in any kind of marketing and business development including negotiations of fees with the issuer whose securities are being rated, the employees' involved in the credit rating process and their dependants do not have ownership of the shares of the issuer and prompt review of the credit ratings of the securities as and when any of its employees joins the respective issuer.

Obligations in Respect of Rating of Structured Finance Products

A CRA may undertake rating of structured finance products, namely, instruments/ pay-outs resulting from securitization transactions. In such cases, apart from following all the applicable requirements in case of non-structured ratings, the following additional requirements shall also be complied with:

- A CRA or its subsidiaries shall not provide consultancy or advisory services regarding the design of the structured finance instrument.
- The rating symbols shall clearly indicate that the ratings are for structured finance products.

Unsolicited Credit Ratings

In case of unsolicited credit ratings, i.e. the credit ratings not arising out of the agreement between a CRA and the issuer, credit rating symbol shall be accompanied by the word "UNSOLICITED" in the same font size. A CRA shall monitor and disclose credit rating during the life of the rated securities, as if it were a solicited rating.

Disclosures

In case of listed securities, the CRA shall also make disclosures to the stock exchanges as specified in the SEBI (Credit Ratings) Regulations, 1999. For ratings assigned and their periodic reviews, the CRA shall issue press releases which shall also be kept on their websites. Where a specific format has been prescribed, the disclosures shall be made in that format. A CRA shall make all the disclosures stipulated below on their websites:

- A CRA shall formulate and disclose its policies, methodology and procedures in detail regarding solicited and unsolicited credit ratings;
- A CRA shall disclose in the formats prescribed about details of new credit ratings assigned during last six-months; Movement of credit rating of all outstanding securities during the last six-months;
- Movement of each credit rating;
- Movement of each credit rating from investment grade to non investment grade and vice versa and
- Movement of each credit rating that has moved by more than one notch;
- The history of credit rating of all outstanding securities;
- On annual basis, the list of defaults separately for each rating category (e.g. AAA, AA, A, BBB, BB, B, C) This shall include the initial credit rating assigned by the CRA, month and year of initial rating, month and year of default, last credit rating assigned by the CRA before the issuer defaulted, comments of CRAs, if any.

- On annual basis, the average one-year and three-year cumulative default rates (based on weighted average), for the last 5 years, separately for each following category:
 - ▶ each credit rating category (e.g. AAA, AA, A, BBB, BB, B, C), separately;
 - ▶ structured instruments and non-structured instruments, separately
- A CRA shall disclose the general nature of its compensation arrangements with the issuers.
- A CRA shall disclose, in case of accepted ratings, its conflict of interest, if any, including the details of relationship – commercial or otherwise – between the issuer whose securities are being rated / any of its associate of such issuer and the CRA or its subsidiaries.
- A CRA shall disclose annually its total receipt from rating services and non-rating services, issuer wise percentage share of non-rating income of the CRA and its subsidiary to the total revenue of the CRA and its subsidiary from that issuer, and names of the rated issuers who along with their associate contribute 10% or more of total revenue of the CRA and its subsidiaries.
- While publishing the ratings of structured finance products and their movements, a CRA apart from following all the applicable requirements in case of non-structured ratings shall also disclose the track record of the originator and details of nature of underlying assets while assigning the credit rating. The track record shall include a brief description of the financials of the originator, rating migrations to speculative categories and defaults.
- A CRA shall also disclose at least once in every six months, the performance of the rated pool, i.e., collection efficiency, delinquencies. A CRA shall also provide a detailed description of the underlying pools including ageing, Credit enhancements such as liquidity supports, first and second loss guarantee provided shall also be disclosed.
- While publishing unsolicited ratings and their movements, a CRA apart from following all the applicable requirements in case of solicited ratings shall make the following disclosures:
 - ▶ the extent of participation by the issuer, its management, bankers and auditors in the credit rating process.
 - ▶ the information used and its source in arriving at and reviewing the credit rating.
- A CRA shall disclose annually all the unsolicited ratings carried out in the last three financial years; names of issuers, which were given, solicited rating in the last financial year.
- A CRA shall disclose its shareholding pattern as prescribed by stock exchanges for a listed company under clause 35 of Listing Agreement.
- A CRA shall disclose the compliance status of each provision of IOSCO code of conduct.

Implementation Schedule and Reporting

The half-yearly disclosures shall be made by the CRAs within 15 days from the end of the half-year (March / September). The yearly disclosures shall be made by the CRAs within 30 days from the end of the financial year.

A CRA can make additional disclosures other than those stipulated with the prior approval of its Board.

Points to Remember

If a company make a public issue of convertible debentures it has to obtained credit rating from one or more credit rating agencies. But in case of issue of equity shares it is optional.

INTERNAL AUDIT OF CREDIT RATING AGENCY

SEBI in consultation with the credit rating agencies (CRAs) prescribed that an internal audit on a half yearly basis to be undertaken by the CRAs which is envisaged under Regulation 22 of the SEBI (Credit Rating

Regulations), 1999 by Company Secretaries, Chartered Accountants, or Cost and Management Accountants who are in practice and who do not have any conflict of interest with the CRA. It shall cover all aspects of CRA operations and procedures, including investor grievance redressal mechanism, compliance with the requirements stipulated in the SEBI Act, Rules and Regulations made thereunder, and guidelines issued by SEBI from time to time. The report shall state the methodology adopted, deficiencies observed, and consideration of response of the management on the deficiencies and also include a summary of operations and of the audit, covering the size of operations, number of transactions audited and the number of instances where violations/deviations were observed while making observations on the compliance of any regulatory requirement. The report shall comment on the adequacy of systems adopted by the CRA for compliance with the requirements of regulations and guidelines issued by SEBI and investor grievance redressal.

The time schedule for the internal audit shall be as under:

- The CRA shall receive the report of the internal audit within two months from the end of the half-year.
- The Board of Directors of the CRA shall consider the report and take steps to rectify the deficiencies, if any, and the CRA shall send an Action Taken Report to SEBI within next two months.

RATING SYMBOLS AND DEFINITIONS

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

- (a) Long term debt instruments
- (b) Short term debt instruments
- (c) Long term structured finance instruments
- (d) Short term structured finance instruments
- (e) Long term mutual fund schemes and
- (f) Short term mutual fund schemes.

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

Long Term Debt Instruments

These instruments are with original maturity exceeding one year.

- | | |
|------------|--|
| AAA | – Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk. |
| AA | – Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk. |
| A | – Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk. |
| BBB | – Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk. |
| BB | – Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations. |
| B | – Instruments with this rating are considered to have high risk of default regarding timely servicing of financial obligations. |
| C | – Instruments with this rating are considered to have very high risk of default regarding timely servicing of financial obligations. |

D – Instruments with this rating are in default or are expected to be in default soon.

Modifiers {"+" (plus) / "-"(minus)} can be used with the rating symbols for the categories AA to C. The modifiers reflect the comparative standing within the category.

Short Term Debt Instruments

These instruments are with original maturity of upto one year.

- A1 – Instruments with this rating are considered to have very strong degree of safety regarding timely payment of financial obligations. Such instruments carry lowest credit risk.
- A2 – Instruments with this rating are considered to have strong degree of safety regarding timely payment of financial obligations. Such instruments carry low credit risk.
- A3 – Instruments with this rating are considered to have moderate degree of safety regarding timely payment of financial obligations. Such instruments carry higher credit risk as compared to instruments rated in the two higher categories.
- A4 – Instruments with this rating are considered to have minimal degree of safety regarding timely payment of financial obligations. Such instruments carry very high credit risk and are susceptible to default.
- D – Instruments with this rating are in default or expected to be in default on maturity.

Modifier {"+" (plus)} can be used with the rating symbols for the categories A1 to A4. The modifier reflects the comparative standing within the category.

Long Term Structured Finance Instruments

These instruments are with original maturity exceeding one year. Rating symbols should have CRA's first name as prefix.

- AAA (SO) – Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk.
- AA (SO) – Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.
- A (SO) – Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.
- BBB (SO) – Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk.
- BB(SO) – Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.
- B(SO) – Instruments with this rating are considered to have high risk of default regarding timely servicing of financial obligations.
- C (SO) – Instruments with this rating are considered to have very high likelihood of default regarding timely payment of financial obligations.
- D (SO) – Instruments with this rating are in default or are expected to be in default soon.

Modifiers {"+" (plus) / "-"(minus)} can be used with the rating symbols for the categories AA(SO) to C(SO). The modifiers reflect the comparative standing within the category.

Short Term Structured Finance Instruments

The instruments with original maturity of upto one year.

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- A1 (SO) – Instruments with this rating are considered to have very strong degree of safety regarding timely payment of financial obligation. Such instruments carry lowest credit risk.
- A2 (SO) – Instruments with this rating are considered to have strong degree of safety regarding timely payment of financial obligation. Such instruments carry low credit risk.
- A3 (SO) – Instruments with this rating are considered to have moderate degree of safety regarding timely payment of financial obligation. Such instruments carry higher credit risk a compared to instruments rated in the two higher categories.
- A4 (SO) – Instruments with this rating are considered to have minimal degree of safety regarding timely payment of financial obligation. Such instruments carry very high credit risk and are susceptible to default.
- D (SO) – Instruments with this rating are in default or expected to be in default on maturity.

Modifier {"+" (plus)} can be used with the rating symbols for the categories A1(SO) to A4(SO). The modifier reflects the comparative standing within the category.

Long Term Debt Mutual Fund Schemes

These debt mutual fund schemes have an original maturity exceeding one year. Rating symbols should have CRA's first name as prefix.

- AAAmfs – Schemes with this rating are considered to have the highest degree of safety regarding timely receipt of payments from the investments that they have made.
- AAmfs – Schemes with this rating are considered to have the high degree of safety regarding timely receipt of payments from the investments that they have made.
- Amfs – Schemes with this rating are considered to have the adequate degree of safety regarding timely receipt of payments from the investments that they have made.
- BBBmfs – Schemes with this rating are considered to have the moderate degree of safety regarding timely receipt of payments from the investments that they have made.
- BBmfs – Schemes with this rating are considered to have moderate risk of default regarding timely receipt of payments from the investments that they have made.
- Bmfs – Schemes with this rating are considered to have high risk of default regarding timely receipt of payments from the investments that they have made.
- Cmfs – Schemes with this rating are considered to have very high risk of default regarding timely receipt of payments from the investments that they have made.

Modifiers {"+" (plus) / "-"(minus)} can be used with the rating symbols for the categories AAmfs to Cmfs. The modifiers reflect the comparative standing within the category.

Short Term Debt Mutual Fund Schemes

These debt mutual fund schemes that have an original maturity of upto one year. Rating symbols should have CRA's first name as prefix.

- A1mfs – Schemes with this rating are considered to have very strong degree of safety regarding timely receipt of payments from the investments that they have made.
- A2mfs – Schemes with this rating are considered to have strong degree of safety regarding timely receipt of payments from the investments that they have made.
- A3mfs – Schemes with this rating are considered to have moderate degree of safety regarding timely receipt of payments from the investments that they have made.

A4mfs – Schemes with this rating are considered to have minimal degree of safety regarding timely receipt of payments from the investments that they have made.

Modifier {"+" (plus)} can be used with the rating symbols for the categories A1mfs to A4mfs. The modifier reflects the comparative standing within the category.

IPO GRADING

IPO grading (Initial Public Offering Grading) is a service aimed at facilitating the assessment of equity issues offered to public. The grade assigned to any individual issue represents a relative assessment of the 'fundamentals' of that issue in relation to the universe of other listed equity securities in India. Such grading is assigned on a five-point scale with a higher score indicating stronger fundamentals.

IPO grading is different from an investment recommendation. Investment recommendations are expressed as 'buy', 'hold' or 'sell' and are based on a security specific comparison of its assessed 'fundamentals factors' (business prospects, financial position etc.) and 'market factors' (liquidity, demand supply etc.) to its price. On the other hand, IPO grading is expressed on a five-point scale and is a relative comparison of the assessed fundamentals of the graded issue to other listed equity securities in India.

As the IPO grading does not take cognizance of the price of the security, it is not an investment recommendation. Rather, it is one of the inputs to the investor to aiding in the decision making process.

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

SEBI has been taking a pioneering role in investor protection by increasing disclosure levels by entities seeking to access equity markets for funding. This has caused India to be amongst one of the more transparent and efficient capital markets in the world. However, these disclosures demand fairly high levels of analytical sophistication of the reader in order to effectively achieve the goal of information dissemination.

IPO grading is positioned as a service that provides 'an independent assessment of fundamentals' to aid comparative assessment that would prove useful as an information and investment tool for investors. Moreover, such a service would be particularly useful for assessing the offerings of companies accessing the equity markets for the first time where there is no track record of their market performance.

As mentioned above, the IPO grade assigned to any issue represents a relative assessment of the 'fundamentals' of that issue in relation to the universe of other listed equity securities in India. This grading can be used by the investor as tool to make investment decision. The IPO grading will help the investor better appreciate the meaning of the disclosures in the issue documents to the extent that they affect the issue's fundamentals. Thus, IPO grading is an additional investor information and investment guidance tool.

Procedure for IPO Grading

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

SEBI does not play any role in the assessment made by the grading agency. The grading is intended to be an independent and unbiased opinion of that agency.

It is intended that IPO fundamentals would be graded on a five point scale from grade 5 (indicating strong fundamentals) to grade 1 (indicating poor fundamentals). The grade would read as: "Rating Agency name" IPO Grade 1 viz. CARE IPO Grade 1, CRISIL IPO Grade 1 etc.

The assigned grade would be a one time assessment done at the time of the IPO and meant to aid investors who are interested in investing in the IPO. The grade will not have any ongoing validity.

The company needs to first contact one of the grading agencies and mandate it for the grading exercise. The

agency would then follow the process outlined below.

- Seek information required for the grading from the company.
- On receipt of required information, have discussions with the company's management and visit the company's operating locations, if required.
- Prepare an analytical assessment report.
- Present the analysis to a committee comprising senior executives of the concerned grading agency. This committee would discuss all relevant issues and assign a grade.
- Communicate the grade to the company along with an assessment report outlining the rationale for the grade assigned.

Though this process will ideally require 2-3 weeks for completion, it may be a good idea for companies to initiate the grading process about 6-8 weeks before the targeted IPO date to provide sufficient time for any contingencies.

LESSON ROUND UP

- Credit rating is the evaluation of the credit worthiness of an individual or of a business concern or of an instrument of a business based on relevant factors indicating ability and willingness to pay obligations as well as net worth.
- The main purpose of credit rating is to communicate to the investors the relative ranking of the default loss probability for a given fixed income investment, in comparison with other rated instruments.
- In India CRISIL (Credit Rating and Information Services (India) Limited) was set up as the first credit rating agency in 1987. This was followed by ICRA Limited (Investment Information and Credit Rating Agency of India Limited) in 1991 and CARE (Credit Analysis and Research Limited) in 1994, in 1999 Fitch Rating India Pvt. Ltd. now known as India Ratings and Research Pvt. Ltd, Brickwork Ratings Pvt. Ltd. in 2008 and SMERA (SME Rating Agency of India Limited) in 2011. All these six credit rating agencies are registered with the Securities and Exchange Board of India.
- Credit Rating Agencies are regulated by SEBI (Credit Rating Agencies) Regulations, 1999.
- SEBI has also prescribed Transparency and Disclosure Norms (Guidelines) for Credit Rating Agencies.
- Practising Company Secretaries are authorized to undertake Internal Audit of CRAs.
- SEBI in consultation with the CRAs and considering the international practices, standardised the Credit Rating Symbols and their definitions for different instruments.
- IPO grading (Initial Public Offering Grading) is a service aimed at facilitating the assessment of equity issues offered to public.
- IPO grading is optional for public issue w.e.f. February 04, 2014.

GLOSSARY

Acid Test Ratio	The value of cash equivalents and accounts receivable (the quick assets) divided by current liabilities. Also known as quick asset ratio or liquidity ratio, it is a measurement of corporate liquidity.
Credit Rating Agency	Credit rating agency means a body corporate which is engaged in, or proposes to be engaged in, the business of rating of securities offered by way of public or rights issue.
Credit Risk	The risk that a counter party will not settle an obligation for full value, either when due or at anytime thereafter. Credit risk includes pre-settlement risk (replacement cost

Lesson 4

Securities Market Intermediaries

LESSON OUTLINE

- Introduction
- Role of Capital Market Intermediaries
- Merchant Bankers
- Registrars and Share Transfer Agents
- Underwriters
- Bankers to issue
- Debenture Trustees
- Portfolio managers
- Syndicate members
- Custodians
- Stock-broker and sub-broker
- Investment Adviser
- Credit Rating Agencies
- Depository Participant
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

Market intermediaries are the institutions which facilitate the smooth functioning of the securities market. They enable the issuers of securities to interact with the investors in the primary as well as the secondary market. They are an important constituent of the securities market. These intermediaries are useful for both the investors as well as to the corporates. They help the investors by providing investment consultancy by their expertise in market analysis and also help the corporates for fund raising by their marketing skills.

This lesson will enable the students to have the basic idea about the Intermediaries playing in the Securities Market and about their role and functions in the primary and secondary market.

INTRODUCTION

The capital market intermediaries are vital link between investor, issuer and regulator. The objective of these intermediaries is to smoothen the process of investment and to establish a link between the investors and the users of funds. Corporations and Governments do not market their securities directly to the investors. Instead, they hire the services of the market intermediaries to represent them to the investors. Investors, particularly small investors, find it difficult to make direct investment. A small investor desiring to invest may not find a willing and desirable borrower. He may not be able to diversify across borrowers to reduce risk. He may not be equipped to assess and monitor the credit risk of borrowers. Market intermediaries help investors to select investments by providing investment consultancy, market analysis and credit rating of investment instruments. In order to operate in secondary market, the investors have to transact through share brokers. Registrars and Share Transfer Agents, Custodians and Depositories are capital market intermediaries that provide important infrastructure services for both primary and secondary markets.

According to SEBI (Intermediaries) Regulations, 2008, “intermediary” means a person mentioned in clauses (b) and (ba) of sub-section (2) of section 11 and sub-section (1) and (1A) of section 12 of the Act and includes an asset management company in relation to the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, a clearing member of a clearing corporation or clearing house and a trading member of a derivative segment or currency derivatives segment of a stock exchange **but does not include foreign institutional investor, foreign venture capital investor, mutual fund, collective investment scheme and venture capital fund.**

ROLE OF CAPITAL MARKET INTERMEDIARIES

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

These market intermediaries provide different types of financial services to the investors. They are constantly operating in the financial market. It is in their (market intermediaries) own interest to behave rationally, maintain integrity and to protect and maintain reputation, otherwise the investors would not be trusting them next time. In principle, these intermediaries bring efficiency to corporate fund raising by developing expertise in pricing new issues and marketing them to the investors.

Presently this lesson briefly covers in a nutshell the core functions of each one of the intermediaries operating in the Primary and the Secondary markets. The Regulatory framework for these intermediaries are covered through different lessons under this module.

The following market intermediaries are involved in the Securities Market:

- Merchant Bankers
- Registrars and Share Transfer Agents
- Underwriters
- Bankers to issue
- Debenture Trustees
- Portfolio managers
- Syndicate members
- Stock-brokers and sub-brokers

- Custodians
- Investment Advisers
- Credit Rating Agencies
- Depository Participant

MERCHANT BANKERS

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

Among the important financial intermediaries are the merchant bankers. They are the key intermediary between the company and issue of capital. It is quite common to come across reference to Merchant Banking and financial services as though they are distinct categories. The services provided by Merchant Bankers depend on their inclination and resources - technical and financial. Merchant bankers (Category I) are mandated by SEBI to manage public issues (as lead managers) and open offers in take-overs. These two activities have major implications for the integrity of the market. They affect investors' interest and, therefore, transparency has to be ensured. Merchant Bankers are rendering diverse services and functions. These include organising and extending finance for investment in projects, assistance in financial management, raising Eurodollar loans and issue of foreign currency bonds. Different merchant bankers specialised in different services.

SEBI has advised that merchant Bankers shall undertake only those activities which relate to securities market. These activities are:

- (a) Managing of public issue of securities;
- (b) Underwriting connected with the aforesaid public issue management business;
- (c) Managing/Advising on international offerings of debt/equity i.e. GDR, ADR, bonds and other instruments;
- (d) Private placement of securities;
- (e) Primary or satellite dealership of government securities;
- (f) Corporate advisory services related to securities market including takeovers, acquisition and disinvestment;
- (g) Stock broking;
- (h) Advisory services for projects;
- (i) Syndication of rupee term loans;
- (j) International financial advisory services.

The activities of the Merchant Bankers in the Indian capital market are regulated by SEBI (Merchant Bankers) Regulations, 1992.

REGISTRARS AND SHARE TRANSFER AGENTS

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

- (i) collecting application for investor in respect of an issue;
- (ii) keeping a proper record of applications and monies received from investors or paid to the seller of the securities;
- (iii) (a) assisting body corporate or person or group of persons in determining the basis of allotment of the securities in consultation with the stock exchange;

- (b) finalising the list of person entitled to allotment of securities;
- (c) processing and despatchment of allotment letters, refund orders or certificates and other related documents in respect of the issue;

‘Share Transfer Agent’ means:

- (i) any person who on behalf of any body corporate, maintains the records of holders of securities issued by such body corporate and deals with all matters connected with the transfer and redemption of its securities;
- (ii) the department or division, by whatever name called, of a body corporate performing the activities as share transfer agents if at any time the total number of holders of its securities issued exceed one lakh.

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

They also render service to the existing companies in servicing the share capital contributed by the investors. The system of share transfers gives liquidity to the investment and helps the investors to easily acquire or dispose off shares in the secondary market. The share transfer agents who have the necessary expertise, trained staff, reliable infrastructure and SEBI licence render service to the corporates by undertaking and executing the transfer and transmission work relating to the company’s shares and securities. Thus they have a role to play both in the primary and the secondary markets.

Pre-issue Activities

- Sending instructions to Banks for reporting of collection figures and collection of applications.
- Providing Practical inputs to the Lead Manager and Printers regarding the design of the Bid cum-Application form.
- Facilitate and establish information flow system between clients , Banks and Managers to the issue.
- Liaison with Regulatory Authorities such as SEBI & Stock Exchanges.

Activities during the Issue

- Collection and Reporting of daily Collection figures.
- Collection of Data and Forms from Banks.
- Liaising with clients and Intermediaries to the Issue.

Post Issue Activities

- Data capturing & validation.
- Reconciliation.
- Provide Allotment Alternatives in consultation with Client / Merchant Banker and Stock Exchanges.
- Facilitating Listing.
- Filing of Return of Allotment.
- Uploading of data to the Depositories for crediting of securities electronically.
- Dispatch of Refund orders / Share Certificates / Credit Advise.
- Periodic Report submission to Regulatory Authorities.

- Reconciliation of Refund payments.
- Attending to post issue Investor queries.
- Web-based investor enquiry system for allotment / refund details.

Share Transfer Agent Services

- Processing of transfer of Securities in physical form.
- Processing Transmission / Transposition / Consolidation of holdings.
- Processing of demat requests and converting physical holding into electronic holding (dematerialization).
- Processing of remat requests and converting electronic holding into physical holding (rematerialization)
- Recording of specimen signatures in electronic media.
- Recording of Change of address, Bank Mandates and ECS requests received from investors in physical mode.
- Accurate scanning and capturing of data.
- Issue of Duplicate/split/Consolidated Share Certificates .
- Registration of Nomination.
- Registration of Legal documents such as Power of Attorney etc.
- Dividend payout management services.
- Maintenance of Records of Inward/Outward.
- Maintain and upkeep of statutory records such as Transfer Deeds , Demat / Remat Request Form, Register of Members , Allotment Registers , undelivered returned security documents and other Registers and Returns.
- Processing of Call payments and Endorsements.
- Investor Services including providing investor related information, across counters through written communication and through telephone and via e-mail.
- Integrating electronic beneficiary positions with the physical shareholding.
- Redress Investor Complaints which appears in SEBI Complaints Redress System (SCORES).
- Assisting Client Companies in the redressing investor grievances which appears in their ID.

UNDERWRITERS

Underwriter means a person who engages in the business of underwriting of an issue of securities of a body corporate.

Underwriting is an arrangement whereby certain parties assure the issuing company to take up shares, debentures or other securities to a specified extent in case the public subscription does not amount to the expected levels. 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.

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

It is the underwriter who agrees to take up securities which are not fully subscribed in a public issue. The underwriter makes a commitment to get the issue subscribing either by others or by themselves.

The lead managers are required to satisfy themselves about the networth of the underwriters and their outstanding commitments and disclose the same to SEBI. In this connection each underwriter should furnish an undertaking to the lead manager about their networth and outstanding commitments. Both the lead managers and the directors are required to give a statement in the prospectus that in their opinion the underwriters have the necessary resources to discharge their liabilities, if any, in full. Penal action will be taken against underwriters for not taking up the assured amount of security in case of development and to debar them from the underwriting public issues in future.

BANKERS TO AN ISSUE

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

- (i) Acceptance of application and application monies;
- (ii) Acceptance of allotment or call monies;
- (iii) Refund of application monies;
- (iv) Payment of dividend or interest warrants.

Bankers to the issue, as the name suggests, carries out all the activities of ensuring that the funds are collected and transferred to the Escrow accounts. The Banks render crucial service in mobilisation of capital for companies. While one or more banks may function as Bankers to the Issue as well as collection banks, others may do the limited work of collecting the applications for securities along with the remittance in their numerous branches in different centres. The banks are expected to furnish prompt information and records to the company and to the lead manager for monitoring and progressing the issue work. For this purpose, the company has to enter into an agreement with different banks specifying the conditions, terms and remuneration for services to be rendered by each such bank.

DEBENTURE TRUSTEES

'Debenture Trustee' means a trustee of a trust deed for securing any issue of debentures of a body corporate. Debentures, Bonds and other hybrid instruments in most cases unless otherwise specified, carry securities for the investors 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.

Role and Functions include:

- Call for periodical reports from the body corporate, i.e., issuer of debentures.
- Take possession of trust property in accordance with the provisions of the trust deed.
- Enforce security in the interest of the debenture holders.
- Ensure on a continuous basis that the property charged to the debenture is available and adequate at all times to discharge the interest and principal amount payable in respect of the debentures and that such property is free from any other encumbrances except those which are specifically agreed with the debenture trustee.

- 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.
- 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.
- 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.
- Inform the Board immediately of any breach of trust deed or provision of any law.
- Appoint a nominee director on the board of the body corporate when required.

PORTFOLIO MANAGERS

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

A portfolio manager plays a pivotal role in deciding the best investment plan for an individual as per his income, age as well as ability to undertake risks. A portfolio manager is responsible for making an individual aware of the various investment tools available in the market and benefits associated with each plan. Make an individual realize why he actually needs to invest and which plan would be the best for him. A portfolio manager is responsible for designing customized investment solutions for the clients according to their financial needs.

SYNDICATE MEMBERS

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

Syndicate Member/Broker is a member of the Stock Exchange to whom the investor has to submit the IPO Bid/ Application form. The Syndicate Member / Broker receives the bid and uploads the same on to the electronic book of the stock exchange. The Syndicate Member/Broker, then submits the bid with cheque to the bankers. In case of online application, the Syndicate Member/Broker generates the electronic application form and submits the same to the registrar with proof of having paid the bid amount.

STOCK BROKERS & SUB-BROKER

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

A sub-broker is one who works along with the main broker and is not directly registered with the stock exchange as a member. Sub-broker means any person not being a member of stock exchange who acts on behalf of a stock broker as an agent or otherwise for assisting the investors in buying, selling or dealing in securities through such stock brokers.

A stock broker plays a very important role in the secondary market helping both the seller and the buyer of the

securities to enter into a transaction. The buyer and seller may be either a broker or a client. The transaction entered cannot be annulled except in the case of fraud, willful misrepresentation or upon prima-facie evidence of a material mistake in the transaction, in the judgement of the existing authorities. If a member of the stock exchange (broker) has orders to buy and to sell the same kind of securities, he may complete the transaction between his clients concerned.

When executing an order the stock broker may on behalf of his client buy or sell securities from his own account i.e. as principal or act as an agent. For each transaction he has to issue necessary contract note indicating whether the transaction has been entered into by him as a principal or as an agent for another. While buying or selling securities as a principal, the stock broker has to obtain the consent of his client and the prices charged should be fair and justified by the conditions of the market.

CUSTODIANS

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

Every custodian should have adequate facilities, sufficient capital and financial strength to manage the custodial services.

The SEBI (Custodian of Securities) Regulations, 1996 prescribe the roles and responsibilities of the custodians. According to the SEBI the roles and responsibilities of the custodians are to:

- Administrate and protect the assets of the clients.
- Open a separate custody account and deposit account in the name of each client.
- Record assets.
- Conduct registration of securities.

Custodial services refer to the safeguarding of securities of a client. The activities relating to custodial services involve collecting the rights benefiting the client in respect to securities, maintaining the securities' account of the client, informing the clients about the actions taken or to be taken, and maintaining records of the services.

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 advisers are those, who guide one about his or her financial dealings and investments.

The globalization of the capital markets, the proliferation of asset classes and the bewildering variety of risks that the average institutional investor is confronted which have increased the need for the specialized expertise that investment advisers provide. The role of investment adviser has got a lot of significance in the present time. Investment adviser serve as facilitators, making sure that all clients have many opportunities to express their financial concerns and issues. Basically Investment adviser give advice and provide services related to the investment management process. The rapid change of market conditions as well as the availability of numerous options for financial investments necessitates the existence of knowledgeable investment adviser. In order to add value, the investment adviser is called upon to apply specialized knowledge, experience and analytical resources to create and deliver focused advice to client and works to increase the investment knowledge of clients and thereby support the fiduciary obligations clients face in the management of their plan.

CREDIT RATING AGENCY

Credit Ratings Agency means a body corporate engaged in or proposes to be engaged in the business of rating of securities offered by way of public or rights issue.

Credit ratings establish a link between risk and return. They thus provide a yardstick against which to measure the risk inherent in any instrument. An investor uses the ratings to assess the risk level and compares the offered rate of return with his expected rate of return (for the particular level of risk) to optimise his risk-return trade-off.

Credit rating is extremely important as it not only plays a role in investor protection but also benefits industry as a whole in terms of direct mobilization of savings from individuals. Rating also provide a marketing tool to the company and its investment bankers in placing company's debt obligations with an investor base that is aware of, and comfortable with, the level of risk. Ratings also encourage discipline amongst corporate borrowers to improve their financial structure and operating risks to obtain a better rating for their debt obligations and thereby lower the cost of borrowing. Companies those get a lower rating are forewarned, as it were and have the freedom, if they desire, to take steps on their financial or business risks and thereby improve their standing in the market. Credit ratings provide individual and institutional investors with information that assists them in determining whether issuers of debt obligations and fixed-income securities will be able to meet their obligations with respect to those securities. Credit rating agencies provide investors with objective analyses and independent assessments of companies that issue such securities.

DEPOSITORY PARTICIPANT

The Depositories Act, 1996 defines a depository to mean "a company formed and registered under the Companies Act, 2013 and which has been granted a certificate of registration under sub-section (IA) of section 12 of the Securities and Exchange Board of India Act, 1992."

A "Depository Participant" (DP) is an agent of the depository who is authorised to offer depository services to investors. Financial institutions, banks, custodians and stockbrokers complying with the requirements prescribed by SEBI/ Depositories can be registered as DP.

A Depository Participant (DP) is described as an agent of the depository. They are the intermediaries between the depository and the investors. The relationship between the DPs and the depository is governed by an agreement made between the two under the Depositories Act, 1996. In a strictly legal sense, a DP is an entity who is registered as such with SEBI under the provisions of the SEBI Act. As per the provisions of this Act, a DP can offer depository related services only after obtaining a certificate of registration from SEBI.

The Depository Participant (DP) maintains securities account balances and intimate the status of holding to the account holder from time to time. While the depository can be compared to a bank, a DP is like a branch of that bank with which an account be opened.

The principal function of a depository is to dematerialise securities and enable their transactions in book-entry form. Dematerialisation of securities occurs when securities issued in physical form are destroyed and an equivalent number of securities are credited into the beneficiary owner's account. In a depository system, the investors stand to gain by way of lower costs and lower risks of theft or forgery, etc. They also benefit in terms of efficiency of the process. A depository established under the Depositories Act can provide any service connected with recording of allotment of securities or transfer of ownership of securities in the record of a depository. A depository cannot directly open accounts and provide services to clients. Any person willing to avail of the services of the depository can do so by entering into an agreement with the depository through any of its Depository Participants.

LESSON ROUND UP

- The role of intermediaries makes the market vibrant, and to function smoothly and continuously. Intermediaries possess professional expertise and play a promotional role in organising a perfect match between the supply and demand for capital in the market.
- Merchant Bankers are the key intermediaries between the company and issue of capital. The activities of the Merchant Bankers in the Indian capital market are regulated by SEBI (Merchant Bankers) Regulation, 1992.
- Underwriting is compulsory for a public issue. It is necessary for a public company which invites public subscription for its securities to ensure that its issue is fully subscribed.
- Bankers to the issue, as the name suggests, carries out all the activities of ensuring that the funds are collected and transferred to the Escrow accounts.
- A stock broker plays a very important role in the secondary market helping both the seller and the buyer of the securities to enter into a transaction.
- Investment advisers are those who guide one about his or her financial dealings and investments.
- Credit rating is extremely important as it not only plays a role in investor protection but also benefits industry as a whole in terms of direct mobilization of savings from individuals.
- The principal function of a depository is to dematerialise securities and enable their transactions in book-entry form.

GLOSSARY

Portfolio	A collection of securities owned by an individual or an institution (such as a mutual fund) that may include stocks, bonds and money market securities.
Investment Profit	Profit which results from the difference between the purchase and selling prices of a security. Trading profit is short term while investment profit is medium or long term.
Netting	A system whereby outstanding financial contracts can be settled at a net figure, i.e. receivables are offset against payables to reduce the credit exposure to a counterparty and to minimize settlement risk.
Institutional Investors	Organisations those invest including insurance companies, depository institutions, pension funds, investment companies and endowment funds.

SELF TEST QUESTIONS

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

1. Explain briefly the role and responsibilities of Registrar and Transfer Agent.
2. Enumerate the functions of Banker to An Issue in the securities market.
3. What is a debenture trustee? Discuss the responsibilities of a debenture trustee.
4. What is an Investment Adviser? Briefly explain the role and functions of investment advisers in capital market.

Lesson 5

Market Infrastructure Institutions – Stock Exchange Trading Mechanism

LESSON OUTLINE

- Introduction
- Stock Exchange Trading Mechanism
- Short selling and Securities Lending and Borrowing
- Bombay Stock Exchange Ltd.
- Basket Trading System
- National Stock Exchange of India Ltd. (NSEIL)
- Straight Through Processing
- Direct Market Access
- Algorithmic Trading
- Demutualization of Stock Exchange
- SME Exchange
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

Stock exchange is taken as a Barometer of the economy of a country. It is the most dynamic and organised component of capital market. Especially, in developing countries like India, the stock exchanges play a cardinal role in promoting the level of capital formation through effective mobilisation of savings and ensuring investment safety. It is equally important to have the understanding of the governance of Stock Exchanges, and the services they provide to investors.

This lesson will enable the students to understand the Regulation of Stock Exchange & Clearing Corporations, Operation of stock exchanges, Stock Exchange Trading Mechanism, Short Selling and Securities Lending and Borrowing, Straight Through Processing, Direct Market Access and Algorithmic Trading, Demutualization of Stock Exchange, SME Exchange and advantages of SME Exchange etc.

INTRODUCTION

There are 15 stock exchanges at present in India. All of them are regulated in terms of Securities Contract (Regulation) Act, 1956 and SEBI Act, 1992 and the rules and regulations made thereunder. Some of the exchanges started of as voluntary non-profit associations such as Bombay Stock Exchange (BSE) and Indore Stock Exchange. The Stock Exchanges at Chennai, Jaipur, Hyderabad and Pune were incorporated as companies limited by guarantee. The other stock exchanges are companies limited by shares and incorporated under the Companies Act, 1956 or earlier acts.

The stock exchanges are managed by Board of Directors or Council of Management consisting of elected brokers and representatives of Government and Public appointed by SEBI. The Boards of stock exchanges are empowered to make and enforce rules, bye-laws and regulations with jurisdiction over all its members.

The Acts, Rules and Regulations governing the stock exchanges have been separately discussed in a lesson in Part B of this study material.

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

STOCK EXCHANGE TRADING MECHANISM

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

Stock exchanges thus represent the market place for buying and selling of securities and ensuring liquidity to them in the interest of the investors. The stock exchanges are virtually the nerve centre of the capital market and reflect the health of the country's economy as a whole.

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

Shares of companies which are not in the spot list are known as 'cash' shares or 'B' Category shares. They are traded on cash basis or delivery basis and cannot be traded on settlement basis. The actual delivery of securities and payment has to be made on or before the settlement date fixed in the case of cash basis trading.

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

All securities whether the specified list or cash list can be traded on spot basis or cash basis.

Types of Securities

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

- (1) **Listed cleared Securities:** The securities of companies, which have signed the listing agreement with a stock exchange, are traded as "Listed Securities" in that exchange. The securities admitted for dealing on stock exchange after complying with all the listing requirements and displayed by the Board on the list of cleared securities.
- (2) **Permitted Securities:** To facilitate the market participants to trade in securities of such companies, which are actively traded at other stock exchanges but are not listed on an exchange, trading in such

securities is facilitated as “permitted securities” provided they meet the relevant norms specified by the stock exchange.

Types of Delivery

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

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

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

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

Margins

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

Margin Trading

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

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

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

When the balance deposit in the client’s margin account falls below the required maintenance margin, the broker shall promptly make margin calls. However, no further exposure can be granted to the client on the basis of any increase in the market value of the securities.

The broker may liquidate the securities if the client fails to meet the margin calls made by the broker or fails to deposit the cheques on the day following the day on which the margin call has been made or the cheque has been dishonoured.

The broker may also liquidate the securities in case the client’s deposit in the margin account (after adjustment for mark to market losses) falls to 30% or less of the latest market value of the securities, in the interregnum between making of the margin call and receipt of payment from the client.

The broker must disclose to the stock exchange details on gross exposure including the name of the client, unique identification number, name of the scrip and if the broker has borrowed funds for the purpose of providing margin trading facilities, name of the lender and amount borrowed, on or before 12 Noon on the following day.

Stock exchanges disclose scripwise gross outstanding in margin accounts with all brokers to the market. Such disclosures regarding margin trading done on any day shall be made available after the trading hours on the following day through the website.

Thus, margin trading acts as a check on the tendency of clients to manipulate markets by placing orders on brokers without having adequate money or securities to backup the transaction.

Margin trading will also acts as a curb on short selling and short buying.

The reduction in above tendencies on the part of clients reduces volatility of prices on the stock exchange and provides stability to the common investors.

Margin trading mechanism also ensures transparency in dealings in securities and public exposure of the information regarding the backing behind all major securities transactions.

In the Indian capital markets particularly excessive short selling and market positioning have been rampant. Margin trading has acted as a stabilising force.

Book Closure and Record Date

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

In accordance with Section 91 of the Companies Act, 2013 a company may close the register of members for a maximum of 45 days in a year and for not more than 30 days at any one time. Book closure is necessary for the purpose of paying dividend, making rights issue or bonus issue. The listed company is required to give notice of book closure in a news paper at least 7 days before the commencement of the book closure. The members whose names appear in the register of members on the last date of book closure are entitled to receive the benefits of dividend, right shares or bonus shares as the case may be.

Trading of Partly Paid Shares and Debentures

Companies fix the last date for payment of allotment or call money in case of partly paid shares or debentures and intimate this to all the stock exchanges wherein such shares or debentures are listed. Based on the date fixed by the company, the stock exchanges determine the settlement date upto which transactions in the scrip will be deemed to be good for delivery. After the said date, transactions in the securities take place only if they are paid up to the extent money has been called up.

Trend Line

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

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

Trading Volume

Trading volumes confirm whether the rise or fall in prices is in line with the trend. The high trading volume is built on rising prices, similarly the high trading volume is also linked with fall in prices. They respectively reflect a BULLISH trend and a BEARISH trend.

Turnover and Outstanding Position

The net turnover and outstanding positions in various scrips show the extent of BULLISH interest in them and are used along with trading volume to judge the intensity of the phase whether BULLISH or BEARISH. In a BULL phase there will be a sharp rise in the daily turnover of key scrips and in a BEAR phase the reverse will be the case.

MARKET MAKING

Though there are thousand companies listed on the stock exchanges in India only a few of them are being

actively traded in the market. Thus the market sentiment was not representative of a wide range of industries or companies, because mostly concentrated on a few scrips. This leads one to conclude that mere listing of securities does not provide liquidity to scrips. A process known as market making was clearly needed to build up liquidity. The market maker by offering a two way quote not only increases the supply of scrips but also triggers of a demand in the scrips. SEBI has taken the view that market making will go a long way in reducing the bane of concentration and thus eliminating the influence of the unbalanced Sensitive Index.

Market-making is aimed at infusing liquidity in securities that are not frequently traded on stock exchanges. A market-maker is responsible for enhancing the demand supply situation in securities such as stocks and futures & options (F&O). To understand this concept better, it would be helpful to have an idea about the existing screen based electronic trading system. In this system , orders placed by buyers and sellers are matched by a computer system (run by stock exchanges). This system is beneficial for actively-traded stocks, but not for lesser-traded ones. Investors usually ignore thinly-traded stocks despite good fundamentals due to fears that they might not be able to trade more frequently in them. This is where a market maker comes into the picture. The introduction of the market-making facility could be a possible means to infuse liquidity into such shares. In overseas markets, a market-maker is usually a broker or an institution. As a result, there is an incentive for the broker to recommend securities for which he creates a market.

A market-maker usually is responsible for enhancing activity in a few chosen securities. In the process, the market-maker provides both a buy and a sell quote for his chosen securities. He profits from the spread between buy and sell quotes. For example, if the market-maker gives a bid-ask quote of ₹ 505-500 (which means the market-maker will buy from the market at ₹ 500 and sell at ₹ 505), then the profit is ₹ 5. For illiquid securities, the profit spreads are usually higher (within a regulator-prescribed band) because of the higher risk taken by the market-maker.

Market-makers are obligated to buy or sell the security at a price and size they have quoted. One may wonder the role of a market- maker in the computerised system , as investors can transact directly without a third party. The market-maker's role here is to ensure supply of stocks at any given point in time. Market-makers are helpful as they are always ready to buy or sell as long as investors are willing to pay the price quoted by them.

SECURITIES LENDING

This method is regulated by SEBI which introduced guidelines in 1997 for this purpose. Under the scheme, a person with idle shares can lend them to another who does not have the shares to fulfill his obligation under a trade finalised by him. There will be no direct contacts between the borrower and lender of securities. An intermediary who can guarantee the scheme and make good the loss in the borrower who fails to honour his obligations can alone provide substance to the scheme. The borrower has to put up collateral for his borrowings and pay cash margin levied on the securities by the authorities. Income from securities lending is exempt from Capital Gains Tax.

SECURITIES' LENDING AND BORROWING

Securities' Lending and Borrowing describes the market practice whereby securities are temporarily transferred by one party (the lender) to another (the borrower) via an approved intermediary.

The Borrower is obliged to return them either on demand or at the end of an agreed term and also has an option to early return. Lender may recall securities at any time within normal market settlement cycle. SLB is a major and growing activity which provides significant benefits for issuers, investors and traders alike. SLB helps in improving market liquidity, more efficient settlement, tighter dealer prices and perhaps a reduction in the cost of capital.

Why participate in Securities Lending & Borrowing ?

- Lender's Motivation
- It provides lender incremental return on an idle portfolio.

- Borrower's Motivation
- To cover a short position: avoidance of settlement failure.
- Hedging of futures & options positions.
- Borrow and lend to reap benefits of the market sentiment.

SHORT SELLING AND SECURITIES LENDING AND BORROWING

SEBI vide Circular no MRD/DoP/SE/Dep/Cir- 14 /2007 dated December 20, 2007 permitted all classes of investors to short sell subject to the broad framework specified there in which are enumerated as follows.

Broad Framework for Short Selling

- “Short selling” shall be defined as selling a stock which the seller does not own at the time of trade.
- All classes of investors, viz., retail and institutional investors, shall be permitted to short sell.
- Naked short selling shall not be permitted in the Indian securities market and accordingly, all investors would be required to mandatorily honour their obligation of delivering the securities at the time of settlement.
- No institutional investor shall be allowed to do day trading i.e., square-of their transactions intra-day. In other words, all transactions would be grossed for institutional investors at the custodians' level and the institutions would be required to fulfill their obligations on a gross basis.
- The custodians, however, would continue to settle their deliveries on a net basis with the stock exchanges.
- The stock exchanges shall frame necessary uniform deterrent provisions and take appropriate action against the brokers for failure to deliver securities at the time of settlement which shall act as a sufficient deterrent against failure to deliver.
- A scheme for Securities Lending and Borrowing (SLB) shall be put in place to provide the necessary impetus to short sell. The introduction of fullfledged securities lending and borrowing scheme shall be simultaneous with the introduction of short selling by institutional investors.
- The securities traded in F&O segment shall be eligible for short selling.
- SEBI may review the list of stocks that are eligible for short selling transactions from time to time.
- The institutional investors shall disclose upfront at the time of placement of order whether the transaction is a short sale. However, retail investors would be permitted to make a similar disclosure by the end of the trading hours on the transaction day.
- The brokers shall be mandated to collect the details on scrip-wise short sell positions, collate the data and upload it to the stock exchanges before the commencement of trading on the following trading day. The stock exchanges shall then consolidate such information and disseminate the same on their websites for the information of the public on a weekly basis.
- The frequency of such disclosure may be reviewed from time to time with the approval of SEBI.

Broad Framework for Securities Lending and Borrowing

- In order to provide a mechanism for borrowing of securities to enable settlement of securities sold short, the stock exchanges shall put in place, a full fledged securities lending and borrowing(SLB) scheme, within the overall framework of “Securities Lending Scheme, 1997” (the scheme), that is open for all market participants in the Indian securities market.
- To begin with, the SLB shall be operated through Clearing Corporation/ Clearing House of stock exchanges having nation-wide terminals who will be registered as Approved Intermediaries (AIs) under the SLS, 1997.

- Eligible scrips for SLB: In addition to the scrips on which derivatives contracts are available, scrips that fulfill the following criteria shall be considered eligible for SLB:
 - (a) Scrip classified as 'Group I security' as per SEBI circular MRD/DoP/SE/Cir-07/2005 dated February 23, 2005;
AND
 - (b) Market Wide Position Limit (MWPL) of the scrip, as defined at para 12 (a) of Annexure 2 of the MRD/DoP/SE/Dep/Cir-14/2007 dated December 20, 2007, shall not be less than Rs.100 crores;
AND
 - (c) Average monthly trading turnover in the scrip in the Cash Market shall not be less than Rs.100 crores in the previous six months.
- Event a scrip fails to meet the eligibility criteria, no new SLB transaction shall be allowed in the scrip from the next trading day. However, the existing contracts in such scrips shall be allowed to continue till expiry.
- The collateral to be accepted for meeting margin obligations related to SLB transactions shall be in the same form as applicable in the Cash Market.
- The SLB shall take place on an automated, screen based, order-matching platform which will be provided by the AIs. This platform shall be independent of the other trading platforms.
- To begin with, the securities traded in F&O segment shall be eligible for lending & borrowing under the scheme.
- Any lender or borrower who wishes to extend an existing lent or borrow position shall be permitted to roll-over such positions i.e. a lender who is due to receive securities in the pay out of an SLB session, may extend the period of lending. Similarly, a borrower who has to return borrowed securities in the pay-in of an SLB session, may, through the same SLB session, extend the period of borrowing. The roll-over shall be conducted as part of the SLB session.
- Rollover shall not permit netting of counter positions, i.e. netting between the 'borrowed' and 'lent' positions of a client.
- Roll-over shall be available for a period of 3 months i.e. the original contract plus 2 rollover contracts.
- Liquid Index ETFs shall be eligible for trading in the SLB segment.
- An Index ETF shall be deemed 'liquid' provided the Index ETF has traded on at least 80% of the days over the past 6 months and its impact cost over the past 6 months is less than or equal to 1%.
- All categories of investors including retail, institutional etc. will be permitted to borrow and lend securities. The borrowers and lenders shall access the platform for lending/borrowing set up by the AIs through the clearing members (CMs) (including banks and custodians) who are authorized by the AIs in this regard.
- The Authorised Intermediary (AIs) shall enter into an agreement with Clearing Members (CMs) for the purpose of facilitating lending and borrowing of securities.
- The agreement shall specify the rights, responsibilities and obligations of the parties to the agreement. The agreement shall include the basic conditions for lending and borrowing of securities as prescribed under SLB framework. Further, the exact role of AIs/CMs vis-à-vis the clients shall be laid down in the agreement. AIs shall ensure that there shall not be any direct agreement between the lender and the borrower.
- In addition to that, AIs may also include suitable conditions in the agreement to have proper execution, risk management and settlement of lending and borrowing transactions with clearing member and client.
- The AIs shall frame a rights and obligations document laying down the rights and obligation of CMs and clients for the purpose of lending and borrowing of securities. The rights and obligation document shall be mandatory and binding on the CMs and the clients for executing trade in the SLB framework.

- The AIs shall allot a unique ID to each client which shall be mapped to the Permanent Account Number (PAN) of the respective clients. The AIs shall put in place appropriate systemic safeguards to ensure that a client is not able to obtain multiple client IDs.
- The tenure of lending/borrowing shall be fixed as standardised contracts. To start with, contracts with tenure of 30 trading days may be introduced.
- The settlement cycle for SLB transactions shall be on T+1 basis.
- The settlement of lending and borrowing transactions shall be independent of normal market settlement.
- The settlement of the lending and borrowing transactions shall be done on a gross basis at the level of the clients i.e. no netting of transactions at any level will be permitted.
- AIs would frame suitable risk management systems to guarantee delivery of securities to borrower and return of securities to the lender. In the case of lender failing to deliver securities to the AI or borrower failing to return securities to the AI, the AI shall conduct an auction for obtaining securities. In the event of exceptional circumstances resulting in non-availability of securities in auction, such transactions would be financially closed-out at appropriate rates, which may be more than the rates applicable for the normal close-out of transactions, so as to act as a sufficient deterrent against failure to deliver securities.
- Position limits at the level of market, CM and client shall be decided from time to time by AIs in consultation with SEBI. To begin with (a) the market-wide position limits for SLB transactions shall be 10% of the free-float capital of the company in terms of number of shares (b) No clearing member shall have open position of more than 10% of the market-wide position limits or ₹ 50 crore (base value), whichever is lower (c) For a FII/MF, the position limits shall be the same as of a clearing member (d) The client level position limits shall be not more than 1% of the market-wide position limits.
- There shall be no lending/borrowing activity during the periods of corporate action in the security and shall be disclosed by AI to the market.
- Any borrowing/lending and return of securities would not amount to purchase/disposal/transfer of the same for the purpose of compliance with the extant FDI/FII limits and the norms regarding acquisition of shares/ disclosure requirements specified under the various Regulations of SEBI.
- Adequate systems shall be put in place by the stock exchanges/Depositories to distinguish the SLB transactions from the normal market transactions in the demat system.
- AIs shall provide suitable arbitration mechanism for settling the disputes arising out of the SLB transactions executed on the platform provided by them.
- AIs shall disseminate in public domain, the details of SLB transactions executed on the platform provided by them and the outstanding positions on a weekly basis. The frequency of such disclosure may be reviewed from time to time with the approval of SEBI.

Settlement System

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

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

Settlement risk or principal risk is the risk that the seller of a security or funds delivers its obligation but does not receive payment or that the buyer of a security or funds makes payment but does not receive delivery. In this event, the full principal value of the securities or funds transferred is at risk.

FAQ's on Settlement Cycle

UNDERSTANDING TRADE SETTLEMENT CYCLE

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

WHAT IS ROLLING SETTLEMENT?

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

WHICH DAYS ARE CALCULATED FOR THE PURPOSE OF ROLLING SETTLEMENT?

For arriving at the settlement day, all intervening holidays, which include bank holidays, exchange holidays, Saturdays and Sundays, are excluded. Typically, trades taking place on Monday are settled on Wednesday, Tuesday's trades are settled on Thursday and so on.

WHEN DOES THE OPEN POSITIONS RESULT IN PAYMENT/ DELIVERY UNDER ROLLING SETTLEMENT?

Under rolling settlement, all open positions at the end of the day mandatorily result in payment/ delivery 'n' days later. Currently, trades in rolling settlement are settled on T+2 basis where T is the trade day. For example, a trade executed on Monday is mandatorily settled by Wednesday (considering two working days from the trade day).

Settlement Cycle for Rolling Settlement

	Activity	Day
Trading	Rolling settlement	T
Clearing	Custodial confirmation and delivery generation	T+1 working days
Settlement	Securities and funds pay-in and pay-out	T+2 working days
Post settlement	Auction	T+3 working days
	Bad delivery reporting	T+4 working days
	Auction settlement	T+5 working days
	Rectified bad delivery pay-in and pay-out	T+6 working days
	Re-bad delivery reporting and pick up	T+8 working days
	Close out of re-bad delivery and funds pay-in and pay-out	T+9 working days

For intraday traders, rolling settlement changes nothing. For institutional investors, who are forbidden to square off anyway, there would be no change. It is for retail investors who take leveraged positions across one night or more that rolling settlement has an impact. The funds and securities pay-in and pay-out are carried out on T+2 days

WHAT IS PAY-IN AND PAY-OUT?

Pay-in day is the day when the securities sold are delivered to the exchange by the sellers and funds for the securities purchased are made available to the exchange by the buyers. Pay-out day is the day the securities purchased are delivered to the buyers and the funds for the securities sold are given to the sellers by the exchange. At present, the pay-in and pay-out happens on the 2nd working day after the trade is executed on the exchange, that is settlement cycle is on T+2 rolling settlement.

WHAT IS NO-DELIVERY PERIOD?

Whenever a company announces a book closure or record date, the exchange sets up a no-delivery period for that security. During this period only trading is permitted in the security. However, these trades are settled only after the no-delivery period is over. This is done to ensure that investor's entitlement for the corporate benefit is clearly determined.

WHAT IS AN AUCTION?

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

BOMBAY STOCK EXCHANGE LTD.

Bombay Stock Exchange Ltd., popularly known as "BSE" was established in 1875 as "The Native Share and Stock Brokers Association". It is the oldest one in Asia, even older than the Tokyo Stock Exchange, which was established in 1878. It is a voluntary non-profit making Association of Persons (AOP) and is currently engaged in the process of converting itself into demutualised and corporate entity. It has evolved over the years into its present status as the premier Stock Exchange in the country. It is the first Stock Exchange in the Country to have obtained permanent recognition in 1956 from the Govt. of India under the Securities Contracts (Regulation) Act, 1956.

The Exchange, provides market for trading in securities, debt and derivatives upholds the interests of the investors and ensures redressal of their grievances whether against the companies or its own member-brokers. It also strives to educate and enlighten the investors by conducting investor education programmes and making available to them necessary informative inputs.

Trading at BSE

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

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

The "F" Group represents the Fixed Income Securities.

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

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

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

BSE also provides a facility to the market participants for on-line trading of odd-lot securities in physical form in 'A', 'B', 'T', and 'Z' groups and in rights renunciations in all groups of scrips in the Equity Segment.

With effect from December 31, 2001, trading in all securities listed in equity in the Equity segment takes place in one market segment, viz., Compulsory Rolling Settlement (CRS) Segment.

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

This facility of selling physical shares in compulsory demat scrips is called as Exit Route Scheme. This facility can also be used by small investors for selling up to 500 shares in physical form in respect of scrips of companies where trades are required to be compulsorily settled by all investors in demat mode.

Computation of Closing Price of Scrips in the Cash Segment

The closing price of scrips is computed by the Exchange on the basis of weighted average price of all trades executed during the last 30 minutes of the continuous trading session. However, if there is no trade recorded during the last 30 minutes, then the last traded price of a scrip in the continuous trading session is taken as the official closing price.

BASKET TRADING SYSTEM

The Exchange commenced trading in the Derivatives Segment with effect from June 9, 2000 to enable the investors to, inter-alia, hedge their risks. Initially, the facility of trading in the Derivatives Segment was confined to Index Futures. Subsequently, the Exchange introduced the Index Options and Options & Futures in select individual stocks. The investors in cash market had felt a need to limit their risk exposure in the market to movement in Sensex.

With a view to provide investors the facility of creating Sensex linked portfolios and also to create a linkage of market prices of the underlying securities of Sensex in the Cash Segment and Futures on Sensex, the Exchange has provided to the investors as well its member-brokers, a facility of Basket Trading System on BOLT. In the Basket Trading System, the investors through the member-brokers of the Exchange are able to buy/sell all 30 scrips of Sensex in one go in the proportion of their respective weights in the Sensex. The investors need not calculate the quantity of Sensex scrips to be bought or sold for creating Sensex linked portfolios and this function is performed by the system. The investors can also create their own baskets by deleting certain scrips from 30 scrips in the Sensex. Further, the investors can alter the weights of securities in such profiled baskets and enter their own weights. The investors can also select less than 100% weightage to reduce the value of the basket as per their own requirements.

To participate in this system, the member-brokers need to indicate number of Sensex basket(s) to be bought or sold, where the value of one Sensex basket is arrived at by the system by multiplying ₹.50 to prevailing Sensex. For e.g., if the Sensex is 19,000, then value of one basket of Sensex would be $19000 \times 50 = \text{i.e., ₹ 9,50,000}$. The investors can also place orders by entering value of Sensex portfolio to be bought or sold with a minimum value of ₹ 50,000/- for each order.

The Basket Trading System provides the arbitrageurs an opportunity to take advantage of price differences in the underlying Sensex and Futures on the Sensex by simultaneous buying and selling of baskets comprising the Sensex scrips in the Cash Segment and Sensex Futures. This is expected to provide balancing impact on the prices in both cash and futures markets.

The Basket Trading System, thus, meets the need of investors and also improves the depth in cash and futures markets.

SETTLEMENT SYSTEM AT BSE

Compulsory Rolling Settlement

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

Under rolling settlements, the trades done on a particular day are settled after a given number of business days. A T+2 settlement cycle means that the final settlement of transactions done on T, i.e., trade day by exchange of monies and securities between the buyers and sellers respectively takes place on second business day (excluding Saturdays, Sundays, bank and Exchange trading holidays) after the trade day.

The transactions in securities of companies which have made arrangements for dematerialization of their securities are settled only in demat mode on T+2 on net basis, i.e., buy and sell positions of a member-broker in the same scrip are netted and the net quantity and value is required to be settled. However, transactions in securities of companies, which are in “Z” group or have been placed under “trade-to-trade” by BSE as a surveillance measure (“T”), are settled only on a gross basis and the facility of netting of buy and sell transactions in such scrips is not available.

The transaction in “F” group securities representing “Fixed Income Securities” and “G” group representing Government Securities for retail investors are also settled at BSE on T+2 basis.

Thus, the pay-in and pay-out of funds and securities takes places on the second business day (i.e., excluding Saturday, Sundays and bank & Exchange trading holidays) of the day of the execution of the trade.

The Information Systems Department of the Exchange generates, inter-alia, the following statements, which can be downloaded by the member-brokers in their back offices on a daily basis.

- (a) Statements giving details of the daily transactions entered into by the member-brokers.
- (b) Statements giving details of margins payable by the member-brokers in respect of the trades executed by them.
- (c) Statements of securities and fund obligation.
- (d) Delivery/Receive orders for delivery/receipt of securities.

The settlement of the trades (money and securities) done by a member-broker on his own account or on behalf of his individual, corporate or institutional clients may be either through the member-broker himself or through a SEBI registered custodian appointed by him/client. In case the delivery/payment in respect of a transaction executed by a member-broker is to be given or taken by a registered custodian, then the latter has to confirm the trade done by a member-broker on the BOLT System through 6A-7A entry. For this purpose, the custodians have been given connectivity to BOLT System and have also been admitted as clearing member of the Clearing House. In case a transaction done by a member-broker is not confirmed by a registered custodian within the time permitted, the liability for pay-in of funds or securities in respect of the same devolves on the concerned member-broker.

6A/7A

A mechanism whereby the obligation of settling the transactions done by a member-broker on behalf of a client is passed on to a custodian based on confirmation of latter. The custodian can confirm the trades done by the member-brokers on-line and upto 11 a.m. on the next trading day. The late confirmation of transactions by the custodian after 11:00 a.m. upto 12:15 p.m., on the next trading day is, however, permitted subject to payment of charges for late confirmation

@ 0.01% of the value of trades confirmed or ₹ 10,000/-, whichever is less.

The introduction of settlement on T+2 basis, as discussed above, has considerably reduced the settlement risk, ensured early receipt of securities and monies by the buyers and sellers respectively and has brought the Indian capital market on par with the internationally accepted standard of settlements.

Pay-in and Pay-out for 'A', 'B', 'T', 'C', 'F', 'G' & 'Z' group of securities

The trades done on BOLT by the Members in all securities in CRS are now settled on BSE by payment of monies and delivery of securities on T+2 basis. All deliveries of securities are required to be routed through the Clearing House.

The Pay-in/Pay-out of funds based on the money statement and that of securities based on Delivery Order/ Receiver Order issued by BSE are settled on T+2 day.

Demat pay-in

The member-brokers can effect pay-in of demat securities to the Clearing House either through the National Securities Depository Ltd. (NSDL) or Central Depository Services (I) Ltd. (CDSL). In case of NSDL, the member-

brokers are required to give instructions to their respective Depository Participants (DPs) specifying settlement no., settlement type, effective pay-in date, quantity, etc.

As regards CDSL, the member-brokers give pay-in instructions to their respective DPs. The securities are transferred by the DPs to the Clearing Member (CM) Principal Account. The member-brokers are required to give confirmation to their DPs, so that securities are processed towards pay-in obligations. Alternatively, the member-brokers may also effect pay-in from the clients' beneficiary accounts. For this, the clients are required to mention the settlement details and clearing member-broker ID of the member-broker through whom they have sold the securities. Thus, in such cases the Clearing Members are not required to give any delivery instructions from their accounts. In case a member fails to deliver the securities, the value of shares delivered short is recovered from him at the standard/closing rate of the scrips in the trading day.

Auto delivery facility

Instead of issuing Delivery instructions for their securities delivery obligations in demat mode in various scrips in a settlement /auction, a facility has been made available to the member-brokers of automatically generating Delivery instructions on their behalf from their CM Pool accounts maintained with NSDL and CM Principal Accounts maintained with CDSL. This auto delivery facility is available for CRS (Normal & Auction) and for trade to trade settlements. This facility is, however, not available for delivery of non-pari passu shares and shares having multiple International Securities Identification Number (ISINs). The member-brokers wishing to avail of this facility have to submit an authority letter to the Clearing House. This auto delivery facility is currently available for Clearing Member (CM) Pool accounts and Principal accounts maintained by the member-brokers with National Securities Depository Ltd. (NSDL) and Central Depositories Services (I) Ltd. (CDSL) respectively.

Pay-in of securities in physical form

In case of delivery of securities in physical form, the member-brokers have to deliver the securities to the Clearing House in special closed pouches along with the relevant details like distinctive numbers, scrip code, quantity, etc., on a floppy. The data submitted by the member-brokers on floppies is matched against the master file data on the Clearing House computer systems. If there is no discrepancy, then a scroll number is generated by the Clearing House and the securities are accepted.

Funds Pay-in

Once the reconciliation of securities is completed by the Clearing House, the bank accounts of member-brokers maintained with the ten clearing banks, are directly debited through computerized posting for their funds settlement obligations. Once the pay-in of securities and funds is complete, the Clearing House arranges for the pay-out of securities and funds.

In case of those members, whose funds pay-in obligations are returned by their clearing banks on account of insufficient funds in their bank accounts at the time of pay-in, their BOLT TWSs are now immediately de-activated during the trading hours itself, on receipt of such intimation from the clearing banks as against the earlier practice of de-activating their BOLT TWSs at the end of trading on that day. BOLT TWSs of such members remain de-activated till the pay-in obligations are cleared by them.

Securities Pay-out

In case of demat securities, the same are credited by the Clearing House in the Pool/Principal Accounts of the member-brokers. The Exchange has also provided a facility to the member-brokers for transfer of pay-out securities directly to the clients' beneficiary owner accounts without routing the same through their Pool/Principal accounts in NSDL/CDSL. For this, the concerned member-brokers are required to give a client wise break up file which is uploaded by the member-brokers from their offices to the Clearing House. Based on the break up given by the member-brokers, the Clearing House instructs depositories, viz., CDSL & NSDL to credit the securities to the Beneficiary Owners (BO) Accounts of the clients. In case delivery of securities received from one depository is to be credited to an account in the other depository, the Clearing House does an inter depository transfer to give effect to such transfers.

In case of physical securities, the Receiving Members are required to collect the same from the Clearing House on the pay-out day.

This process of passing on delivery of securities purchased by the member-brokers to them by the Clearing House is called pay-out of securities.

Funds Payout

The bank accounts of the member-brokers having pay-out of funds are credited by the Clearing House with the Clearing Banks on the same day. This process is referred to as Pay-out of Funds.

In case, if a member-broker fails to deliver the securities, then the value of shares delivered short is recovered from him at the standard/closing rate of the scrips on the trading day.

In case of Rolling Settlements, pay-in and pay-out of both funds and securities, as stated earlier, is completed on the same day.

The member-brokers are required to make payment for securities sold and/ or deliver securities purchased to their clients within one working day (excluding Saturday, Sunday, bank & Exchange trading holidays) after the pay-out of the funds and securities for the concerned settlement is completed by the Exchange. This is the timeframe permitted to the member-brokers of the Exchange to settle their funds/securities obligations with their clients as per the Byelaws of the Exchange.

The settlement calendar, which indicates the dates of the various settlement related activities, is drawn by the Exchange in advance on a quarterly basis and is circulated among the market participants. The settlement calendars so drawn have been strictly adhered to by the Exchange and there has been generally no case of clubbing of settlements or postponement of pay-in and/ or pay-out during the last over seven years.

The Exchange maintains database of fake/forged, stolen, lost and duplicate securities in physical form with the Clearing House so that distinctive numbers submitted by member-brokers in case of physical securities on delivery may be matched against the database to weed out bad paper from circulation at the time of introduction of such securities in the market. This database has also been made available to the member-brokers so that both delivering and receiving member-brokers can check the entry of fake, forged and stolen shares in the market.

Surveillance at BSE

The main objective of the Surveillance function of the Exchange is to promote market integrity in two ways, first, by monitoring price and volume movements (volatility) as well as by detecting potential market abuses at a nascent stage, with a view to minimizing the ability of the market participants, both in Cash and Derivative market, to influence the price of the scrip/series in the absence of any meaningful information, and second, by managing default risk by taking necessary actions timely. All the instruments traded in the equity segment of Cash and Derivative market come under the Surveillance umbrella of BSE. Surveillance activities at the Exchange are divided broadly into two major segments, namely, price monitoring and position monitoring. Price monitoring is mainly related to the price movement/abnormal fluctuation in prices or volumes etc. whereas the position monitoring relates mainly to abnormal positions of members, etc. in order to manage default risk.

Market Abuse

Market abuse is a broad term which includes abnormal price/ volume movement, artificial transactions, false or misleading impressions, insider trading, etc. In order to detect aberrant behaviour/ movement, it is necessary to know the normal market behaviour. The department uses various tools to determine normal and abnormal market behaviour. The necessary actions are initiated like imposition of special margin, reduction of circuit filters, trade to trade settlement, suspensions, de-activation of terminals, etc. to control abnormal market behaviour. The department carries out investigation, if necessary, based on the preliminary examination/analysis and suitable actions are taken against members involved based on the investigation. The detailed explanation of the various Surveillance activities are as follows:

(a) Price Monitoring

The functioning of the Price Monitoring is broadly divided into following activities:

- (i) On-Line Surveillance
- (ii) Off-Line Surveillance
- (iii) Derivative Market Surveillance
- (iv) Investigations
- (v) Surveillance Actions
- (vi) Rumour Verification
- (vii) Pro-active Measures

(i) On line Surveillance

One of the most important tools of the Surveillance is the On-line Real Time Surveillance system which was commissioned in 1999 with main objectives of detecting potential market abuses at a nascent stage to reduce the ability of the market participants to unduly influence the price and volumes of the scrips traded at the Exchange, improve the risk management system and strengthen the self regulatory mechanism at the Exchange.

The system has a facility to generate the alerts on-line, in real time, based on certain preset parameters like price and volume variations in scrips, members taking unduly large positions not commensurate with their financial position or having large concentrated position(s) in one or few scrips, etc. An alert is a measure of abnormal behaviour. An Alert occurs in the Surveillance system when a metric behaves significantly differently from its benchmark. The alerts generated by the system are analyzed and corrective action based on preliminary investigations is taken in such cases. The system also provides facility to access trades and orders of members.

(ii) Off-Line Surveillance

The Off-Line Surveillance system comprises of the various reports based on different parameters and scrutiny thereof.

- High/Low Difference in prices
- % change in prices over a week/fortnight/month
- Top N scrips by Turnover
- Trading in infrequently traded scrips
- Scrips hitting New High/Low

The Surveillance actions or investigations are initiated in the scrips identified from the above-stated reports.

(iii) Derivative Market Surveillance*Areas of Focus*

- Abnormal fluctuation in the prices of a Series
- Market Movement (Cash vis-à-vis Derivative)
- Member Concentration (Cash vis-à-vis Derivative)
- Closing Price Manipulation (Cash & Derivative)

(iv) Investigations

The Exchange conducts in-depth investigations based on preliminary enquiries/ analysis made into trading of the scrip as also at the instance of SEBI. In case irregularities observed, necessary actions are initiated and/or investigation case forwarded to SEBI, if necessary.

(v) Surveillance Actions*Special Margins*

Special margins are imposed on scrips which have witnessed abnormal price/ volume movements. Special

margin is imposed @ 25 % or 50 % or 75 % as the case may be, on the client wise net outstanding purchase or sale position (or on both side) by the department.

Reduction of Circuit Filters

The circuit filters are reduced in case of illiquid scrips or as a price containment measure in low volume scrips. The circuit filters are reduced to 10 % or 5 % or 2 % as the case may be, based on the criteria decided by the Exchange.

Circuit Breakers

In addition to the price bands on individual scrips, SEBI decided to implement index based market wide circuit breakers system, w.e.f., July 02, 2001. The circuit breakers are applicable at three stages of the index movement either way at 10 %, 15 % and 20 %. These circuit breakers will bring about a coordinated trading halt in both Equity and Derivative market.

The market wide circuit breakers can be triggered by movement of either BSE SENSEX or the NSE NIFTY, whichever is breached earlier. The percentage movement are calculated on the closing index value of the quarter. These percentages are translated into absolute points of index variation (rounded off to the nearest 25 points in case of SENSEX). At the end of each quarter, these absolute points of index variations are revised and made applicable for the next quarter. The absolute points of SENSEX variation triggering market wide circuit breaker for a specified time period for any day of the quarter is informed by the Exchange through Press Release from time to time.

Trade to Trade

If a scrip is shifted on a Trade-to trade settlement basis, selling/ buying of shares in that scrip would result into giving/ taking delivery of shares at the gross level and no intra day/ settlement netting off/ square off facility would be permitted. The scrips which form part of 'Z group' are compulsorily settled on a trade to trade settlement basis. In addition to that Surveillance department transfers various scrips from time to time on a trade to trade settlement basis to contain the excessive volatility and/or abnormal volumes in the scrip.

Suspension of a scrip

The scrips are suspended by the Surveillance department in exceptional cases pending investigation or if the same scrip is suspended by any other Stock Exchange as a Surveillance action.

Warning to Members

The department may issue verbal/ written warning to member/s when market manipulation in the scrip is suspected.

Imposition of penalty/suspension/de-activation of terminals

The department imposes penalty or deactivate BOLT terminals or suspend the member/s who are involved in market manipulation, based on the input/ evidence available from investigation report or as and when directed by SEBI.

(vi) Rumour Verification

The following steps are involved in Rumour verification process:

- Surveillance Department liaises with Compliance Officers of companies to obtain comments of the company on various price sensitive corporate news items appearing in the selected New Papers.
- Comments received from the companies are disseminated to the Market by way of BOLT Ticker and/ or Notices in the Bulletin.
- Show cause notices are issued to companies which do not reply promptly to the Exchange.
- Investigations based on rumour verifications are carried out, if required, to detect cases of suspected insider trading

(vii) Pro-active Measures

- The Department compiled and disseminated a list of companies who have changed their names to suggest that their business interest is in the software Industry.
- List of NBFC's, whose application for registration rejected by RBI, was compiled and disseminated by the department.

(b) Position Monitoring

- (i) Statement of Top 100 Purchasers/Sellers
- (ii) Concentrated Purchases/Sales
- (iii) Purchases/Sales of Scrips having Thin Trading
- (iv) Trading in B1, B2 and Z group Scrips
- (v) Pay-in liabilities above a Threshold Limit
- (vi) Verification of Institutional Trades
- (vii) Snap Investigation
- (viii) Market Intelligence

The Surveillance Department closely monitors outstanding exposure of members on a daily basis. For this purpose, it has developed various off-line and on-line market monitoring reports. The reports are scrutinised to ascertain whether there is excessive purchase or sale position build up compared to the normal business of the member, whether there are concentrated purchases or sales, whether the purchases have been made by inactive or financially weak members and even the quality of scrips is considered to assess the quality of exposure. Based on analysis of the above factors and the margins already paid and the capital deposited by the member, ad-hoc margins/early pay-in calls are made, if required. Some members are even advised to reduce their outstanding exposure in the market. Trading restrictions are placed on their business as and when deemed fit.

The department thus executes the Risk Management functions to avert possible payment default of members by taking timely corrective measures.

The following key areas are examined to assess the market risk involved.

(i) Statement of Top 100 Purchasers/Sellers

Statements of top 100 net purchasers and top 100 net sellers in case of A, B1, B2 and Z group of scrips are scrutinized, on a daily basis. This enables the Department to keep a watch on the exposure of the members, ascertain the quality of exposures, measure the risk vis-a-vis cover available by way of margins, capital etc. and initiate action such as imposition of ad-hoc margins, trading restriction etc. on the members.

A detailed report on the net outstanding positions of top purchasers and top sellers with exposures in individual scrips above certain limit, margin cover available etc., is prepared on a daily basis.

(ii) Concentrated Purchases/Sales

The concentration in purchases/sales of a member in a few scrips could be considered risky. In case, such a situation is noticed, fundamentals of the scrips, their daily turnover, their nature of transactions is ascertained. Thereafter, based on the market risk perception appropriate surveillance actions are taken.

(iii) Purchases/Sales of Scrips having Thin Trading

Purchases/sales by members in scrips having thin trading is closely scrutinised as comparatively high market risk is involved in trading in such scrips. Details of trades in such scrips are called from the members to assess the market risk involved and decide on the appropriate surveillance action.

(iv) Trading in B1, B2 and Z Group Scrips

The Exchange has classified the scrips listed on the Exchange into 'A', 'B1', 'B2' and 'Z' groups. In view of the price manipulation witnessed in a few B1, B2 and Z group scrips and also as a risk management measure, the Exchange has prescribed Exposure limits in B1, B2 and Z group scrips in a single Rolling Settlement.

(v) Pay-in liabilities of members above a threshold limit

The pay-in liability of members above a certain threshold limit is monitored with respect to the pay-in amount of the members, the members capital, the margin cover available to the Exchange against the members pay-in liability, etc. In case of inadequate margin cover, the reasons of the pay-in are ascertained. If warranted, advance pay-in is called to ensure that pay-in is completed smoothly.

(vi) Verification of Institutional Trade

The institutional trades executed by the member-brokers are verified to ascertain the genuineness of trades.

(vii) Snap Investigation

The Department also carries out, wherever considered necessary, preliminary investigation of certain dealings to verify irregularities. Further actions, viz., referring the case for detailed investigations, referring the cases to the Disciplinary Action Committee (DAC) of the Exchange for taking disciplinary action against members, referring cases to the Scrutiny Committee of the Exchange to re-assess the financial soundness of the members etc., are taken depending on the findings of preliminary investigation.

(viii) Market Intelligence

The rumours floating in the market are verified with the data available with the Exchange. Newspapers, Television news channels are referred to ascertain the national and global factors affecting the market sentiments. This enables the Exchange to avert market problems before it causes a serious damage.

On assessment of the market risk, decisions to call ad-hoc margins/early pay-in, advising the member to limit his business, summoning him for explanation, placing trading restriction, deactivation of BOLT TWS, etc. are taken.

NATIONAL STOCK EXCHANGE OF INDIA LTD. (NSEIL)

Based on Pherwani Committees report submitted in June, 1991, the National Stock Exchange of India Limited (NSEIL) was established to provide an efficient system eliminating all the deficiencies of stock exchanges and is geared to meet the requirements of the large investor population. It is a single stock exchange and all other centres are electronically linked to this exchange.

NSEIL was promoted by leading FIs at the behest of Government of India and was incorporated in November 1992 as a tax-paying company unlike other stock exchanges in the country. On its recognition as a stock exchange under the Securities Contracts (Regulation) Act, 1956 in April 1993, NSEIL commenced operations in the Wholesale Debt Market (WDM) segment in June 1994, operations in the Capital Market (CM) segment in November 1994, and operations in derivatives segment in June 2000.

Capital Market Segment

The Capital Market (CM) segment of NSEIL provides a fully automated screen based trading system for trading of equity and preference shares, debentures, warrants and coupons. The trading system, known as the National Exchange for Automated Trading (NEAT) system, is an anonymous order-driven system and operates on a strict price/time priority. It enables members from across the country to trade simultaneously with enormous ease and efficiency. It provides tremendous flexibility to the users in terms of kinds of orders that can be placed on the system. Several time-related (Good-till-Cancelled, Good-till-Day, Immediate-or-Cancel), price-related (buy/sell limit and stop-loss orders) or volume related (All-or-None, Minimum Fill, etc.) conditions can be easily

built into an order. Orders are sorted and matched automatically by the computer keeping the system transparent, objective and fair. The trading system also provides complete market information on-line, which is updated on real time basis.

Wholesale Debt Market Segment

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

The WDM trading system, known as NEAT (National Exchange for Automated Trading), is a fully automated screen based trading system that enables members across the country to trade simultaneously with enormous ease and efficiency. The trading system is an order driven system, which matches best buy and sell orders on a price/time priority.

Trading system provides two market sub-types: continuous market and negotiated market. In continuous market, the buyer and seller do not know each other and they put their best buy/sell orders, which are stored in order book with price/time priority. If orders match, it results into a trade. The trades in WDM segment are settled directly between the participants, who take an exposure to the settlement risk attached to any unknown counterparty. In the NEAT-WDM system, all participants can set up their counter-party exposure limits against all probable counterparties. This enables the trading member/participant to reduce/minimise the counterparty risk associated with the counterparty to trade. A trade does not take place if both the buy/sell participants do not invoke the counter-party exposure limit in the trading system.

In the negotiated market, the trades are normally decided by the seller and the buyer, and reported to the Exchange through the broker. Thus deals negotiated or structured outside the exchange are disclosed to the market through NEAT-WDM system. In negotiated market, as buyers and sellers know each other and have agreed to trade, no counter-party exposure limit needs to be invoked.

The trades on the WDM segment could be either outright trades or repo transactions with flexibility for varying days of settlement (T+0 to T+2) and repo periods (1 to 14 days). For every trade, it is necessary to specify the number of settlement days and the trade type (repo or non-repo) and in the event of a repo trade, the repo term.

The Futures and Option trading system, called NEAT-F&O trading system, provides a fully automated screen-based trading for S&P CNX Nifty futures on a nationwide basis and an online monitoring and surveillance mechanism. It supports an order driven market and provides complete transparency of trading operations. It is similar to that of trading of equities in the CM segment.

The NEAT-F&O trading system is accessed by two types of users. The Trading Member (TM) has access to functions such as, order entry, order matching, order and trade management. The Clearing Member (CM) uses the trader workstation for the purpose of monitoring the trading member(s) for whom he clears the trades. Additionally, he can enter and set limits to position, which a trading member can take.

Contracts

Futures contract on the NSEIL is based on S&P CNX Nifty Index. Currently, it has a maximum of 3-month expiration cycle. Three contracts are available for trading with 1 month, 2 months and 3 months expiry. A new contract is introduced on the next trading day following the expiry of the near month contract. Various conditions like, Good-till-Day, Good-till-Cancelled, Good-till- Date, Immediate or Cancel, Stop loss, etc. can be built into an order.

Clearing and Settlement

NSCCL undertakes clearing and settlement of all deals executed on the NSEIL's Derivatives segment. It acts as legal counterparty to all deals on the Derivatives segment and guarantees settlement.

Derivatives Segment

In the Derivatives segment, NSCCL has admitted Clearing Members (CMs) distinct from Trading Members (TMs) in line with the 2-tier membership structure stipulated by SEBI to enable wider participation in the Derivatives segment. All trades on the Derivatives segment are cleared through a CM of NSCCL.

Nifty index futures contracts are cash settled, i.e. through exchange of cash differences in value. Settlement is done on a daily basis by marking to market all open positions on the basis of the daily settlement price. The contracts are finally settled on expiry of the Nifty index futures contract when NSCCL marks the open positions of a CM to the closing price of the underlying index and resulting profit/loss is settled in cash.

TRADING AND SETTLEMENT AT NSE

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

The NSE trading system called 'National Exchange for Automated Trading' (NEAT) is a fully automated screen based trading system, which adopts the principle of an order driven market.

National Securities Clearing Corporation Limited (NSCCL)

This company incorporated as a wholly owned subsidiary of the National Stock Exchange of India Limited carries out clearing and settlement of the trades executed in the capital market segment of National Stock Exchange. This company completes the settlement promptly without delay or deferment. It operates on behalf of the clearing members from and to regional clearing centres and central clearing centres at Mumbai. It was the first organisation to start pre-delivery verification to detect bad papers in the form of fake or forged certificates or lost and stolen share certificates through the automated mechanism of the clearing corporation. A facility is provided to lend/borrow securities as well as funds at market determined rates and enables timely delivery of securities with efficiency. This corporation is connected to National Securities Depository Limited (NSDL) and Central Depositories Services (India) Limited (CDSL) and carries out clearing and settlement services for other exchanges as well as for Index Futures.

Clearing Mechanism

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

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

Trade-for-trade deals and Limited Physical Market deals are settled on a trade for trade basis and settlement obligations arise out of every deal.

Clearing & Settlement (Equities)

NSCCL carries out clearing and settlement functions as per the settlement cycles of different sub-segments in the Equities segment.

The clearing function of the clearing corporation is designed to work out a) what counter parties owe and b) what

counter parties are due to receive on the settlement date. Settlement is a two way process which involves legal transfer of title to funds and securities or other assets on the settlement date.

NSCCL has also devised mechanism to handle various exceptional situations like security shortages, bad delivery, company objections, auction settlement etc.

NSCCL has empanelled 8 clearing banks to provide banking services to trading members and has established connectivity with both the depositories for electronic settlement of securities.

Clearing

Clearing is the process of determination of obligations, after which the obligations are discharged by settlement.

NSCCL has two categories of clearing members: trading members and custodians. The trading members can pass on its obligation to the custodians if the custodian confirms the same to NSCCL. All the trades whose obligation the trading member proposes to pass on to the custodian are forwarded to the custodian by NSCCL for their confirmation. The custodian is required to confirm these trade on T + 1 days basis.

Once, the above activities are completed, NSCCL starts its function of Clearing. It uses the concept of multi-lateral netting for determining the obligations of counter parties. Accordingly, a clearing member would have either pay-in or pay-out obligations for funds and securities separately. Thus, members pay-in and pay-out obligations for funds and securities are determined latest by T + 1 day and are forwarded to them so that they can settle their obligations on the settlement day (T+2).

Cleared and non-cleared deals

NSCCL carries out the clearing and settlement of trades executed in the following sub-segments of the Equities segment:

1. All trades executed in the Book entry/Rolling segment.
2. All trades executed in the Limited Physical Market segment.

NSCCL does not undertake clearing and settlement of deals executed in the Trade for Trade sub-segment of the Equities (Capital Market) segment of the Exchange. Primary responsibility of settling these deals rests directly with the members and the Exchange only monitors the settlement. The parties are required to report settlement of these deals to the Exchange.

Trading in Retail Debt Segment

Trading in the Retail Debt Market takes place in the same manner in which the trading takes place in the equities (Capital Market) segment. The RETDEBT Market facility on the NEAT system of Capital Market Segment is used for entering transactions in RDM session.

Members eligible for trading in RDM segment

Trading Members who are registered members of NSE in the Capital Market segment and Wholesale Debt Market segment are allowed to trade in Retail Debt Market (RDM) subject to fulfilling the capital adequacy norms.

Trading Members with membership in Wholesale Debt Market segment only, can participate in RDM on submission of a letter in the prescribed format

Trading System

Trading in RDM also take place on the 'National Exchange for Automated Trading' (NEAT) system, a fully automated screen based trading system, which adopts the principle of an order driven market. The RETDEBT Market facility on the NEAT system of Capital Market Segment is used for entering transactions in RDM session.

The securities available in this segment will not available in F & O and inquiry terminal.

Trading Cycle

Trading in Retail Debt Market is permitted under Rolling Settlement, where in each trading day is considered as a trading period and trades executed during the day are settled based on the net obligations for the day.

Settlement is on a T+2 basis i.e. on the 2nd working day. For arriving at the settlement day all intervening holidays, which include bank holidays, NSE holidays, Saturdays and Sundays are excluded. Typically trades taking place on Monday are settled on Wednesday, Tuesday's trades settled on Thursday and so on.

Settlement

Primary responsibility of settling trades concluded in the WDM segment rests directly with the participants and the Exchange monitors the settlement. Mostly these trades are settled in Mumbai. Trades are settled gross, i.e. on trade for trade basis directly between the constituents/participants to the trade and not through any Clearing House mechanism. Thus, each transaction is settled individually and netting of transactions is not allowed.

Settlement is on a rolling basis, i.e. there is no account period settlement. Each order has a unique settlement date specified upfront at the time of order entry and used as a matching parameter. It is mandatory for trades to be settled on the predefined settlement date. The Exchange currently allows settlement periods ranging from same day (T+0) settlement to a maximum of (T+2).

On the scheduled settlement date, the Exchange provides data/information to the respective member/participant regarding trades to be settled on that day with details like security, counter party and consideration.

The participants through their Subsidiary General Ledger (SGL) account (a book entry settlement system) settle government securities including treasury bills with RBI or through exchange of physical certificates. Other instruments are settled through delivery of physical securities.

Where trade is settled through the SGL account, exchange of securities and funds is done on DVP basis. Where trade is settled through delivery of certificates, the consideration is paid through cheque, payorder, Banker's cheque or RBI cheque.

The required settlement details, i.e. certificate no., SGL form no., Cheque no., constituent etc. are reported by the member/participant to the Exchange.

The Exchange closely monitors the settlement of transactions through the reporting of settlement details by members and participants. In case of deferment of settlement or cancellation of trade, participants are required to seek prior approval from the Exchange. For any dispute arising in respect of the trades or settlement, the exchange has established arbitration mechanism for resolving the same.

STRAIGHT THROUGH PROCESSING

The global securities market is passing through an interesting phase. Driven by globalization of the securities market, technology innovations and increasing trade volumes, the financial industry is moving towards Straight Through Processing.

Straight Through Processing (STP) is generally understood to be a mechanism that automates the end to end processing of transactions of financial instruments. It involves use of a system to process or control all elements of the work flow of a financial transaction, what are commonly known as the Front, Middle, Back office and General Ledger. In other words, STP allows electronic capturing and processing of transactions in one pass from the point of order origination to final settlement.

STP thus streamlines the process of trade execution and settlement and avoids manual entry and re-entry of the details of the same trade by different market intermediaries and participants. Usage of STP enables orders to be

processed, confirmed, settled in a shorter time period and in a more cost effective manner with fewer errors. Apart from compressing the clearing and settlement time, STP also provides a flexible, cost effective infrastructure, which enables e-business expansion through online processing and access to enterprise data.

Advantages of Straight Through Processing

Advantages of Straight through Processing as under:

- Reduced risk
- Automation of manual process minimizing errors
- Improved operational efficiency in handling larger volumes
- Facilitates movement towards shorter settlement cycles (T+1)
- Lower cost per trade
- Timely settlement of trades and instructions
- Eliminates paper work and minimizes manual intervention
- Enables increased cross border trading (FII trades)
- Greater transparency with clear audit trail
- Increases competitive advantage of our markets
- Messaging standards as per ISO 15022 standards

Straight Through Processing (STP) thus aims to bring in non-duplication of work, efficiency and automation of the manual procedures right from trade initiation to settlement processes.

SEBI had mandated the use of Straight Through Processing (STP) system for all institutional trades w.e.f. July, 2004. In order to regulate the STP service it had also issued SEBI (STP Centralised Hub and STP Service Providers) Guidelines, 2004 (STP Guidelines) which also prescribes the model agreement between the STP centralised hub and the STP service providers.

STP guidelines prescribes the eligibility criteria and conditions of approval for the STP centralised hub and the STP service providers, obligations and responsibilities of the STP centralised hub and the STP service providers and code of conduct for the STP service providers. The STP centralised hub and the STP service providers are required to abide by these Guidelines. To prescribe contractual obligations between the STP centralised hub and the STP service providers and to facilitate standardisation of service, a model agreement between the STP centralised hub and the STP service providers has also been prescribed by SEBI as Schedule II to the Guidelines. The agreement between the STP centralised hub and the STP service provider includes the provisions included in the model agreement.

DIRECT MARKET ACCESS (DMA)

Direct Market Access (DMA) is a facility which allows brokers to offer clients direct access to the exchange trading system through the broker's infrastructure without manual intervention by the broker. Some of the advantages offered by DMA are direct control of clients over orders, faster execution of client orders, reduced risk of errors associated with manual order entry, greater transparency, increased liquidity, lower impact costs for large orders, better audit trails and better use of hedging and arbitrage opportunities through the use of decision support tools / algorithms for trading.

While ensuring conformity with the provisions of the Securities Contract (Regulations) Act, 1956, Stock Exchanges may facilitate Direct Market Access for investors subject to the following conditions:

1. Application for Direct Market Access (DMA) facility

Brokers interested to offer DMA facility shall apply to the respective stock exchanges giving details of the software and systems proposed to be used, which shall be duly certified by a Security Auditor as reliable.

The stock exchange should grant approval or reject the application as the case may be, and communicate its decision to the member within 30 calendar days of the date of completed application submitted to the exchange.

The stock exchange, before giving permission to brokers to offer DMA facility shall ensure the fulfillment of the conditions specified in this circular.

2. Operational specifications

All DMA orders shall be routed to the exchange trading system through the broker's trading system. The broker's server routing DMA orders to the exchange trading system shall be located in India. The broker should ensure sound audit trail for all DMA orders and trades, and be able to provide identification of actual user-id for all such orders and trades. The audit trail data should be available for at least 5 years. Exchanges should be able to identify and distinguish DMA orders and trades from other orders and trades. Exchanges shall maintain statistical data on DMA trades and provide information on the same to SEBI on a need basis. The DMA system shall have sufficient security features including password protection for the user ID, automatic expiry of passwords at the end of a reasonable duration, and reinitialisation of access on entering fresh passwords. Brokers should follow the similar logic/priorities used by the Exchange to treat DMA client orders. Brokers should maintain all activities/alerts log with audit trail facility. The DMA Server should have internally generated unique numbering for all such client order/trades. A systems audit of the DMA systems and software shall be periodically carried out by the broker as may be specified by the exchange and certificate in this regard shall be submitted to the exchange. The exchanges and brokers should provide for adequate systems and procedures to handle the DMA trades.

3. Client Authorization and Broker – Client agreement

Exchanges shall specify from time to time the categories of investors to whom the DMA facility can be extended. Initially, the permission is restricted to institutional clients. Brokers shall specifically authorize clients for providing DMA facility after fulfilling Know Your Client requirements and carrying out due diligence regarding clients' credit worthiness, risk taking ability, track record of compliance and financial soundness. Brokers shall ensure that only those clients who are deemed fit and proper for this facility are allowed access to the DMA facility. Brokers shall maintain proper records of such due diligence. Individual users at the client end shall also be authorized by the broker based on minimum criteria. The records of user details, user-id and such authorization shall be maintained by the broker. Details of all user-ids activated for DMA shall be provided by the broker to the exchange.

The broker shall enter into a specific agreement with the clients for whom they permit DMA facility. This agreement will include the following safeguards:

- (a) The client shall use the DMA facility only to execute his own trades and shall not use it for transactions on behalf of any other person / entity.
- (b) Electronic/Automated Risk management at the broker's level before release of order to the Exchange system. The client shall agree to be bound by the various limits that the broker shall impose for usage of the DMA facility.
- (c) Right to withdraw DMA facility if the limits set up are breached or for any other such concerns
- (d) Withdrawal of DMA facility on account of any misuse or on instructions from SEBI/Exchange.

Exchanges shall prepare a model agreement for this purpose. The broker's agreement with clients should not have any clause that is less stringent/contrary to the conditions stipulated in the model agreement

4. Risk Management

The broker shall ensure that trading limits/ exposure limits/ position limits are set for all DMA clients based on risk assessment, credit quality and available margins of the client. The broker system shall have appropriate authority levels to ensure that the limits can be set up only by persons authorized by the risk / compliance manager. The broker shall ensure that all DMA orders are routed through electronic/automated risk management systems of the broker to carry out appropriate validations of all risk parameters including Quantity Limits, Price Range Checks, Order Value, and Credit Checks before the orders are released to the Exchange.

All DMA orders shall be subjected to the following limits:

- (a) Order quantity / order value limit in terms of price and quantity specified for the client.
- (b) All the position limits which are specified in the derivatives segment as applicable.
- (c) Net position that can be outstanding so as to fully cover the risk emanating from the trades with the available margins of the specific client.
- (d) Appropriate limits for securities which are subject to FII limits as specified by RBI.

The broker may provide for additional risk management parameters as they may consider appropriate.

5. Broker to be liable for DMA trades

The broker shall be fully responsible and liable for all orders emanating through their DMA systems. It shall be the responsibility of the broker to ensure that only clients who fulfill the eligibility criteria are permitted to use the DMA facility

6. Cross Trades

Brokers using DMA facility for routing client orders shall not be allowed to cross trades of their clients with each other. All orders must be offered to the market for matching.

7. Other legal provisions

In addition to the requirements mentioned above, all existing obligations of the broker as per current regulations and circulars will continue without change. Exchanges may also like to specify additional safeguards / conditions as they may deem fit for allowing DMA facilities to their brokers.

DEMUTUALIZATION OF STOCK EXCHANGES

The process of demutualization is to convert the traditional “not for-profit” stock exchanges into a “for profit” company and this process is to transform the legal structure from a mutual form to a business corporation form. SEBI had set up a committee under the Chairmanship of Justice Kania for the same which came up with report on demutualization of Stock Exchanges through uniform scheme prescribed. Accordingly, SEBI issued scheme of demutualization to BSE and other Regional Stock Exchanges.

The important features of the demutualisation exercise are as follows :

- (1) The board of a stock exchange should consist of 75% public interest/ shareholder directors and only 25% broker directors, and
- (2) 51% shareholding of the stock exchange should be divested to public/ investors other than trading member brokers and only 49% of shareholding can remain with the trading member brokers. This will transform our broker-owned stock exchanges into professionally-run corporate stock exchanges.

The options prescribed for divestment/dilution of brokers’ shareholding in a stock exchange are as follows:

- (1) Offer for sale, by issue of prospectus, of shares held by trading member brokers.
- (2) Private placement of shares (either of the shares held by the member brokers or new shares by the exchange) to any person or group of persons subject to the prior approval of SEBI and the maximum limit of 5% to any single person/group of persons.
- (3) Fresh issue of shares to the public through an IPO.

The purpose of demutualisation is as follows:

1. Stock exchanges owned by members tend to work towards the interest of members alone, which could on occasion be detrimental to rights of other stakeholders. Division of ownership between members and outsiders can lead to a balanced approach, remove conflicts of interest, create greater management accountability.
2. Publicly owned stock exchanges can enter into capital market for expansion of business.
3. Publicly owned stock exchange would be more professionally managed than broker owned.
4. Demutualisation enhances the flexibility of management.

SME EXCHANGE

SME exchange means a trading platform of a recognised stock exchange having nationwide trading terminals permitted by SEBI to list the specified securities issued in accordance with SEBI (ICDR) Regulation and includes a stock exchange granted recognition for this purpose but does not include the Main Board.

Here Main Board means a recognized stock exchange having nationwide trading terminals, other than SME exchange.

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

Benefits of Listing on SME Exchange

- Access to capital and future financing opportunities
- Going public would provide the MSME's with equity financing opportunities to grow their business - from expansion of operations to acquisitions.
- Companies in the growth phase tend to get over-leveraged at which point, banks are reluctant to provide further credit. Equity capital is then necessary to bring back strength to the balance sheet. The option of equity financing through the equity market allows the firm to not only raise long-term capital but also get further credit due through an additional equity infusion. The issuance of public shares expands the investor base, and this in turn will help set the stage for secondary equity financings, including private placements.
- In addition, Issuers often receive more favourable lending terms when borrowing from financial institutions. The mechanics of listing on a stock exchange (audited balance sheets, being subject to corporate governance norms etc) would address many of the transparency and informational asymmetry constraints that the financial institutions face in lending to the SME sector. In addition, equity financing lowers the debt burden leading to lower financing costs and healthier balance sheets for the firms. The continuing requirement for adhering to the stock market rules for the issuers lower the on-going information and monitoring costs for the banks.

– *Increased visibility and prestige*

Going public is likely to enhance the company's visibility. Greater public awareness gained through media coverage, publicly filed documents and coverage of stock by sector investment analysts can provide the SME with greater profile and credibility. This can result in a more diversified group of investors, which may increase the demand for that company's shares leading to an increase in the company's value.

– *Venture Capital (VC)*

It has been seen that there is greater vitality of venture capital in stock market centered systems. The underdeveloped equity culture has made it difficult for companies to both get into the VC phase as well as graduate from venture capital/startups phase to a scale of operations that would make them internationally competitive. A vibrant equity market would provide prove to be an added incentive for greater venture capital participation by providing an exit option leading to a reduction in their lock-in period.

– *Liquidity for shareholders*

Becoming a public company establishes a market for the company's shares, providing its investors with an efficient and regulated vehicle in which to trade their own shares. Greater liquidity in the public market can lead to better valuation for shares than would be seen through private transactions.

– *Create employee incentive mechanisms*

The employees of the SME enterprises can participate in the ownership of their own company and benefit from being a shareholder. This can serve to ensure stronger employee commitment to the company's performance and success. Share options in a public company have an immediate and tangible value to employees, especially as a recruitment incentive.

– *Facilitate growth through Mergers and Acquisitions*

As a public company, company's shares can be utilized as an acquisition currency to acquire target companies, instead of a direct cash offering. Using shares for an acquisition can be a tax efficient and cost effective vehicle to finance such a transaction.

– *Encourages Innovation & Entrepreneurial Spirit*

The ability of companies in their early stages of development to raise funds in the capital markets allows these companies to grow very quickly. This growth helps speed up the dissemination of new technologies throughout the economy. In addition, by raising the returns available from pursuing new ideas, technologies etc the capital markets facilitate entrepreneurial activities.

– *Efficient Risk Distribution*

The development of the capital markets has helped distribute risk more efficiently by transfer of risk to those best able to bear it. This ability to transfer risk facilitates greater risk- taking, but this increased risk-taking does not destabilize the economy. Thus the capital markets ensure that capital flows to its best uses and that riskier activity with higher payoffs are funded.

Model Listing Agreement for SMEs

To facilitate listing of specified securities in the SME exchange, "Model Equity Listing Agreement" to be executed between the issuer and the Stock Exchange, to list/migrate the specified securities on SME Exchange. The listing agreement covers routine listing compliances such as intimation to exchange, publication requirements, Corporate Governance compliances etc. All listed SMEs on SME platform are also required to appoint the

Company Secretary of the Issuer as Compliance Officer who will be responsible for monitoring the share transfer process and report to the Issuers board in each meeting. The Compliance Officer will directly liaise with the authorities such as SEBI, Stock Exchanges, ROC etc., and investors with respect to implementation of various clause, rules, regulations and other directives of such authorities and investor service & complaints related matter. Further Registrar & Transfer Agents of listed SMEs are required to produce a certificate from a practicing company secretary that all transfers have been completed within the stipulated time and certification regarding compliance of conditions of Corporate Governance.

Certification to Practicing Company Secretary

Companies seeking listing on BSE SME platform through IPO are required to comply with the quantitative eligibility norms as prescribed by BSE. Additionally, it will be desirable for the company to file a compliance certificate by a practicing company secretary as per the guidance note issued by the Institute of Company Secretaries of India as and when such a certification is made applicable by the SME platform of BSE Ltd.

ALGORITHMIC TRADING

Any order that is generated using automated execution logic shall be known as algorithmic trading.

With the increasing trend amongst capital market players of generating orders through automated execution logic called Algorithmic Trading. SEBI have formulated broad guidelines to be followed by both Stock Exchanges and Stock Brokers for Algorithmic Trading. These guidelines permits secure systems for algorithmic trading and help to keep pace with the speed of trade and volume of data that may arise through it.

Broadly the Guidelines provides for following directions to Stock Exchanges amongst others:

- To have arrangements, procedures and systems to adequately manage the trade load of algorithm orders.
- To put in place effective economic disincentives with regard to high daily order to trade ratio of algorithm orders.
- To ensure all trades are routed through servers of stock brokers located in India only.
- To have appropriate risk control mechanisms covering price band check and quantity limit check.
- To report algorithmic trading details in the Monthly Development Report submitted to SEBI.
- To ensure that the stock brokers provide the facility of algorithmic trading only after obtaining prior permission of the stock exchanges.

For Stock Brokers the new Guidelines provides for followings:

- Stock Brokers are directed to implement the minimum levels of risk controls and shall ensure that the algorithm orders are not released in breach of price band check, Quantity limit check, Value per order check.
- Stock Brokers are directed to prescribe individual client level cumulative open order value check.
- To have pre- defined parameters for algorithm systems, for an automatic stoppage if algorithm execution leads to loop or a runaway situation.
- To tag algorithm orders with a unique identifier which is provided by the Stock Exchanges to establish audit trail.
- To include a specific report ensuring that the checks are in place in the annual system audit report submitted by the Stock Brokers to Stock Exchanges.

- Stock brokers interesting in Algorithmic Trading are required to submit to Stock exchanges undertakings w.r.t. having proper procedures, systems and technical capability to carry such trades, safeguards to protect any misuse, real time monitoring system and logs of all trading to facilitate audit trail etc.

LESSON ROUND UP

- Securities traded in the stock exchanges can be classified as Listed cleared Securities and Permitted Securities.
- Settlement is the process of netting of transactions and actual delivery/receipt of securities and transfer deeds against receipts/payment of agreed amount.
- National Securities Clearing Corporation Limited incorporated as a wholly owned subsidiary of the National Stock Exchange of India Limited carries out clearing and settlement of the trades executed in the capital market segment of National Stock Exchange.
- The member-brokers at BSE &NSE now enter orders for purchase or sell of securities from Trader Work Stations (TWSs) through BOLT and NEAT system.
- Securities lending is a scheme under which a person with idle shares can lend them to another who does not have the shares to fulfill his obligation under a trade finalized by him.
- Straight Through Processing (STP) is a mechanism that automates the end to end processing of transactions of financial instruments.
- Direct Market Access (DMA) is a facility which allow brokers to offer clients direct access to the exchange trading system through the broker’s infrastructure without manual intervention by the broker.
- With the increasing trend amongst capital market players of generating orders through automated execution logic called Algorithmic Trading.
- SME exchange means a trading platform of a recognised stock exchange having nationwide trading terminals permitted by SEBI to list the specified securities issued in accordance with SEBI (ICDR) Regulation and includes a stock exchange granted recognition for this purpose but does not include the Main Board.

GLOSSARY

Bear Market	A weak or falling market characterized by the dominance of sellers.
Bull Market	A rising market with abundance of buyers and relatively few sellers.
Cash Market	A market for sale of security against immediate delivery, as opposed to the futures market.
Clearing	Settlement or clearance of accounts, for a fixed period in a Stock Exchange.
Daily Margin	The amount that has to be deposited at the Stock Exchange on a daily basis for the purchase or sale of a security. This amount is decided by the stock exchange.
Jobber	Member brokers of a stock exchange who specialize, by giving two way quotations, in buying and selling of securities from and to fellow members. Jobbers do not have any direct contact with the public but they serve the useful function of imparting liquidity to the market.

SELF TEST QUESTIONS

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

1. What is a SME Exchange? What are the benefits available to accompany on listing at SME exchange?
2. Discuss the procedure for settlement of securities under rolling settlement.
3. Discuss the framework for securities lending and borrowng.
4. What is straight through processing? What are its advantages?
5. Briefly explain about Direct Market Access.
6. What is Algorithmic Trading? Enumerated the guidelines prescribed SEBI for Stock Broker in this behalf?
7. What is 'demutualization'? Briefly discuss the important features of demutualization.

Blank area for writing answers, consisting of multiple horizontal lines.

Lesson 6

Debt Market

LESSON OUTLINE

- Introduction
- Debt Market Instruments
- Corporate Debenture
- Fixed Income Product
- Interest Based Bonds
- Money Market Activities
- Investors in Debt Market
- Debt Market Intermediaries/Participants
- Debt Market in India – Regulatory Framework
- SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009
- SEBI (Issue and Listing of Debt Securities) Regulations, 2008
- SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008
- Role of Company Secretary in Simplified Debt Listing Agreement
- Listing Agreement for Securitised Debt Instruments
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

Debt Market are market for issuance, trading and settlement of various types and features of fixed income securities.

A vibrant debt market enables investors to shuffle and reshuffle their portfolio depending upon the expected changes. A well functioning debt market becomes significant for all the market participants. The debt market in India comprises broadly of two segments, viz., Government Securities Market and Corporate Debt Market.

In this lesson the significance of debt market in general and its role in accelerating the development of economic growth in particular, Development of Debt Market in India, the policies initiated by Securities and Exchange Board of India, instruments, investors, participants, issuers and intermediaries available in the Debt market, Regulatory Framework for issue of debt securities, Role of Company Secretary in Simplified Debt Listing Agreement is explained.

INTRODUCTION

Debt markets are markets for the issuance, trading and settlement of various types and features of fixed income securities. Fixed income securities can be issued by any legal entity like central and state governments, public bodies, statutory corporations, banks and institutions and corporate bodies.

The debt market in India comprises mainly of two segments viz., the Government securities market consisting of Central and State Governments securities, Zero Coupon Bonds (ZCBs), Floating Rate Bonds (FRBs), T-Bills and the corporate securities market consisting of FI bonds, PSU bonds, and Debentures/Corporate bonds. Government securities form the major part of the market in terms of outstanding issues, market capitalization and trading value.

The trading of government securities on the Stock exchanges is currently through Negotiated Dealing System using members of Bombay Stock Exchange (BSE) / National Stock Exchange (NSE) and these trades are required to be reported to the exchange. The bulk of the corporate bonds, being privately placed, were, however, not listed on the stock exchanges. Two Depositories, National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) maintain records of holding of securities in a dematerialized form. Records of holding of government securities for wholesale dealers like banks/Primary Dealers (PDs) and other financial institutions are maintained by the RBI.

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

RBI prescribes a minimum rating for issue of Commercial Paper, SEBI, which regulates CRAs, has stipulated that ratings are compulsory for all public issues of Convertible debentures and the government has also stipulated investments by Pension funds only in debt securities that have high ratings.

DEBT MARKET INSTRUMENTS

CORPORATE DEBENTURE

A Debenture is a debt security issued by a company, which offers to pay interest in lieu of the money borrowed for a certain period. In essence it represents a loan taken by the issuer who pays an agreed rate of interest during the lifetime of the instrument and repays the principal normally, unless otherwise agreed, on maturity.

These are long-term debt instruments issued by private sector companies, in denominations as low as ₹ 1000 and have maturities ranging between one and ten years. Debentures enable investors to reap the dual benefits of adequate security and good returns. Unlike other fixed income instruments such as Fixed Deposits, Bank Deposits, Debentures can be transferred from one party to another.

Debentures can be divided into different categories on the basis of convertibility of the instrument and Security.

The debentures issued on the basis of Security includes –

- Non-Convertible Debentures (NCDs)
- Partly Convertible Debentures (PCDs)
- Fully convertible Debentures (FCDs)
- Optionally Convertible Debentures (OCDs)
- Secured Debentures
- Unsecured Debentures

FIXED INCOME PRODUCTS

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

Fixed Deposit: Fixed Deposits are sums accepted by most of the NBFCs and banks. The amount of deposits that may be raised by NBFCs is linked to its net worth and rating. However, the interest rate that may be offered by a NBFC is regulated. The deposits offered by NBFCs are not insured whereas the deposits accepted by most banks are insured upto a maximum of ₹1,00,000.

INTEREST BASED BONDS

Coupon Bonds

Coupon Bonds typically pay interest periodically at the pre specified rate of interest. The annual rate at which the interest is paid is known as the coupon rate or simply the coupon. Interest is usually paid half-yearly though in some cases it may be monthly, quarterly, annually or at some other periodicity. The dates on which the interest payments are made, are known as the coupon due dates.

Zero Coupon Bonds

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

DERIVED INSTRUMENT

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

Mortgage Bonds

Mortgage backed bonds is a collateralized term-debt offering. Every issue of such bonds is backed by a pledged collateral. Property that can be pledged as security for mortgage bonds is called eligible collateral. The terms of these bonds are like the bonds floated in the capital market, semi-annual or quarterly payments of interest and final bullet payment of principal.

Pass Through Certificates

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

Participation Certificates

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

BENCHMARKED INSTRUMENTS

There are certain debt instruments wherein the fixed income earned is based on a benchmark. For instance, the Floating Interest rate Bonds are benchmarked to either the LIBOR, MIBOR etc.

Floating Interest Rate

Floating rate of interest simply means that the rate of interest is variable. Periodically the interest rate payable for the next period is set with reference to a benchmark market rate agreed upon by both the lender and the borrower. The benchmark market rate is the State Bank of India Prime Lending Rate in domestic markets and LIBOR or US Treasury Bill Rate in the overseas markets.

Inflation Linked Bonds

A bond is considered indexed for inflation if the payments on the instrument are indexed by reference to the change in the value of a general price or wage index over the term of the instrument. The options are that either the interest payments are adjusted for inflation or the principal repayment or both.

MONEY MARKET INSTRUMENTS

Call Money

Call/Notice money is an amount borrowed or lent on demand for a very short period. If the period is more than one day and upto 14 days it is called 'Notice money' otherwise the amount is known as Call money. No collateral security is required to cover these transactions. The call market enables the banks and institutions to even out their day to day deficits and surpluses of money. Commercial banks, Co-operative Banks and primary dealers are allowed to borrow and lend in this market for adjusting their cash reserve requirements.

Treasury Bills

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

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

Term Money Market

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

Certificates of Deposits (CDs)

After treasury bills, the next lowest risk category investment option is the certificate of deposit (CD) issued by banks and Financial Institutions.

CDs are issued by banks and FIs mainly to augment funds by attracting deposits from corporates, high net worth individuals, trusts, etc. The foreign and private banks, especially, which do not have large branch networks and hence lower deposit base use this instrument to raise funds.

Commercial Papers (CP)

CPs are negotiable short-term unsecured promissory notes with fixed maturities, issued by well rated companies generally sold on discount basis. Companies can issue CPs either directly to the investors or through banks / merchant banks (called dealers). These are basically instruments evidencing the liability of the issuer to pay the holder in due course a fixed amount i.e. face value of the instrument, on the specified due date. These are issued for a fixed period of time at a discount to the face value and mature at par.

Inter-corporate Deposits

Apart from CPs, corporates have access to another market called the inter corporate deposits (ICD) market. An ICD is an unsecured loan extended by one corporate to another. This market allows funds surplus corporates to lend to other corporates. As the cost of funds for a corporate is much higher than a bank, the rates in this market remain higher than those in the other markets.

Commercial Bills

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

INVESTORS IN DEBT MARKET

Investors are the entities who invest in fixed income instruments. The investors in such instruments are generally Banks, Financial Institutions, Mutual Funds, Insurance companies, Provident Funds etc. The individual investors invest to a great extent in Fixed Income products.

Banks

Collectively all the banks put together are the largest investors in the debt market. They invest in all instruments ranging from T-Bills, CPs and CDs to GOISECs, private sector debentures etc. Banks lend to corporate sector directly by way of loans and advances and also invest in debentures issued by the private corporate sector and in PSU bonds.

Insurance Companies

The second largest category of investors in the debt market are the insurance companies.

Provident funds

Provident funds are estimated to be the third largest investors in the debt market. Investment guidelines for provident funds are being progressively liberalized and investment in private sector debentures is one step in this direction.

Most of the provident funds are very safety oriented and tend to give much more weightage to investment in government securities although they have been considerable investors in PSU bonds as well as state government backed issues.

Mutual funds

Mutual funds represent an extremely important category of investors. World over, they have almost surpassed banks as the largest direct collector of primary savings from retail investors and therefore as investors in the wholesale debt market. Mutual funds include the Unit Trust of India, the mutual funds set up by nationalized banks and insurance companies as well as the private sector mutual funds set up by corporates and overseas mutual fund companies.

Trusts

Trusts include religious and charitable trusts as well as statutory trusts formed by the government and quasi government bodies.

There are very few instruments in which trusts are allowed to invest. Most of the trusts invest in CDs of banks and bonds of financial institutions and units of Unit Trust of India.

Corporate Treasuries

Corporate Treasuries have become prominent investors only in the last few years. Treasuries could be either those of the public sector units or private sector companies or any other government bodies or agencies. The treasuries of PSUs as well as the governmental bodies are allowed to invest in papers issued by DFIs and banks as well as GOISECs of various maturities. However the orientation of the investments is mostly in short-term instruments or sometimes in extremely liquid long term instruments which can be sold immediately in the markets.

In complete contrast to public sector treasuries, those in the private sector invest in CDs of banks and CPs of other private sector companies, GOISECs as well as debentures of other private sector companies.

Foreign Institutional Investors (FIIs)

India does not allow capital account convertibility either to overseas investors or to domestic residents. Registered FIIs are exception to this rule. FIIs have to be specifically and separately approved by SEBI for equity and debt. Each FII is allocated a limit every year up to which it can invest in Indian debt securities. They are also free to disinvest any of their holdings, at any point of time, without prior permission.

Retail Investors

Since January 2002, retail investors have been permitted to submit non-competitive bids at primary auction through any bank or Primary Dealers (PDs).

DEBT MARKET INTERMEDIARIES/PARTICIPANTS**Primary Dealers**

Primary dealers (PDs) are important intermediaries in the government securities markets. They act as underwriters in the primary market, and as market makers in the secondary market. PDs underwrite a portion of the issue of government security that is floated for a pre-determined amount. The underwriting commitment of each PD is broadly decided on the basis of its size in terms of its net owned funds, its holding strength, the committed amount of bids and the volume of turnover in securities.

Brokers

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

DEBT MARKET – REGULATORY FRAMEWORK**Role of RBI**

The Reserve Bank of India manages the public debt and issues new loans on behalf of the Union and the State Governments under the powers derived from the Reserve Bank of India Act. It also undertakes cash and liquidity management for the Government of India and State Governments and administers the scheme of Ways and Means Advances (WMA).

Internal Debt Management Department of the RBI manages internal debt. This involves auctioning the Government debt from time to time, introduction of new instruments, smoothening the maturity structure of debt, placing of debt at market related rates and improving depth and liquidity of Government securities by developing active secondary market for them. The Government Securities Act, 2006 governs the Government Debt Market.

The Reserve Bank of India is, therefore, the main regulator for the Money Market. Reserve Bank of India also controls and regulates the G-Secs Market. Apart from its role as a regulator, it has to simultaneously fulfill

several other important objectives viz. managing the borrowing program of the Government of India, controlling inflation, ensuring adequate credit at reasonable costs to various sectors of the economy, managing the foreign exchange reserves of the country and ensuring a stable currency environment.

RBI controls the issuance of new banking licenses to banks; the manner in which various scheduled banks raise money from depositors; and deployment of money through its policies on CRR, SLR, priority sector lending, export refinancing, guidelines on investment assets etc.

Another major area under the control of the RBI is the interest rate policy. Earlier, it used to strictly control interest rates through a directed system of interest rates. Each type of lending activity was supposed to be carried out at a pre-specified interest rate. Over the years RBI has moved slowly towards a regime of market determined controls. RBI provides negotiated dealing system which is an electronic platform for facilitating dealing in Government Securities and money market instruments.

Role of SEBI

The Securities and Exchange Board of India (SEBI) controls bond market and corporate debt market in cases where entities raise money from public through public issues.

It regulates the manner in which such moneys are raised and ensure a fair play for the retail investor. The issuers are required to make the retail investor aware, of the risks inherent in the investment, by way of disclosure. Being regulator for the Mutual Funds in India SEBI regulates the entry of new mutual funds in the industry and also the instruments in which mutual funds can invest.

Other Regulator

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

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

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

Credit Rating

An issuer can make an initial public offer of convertible debt instruments without making a prior public issue of its equity shares and listing thereof, subject to the following conditions:

- No company can make a public issue or rights issue of convertible debt instruments unless credit rating is obtained from one or more agencies i.e. credit rating is mandatory.
- The company is required to give the following details of credit ratings in case of a public issue or rights issue of convertible debt instruments:
 - (a) The names of all the credit rating agencies from which credit rating including unaccepted rating has been obtained for the issue of convertible debt instruments.
 - (b) All the credit ratings obtained during three years prior to the filing the offer document for any of the issuer's listed convertible debt instruments at the time of accessing the market through a convertible debt instrument.

Appointment of Debenture Trustee

The company is required to appoint one or more debenture trustees in accordance with the provisions of section 71 of the Companies Act, 2013 and SEBI (Debenture Trustees) Regulations, 1993.

The issuer is required to disclose the complete name and address of the debenture trustee in the annual report.

Debenture Redemption Reserve

The company is required to create a debenture redemption reserve in accordance with the provisions of section 71 of the Companies Act, 2013.

Redemption

The issuer is required to redeem the convertible debt instruments in terms of the offer document.

Documents to be Submitted Before Opening of the Issue

The lead merchant bankers shall submit a due diligence certificate from the debenture trustee in a prescribed form to SEBI along with the draft offer document.

Creation of Charge

If the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it is required to ensure that-

- (i) such assets are sufficient to discharge the principal amount at all times;
- (ii) such assets are free from any encumbrance;
- (iii) where security is already created on such assets in favour of financial institutions or banks or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such financial institution, bank or lessor for a second or pari passu charge has been obtained and submitted to the debenture trustee before the opening of the issue;
- (iv) the security/asset cover is required to be arrived at after reduction of the liabilities having a first/prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.

However, the creation of fresh security and execution of fresh trust deed is not mandatory if the existing trust deed or the security documents provide for continuance of the security till redemption of secured convertible debt instruments.

Further, whether the issuer is required to create fresh security and to execute fresh trust deed or not is to be decided by the debenture trustee.

Roll Over of Non Convertible Portion of Partly Convertible Debt Instruments

The non-convertible portion of partly convertible debt instruments issued by a listed issuer, the value of which exceeds fifty lakh rupees can be rolled over without change in the interest rate, subject to compliance with the the following conditions–

- (a) 75% of the holders of the convertible debt instruments of the issuer have, through a resolution through postal ballot, approved the rollover.
- (b) the issuer has along with the notice for passing the resolution, sent to all holders of the convertible debt instruments, an auditors' certificate on the cash flow of the issuer and with comments on the liquidity position of the issuer.
- (c) the issuer has undertaken to redeem the non-convertible portion of the partly convertible debt instruments of all the holders of the convertible debt instruments who have not agreed to the resolution.

- (d) credit rating has been obtained from at least one credit rating agency registered with the SEBI within a period of six months prior to the due date of redemption and has been communicated to the holders of the convertible debt instruments, before the roll over.

Conversion of Optionally Convertible Debt Instruments into Equity Share Capital

(1) No issuer can convert its optionally convertible debt instruments into equity shares unless the holders of such convertible debt instruments have sent their positive consent to the issuer and non-receipt of reply to any notice sent by the issuer for this purpose is not construed as consent for conversion of any convertible debt instruments.

(2) Where the value of the convertible portion of any convertible debt instruments issued by a listed issuer exceeds fifty lakh rupees and the issuer has not determined the conversion price of such convertible debt instruments at the time of making the issue, the holders of such convertible debt instruments are required to be given the option of not converting the convertible portion into equity shares.

However, where the upper limit on the price of such convertible debt instruments and justification thereon is determined and disclosed to the investors at the time of making the issue, it is not necessary to give such option to the holders of the convertible debt instruments for converting the convertible portion into equity share capital within the said upper limit.

(3) Where an option is to be given to the holders of the convertible debt instruments in terms of Para (2) and if one or more of such holders do not exercise the option to convert the instruments into equity share capital at a price determined in the general meeting of the shareholders, the issuer is required to redeem that part of the instruments within one month from the last date by which option is to be exercised, at a price which shall not be less than its face value.

However, this provision is not applicable if such redemption is in terms of the disclosures made in the offer document.

Restriction

An issuer can not issue convertible debt instruments for financing replenishment of funds or for providing loan to or for acquiring shares of any person who is part of the same group or who is under the same management.

However, an issuer may issue fully convertible debt instruments for these purposes if the period of conversion of such debt instruments is less than eighteen months from the date of issue of such debt instruments.

Determination of Coupon Rate and Conversion Price

An issuer can determine the coupon rate and conversion price of convertible debt instruments in consultation with the lead merchant banker or through the book building process.

Minimum Promoter's Contribution

In case of public issue or composite issue of convertible debt securities, the promoters shall contribute twenty per cent as stipulated for public issue under Regulation 32(1), either by way of equity shares or by way of subscription to the convertible securities. However, if the price of the equity shares allotted pursuant to conversion is not predetermined and not disclosed in the offer document, the promoters shall contribute only by way of subscription to the convertible securities being issued in the public issue and shall undertake in writing to subscribe to the equity shares pursuant to conversion of such securities.

In case of an initial public offer of convertible debt instruments without a prior public issue of equity shares, the promoters are required to bring in a contribution of at least twenty per cent of the project cost in the form of equity shares, subject to contributing at least twenty per cent of the issue size from their own funds in the form of equity shares.

However, if the project is to be implemented in stages, the promoters' contribution is required to be with respect to total equity participation till the respective stage vis-à-vis the debt raised or proposed to be raised through the public issue.

Auditor's Certificate

The issuer is required to forward the details of utilisation of the funds raised through the convertible debt instruments duly certified by the statutory auditors of the issuer, to the debenture trustees at the end of each half-year.

Obligation of The Issuer

The issuer is required to provide a compliance certificate to the convertible debt instrument holders on yearly basis in respect of compliance with the terms and conditions of issue of convertible debt instruments as contained in the offer document, duly certified by the debenture trustee.

The issuer is also required to furnish a confirmation certificate that the security created by the issuer in favour of the convertible debt instrument holders is properly maintained and is adequate to meet the payment obligations towards the convertible debt instrument holders in the event of default.

The issuer is required to ensure that necessary cooperation with the credit rating agency(ies) has been extended in providing true and adequate information till the debt obligations in respect of the instrument are outstanding.

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

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

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

ISSUE OF DEBT SECURITIES

Conditions

A Company can not make any public issue of debt securities if –

1. The Company or the person in control, or its promoter, has been restrained or prohibited or debarred by SEBI from accessing the securities market or dealing in securities and such direction or order is in force.
2. It has made an application to one or more recognized stock exchanges for listing of such securities therein. If the application is made to more than one recognized stock exchanges, the issuer must choose one of them which has nationwide trading terminals as the designated stock exchange.
3. It has obtained in-principle approval for listing of its debt securities.
4. Credit rating including the unaccepted ratings obtained from more than one credit rating agencies, registered with SEBI shall be disclosed in the offer document.
5. The Company can not issue debt securities for providing loan to or acquisition of shares of any person who is part of the same group or who is under the same management.

Appointment of Intermediaries

1. It shall enter into an arrangement with a depository registered with SEBI in accordance with the Depositories Act, 1996 and regulations made there under.

2. The Company should appoint one or more merchant bankers registered with SEBI at least one of whom shall be a lead merchant banker.
3. The Company is required to appoint one or more debenture trustees in accordance with the provisions of Section 71 of the Companies Act, 2013 and SEBI (Debenture Trustees) Regulations, 1993.

Disclosures of Material Information

1. The offer document must contain all material disclosures which are necessary for the subscribers of the debt securities to take an informed investment decision. The offer document contains the following:
 - (a) the disclosures specified in Section 26 of the Companies Act, 2013;
 - (b) disclosure specified in Schedule I of these regulations;
 - (c) additional disclosures as may be specified by SEBI
2. The amount of minimum subscription which the issuer seeks to raise and underwriting arrangements shall be disclosed in the offer document.

Filing

The Company shall file a draft offer document with the designated stock exchange through the lead merchant banker and also forward a copy of the draft & final offer document to SEBI.

Filing of Shelf Prospectus

(1) The following companies or entities may file shelf prospectus under section 31 of Companies Act, 2013 for public issuance of their debt securities,-

- (a) Public financial institutions as defined under clause (72) of section 2 of the Companies Act, 2013, and scheduled banks as defined under clause (e) of section 2 of the Reserve Bank of India Act, 1934; or
- (b) Issuers authorized by the notification of Central Board of Direct Taxes to make public issue of tax free secured bonds, with respect to such tax free bond issuances; or
- (c) Infrastructure Debt Funds – Non-Banking Financial Companies regulated by Reserve Bank of India; or
- (d) Non-Banking Financial Companies registered with Reserve Bank of India and Housing Finance Companies registered with National Housing Bank complying with the following criteria:
 - (i) having a net worth of at-least Rs.500 crore, as per the audited balance sheet of the preceding financial year;
 - (ii) having consistent track record of distributable profit for the last three years;
 - (iii) securities issued under the shelf prospectus have been assigned a rating of not less than “AA-” category or equivalent by a credit rating agency registered with SEBI;
 - (iv) no regulatory action is pending against the company or its promoters or directors before the Board, Reserve Bank of India or National Housing Bank;
 - (v) the issuer has not defaulted in the repayment of deposits or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any public financial institution or banking company, in the last three financial years.

Or

- (e) Listed entities complying with the following criteria:

- (i) whose public issued equity shares or debt securities are listed on recognized stock exchange for a period of at least three years immediately preceding the issue and have been complying with the listing agreement entered into between the issuer and the recognized stock exchanges where the said securities of the issuer are listed;
 - (ii) having a net worth of at-least Rs.500 crore, as per the audited balance sheet of the preceding financial year;
 - (iii) having consistent track record of distributable profit for the last three years;
 - (iv) securities issued under the shelf prospectus have been assigned a rating of not less than "AA-" category or equivalent by a credit rating agency registered with SEBI;
 - (v) no regulatory action is pending against the company or its promoters or directors before the Board, Reserve Bank of India or National Housing Bank;
 - (vi) the issuer has not defaulted in the repayment of deposits or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any public financial institution or banking company, in the last three financial years.
- (2) The issuer filing a shelf prospectus shall file a copy of an information memorandum with the recognised stock exchanges and SEBI, immediately on filing the same with the Registrar.
- (3) The information memorandum shall contain the disclosures specified in Companies Act, 1956 or Companies Act, 2013, whichever is applicable and rules made thereunder and shall include disclosures regarding summary term sheet, material updations including revision in ratings, if any along with the rating rationale and financial ratios specified in Schedule I, indicating the pre and post issue change.
- (4) Not more than four issuances shall be made through a single shelf prospectus.

Responsibilities of Merchant Banker

The lead merchant banker must ensure that –

- The draft offer document clearly specifies the names and contact particulars of the compliance officer of the lead merchant banker and the Company including the postal and email address, telephone and fax numbers.
- All comments received on the draft offer document are suitably addressed and shall also furnish to SEBI a due diligence certificate as per these regulations prior to the filing of the offer document with the Registrar of Companies.

Mode of Disclosure

- The draft offer document shall be made public by posting it on the website of the designated stock exchange for seeking public comments for a period of seven working days from the date of filing the draft offer document with such exchange.
- The draft offer document can also be displayed on the website of the issuer, merchant bankers and the stock exchanges where the debt securities are proposed to be listed.
- The draft and final offer document shall be displayed on the websites of stock exchanges and shall be available for download in PDF / HTML formats.
- Where any person makes a request for a physical copy of the offer document, the same shall be provided to him by the issuer or lead merchant banker.

Prohibition of Mis-statements In The Offer Document

- The offer document shall not omit disclosure of any material fact which may make the statements made therein, in light of the circumstances under which they are made, misleading.
- The offer document or abridged prospectus or any advertisement issued by an issuer in connection with a public issue of debt securities shall not contain any false or misleading statement.

Advertisements

- The Company should make an advertisement in a national daily with wide circulation, on or before the issue opening date and such advertisement, amongst other things must contain the disclosures specified in these regulations.
- An Company should not issue an advertisement–
 - which is misleading in material particular or which contains any information in a distorted manner or which is manipulative or deceptive or extraneous matters.
 - which contain a statement, promise or forecast which is untrue or misleading and the advertisement shall be truthful, fair and clear.
 - during the subscription period any reference to the issue of debt securities or be used for solicitation.

Abridged Prospectus and Application Forms

The issuer and lead merchant banker shall ensure that :

- Every application form issued is accompanied by a copy of the abridged prospectus and it shall not contain any extraneous matters
- Adequate space has been provided in the application form to enable the investors to fill in various details like name, address, etc.

The Company may provide the facility for subscription of application in electronic mode.

On-line Issuances

A Company proposing to issue debt securities to the public through the on-line system of the designated stock exchange shall comply with the relevant applicable requirements as may be specified by SEBI.

Issue Price

A Company may determine the price of debt securities in consultation with the lead merchant banker and the issue may be at fixed price or the price may be determined through book building process in accordance with the procedure as may be specified by SEBI.

Minimum Subscription

The minimum subscription for public issue of debt securities shall be specified as 75% of the base issue size for both NBFCs and Non NBFC issuers. Further, if the issuer does not receive minimum subscription of its base issue size (75%), then the entire application monies shall be refunded within 12 days from the date of the closure of the issue. In the event, there is a delay, by the issuer in making the aforesaid refund, then the issuer shall refund the subscription amount along with interest at the rate of 15% per annum for the delayed period.

However, the issuers issuing tax-free bonds, as specified by CBDT, shall be exempted from the above proposed minimum subscription limit.

Explanation: In any public issue of debt securities, the Base Issue size shall be minimum Rs 100 crores.

Optional Underwriting

A public issue of debt securities may be underwritten by an underwriter registered with SEBI and in such a case adequate disclosures regarding underwriting arrangement shall be disclosed in the offer document.

Trust Deed

A trust deed shall–

- (1) be executed by the Company in favour of the debenture trustee within three months of the closure of the issue.
- (2) contain such clauses as may be prescribed under section 71 of the Companies Act, 2013 and those mentioned in Schedule IV of SEBI (Debenture Trustees) Regulations, 1993.
- (3) not contain a clause which has the effect of –
 - limiting or extinguishing the obligations and liabilities of the debenture trustees or the issuer in relation to any rights or interests of the investors.
 - limiting or restricting or waiving the provisions of the Act, these regulations and circulars or guidelines issued by SEBI.
 - indemnifying the debenture trustees or the issuer for loss or damage caused by their act of negligence or commission or omission.

Debenture Redemption Reserve

- (1) The Company shall create a debenture redemption reserve in accordance with the provisions of the Companies Act, 2013 and circulars issued by Central Government in this regard.
- (2) Where the Company has defaulted in payment of interest on debt securities or redemption thereof or in creation of security as per the terms of the issue of debt securities, any distribution of dividend shall require approval of the debenture trustees.

Creation of Charge

- (1) The proposal to create a charge or security, if any, in respect of secured debt securities shall be disclosed in the offer document along with its implications.
- (2) An undertaking from the Company is given in the offer document that the assets on which charge is created are free from any encumbrances and if the assets are already charged to secure a debt, the permissions or consent to create second or *pari pasu* charge on the assets of the issuer have been obtained from the earlier creditor.
- (3) The issue proceeds shall be kept in an escrow account until the documents for creation of security as stated in the offer document, are executed.

Redemption and Roll-over

- (1) The Company shall redeem the debt securities in terms of the offer document.
- (2) A Company desirous of rolling-over the debt securities issued by it, it shall do so only upon passing of a special resolution of holders of such securities and give twenty one days notice of the proposed roll over to them.
- (3) The notice shall contain disclosures with regard to credit rating and rationale for roll-over.
- (4) Prior to sending the notice to holders of debt securities, the company must file a copy of the notice and proposed resolution with the stock exchanges where such securities are listed, for dissemination of the

same to public on its website.

- (5) The debt securities issued can be rolled over subject to the following conditions –
- A special resolution has been passed by the holders of debt securities through postal ballot having the consent of not less than 75% of the holders by value of such debt securities.
 - At least one rating is obtained from a credit rating agency within a period of six months prior to the due date of redemption and is disclosed in the notice.
 - Fresh trust deed shall be executed at the time of such roll-over or the existing trust deed can be continued if the trust deed provides for such continuation.
 - Adequate security shall be created or maintained in respect of such debt securities to be rolled-over.
- (6) The Company shall redeem the debt securities of all the debt securities holders, who have not given their positive consent to the roll-over.

Mandatory Listing

- (1) A Company desirous of making an offer of debt securities to public shall make an application for listing to one or more recognized stock exchanges in terms of sub-section (1) of section 40 of the Companies Act, 2013.
- (2) It must comply with conditions of listing of such debt securities as specified in the Listing Agreement with the stock exchange where such debt securities are sought to be listed.
- (3) Where of the Company has disclosed the intention to seek listing of debt securities issued on private placement basis, it shall forward the listing application along with the disclosures specified in Schedule I to the recognized stock exchange within fifteen days from the date of allotment of such debt securities.

CONDITIONS FOR PRIVATE PLACEMENT

1. A Company may list its debt securities issued on private placement basis on a recognized stock exchange subject to the following conditions:
 - In compliance with the provisions of the Companies Act, 2013, rules prescribed there under and other applicable laws.
 - Credit rating has been obtained from at least one credit rating agency registered with SEBI.
 - Should be in dematerialized form.
 - The disclosures as provided in these regulation have been made.
2. The Company shall comply with conditions of listing of such debt securities as specified in the Listing Agreement with the stock exchange where such debt securities are sought to be listed.
3. The company making a private placement of debt securities and seeking listing thereof on a recognised stock exchange shall make disclosures in a disclosure document as specified in Schedule I of these regulations accompanied by the latest Annual Report of the issuer.

Filing of Shelf Disclosure Document

- A Company making a private placement of debt securities and seeking listing thereof on a recognized stock exchange may file a Shelf Disclosure Document containing disclosures as provided in Schedule I of these regulations.

- The Company is not required to file disclosure document, while making subsequent private placement of debt securities for a period of 180 days from the date of filing of the shelf disclosure document.
- However, while making any private placement under Shelf Disclosure Document, it shall file with the concerned stock exchange updated disclosure document with respect to each tranche, containing details of the private placement and material changes, if any, in the information provided in Shelf Disclosure Document.

RELAXATION OF STRICT ENFORCEMENT OF RULE 19 OF SECURITIES CONTRACTS (REGULATION) RULES, 1957

In exercise of the powers conferred by sub-rule (7) of rule 19 of the Securities Contracts (Regulation) Rules, 1957, SEBI relaxed the strict enforcement of:

- (1) Sub-rules (1) and (3) of rule 19 of the said rules in relation to listing of debt securities issued by way of a public issue or a private placement.
- (2) Clause (b) of sub-rule (2) of rule 19 of the said Rules in relation to listing of debt securities–
 - (i) Issued by way of a private placement by any Company.
 - (ii) Issued to public by an infrastructure company, a Government Company, a statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in infrastructure sector.

LISTING AND TRADING OF DEBT SECURITIES

Continuous Listing

- (1) All the Companies shall comply with the conditions of listing specified in the respective listing agreement for debt securities while making public issues of debt securities or seeking listing of debt securities issued on private placement basis.
- (2) Each rating obtained by the company shall be periodically reviewed by the registered credit rating agency and any revision in the rating shall be promptly disclosed by the Company to the stock exchange(s) where the debt securities are listed.
- (3) Any change in rating shall be promptly disseminated to investors and prospective investors in such manner as the stock exchange may determine from time to time.
- (4) Debenture trustee must disclose the information to the investors and the general public by issuing a press release in any of the following events:
 - (a) default by the Company to pay interest on debt securities or redemption amount;
 - (b) failure to create a charge on the assets;
 - (c) revision of rating assigned to the debt securities.

Trading

- (1) While issuing debt securities to the public or on a private placement basis, which are listed in recognized stock exchanges, shall be traded and such trades shall be cleared and settled in recognized stock exchanges it should satisfy the conditions as specified by SEBI.
- (2) The trades of debt securities which have been made over the counter shall be reported on a recognized stock exchange having a nationwide trading terminal or such other platform as may be specified by SEBI.

- (3) SEBI may specify conditions for reporting of trades on the recognized stock exchange or other platform

Information to be Displayed on Website

- The disclosures as specified in Schedule-I accompanied by the latest annual report shall be made on the web sites of stock exchanges where such securities are proposed to be listed and shall be available for download in PDF / HTML formats.
- The Company, the respective debenture trustees and stock exchanges shall disseminate all information and reports including compliance reports filed by the issuers and the debenture trustees regarding the debt securities to the investors and the general public by placing them on their websites.
- The information shall also be placed on the websites, if any, of the debenture trustee, the Company and the stock exchanges.

Obligations of Debenture Trustee

- (1) The debenture trustee shall prior to the opening of the public issue, furnish to SEBI a due diligence certificate as per of these regulations.
- (2) The debenture trustee shall be vested with the requisite powers for protecting the interest of holders of debt securities including a right to appoint a nominee director on the Board of the issuer in consultation with institutional holders of such securities.
- (3) The debenture trustee shall carry out its duties and perform its functions under these regulations, the Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993, the trust deed and offer document, with due care, diligence and loyalty.
- (4) The debenture trustee shall ensure disclosure of all material events on an ongoing basis.
- (5) The debenture trustees shall supervise the implementation of the conditions regarding creation of security for the debt securities and debenture redemption reserve.

Obligations of the Issuer, Lead Merchant Banker, etc.

- (1) The Company ensure that all the material facts disclosed in the offer documents issued or distributed to the public are true, fair and adequate and there is no mis-leading or untrue statements or mis-statement in the offer document.
- (2) The Merchant Banker shall ensure verify and confirm that the disclosures made in the offer documents are true, fair and adequate and the issuer is in compliance with these regulations as well as all transaction specific disclosures specified in section 26 of the Companies Act, 2013.
- (3) The Company shall treat the applicant in a fair and equitable manner as per the procedures as may be specified by SEBI.
- (4) In respect of assignments undertaken for issue, offer and distribution of securities to the public the intermediaries shall be responsible for the due diligence.
- (5) A person shall not employ any device, scheme or artifice to defraud in connection with issue or subscription or distribution of debt securities which are listed or proposed to be listed on a recognized stock exchange.
- (6) The Company and the merchant banker shall ensure that the security created to secure the debt securities is adequate to ensure 100% asset cover for the debt securities.

Disclosure chart

Equity already listed	Type of offering	Manner of disclosures
Yes	Public offering	<ul style="list-style-type: none"> – Material disclosures from section 26 of Companies Act, 2013 – Sch I of the Regulations – Simplified debt listing agreement.
Yes	Private placement with listing	<ul style="list-style-type: none"> – Sch I of the Regulations – Simplified debt listing agreement – (reference to) last annual report
No	Public offering	<ul style="list-style-type: none"> – Material disclosures from section 26 of Companies Act, 2013 – Sch I of the Regulations – Debt listing agreement
No	Private placement with listing	<ul style="list-style-type: none"> – Sch I of the Regulations – Debt listing agreement – (reference to) last annual report

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

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

1. The special purpose distinct entity i.e. issuer shall be in the form of a trust; the trustees thereof will require registration from SEBI. The registration granted to a trustee shall be permanent subject to compliance with the provisions with the Securities Contract (Regulation) Rules (SCRR) and the said regulations and payment of appropriate fees.
2. If a debenture trustee registered with SEBI or a securitization company or a asset reconstruction company registered with Reserve Bank of India or National Housing Bank or the NABARD is the trustee of the issuer no registration from SEBI to act as such shall be required.
3. The securitized debt instruments issued to public or listed on recognized stock exchange shall acknowledge the beneficial interest of the investors in underlying debt or receivables assigned to the issuer. The regulations provide flexibility in terms of pay through / pass through structures and do not restrict any particular mode.
4. The assignment of assets to the issuer shall be a true sale. The debt or receivables assigned to the issuer should be expected to generate identifiable cash flows for the purpose of servicing the instrument and the originator should have valid enforceable interests in the assets and in cash flow of assets prior to securitization.
5. Originator shall be an independent entity from the issuer and its trustees and the originator and its associates shall not exercise any control over the issuer. However, the originator may be appointed as a servicer. The issuer may appoint any other person as servicer in respect of any its schemes to co-

ordinate with the obligors, manage the said pool and collection there from administer the cash flows of asset pool, distribution to investors and reinvestments. The issuer shall not acquire any debt or receivables from any originator who is part of the same group or which is under the same management as the trustee. These regulations require strict segregation of assets of each scheme.

6. The issuer may offer securitised debt instruments to public for subscription through an offer document containing disclosures of all relevant material facts including financials of the issuer, originator, quality of the asset pool, disclosure of various kinds of risks, credit ratings including unaccepted ratings, arrangements made for credit enhancement, liquidity facilities availed, underwriting of the issue etc. apart from the routine disclosures relating to issue, offer period, application, etc.
7. Rating from at least two credit rating agencies is mandatory and all ratings including unaccepted ratings shall be disclosed in the offer documents. The rating rationale should include reference to the quality of the said pool and strengthen of cash flows, originator profile, payment structure, risks and concerns for investors, etc.
8. The instrument shall be in dematerialized form.
9. The draft offer document shall be filed with SEBI at least 15 days before opening of the issue.
10. In case of public issuances listing will be mandatory. The instruments issued on private placement basis may also be listed subject to the compliance of simplified provisions of the regulations. The securitised debt instruments issued to the public or listed on a recognized stock exchange in accordance with these regulations shall be freely transferable.

SIMPLIFIED LISTING AGREEMENT FOR DEBT SECURITIES

Continuing with rationalization of disclosure norms for listing of debt issuances, SEBI has put in place a simplified Listing Agreement for debt securities.

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

The Listing Agreement has two parts; Part A is applicable where equity shares of the issuer are already listed on the exchange and continues to comply with the listing agreement for equity. Part B is applicable for issuers who do not have their equity shares already listed on the exchange. An issuer complying with Part B would move to compliance with Part A in case its equity shares listed at a future date. Similarly, an issuer delisting equity need to comply with Part B.

Role of Company Secretary in Simplified Debt Listing Agreement

The Debt Listing Agreement authorises Company Secretaries to issues half yearly certificate regarding maintenance of 100% security cover in respect of listed secured debt securities. Clause 2 and 13 of the Listing agreement reads as under:

- I. Part A of the Debt Listing Agreement applicable to the Issue of Debt Securities where equity shares of the Issuer are listed
 - “2. The Issuer agrees that it shall forward to the debenture trustee promptly, whether a request for the same has been made or not:
- (d) half-yearly certificate regarding maintenance of 100% asset cover in respect of listed debt securities, by either a practicing company secretary or a practicing chartered accountant, along with the half

yearly financial results. (not applicable for Bank or NBFC Issuers registered with RBI or where bonds are secured by a Government guarantee).”

- II. Part B of the Debt Listing Agreement applicable to the Issue of Debt Securities where equity shares of the Issuer are not listed on the Exchange.

“13. The Issuer agrees that it shall forward to the debenture trustee promptly, whether a request for the same has been made or not:

- (d) a half-yearly certificate regarding maintenance of 100% asset cover in respect of listed debt securities, by either a practicing company secretary or a practicing chartered accountant, along with the half yearly financial results. (not applicable for Bank or NBFC Issuers registered with RBI or where bonds are secured by a Government guarantee).”

Further Clause 22 of the Debt Listing Agreement requires the issuer to designate Company Secretary or any other person as Compliance Officer responsible for ensuring compliance with the regulatory provisions applicable to such issuance of debt securities, reporting to various authorities etc. The extract of the clause is as under:

“22. The Issuer agrees and undertakes to designate the Company Secretary or any other person as Compliance Officer who

- (a) shall be responsible for ensuring compliance with the regulatory provisions applicable to such issuance of debt securities and report the same at the meeting of Board of Directors/ Council of Issuer held subsequently;
- (b) shall directly report to the Securities and Exchange Board of India, Stock Exchanges, Registrar of Companies, etc., and investors on the implementation of various clauses, rules, regulations and other directives of these authorities;
- (c) shall be responsible for filing the information in the Corp Filing system or any other platform as may be mandated by SEBI from time to time. The compliance officer and the Issuer shall ensure the correctness and authenticity of the information filed in the system and that it is in conformity with applicable laws and terms of the Listing Agreement;
- (d) shall monitor the designated e-mail ID of the grievance redressal division which shall be exclusively maintained for the purpose of registering complaints by investors. The company shall display the email ID and other relevant details prominently on their websites and in the various materials / pamphlets/ advertisement campaigns initiated by them for creating investor awareness.”

LISTING AGREEMENT FOR SECURITIZED DEBT INSTRUMENTS

To improve the secondary market liquidity for securitized debt instruments and to enhance information available in the public domain on performance of asset pools on which securitized debt instruments are issued, put in place a Listing Agreement for securitized debt instruments.

In respect of listed securitized debt instruments the Special Purpose Distinct Entity (SPDEs) which make frequent issues of securitized debt instruments are permitted to file umbrella offer documents on the lines of a ‘shelf prospectus’. In order to ensure uniform market convention for secondary market trades of securitized debt instruments, actual/ actual day count convention, shall be mandatory for all listed securitized debt instruments. The Listing Agreement places the burden of disclosures on the Special Purpose Distinct Entity (SPDE) which is the issuer of securitized debt and disclosure of pool level, tranche level and select loan level information. The Highlights of the Listing Agreement for Securitized Debt Instruments are as follows:

1. The Special Purpose Distinct Entity (SPDE) requires:

- to intimate the Exchange, of its intention to issue new securitized debt instruments either through a public issue or on private placement basis prior to issuing such securities:

- to ensure that any scheme of arrangement/ amalgamation/ merger/ reconstruction/ reduction of capital to be presented to any Court or Tribunal does not in any way violate, override or circumscribe the provisions of securities laws or the Exchange requirements;
 - no material modification should be made in terms of coupon, conversion, redemption, or otherwise without prior approval of the Exchanges.
 - to abide by the requirements of the SEBI Act, 1992, the Securities Contracts (Regulations) Act, 1956 and rules and the regulations made thereunder.
2. The SPDE either by itself or through the servicer ensure timely interest/ redemption payment; make credit enhancement available for listed securitized debt instruments at all times; ensure that services of ECS, Direct Credit, RTGS or NEFT are used for payment of interest and redemption or repayment amounts as per applicable norms of the Reserve Bank of India and if not possible to make payment through electronic means, the SPDE is required to issue 'payable-at-par' warrants/ cheques for payment of interest and redemption amount;
 3. The SPDE will not forfeit unclaimed interest and principal and such unclaimed interest and principal should be, after a period of seven years, transferred to the SEBI (Investor Protection and Education Fund).
 4. The SPDE undertakes to designate any person as Compliance Officer who would be responsible for ensuring compliance with the regulatory provisions applicable; directly report to the SEBI, Stock Exchanges, Registrar of Companies, etc., and investors on the implementation of various clauses, rules, regulations and other directives of these authorities; for filing the information in any electronic platform as may be mandated by SEBI from time to time; monitor the designated e-mail ID of the grievance redressal division and also ensure the correctness and authenticity of the information filed in the system and that it is in conformity with applicable laws and terms of the Listing Agreement;
 5. The SPDE requires to credit the demat accounts of the allottees within two working days from the date of allotment.
 6. The SPDE ensures that:
 - (a) allotment of securities offered to public should be made in accordance with Regulation 31 of the SEBI (Public Offer and Listing of Securitized Debt Instruments) Regulations, 2008.
 - (b) it shall pay interest @ 15% per annum if the allotment has not been made and/or the refund orders have not been despatched to the investors within the period specified above.
 7. The SPDE either by itself or through the sponsor, deposit before the opening of subscription list and keep deposited with the Exchange (in cases where the securitized debt instruments are offered for subscription whether through an offer document or otherwise) an amount calculated at the rate of 1% of the amount of securitized debt instruments offered for subscription to the public within the prescribed or stipulated period. However, 50% of the above mentioned security deposit should be paid to the Exchange in cash and the amount to be paid in cash is limited to Rs. 3crores. The balance amount can be provided for by way of a bank guarantee.
 8. The SPDE either by itself or through the sponsor, pay to the Exchange fees as prescribed by the Exchange as soon as its securitized debt instruments are listed on the Exchange and thereafter, so long as the securities continued to be listed on the Exchange, it will pay to the Exchange on or before April 30, in each year an Annual Listing Fee computed on the basis of the securities of the SPDE which are outstanding as on March 31 and listed on the Exchange.
 9. The SPDE undertakes as a pre-condition for continued listing to comply with any regulations, requirements, practices and procedures as may be laid down by the Exchange for the purpose of dematerialization of securities to facilitate dematerialized trading.

10. The SPDE closes, transfers or fix a record date for purposes of payment of interest and payment of redemption or repayment amount or for such other purposes and to give to the Exchange the notice in advance of at least seven clear working days, or of as many days as the Exchange may from time to time reasonably prescribe, stating the dates of closure of transfers and specifying the purpose or purposes for which the transfers are to be closed.
11. The SPDE requires complying with such provisions as specified by the Exchange for clearing and settlement of transactions in securitized debt instruments.
12. The SPDE agrees to comply with the provisions of the relevant Acts including the SEBI Act, 1992, SEBI (Public Offer and Listing of Securitized Debt Instruments) Regulations, 2008, Securities Contracts (Regulation) Act, 1956, the Securities Contracts (Regulation) Rules, 1957 and guidelines issued by SEBI and also such other guidelines as may be issued from time to time by the Government, Reserve Bank of India.
13. The SPDE is required to notify the Exchange of:
 - any attachment or prohibitory orders restraining the SPDE from transferring securitized debt instruments from the account of the registered holders and furnish to the Exchange particulars of the numbers of securitized debt instruments so affected and the names of the registered holders and their demat account details;
 - any action which will result in the redemption, conversion, cancellation, retirement in whole or in part of any securitized debt instruments;
 - any action that would affect adversely payment of interest;
 - any change in the form or nature of any of its securitized debt instruments or in the rights or privileges of the holders ;
 - any other change that would affect the rights and obligations of the holders;
 - any expected default in timely payment of interest or redemption or repayment amount or both;
 - any other information not in the public domain necessary to enable the holders to clarify its position and to avoid the creation of a false market in such listed securities;
 - the date of the meetings of its Trustees at which the recommendation or declaration of issue of securitized debt instruments or any other matter affecting the rights or interests of holders is proposed to be taken up, at least two days in advance;
 - any changes in the General Character or nature of business / activities, disruption of operation due to natural calamity, revision in ratings, etc.;
 - delay/ default in Payment of Interest / Principal Amount to the investors for a period of more than three months from the due date; and any other information having bearing on the operation/ performance of the SPDE as well as price sensitive information.
14. The SPDE is required to provide at the request of the investor or the Exchange, loan level information without disclosing particulars of individual borrowers.
15. The SPDE is required to furnish statements on a monthly basis in the format specified within 7 days from the end of the month/ actual payment date and where periodicity of the receivables is not monthly, reporting should be made for such relevant periods.
16. The SPDE need to file the information, statements and reports, etc in such manner and format and within such time as may be specified by SEBI or the stock exchange as may be applicable.

LESSON ROUND UP

- Debt markets are markets for the issuance, trading and settlement in fixed income securities of various types and features. Fixed income securities can be issued by almost any legal entity like central and state governments, public bodies, statutory corporations, banks and institutions and corporate bodies.
- The debt market in India comprises mainly of two segments viz., the Government securities market consisting of Central and State Governments securities, Zero Coupon Bonds (ZCBs), Floating Rate Bonds (FRBs), T-Bills and the corporate securities market consisting of FI bonds, PSU bonds, and Debentures/Corporate bonds.
- Investors in debt market are the entities who invest in such fixed income instruments. The investors in such instruments are generally Banks, Financial Institutions, Mutual Funds, Insurance companies, Provident Funds etc.
- Primary dealers (PDs) act as underwriters in the primary market, and as market makers in the secondary market. PDs underwrite a portion of the issue of government security that is floated for a pre-determined amount.
- Brokers play an important role in secondary debt market by bringing together counterparties and negotiating terms of the trade. It is through them that the trades are entered on the stock exchanges.
- The Reserve Bank of India is the main regulator for the Money Market. Reserve Bank of India also controls and regulates the G-Secs Market. The Securities and Exchange Board of India (SEBI) controls bond market and corporate debt market in cases where entities raise money from public through public issues. Apart from the two main regulators, the RBI and SEBI, there are several other regulators specific for different classes of investors.

GLOSSARY

Indenture	Agreement between lender and borrower which details specific terms of the bond issuance. Specifies legal obligations of bond issuer and rights of the bondholder. Document spelling out the specific terms of a bond as well as the rights and responsibilities of both the issuer of the security and the holder
Originator	It means the assignor of debt or receivables to a special purpose distinct entity for the purpose of securitisation.
Real Time Gross Settlement (RTGS)	Concept designed to achieve sound risk management in the settlement of interbank payments. Transactions are settled across accounts held at the Central Bank on a continuous gross basis where settlement is immediate, final and irrevocable.
Special Purpose Distinct Entity (SPDE)	SPDE means a trust which acquires debt or receivables out of funds mobilized by it by issuance of securitised debt instruments through one or more schemes.
Ways and Means Advances (WMA)	It is a mechanism used by RBI under its credit policy to the State, banking with it to help them to tide over temporary mismatches in the cash flow of their receipts and payment.

SELF TEST QUESTIONS

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

1. The debt market in India comprises mainly of two segments viz., the Government securities market and the corporate securities market – Discuss.

Lesson 7

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
- Treasury Bill
- Certificate of Deposits
- Inter-Corporate Deposits
- Commercial Bills
- Commercial Paper
- Factoring Agreement
- Bill Rediscounting
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

The money market deals in the lending and borrowing of short term finance varying from one year or less. The main credit instrument of the money market are call money, treasury bills, commercial bills, commercial papers and bills of exchange. Important institutions operating in the money market are central banks, commercial banks, acceptance house, non-banking financial institutions, bill brokers etc. The money market meets the short-term credit needs of business, it provides working capital to the industrialists.

Keeping this in view in this lesson the basic understanding of money market, its feature and structures, various instruments available in the money market and difference between the money market and capital market are explained.

INTRODUCTION

Money market is a very important segment of a financial system. Monetary assets of short-term nature 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 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 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 lent 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 SLR and 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.

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:

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.

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.

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.

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.

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.

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.

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 markets 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 facts :

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:

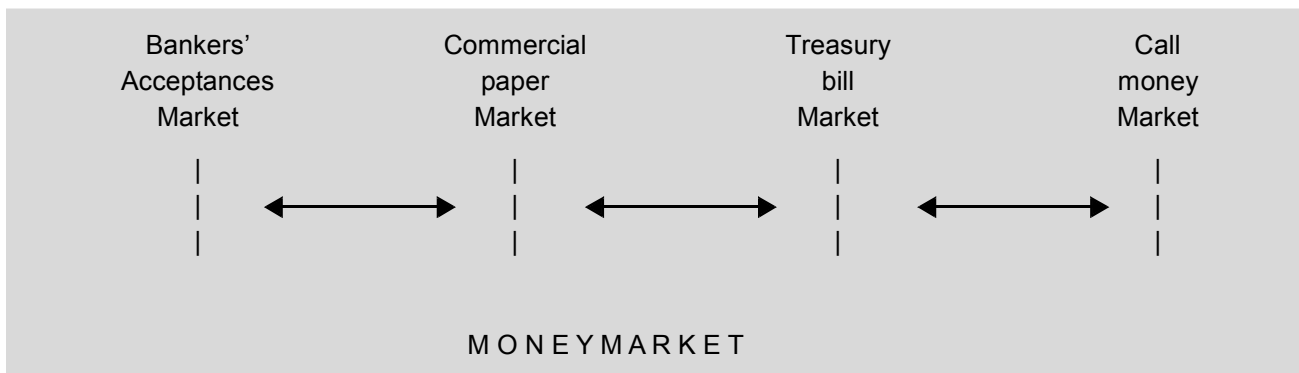
1. It had a very narrow base with RBI, Banks, LIC and UTI as the only participants lending funds while the borrowers were large in number;
2. There were only few money market instruments.
3. The interest rates were not market determined but were controlled either by RBI or by a voluntary agreement between 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

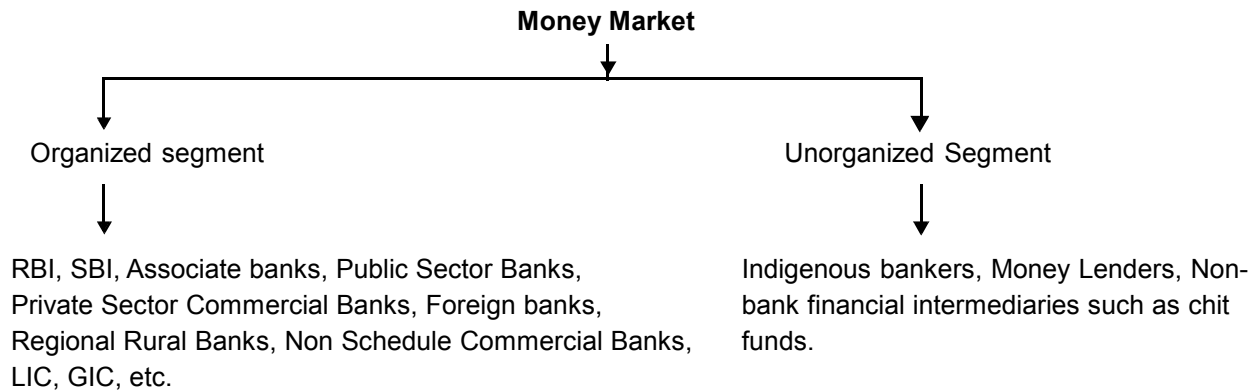
The following diagram depicts the important segments and inter-relation in the money market:



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. For these institutions there is no clear cut demarcation between short-term and long-term and between a genuine trade bill and mere financial accommodation. The share of the 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 INSTRUMENTS

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

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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 INVESTMENT IN TREASURY BILLS

- (a) No tax deducted at source
- (b) Zero default risk being sovereign paper
- (c) Highly liquid money market instrument
- (d) Better returns especially in the short term
- (e) Transparency
- (f) Simplified settlement
- (g) High degree of tradeability and active secondary market facilitates meeting unplanned fund requirements.

FEATURES OF TREASURY BILLS

(a) Form

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

(b) Minimum Amount of Bids

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

(c) Eligibility

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

(d) Repayment

The treasury bills are repaid at par on the expiry of their 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 cooperative 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:

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

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

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

Primary Market

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

Salient Features of the Auction Technique:

- (a) The auction of treasury bills is done only at Reserve Bank of India, Mumbai.
- (b) Bids are to be submitted on 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 value 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.

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:

- **Multiple Price Based or French Auction:** Under this method, all bids equal to or above the cut-off price are accepted. However, the bidder has to obtain the treasury bills at the price quoted by him. This method is followed in the case of 364 days treasury bills and is valid only for competitive bidders.
- **Uniform Price Based or Dutch Auction:** Under this system, all the bids equal to or above the cut-off price are accepted at the cut-off level. However, unlike the Multiple Price based method, the bidder obtains the treasury bills at the cut-off price and not the price quoted by him. This method is applicable in the case of 91 days treasury bills only. The system of Dutch auction has been done away with by the RBI w.e.f 08.12.2002 for the 91 day treasury T Bill.

What is Dutch auction?

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

What is French Auction?

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

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 not be 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.

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- 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 tempering with the document. They should be signed by two or more authorized signatories.

PAYMENT OF CERTIFICATE

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

ISSUE OF DUPLICATE CERTIFICATES

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

Companies, PDs and financial institutions (FIs) are permitted to raise short-term resources under the umbrella limit fixed by the Reserve Bank of India (RBI) are eligible to issue CP.

A company 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.

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 Securities and Exchange Board of India (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.

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.

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).

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.

An FI can issue CP shall be within the overall umbrella limit prescribed in the Master Circular on Resource Raising Norms for FIs, issued by Reserve Bank of India, Department of Banking Operations and Development as prescribed and updated from time-to-time.

The total amount of CP proposed to be issued should be raised within a period of two weeks from the date on which the issuer opens the issue for subscription. CP may be issued on a single date or in parts on different dates provided that in the latter case, each CP shall have the same maturity date. Every issue of CP, including renewal, should be treated as a fresh issue.

Issuing and Paying Agent (IPA)

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

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.

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.

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. Provided all RBI regulated entities can deal in and hold CP only in dematerialised form through such depositories. CP will be issued at a discount to face value as may be determined by the issuer. No issuer shall have the issue of CP underwritten or co-accepted.

Preference for Dematerialisation

While option is available to both issuers and subscribers to issue/hold CP in dematerialised or physical form, issuers and subscribers are encouraged to 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.

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 is issued 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.
- (v) The IPA shall certify that it has a valid agreement with the issuer.

(c) CRA

- (i) The CRA shall 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) The CRAs 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

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:

- The Seller, who has produced the goods/services and raised the invoice.
- The Buyer, the consumer of goods/services and the party to pay.
- The Factor, the financial institution that advances the portion of funds to the seller.

FACTORING PROCESS

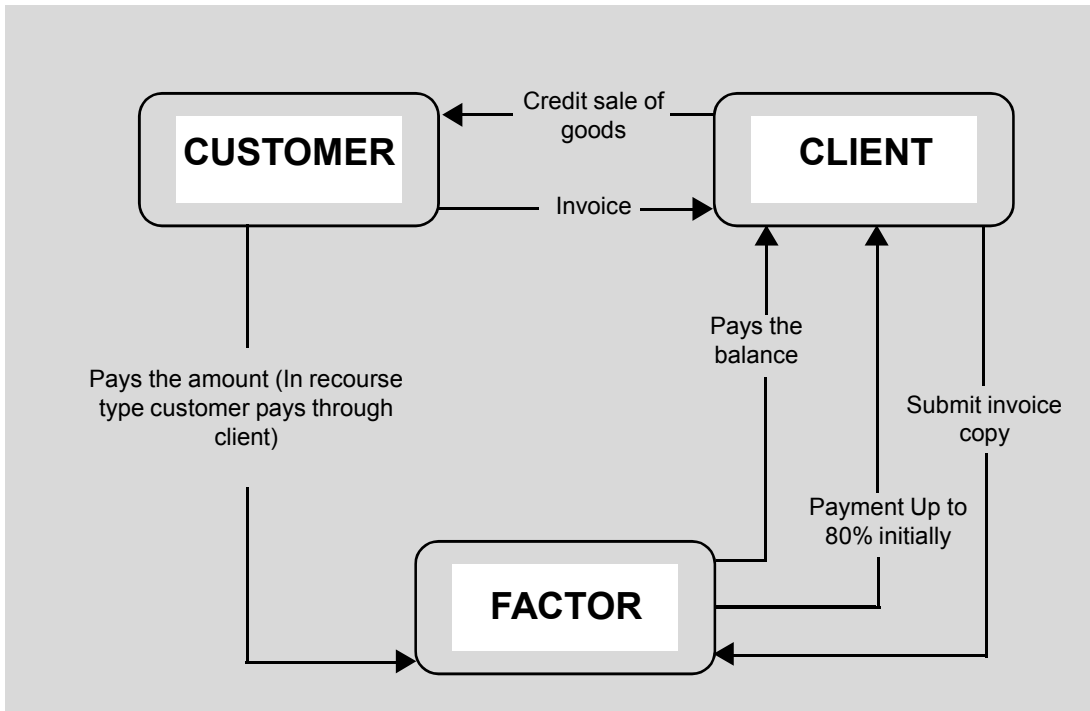
The steps involved in factoring are listed below:

- The seller interacts with the funding specialist/broker and explains the funding needs.
- The broker prepares a preliminary client profile form and submits to the appropriate funder for consideration.
- 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.
- 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.
- 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.
- 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.
- 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).

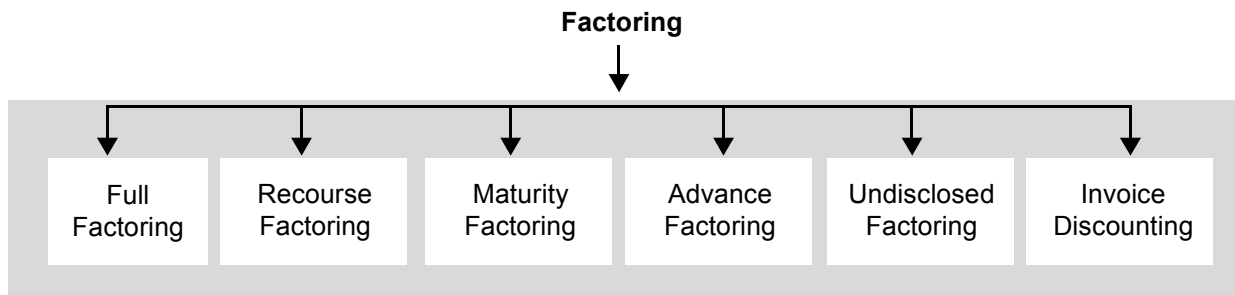
- Sanction terms must contain the following.
 - All Facilities covered under the sanction.
 - The period for which the sanction is valid
 - When the Facility comes into effect e.g. (if Facility is dated 1/12/13, it can state that invoices raised from or after 15/12/13 only would be Factored).
 - Who the authorized signatories are for signing invoices for factoring.
 - The limits.
 - The seller has to advise the buyer of the Factoring agreement.
 - 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.
- The discounting rates, charges fixed.
- 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).
- Usually within 7 to 10 days of the initial contact with the factor, agreements are signed, customers are notified, 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.
- The seller performs services or delivers products, thus creating an invoice.
- The seller sends or faxes a copy of the invoice directly to the factor.
- 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.
- 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



Non-Recourse or Full factoring

Under this type of factoring the bank takes all the risk and bear all the loss in case of debts becoming bad debts.

Recourse Factoring

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

Maturity Factoring

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

Advance Factoring

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

Undisclosed Factoring

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

Invoice Discounting

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

BILLS REDISCOUNTING

Bill rediscounting means 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. Bill rediscounting is a money market instrument where the bank buys the bill (i.e. Bill of Exchange or Promissory Note) before it is due and credits the value of the bill after a discount charge to the customer's account. Now, the bank which has discounted the bill may require getting it 'rediscounted' with some other bank to get the fund.

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.
- 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.

LESSON ROUND UP

- Money market is a very important segment of the Indian financial system. It is the market for dealing in monetary assets of short-term nature.
- There are a large number of participants in the money market: commercial banks, mutual funds, investment institutions, financial institutions and the Regulatory Authority.
- The money market possesses different operational features as compared to capital market. It deals with raising and deployment of funds for short duration while the capital market deals with long-term funding.
- The money market operates as a wholesale market and has a number of inter-related sub-markets such as the call market, the bill market, the treasury bill market, the commercial paper market, the certificate of deposits market etc.
- Money market instruments mainly include Government securities, securities issued by Banking sector and securities issued by private sector.
- Treasury Bills are money market instruments to finance the short term requirements of the Government of India.
- Certificates of Deposit (CDs) is a negotiable money market instrument and is issued in dematerialised form or as a Usance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period.

- Commercial bills are basically negotiable instruments accepted by buyers for goods or services obtained by them on credit.
- Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note. CP, as a privately placed instrument, was introduced in India in 1990 with a view to enabling highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors.
- Factoring is a financed transaction where an entity sells its receivables to a third parties called a factor, at discounted prices.

GLOSSARY

CRR	Cash reserve ratio is the cash parked by the banks in their specified current account maintained with RBI.
DFHI	The Discount and Finance House of India Limited(DFHI) has been set up by the Reserve bank of India jointly with public sector banks and all India Financial Institutions to deal in short term money market instruments.
FIMMDA	The Fixed Income Money Market and Derivatives Association of India (FIMMDA), an association of Scheduled Commercial Banks, Public Financial Institutions, Primary Dealers and Insurance Companies was incorporated as a Company under section 25 of the Companies Act, 1956 on June 3rd, 1998. FIMMDA is a voluntary market body for the bond, money and derivatives markets.
Negotiated Dealing System (NDS)	An electronic trading platform, operated by the Reserve Bank of India, used to facilitate the exchange of government securities and other money market instruments. The negotiated dealing system will also be responsible for hosting new issues of government securities.
Online Returns Filing System (ORFS)	It is a single window return submission system for submission of certain important returns by Commercial Bank to the Reserve Bank of India
Repo rate	The rate at which the RBI lends money to commercial banks is called repo rate. It is an instrument of monetary policy. Whenever banks have any shortage of funds they can borrow from the RBI.
SLR	Statutory liquidity ratio is in the form of cash (book value), gold (current market value) and balances in unencumbered approved securities.
Yield to maturity (YTM)	The Yield to maturity (YTM) is the yield promised to the bondholder on the assumption that the bond will be held to maturity and coupon payments will be reinvested at the YTM. It is a measure of the return of the bond.

SELF TEST QUESTIONS

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

1. “Money market is very important segment of Indian Financial System”. Comment and discuss various features of money market.
2. State how yield of Treasury Bill is calculated.
3. Briefly discuss the guidelines for issue of commercial paper.

Lesson 8

Mutual Funds

LESSON OUTLINE

- Introduction
- An Overview of Trends in Mutual Funds
- Advantages of Mutual Funds
- Schemes of Mutual Funds
- Investment Strategies
- Offer Document of Mutual Fund Scheme
- Additional mode of payment through Applications Supported by Blocked Amount in mutual funds
- Risks Involved in Mutual Funds
- Calculation of Net Asset Value
- Mutual Fund Costs
- Transaction Costs
- Roll Over of a Scheme
- Switch Over one Scheme to Another
- Annualised Returns
- Asset Management Company
- SEBI (Mutual Fund) Regulations, 1996
- Code of Conduct for Mutual Fund
- Independent Director's Responsibilities
- Advertisement Code for Mutual Funds
- Infrastructure Debt fund Scheme
- Gold Exchange Traded Scheme
- Real Estate Mutual Fund Scheme
- Lesson Round-Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

Different investment avenues are available to investors, one of them being Mutual Fund. Mutual fund is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with objectives as disclosed in offer document.

Mutual funds offer good investment opportunities to the investors. Like all investments, they also carry certain risks. The investors should compare the risks and expected yields after adjustment of tax on various instruments while taking investment decisions.

SEBI formulates policies and regulates the mutual funds to protect the interest of the investors. SEBI notified regulations for the mutual funds in 1993. Thereafter, mutual funds sponsored by private sector entities were allowed to enter the capital market. The regulations were fully revised in 1996 and have been amended thereafter from time to time.

Keeping the above in view this lesson is designed to enable the students to understand the trend of mutual funds in India over a period of time. Various schemes of mutual funds, advantages and risk involved in Mutual Fund and SEBI regulations pertaining the mutual fund operating in India etc.

INTRODUCTION

Mutual fund is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with objectives as disclosed in offer document. Investments in securities are spread across a wide cross-section of industries and sectors and thus the risk is reduced. Diversification reduces the risk because all stocks may not move in the same direction in the same proportion at the same time. Mutual fund issues units to the investors in accordance with quantum of money invested by them. Investors of mutual funds are known as unitholders. The profits or losses are shared by the investors in proportion to their investments. The mutual funds normally come out with a number of schemes with different investment objectives which are launched from time to time. A mutual fund is required to be registered with SEBI which regulates securities markets before it can collect funds from the public.

The small investors who generally lack expertise to invest on their own in the securities market have reinforced the saying "Put not your trust in money, put your money in trust". They prefer some kind of collective investment vehicle like, MFs, which pool their marginal resources, invest in securities and distribute the returns therefrom among them on cooperative principles. The investors benefit in terms of reduced risk and higher returns arising from professional expertise of fund managers employed by the MFs. This approach was conceived in the USA in the 1930s. In developed financial markets, MFs have almost overtaken bank deposits and total assets of insurance funds.

Experiment with MFs in India began in 1964 with the establishment of Unit Trust of India (UTI). UTI lost its monopoly status in 1987 with the entry of other public sector MFs promoted by public sector banks and insurance companies. The industry was opened to private sector, including foreign institutions, in 1993 giving Indian investors a broader choice and increasing competition to public sector funds.

AN OVERVIEW OF TRENDS IN MUTUAL FUNDS

As in mature markets, mutual funds in emerging markets have been among the fastest growing institutional investors. One key difference between mutual funds of mature and emerging markets has been the relative importance of bond and equity funds are often much larger than those of bond funds (particularly in Japan, the United Kingdom, the United States). In contrast, emerging market bond funds in a number of countries have larger assets under management than do equity funds particularly in Brazil, Mexico, Korea and Taiwan. In part, this reflects the difference in the relative development of the local markets in mature and emerging markets. This difference reflects a search for higher yield on the part of retail investors. As the nominal interest rates have declined in many emerging countries since the late 1990s, retail investors have seen an extended decline in the interest rate of traditional savings instruments. To obtain higher yields, retail investors subscribe to bond funds with investment in longer term government and corporate bonds.

Household savings play an important role in domestic capital formation. Only a small part of the household savings in India is channelised to the capital market. Attracting more households to the capital market requires efficient intermediation. The mutual funds have emerged as one of the important class of financial intermediaries which cater to the needs of retail investors. As a traditional investment vehicle, the mutual funds pool resources from the households and allocate them to various investment opportunities.

ADVANTAGES OF MUTUAL FUNDS

The advantages of investing in a mutual fund are:

1. **Professional Management:** Investors avail the services of experienced and skilled professionals who are backed by a dedicated investment research team which analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme.

2. **Diversification:** Mutual funds invest in a number of companies across a broad cross-section of industries and sectors. This diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion. Investors achieve this diversification through a Mutual Fund with far less money than one can do on his own.
3. **Convenient Administration:** Investing in a mutual fund reduces paper work and helps investors to avoid many problems such as bad deliveries, delayed payments and unnecessary follow up with brokers and companies. Mutual funds save investors time and make investing easy and convenient.
4. **Return Potential:** Over a medium to long term, Mutual funds have the potential to provide a higher return as they invest in a diversified basket of selected securities.
5. **Low Costs:** Mutual funds are a relatively less expensive way to invest compared to directly investing in the capital markets because the benefits of scale in brokerage, custodial and other fees translate into lower costs for investors.
6. **Liquidity:** In open ended schemes, investors can get their money back promptly at net asset value related prices from the mutual fund itself. With close ended schemes, investors can sell their units on a stock exchange at the prevailing market price or avail of the facility of direct repurchase at net asset value (NAV) related prices which some close ended and interval schemes offer periodically or offer it for redemption to the fund on the date of maturity.
7. **Transparency:** Investors get regular information on the value of their investment in addition to disclosure on the specific investments made by scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

SCHEMES ACCORDING TO MATURITY PERIOD

The MFs in India offer a wide array of schemes that cater to different needs suitable to any age, financial position, risk tolerance and return expectations. These include: open-ended schemes, which provide easy liquidity; close-ended schemes with a stipulated maturity period; growth schemes, which provide capital appreciation over medium to long term; income schemes, which provide regular and steady income to investors; balanced schemes, which provide both growth and income by periodically distributing a part of income and capital gains they earn; money market schemes; which provide easy liquidity, preservation of capital and moderate income; and tax saving schemes, which offer tax rebates to investors under tax laws as prescribed from time to time.

(i) **Open ended mutual funds:** An open ended mutual funds is a fund with a non-fixed number of outstanding shares/units, that stands ready at any time to redeem them on demand. The fund itself buys back the shares surrendered and is ready to sell new shares. Generally the transaction takes place at the net asset value which is calculated on a periodical basis. The net asset value (Net Asset Value per share value of the fund's is total net assets after liabilities divided by the total number of shares outstanding on a given day) of the mutual funds rises or falls as a result of the performance of securities in the portfolio and the stock exchanges.

(ii) **Close ended mutual funds:** It is the fund where mutual fund management sells a limited number of shares and does not stand ready to redeem them. Primary example of such mutual fund is **IDFC Fixed Maturity Plan – Thirteen Months Series – 5 – Growth**. The shares of such mutual funds are traded in the secondary markets. The requirement for listing is laid down to grant liquidity to the investors who have invested with the mutual fund. Therefore, close ended funds are more like equity shares. The main differences between close ended and open ended funds are :

CLOSE ENDED SCHEMES	OPEN ENDED SCHEMS
1. Fixed corpus: no new units can be offered beyond the limit.	1. Variable corpus due to on going purchase and redemption.
2. Listed on the stock exchange for buying and selling.	2. No listing on exchange transactions done directly with the fund.
3. Two values available namely NAV and the Market Trading Price.	3. Only one price namely NAV.
4. Mostly liquid.	4. Highly Liquid.

SCHEMES ACCORDING TO INVESTMENT OBJECTIVE

Besides these, there are other types of mutual funds also to meet the investment needs of several groups of investors. Some of them include the following:

- (a) **Income Oriented Schemes:** The fund primarily offer fixed income to investors. Naturally enough, the main securities in which investments are made by such funds are the fixed income yielding ones like bonds.
- (b) **Growth Oriented Schemes:** These funds offer growth potentialities associated with investment in capital market namely: (i) high source of income by way of dividend and (ii) rapid capital appreciation, both from holding of good quality scrips. These funds, with a view to satisfying the growth needs of investors, primarily concentrate on the low risk and high yielding spectrum of equity scrips of the corporate sector.
- (c) **Hybrid Schemes:** These funds cater to both the investment needs of the prospective investors - namely fixed income as well as growth orientation. Therefore, investment targets of these mutual funds are judicious mix of both the fixed income securities like bonds and debentures and also sound equity scrips. In fact, these funds utilise the concept of balanced investment management. These funds are, thus, also known as “balanced funds”.
- (d) **High Growth Schemes:** As the nomenclature depicts, these funds primarily invest in high risk and high return volatile securities in the market and induce the investors with a high degree of capital appreciation. Aggressive investors willing to take excessive risks are the normal target group of such funds.
- (e) **Capital Protection Oriented Scheme:** It is a scheme which protects the capital invested in the mutual fund through suitable orientation of its portfolio structure.
- (f) **Tax Saving Schemes:** These schemes offer tax rebates to the investors under tax laws as prescribed from time to time. This is made possible because the Government offers tax incentive for investment in specified avenues. For example, Equity Linked Saving Schemes (ELSS) and pensions schemes.
- (g) **Special Schemes:** This category includes index schemes that attempt to replicate the performance of particular index such as the BSE, Sensex or the NSE-50 or industry specific schemes (which invest in specific industries) or sectoral schemes (which invest exclusively in segment such as ‘A’ Group or initial public offering). Index fund schemes are ideal for investors who are satisfied with a return approximately equal to that of an index. Sectoral fund schemes are ideal for investors who have already decided to invest in particular sector or segment.
- (h) **Real Estate Funds:** These are close ended mutual funds which invest predominantly in real estate and properties.
- (i) **Off-shore Funds:** Such funds invest in securities of foreign companies with RBI permission.

- (j) **Leverage Funds:** Such funds, also known as borrowed funds, increase the size and value of portfolio and offer benefits to members from out of the excess of gains over cost of borrowed funds. They tend to indulge in speculative trading and risky investments.
- (k) **Hedge Funds:** They employ their funds for speculative trading, i.e. for buying shares whose prices are likely to rise and for selling shares whose prices are likely to dip.
- (l) **Fund of Funds:** They invest only in units of other mutual funds. Such funds do not operate at present in India.
- (m) **New Direction Funds:** They invest in companies engaged in scientific and technological research such as birth control, anti-pollution, oceanography etc.
- (n) **Exchange Trade Funds (ETFs)** are a new variety of mutual funds that first introduced in 1993. ETFs are sometimes described as mere “tax efficient” than traditional equity mutual funds, since in recent years, some large ETFs have made smaller distribution of realized and taxable capital gains than most mutual funds.
- (o) **Money Market Mutual Funds:** These funds invest in short- term debt securities in the money market like certificates of deposits, commercial papers, government treasury bills etc. Owing to their large size, the funds normally get a higher yield on such short term investments than an individual investor.
- (p) **Infrastructure Debt Fund :** They invest primarily in the debt securities or securitized debt investment of infrastructure companies.

INVESTMENT STRATEGIES

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

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

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

Balanced funds are considered moderate since investors seek growth and stability but with moderate risk. Such funds invest both in bonds and blue chip shares. While bonds give stable interest income, the share dividends will be fluctuated though in the long run, they may give larger benefits. The exact balance between the two asset classes namely - shares and bonds depends on the fund managers ability to take risk and his priority for return. The normal ratio between stocks and bonds is 55:45 but if the fund manager is aggressive he could choose a larger equity component.

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

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

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

OFFER DOCUMENT OF MUTUAL FUND SCHEME

The Offer Document shall have two parts i.e. Scheme Information Document (SID) and Statement of Additional Information (SAI). SID shall incorporate all information pertaining to a particular scheme. SAI shall incorporate all statutory information on Mutual Fund. The Mutual Funds shall prepare SID and SAI in the prescribed formats. Contents of SID and SAI shall follow the same sequence as prescribed in the format. The Board of the AMC and the Trustee(s) shall exercise necessary due diligence, ensuring that the SID/SAI and the fees paid are in conformity with the Mutual Funds Regulations. All offer documents (ODs) of Mutual Fund schemes shall be filed with SEBI in terms of the Regulations. For the schemes launched in the first half of a financial year, the SID shall be updated within 3 months from the end of the financial year. However, for the schemes launched in the second half of a financial year, SID shall be updated within 3 months of the end of the subsequent financial year.

For example, for a scheme launched in May, 2014, the SID shall be updated by June 30, 2014 and for a scheme launched in December 2013, the SID shall be updated by June 30, 2015. Thereafter, the SID shall be updated once every year.

ADDITIONAL MODE OF PAYMENT THROUGH APPLICATIONS SUPPORTED BY BLOCKED AMOUNT IN MUTUAL FUNDS

ASBA facility which investors have been enjoying for subscription to public issue of equity capital of companies has been extended to the investors subscribing to New Fund Offers (NFOs) of mutual fund schemes. It shall co-exist with the current process, wherein cheques/ demand drafts are used as a mode of payment. The banks which are in SEBI's list shall extend the same facility in case of NFOs of mutual fund schemes to all eligible investors in Mutual Fund units. Mutual Funds shall ensure that adequate arrangements are made by Registrar and Transfer Agents for the implementation of ASBA. Mutual Funds/AMCs shall make all relevant disclosures in this regard in the SAI. The Mutual Funds/AMCs have to compulsorily provide ASBA facility to the investors for all the NFOs launched by them.

RISKS INVOLVED IN MUTUAL FUNDS

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

1. Excessive diversification of portfolio, losing focus on the securities of the key segments.
2. Too much concentration on blue-chip securities which are high priced and which do not offer more than average return.
3. Necessity to effect high turnover through liquidation of portfolio resulting in large payments of brokerage and commission.
4. Poor planning of investment with minimum returns.
5. Unresearched forecast on income, profits and Government policies.
6. Fund managers being unaccountable for poor results.
7. Failure to identify clearly the risk of the scheme as distinct from risk of the market.

CALCULATION OF NET ASSET VALUE (NAV)

Mutual funds raise money by selling their shares to public and redeeming them at current net asset value. Net asset value is the value of the assets of each unit of the scheme. Thus if the NAV is the more than the face value of ₹ 10/-, there is an appreciation for the investment. If the NAV is less than the face value, it indicates depreciation of the investment. NAV also includes dividends, interest accruals and reduction of liabilities and expenses apart from market value of investments. Every mutual fund shall compute the NAV of each scheme by dividing the net asset of the scheme by the number of units of that scheme outstanding on the date of valuation and public the

same at least in two daily newspapers at intervals not exceeding one week. However, the net asset value of any scheme for special target segment or any monthly scheme which are not mandatorily required to be listed in the stock exchange may publish the NAV at monthly or quarterly intervals as permitted by SEBI.

MUTUAL FUND COSTS

There are two broad categories of mutual fund costs, namely - (a) Operating expenses (b) Sales charges. These terms are explained below:

- (a) Operating Expenses:** Costs incurred in operating mutual funds include advisory fees paid to investment managers, custodial fees, audit fees, transfer agent fees, trustee fees, agents commission etc. The break-up of these expenses is required to be reported in the schemes offer document. When the operating expenses are divided by the average net asset, the expense ratio is arrived at. Based on the type of the scheme and the net assets, operating expenses are determined within the limits indicated by SEBI Mutual Fund Regulations, 1996. Expenditure which is in excess over the specified limits shall be borne by the Asset Management Company, the Trustees or the Sponsors. Operating expenses are calculated on an annualised basis but are accrued on a daily basis. Therefore, an investor face expenses prorated for the time he has invested in the fund.
- (b) Sales Charges:** These are otherwise called as sales loads and are charged directly to the investors. Mutual funds use the sales loads for payment of agents commission and expenses for distribution and marketing.

There is no entry load for all mutual fund schemes. The scheme application forms carry a suitable disclosure to the effect that the upfront commission to distributors will be paid by the investor directly to the distributor, based on his assessment of various factors including the service rendered by the distributor. Of the exit load or Contingent Deferred Sales charges (CDSC) charged to the investor, a maximum of 1% of the redemption proceeds is required to be maintained in a separate account which can be used by the AMC to pay commissions to the distributor and to take care of other marketing and selling expenses. Any balance shall be credited to the scheme immediately. CDSC is a structured back end load paid when the units are redeemed during the initial of ownership. The distributors should disclose all the commissions (in the form of trail commission or any other mode) payable to them for the different competing schemes of various mutual funds from amongst which the scheme is being recommended to the investor. AMC(s) shall not charge entry/or exit load on bonus units and units allotted on reinvestment of dividend.

TRANSACTION COSTS

Some funds impose a switch over fee as a charge on transfer of investment from one scheme to another within the same mutual fund family and also to switch over from one plan to another within the same scheme. A cost conscious investor has to consider two aspects: (i) compare a funds expense ratio with that of similar funds in the industry and find out justification based on performance (ii) compare the exit load with that of similar funds, since a load will reduce the investment by the amount of load. Besides these aspects the investors should carefully consider his goals, risk tolerance and investment preferences.

Judging efficiency of mutual funds is done with reference to various factors such as –

- whether the fund is stable
- whether it is liquid (listed on exchanges)
- whether it offers increase in NAV, consistent growth in dividend and capital appreciation
- whether the investment objectives are clearly laid and implemented
- whether the issuer has a proven track record and offers assured returns or returns not less than a percentage
- whether it observes investment norms to balance risks and profits

ROLL OVER OF A SCHEME

A mutual fund can roll over a close ended scheme on or before the redemption of the scheme after giving an option to investors to redeem their units at NAV based price. The roll over scheme may include a fresh extension of period or continue under the same terms of the original scheme with or without modifications.

SWITCH OVER ONE SCHEME TO ANOTHER

A mutual fund may use its discretion to permit switching over of the investment in units from one to another of its schemes, to help the investor shift, from a high risk scheme to a low risk one or vice-versa.

ANNUALISED RETURNS

Investors buy and sell mutual fund shares/units during a short period and make profits. Percentage of profits in such short periods can not be a reliable measure. The proper method is to calculate returns on an annualised basis at the compounded average rate over a year.

ASSET MANAGEMENT COMPANY (AMC)

Under SEBI Regulations, every mutual fund is required to have an Asset Management Company (AMC) incorporated in accordance with the Companies Act, 2013 to manage the funds of the mutual fund. The AMC should be approved by SEBI and should enter into an agreement with the trustees of the mutual fund to formulate schemes, raise money against units, invest the funds in accrued securities and after meeting the permissible costs as per norms, distribute income to the share holders of the funds.

SEBI (MUTUAL FUND) REGULATIONS, 1996

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

IMPORTANT DEFINITIONS

- **Advertisement** shall include all forms of communication issued by or on behalf of the asset management company/mutual fund that may influence investment decisions of any investor/prospective investors.
- **Asset Management Company** means a company formed and registered under the Companies Act, 2013 and approved as such by SEBI under Regulation 21(2).
- **Custodian** means a person who has been granted a certificate of registration to carry on the business of custodian securities under SEBI (Custodian of Securities) Regulations, 1996.
- **Mutual Fund** means a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities including money market instruments or gold or gold related instruments.
- **Money Market Mutual Fund** means a scheme of a mutual fund, set up with the objective of investing exclusively in money market instruments.
- **Money Market Instruments** includes commercial papers, commercial bills, treasury bills, Government securities having an unexpired maturity upto one year, call or notice money, certificate of deposit, and any other like instruments as specified by RBI from time to time.
- **Sponsor** means any person who, acting alone or in combination with another body corporate establishes a mutual fund.
- **Trustees** mean the Board of Trustees or the Trustee Company who hold the property of the mutual fund in trust for the benefit of the unit holders.

- **Unit** means the interest of the unit holders in a scheme which consists of each unit representing one undivided share in the assets of a scheme.
- **Unit Holder** means a person holding one or more units in a scheme of a mutual fund.
- **Close-ended scheme** means any scheme of a mutual fund in which the period of maturity of scheme is specified.
- **Open-ended scheme** means a scheme of a mutual fund which offers units for sale without specifying any duration for redemption.
- **Gold exchange traded fund** scheme means a mutual fund scheme that invests primarily in gold or gold related instruments.
- **Gold related instrument** means such instrument having gold as underlying, as may be specified by the Board from time to time.
- **Capital protection oriented scheme** means a mutual fund scheme which is designated as such and which endeavours to protect the capital invested therein through suitable orientation of its portfolio structure.

ELIGIBILITY CRITERIA

Regulation 7 lays down the following eligibility criteria to be fulfilled by an applicant to get a certificate of registration. In the opinion of SEBI the applicant should be a fit and proper person. The other criteria are:

- (a) the sponsor should have a sound track record and general reputation of fairness and integrity in all his business transactions.

The regulations provide that “Sound track record” means the sponsor should –

- (i) be carrying on business in financial services for a period of not less than five years; and
- (ii) the networth is positive in all the immediately preceding five years; and
- (iii) the networth in the immediately preceding year is more than the capital contribution of the sponsor in the asset management company; and
- (iv) the sponsor has profits after providing for depreciation, interest and tax in three out of the immediately preceding five years, including the fifth year;

- (aa) the applicant is a fit and proper person;

- (b) in the case of an existing mutual fund, such fund is in the form of a trust and the trust deed has been approved by SEBI;

- (c) the sponsor has contributed or contributes at least 40% to the networth of the asset management company;

However any person who holds 40% or more of the net worth of an asset management company shall be deemed to be a sponsor and will be required to fulfil the eligibility criteria specified in these regulations;

- (d) the sponsor or any of its directors or the principal officer to be employed by the mutual fund should not have been guilty of fraud or has not been convicted of an offence involving moral turpitude or has not been found guilty of any economic offence;

- (e) appointment of trustees to act as trustees for the mutual fund in accordance with the provisions of the regulations;

- (f) appointment of asset management company to manage the mutual fund and operate the scheme of such funds in accordance with the provisions of these regulations;

- (g) appointment of custodian in order to keep custody of the securities or gold and gold related instrument or other assets of the mutual fund held in terms of these regulations, and provide such other custodial services as may be authorised by the trustees.

TERMS AND CONDITIONS OF REGISTRATION

Regulation 10 lays down that the registration granted to a mutual fund is subject to the following terms and conditions:

- (a) the trustees, the sponsor, the asset management company and the custodian comply with the provisions of these regulations;
- (b) the mutual fund to inform SEBI, if any information or particulars previously submitted to SEBI was misleading or false in any material respect;
- (c) the mutual fund to inform SEBI, of any material change in the information or particulars previously furnished, which have a bearing on the registration granted by it;
- (d) payment of the fees as specified in the regulation and the second schedule.

CONSTITUTION AND MANAGEMENT OF MUTUAL FUND AND OPERATION OF TRUSTEES

Regulation 14 stipulates that a mutual fund shall be constituted in the form of a trust and the instrument of trust shall be in the form of a deed duly registered under the provisions of Indian Registration Act, 1908 and executed by the sponsor in favour of the trustees named in such instrument.

Regulation 15 lays down that the trust deed shall not contain such clause which has the effect of limiting or extinguishing the obligations and liabilities of the trusts in relation to any mutual fund or the unit holders or indemnifying the trustees or the asset management company for loss or damage caused to the unit holders by their acts of negligence, commission or omission.

CONTENTS OF THE TRUST DEED

The Third Schedule prescribing the contents of the Trust Deed is reproduced below:

1. (i) A trustee in carrying out his responsibilities as a member of the Board of Trustees or of trustee company, shall maintain arms' length relationship with other companies, or institutions or financial intermediaries or any body corporate with which he may be associated.
(ii) No trustee shall participate in the meetings of the Board of Trustees or trustee company when any decision for investments in which he may be interested are taken.
(iii) All the trustees shall furnish to the board of trustees or trustee company particulars of interest which he may have in any other company, or institution or financial intermediary or any corporate by virtue of his position as director, partner or with which he may be associated in any other capacity.
2. Minimum number of trustees must be mentioned in the Trust Deed.
3. The Trust Deed must provide that the trustees shall take into their custody, or under their control all the property of the schemes of the mutual fund and hold it in trust for the unit holders.
4. The Trust Deed must specifically provide that unit holders would have beneficial interest in the trust property to the extent of individual holding in respective schemes only.
5. The trust deed shall provide that it is the duty of trustees to provide or cause to provide information to unit holders and Board as may be specified by the Board.
6. The trust deed shall provide that it would be the duty of the trustees to act in the interest of the unit holders.
7. The trust deed shall provide that the trustees shall appoint an AMC approved by the Board, to float

schemes for the mutual fund after approval by the trustees and Board, and manage the funds mobilised under various schemes, in accordance with the provisions of the trust deed and Regulations. The trustees shall enter into an Investment Management Agreement with the AMC for this purpose, and shall enclose the same with the Trust Deed.

8. The trust deed shall provide for the duty of the trustee to take reasonable care to ensure that the funds under the schemes floated by and managed by the AMC are in accordance with the Trust Deed and Regulations.
9. The trust deed must provide for the power of the trustees to dismiss the AMC under the specific events only with the approval of Board in accordance with the Regulations.
10. The trust deed shall provide that the trustees shall appoint a custodian and shall be responsible for the supervision of its activities in relation to the mutual fund and shall enter into a Custodian Agreement with the custodian for this purpose.
11. The trust deed shall provide that the auditor for the mutual fund shall be different from the Auditor of the AMC.
12. The trust deed shall provide for the responsibility of the trustees to supervise the collection of any income due to be paid to the scheme and for claiming any repayment of tax and holding any income received in trust for the holders in accordance with the Trust Deed Regulations.
13. Board policies regarding allocation of payments to capital or income must be indicated in the Trust Deed.
14. The trust deed shall also explicitly forbid the acquisition of any asset out of the trust property which involves the assumption of any liability which is unlimited or shall not result in encumbrance of the trust property in any way.
15. The trust deed shall forbid the mutual fund to make or guarantee loans or take up any activity not in contravention of the Regulations.
16. Trusteeship fee, if any, payable to trustee shall be provided in the Trust Deed.
17. The trust deed shall provide that no amendment to the Trust Deed shall be carried out without the prior approval of the Board or unit holders.

However in case a Board of trustees is converted into a trustee company subsequently such conversion shall not require the approval of unit holders.
18. The removal of the trustee in all cases would require the prior approval of Board.
19. The trust deed shall lay down the procedure for seeking approval of the unit holders under such circumstances as are specified in the Regulations.
20. The trust deed shall state that a meeting of the trustees shall be held at least once in every two months and at least six such meetings shall be held in every year.
21. The trust deed shall specify the quorum for a meeting of the trustees.

However the quorum for a meeting of the trustees shall not be constituted unless one independent trustee or director is present at the meeting.
22. The trust deed shall state that the minimum number of trustees shall be four.

Disqualification from being appointed as trustees

Regulation 16 lays down the attributes of a person to be appointed as trustee. A mutual fund shall appoint trustees in accordance with these regulations. A person shall not be eligible to be appointed as trustees unless –

- (a) he should be a person of ability, integrity and standing;
- (b) he has not been found guilty of moral turpitude;
- (c) he has not convicted of any economic offence or violation of any securities laws and has furnished particulars as required in the prescribed form;
- (d) an asset management company or any of its directors including independent directors, officers or employees shall not be eligible to act as a trustee of any mutual fund;
- (e) a person already appointed as a trustee of a mutual fund can not be appointed again as a trustee of any other mutual fund;
- (f) 2/3 of the trustees shall be independent persons not associated with the sponsors in any manner, whatsoever;
- (g) where the companies appointed as trustee, then its directors can act as trustees of any other trust provided that the object of the trust is not in conflict with the object of the mutual fund; and
- (h) prior approval of SEBI shall be necessary for the appointment of any trustee.

RIGHTS AND OBLIGATIONS OF TRUSTEES

Regulation 18 lays down the following rights and obligations for the trustees:

- (1) The trustees and the AMC shall with the prior approval of SEBI enter into an investment management agreement.
- (2) Such agreement shall contain all the clauses as prescribed in these Regulations or as well as other clauses necessary for the purpose of making investments; The fourth Schedule contains clauses which are to be included as contents of the investment management agreement.
- (3) The trustees are entitled to obtain from the AMC all the information which the trustees consider necessary;
- (4) the trustees shall ensure before the launch of any scheme that the asset management company has—
 - (a) systems in place for its back office, dealing room and accounting;
 - (b) appointed all key personnel including fund manager(s) for the scheme(s) and submitted their bio-data which shall contain the educational qualification, past experience in the securities market with the trustees, within 15 days of their appointment;
 - (c) appointed auditors to audit its accounts;
 - (d) appointed a compliance officer who shall responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by the board or the Central Government and for redressal of investors grievances.
 - (e) appointed registrars and laid down parameters for their supervision;
 - (f) prepared a compliance manual and designed internal control mechanisms including internal audit systems;
 - (g) specified norms for empanelment of brokers and marketing agents;
 - (h) obtained, wherever required under these regulations, prior in-principle approval from the recognised stock exchange(s) where units are proposed to be listed.

- (5) The compliance officer appointed under clause (d) of sub-regulation (4) shall immediately and independently report to SEBI any non-compliance observed by him.
- (6) The trustees shall ensure that the asset management company (AMC) has been diligent in empaneling the brokers, in monitoring the securities transactions with brokers and avoiding undue concentration of business with any broker;
- (7) The trustees shall ensure the AMC has not given any undue or unfair advantage to any associate or dealt with any of the associates of the AMC in a manner detrimental to the interest of the unit holders;
- (8) The trustees shall ensure that the transaction entered into by the AMC or in accordance with these regulations and the mutual fund scheme concerned;
- (9) The trustees shall ensure that the AMC has been managing the mutual fund schemes independently of other activities and have taken adequate steps to ensure that the interest of the investors of one scheme are not being compromised with those of any other scheme or of other activities of the AMC;
- (10) The trustees shall ensure that all the activities of the AMC are in accordance with the provisions of these regulations;
- (11) Where the trustees have reason to believe that the conduct of business of the mutual fund is not in accordance with these regulations and the scheme, they shall forthwith take such remedial steps as are necessary by them and shall immediately inform SEBI of the violation and the action taken by them;
- (12) Each trustee shall file the details of his transactions of dealing in securities with a mutual fund on a quarterly basis;
- (13) The trustees shall be accountable for and be the custodian of the funds and the property of the respective schemes and shall hold the same in trusts for the benefit of the unitholders in accordance with these regulations and the trust deed;
- (14) The trustees shall take steps to ensure that the transactions of the mutual fund are in accordance with the provisions of the trust deed;
- (15) The trustees shall be responsible for the calculation of any income due to be paid to the mutual fund and also of any income received in the mutual fund for the holders of the unit of any scheme in accordance with these regulations and the trust deed;
- (16) The trustees shall obtain the consent of the unit holders –
- (a) whenever required to do so by SEBI in the interest of the unit holders; or
 - (b) whenever required to do so on the requisition of 3/4 of the unit holders of any scheme; or
 - (c) when the majority of the trustees decide to wind up or pre-maturely redeem the units;
- (17) The trustees shall ensure that no change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme and affects the interest of unit holders, shall be carried out unless, -
- (i) a written communication about the proposed change is sent to each unit holder and an advertisement is given in one English daily newspaper having nationwide circulation as well as in a newspaper published in the language of the region where the Head Office of the mutual fund is situated; and
 - (ii) the unit holders are given an option to exit at the prevailing Net Asset Value without any exit load;
- (18) The trustees shall on a quarterly basis review all transactions carried out between the mutual funds, AMC and its associates and also the networth of the AMC. In case of any short fall in the networth the trustees shall ensure that the AMC make up for the short fall;

(19) The trustees shall periodically review all service contracts such as custody arrangements, transfer agency of the securities and satisfy itself that they are executed in the interest of the unit holders. Similarly, the trustees shall periodically review the investor complaints received and ensure redressal of the same by the AMC;

(20) The trustees shall ensure that there is no conflict of interest between the manner of deployment of its networth by the asset management company and the interest of the unit-holders.

(21) The trustees shall furnish to SEBI on a half yearly basis –

- (a) a report on the activities of the mutual fund;
- (b) a certificate stating that the trustees have satisfied themselves that there have been no instances of self dealing or front running by any of the trustees, directors or key personnel of the AMC.
- (c) a certificate that the trustees have not found any instances of self dealing or front running by any of the trustees, directors or key personnel of the AMC and a certificate to the effect that the AMC has been managing the schemes independently of any other activities and protecting the interest of the unit holders.

(22) The independent trustees shall give their comments on the report of the AMC as regards investments by the mutual fund in the securities of group companies of the sponsor.

(23) The trustees shall abide by the code of conduct as specified in the Fifth Schedule, which is discussed below:

CODE OF CONDUCT FOR MUTUAL FUNDS

- (a) Mutual fund schemes should not be organised, operated, managed or the portfolio of securities selected, in the interest of sponsors, directors of AMCs, members of Board of trustees or directors of trustee company, associated persons as in the interest of special class of unit holders rather than in the interest of all classes of unit holders of the scheme.
- (b) Trustees and AMCs must ensure the dissemination to all unit holders of adequate, accurate, explicit and timely information fairly presented in a simple language about the investment policies, investment objectives, financial position and general affairs of the scheme.
- (c) Trustees and AMCs should avoid excessive concentration of business with broking firms, affiliates and also excessive holding of units in a scheme among a few investors.
- (d) Trustees and AMCs must avoid conflicts of interest in managing the affairs of the schemes and keep the interest of all unit holders paramount in all matters.
- (e) Trustees and AMCs must ensure schemewise segregation of bank accounts and securities accounts.
- (f) Trustees and AMCs shall carry out the business and invest in accordance with the investment objectives stated in the offer documents and take investment decision solely in the interest of unit holders.
- (g) Trustees and the AMC shall maintain high standards of integrity and fairness in all their dealings and in the conduct of their business.
- (h) Trustees and AMC must not use any unethical means to sell; market or induce any investor to buy their schemes.
- (i) Trustees and the AMC shall render at all times high standard of service, exercise due diligence, ensure proper care and exercise independent professional judgment.
- (j) The AMC shall not make any exaggerated statement, whether oral or written, either about their qualifications or capability to render investment management services or their achievements.
- (k) (a) The sponsor of the mutual fund, the trustees or the asset management company and any of their

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

(b) In case, an employee of the sponsor, the trustees or the asset management company is rendering such advice, he shall also disclose the interest of his dependent family members and the employer including their long or short position in the said security, while rendering such advice.

GENERAL DUE DILIGENCE AND SPECIFIC DUE DILIGENCE BY TRUSTEES

The trustees shall exercise due diligence as under:

(A) *General Due Diligence:*

- (i) the trustees shall be discerning in the appointment of the directors on SEBI of the asset management company.
- (ii) trustees shall review the desirability of continuance of the asset management company if substantial irregularities are observed in any of the schemes and shall not allow the asset management company to float new schemes.
- (iii) the trustee shall ensure that the trust property is properly protected, held and administered by proper persons and by a proper number of such persons.
- (iv) the trustee shall ensure that all service providers are holding appropriate registrations from SEBI or concerned regulatory authority.
- (v) the trustees shall arrange for test checks of service contracts.
- (vi) trustees shall immediately report to SEBI of any special developments in the mutual fund.

(B) *Specific Due Diligence:*

The trustees shall:

- (i) obtain internal audit reports at regular intervals from independent auditors appointed by the trustees;
- (ii) obtain compliance certificate at regular intervals from the asset management company;
- (iii) hold meeting of trustee more frequently;
- (iv) consider the reports of the independent auditor and compliance reports of asset management company at the meetings of trustees for appropriate action;
- (v) maintain records of the decisions of the trustees at their meetings and of the minutes of the meetings;
- (vi) prescribe and adhere to a code of ethics by the trustees, asset management company and its personnel;
- (vii) communicate in writing to the asset management company of the deficiencies and checking on the rectification of deficiencies.

INDEPENDENT DIRECTORS' RESPONSIBILITIES

The independent directors of the trustees or the AMC shall pay specific attention to the following:

- (1) the Investment Management Agreement and the compensation paid under the agreement,
- (2) service contracts with affiliates – whether the asset management company has charged higher fees than outside contractors for the same services,
- (3) selections of the asset management company's independent directors,
- (4) securities transactions involving affiliates to the extent such transactions are permitted,

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- (5) selecting and nominating individuals to fill independent directors vacancies,
- (6) code of ethics must be designed to prevent fraudulent, deceptive or manipulative practices by insiders in connection with personal securities transactions,
- (7) the reasonableness of fees paid to sponsors, asset management company and any others for services provided,
- (8) principal underwriting contracts and their renewals,
- (9) any service contract with the associates of the asset management company.

ADVERTISEMENT CODE FOR MUTUAL FUNDS

Advertisements shall be in accordance with the advertisement code specified in the Sixth Schedule and shall be submitted to SEBI within 7 days from the date of their issue.

The Advertisement code prescribes for the following :

- (a) Advertisements shall be accurate, true, fair, clear, complete, unambiguous and concise.
- (b) Advertisements shall not contain statements which are false, misleading, biased or deceptive, based on assumption/projections and shall not contain any testimonials or any ranking based on any criteria.
- (c) Advertisements shall not be so designed as likely to be misunderstood or likely to disguise the significance of any statement. Advertisements shall not contain statements which directly or by implication or by omission may mislead the investor.
- (d) Advertisements shall not carry any slogan that is exaggerated or unwarranted or slogan that is inconsistent with or unrelated to the nature and risk and return profile of the product.
- (e) No celebrities shall form part of the advertisement.
- (f) Advertisements shall not be so framed as to exploit the lack of experience or knowledge of the investors. Extensive use of technical or legal terminology or complex language and the inclusion of excessive details which may detract the investors should be avoided.
- (g) Advertisements shall contain information which is timely and consistent with the disclosures made in the Scheme Information Document, Statement of Additional Information and the Key Information Memorandum.
- (h) No advertisement shall directly or indirectly discredit other advertisements or make unfair comparisons.
- (i) Advertisements shall be accompanied by a standard warning in legible fonts which states „Mutual Fund investments are subject to market risks, read all scheme related documents carefully. No addition or deletion of words shall be made to the standard warning.
- (j) In audio-visual media based advertisements, the standard warning in visual and accompanying voice over reiteration shall be audible in a clear and understandable manner. For example, in standard warning both the visual and the voice over reiteration containing 14 words running for at least 5 seconds may be considered as clear and understandable.

LISTING OF CLOSE ENDED SCHEME

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

Regulation 33 says that Units of a close ended scheme, other than those of an equity linked savings scheme, shall not be repurchased before the end of maturity period of such scheme.

The units of close ended schemes referred to in the proviso to regulation 32 may be open for sale or redemption

at fixed predetermined intervals if the maximum and minimum amount of sale or redemption of the units and the periodicity of such sale or redemption have been disclosed in the offer document.

It also permits conversion of close ended scheme into open ended scheme subject to specified conditions, otherwise a close ended scheme shall be fully redeemed at the end of the maturity period.

A close-ended scheme may be allowed to be rolled over if the purpose, period and other terms of the roll over and all other material details of the scheme including the likely composition of assets immediately before the roll over, the net assets and net asset value of the scheme, are disclosed to the unitholders and a copy of the same has been filed with SEBI:

Further, such roll over will be permitted only in the case of those unitholders who express their consent in writing and the unitholders who do not opt for the roll over or have not given written consent shall be allowed to redeem their holdings in full at net asset value based price.

Regulation 34 lays down that no scheme of mutual fund other than an initial offering of equity linked savings scheme shall be open for subscription for more than 15 days. However, in case of mutual fund schemes eligible under Rajiv Gandhi Equity Saving Scheme, the period specified in these regulations shall not be more than thirty days.

Regulations 35 and 36 deal with allotment of units, refunds and issue of unit certificates and statement of accounts.

Regulation 37 states that a unit is freely transferable except where it is specifically restricted or prohibited under the scheme. A unit holder in a close ended scheme listed on a recognized stock exchange, who desires to trade in units shall hold units in dematerialized form. The asset management company shall, on production of instrument of transfer with relevant unit certificates, register the transfer and return the unit certificate to the transferee within 30 days from the date of such production. However, if the units are with the depository such units will be transferable in accordance with the provisions of SEBI (Depositories and Participants) Regulations, 1996.

GUARANTEED RETURNS

Regulation 38 lays down that no guaranteed return shall be provided in a scheme : -

- (a) unless such scheme fully guaranteed by the sponsor or AMC;
- (b) unless a statement indicating the name of the person who will guarantee the return, is made in the offer document.
- (c) the manner in which the guarantee is to be met be also indicated therein.

CAPITAL PROTECTION ORIENTED SCHEMES

Regulation 38A of the Regulations provides that a capital protection oriented scheme may be launched, subject to the following:

- (a) the units of the scheme are rated by a registered credit rating agency from the viewpoint of the ability of its portfolio structure to attain protection of the capital invested therein;
- (b) the scheme is close ended; and
- (c) there is compliance with such other requirements as may be specified by SEBI in this behalf.

Regulation 39 to 42 deal with winding up of a close ended scheme on the expiry of its duration, the effect of winding up, the procedure and manner thereof. It is enjoined that trustees shall forward to SEBI and to the unitholders a report on the winding up. On SEBI being satisfied about the completion of all the necessary measures, a scheme shall cease to exist. The units of a mutual fund scheme must delisted from a recognized stock exchange in accordance with the guidelines as may be specified by SEBI.

DELISTING OF UNITS

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

INVESTMENT OBJECTIVES AND VALUATION POLICIES

Regulation 43 lays down that the monies collected under any scheme of a mutual fund shall be invested only in securities, money market instruments; privately placed debentures; securitised debt instruments which are either asset backed or mortgage backed securities, gold or gold related instruments or real estate assets, infrastructure debt instrument and assets. Investment shall be made in accordance with the investment objective of the relevant mutual fund scheme. However monies collected under any money market scheme of a mutual fund shall be invested only in money market instruments. Moneys collected under any gold exchange trade fund scheme shall be invested only in gold or gold related instruments, moneys collected under a real estate scheme shall be invested in accordance with Regulation 49E.

Regulation 44 talks about investment, borrowing and connected restrictions. Any investments shall be made subject to the investment restriction specified in the Seventh Schedule to the Regulations which contains 11 clauses. However, seventh schedule does not apply to a gold exchange traded fund scheme.

A mutual fund having an aggregate of securities which are worth Rs. 10 crore or more as on the latest balance sheet date, shall settle their transactions only through dematerialised securities, as per instructions of SEBI. The mutual funds shall not borrow except to meet temporary liquidity needs for the purpose of repurchase, redemption of units or payment of interest or dividend to the unit holders. Such borrowals should not exceed 20% of the net asset value of the scheme and the duration of the borrowing shall not exceed six months. The mutual fund shall not advance any loans for any purpose but may lend securities in accordance with the framework relating to short selling and securities lending and borrowing specified by SEBI.

OVERSEAS INVESTMENT BY MUTUAL FUNDS

Mutual Funds are permitted to make investment in:

- (i) ADRs/ GDRs issued by Indian or foreign companies
- (ii) Equity of overseas companies listed on recognized stock exchanges overseas
- (iii) Initial and follow on public offerings for listing at recognized stock exchanges overseas
- (iv) Foreign debt securities in the countries with fully convertible currencies, short term as well as long term debt instruments with rating not below investment grade by accredited/registered credit rating agencies
- (v) Money market instruments rated not below investment grade
- (vi) Repos in the form of investment, where the counterparty is rated not below investment grade; repos should not however, involve any borrowing of funds by mutual funds
- (vii) Government securities where the countries are rated not below investment grade
- (viii) Derivatives traded on recognized stock exchanges overseas only for hedging and portfolio balancing with underlying as securities
- (ix) Short term deposits with banks overseas where the issuer is rated not below investment grade
- (x) Units/securities issued by overseas mutual funds or unit trusts registered with overseas regulators and investing in (a) aforesaid securities, (b) Real Estate Investment Trusts (REITs) listed in recognized stock exchanges overseas or (c) unlisted overseas securities (not exceeding 10% of their net assets).

Transaction in excess of permissible limits — A case study***SEBI v. Shriram Mutual Fund & Others - Appeal No. 9523-24 of 2003***

- (a) A penalty of Rs.2 lakh was imposed by Adjudicating Officer (AO) on Shriram Mutual Fund (SMF) as it had repeatedly exceeded the permissible limits of transactions through its associate broker, in terms of Regulation 25(7) (a) of SEBI (Mutual Funds) Regulations.
- (b) On an appeal by SMF, SAT vide its final judgment and order dated August 21, 2003, set aside AO's order inter-alia on the ground that the limit was not exceeded intentionally.
- (c) SEBI filed an appeal under Section 15Z of the SEBI Act in the Hon'ble Supreme Court.
- (d) The Hon'ble Supreme Court pronounced its final judgment and order on May 23, 2006. Hon'ble Supreme Court set aside the judgment of SAT and settled the issues, as under:
 - Mens rea is not an essential ingredient for contravention of the provisions of a Civil Act.
 - Penalty is attracted as soon as contravention of the statutory obligation as contemplated by the Act is established, and therefore the intention of the parties committing such violation becomes immaterial.
 - Unless the language of the statute indicated the need to establish the element of mens rea, it is generally sufficient to prove that a default in complying with the statute has occurred.
 - Once the contravention is established, the penalty has to follow and only the quantum of penalty is discretionary
 - The SAT has erroneously relied on the judgment in the case of Hindustan Steel Limited vs. State of Orissa (AIR 1970 SC 253) as the said case has no application in the present case which relates to imposition of civil liabilities under SEBI Act and Regulations; and is not a criminal / quasi-criminal proceeding.
 - Imputing mens rea into the provisions of Chapter VIA is against the plain language of the statute and frustrates entire purpose and object of introducing Chapter VIA which was to give teeth to the SEBI to secure strict compliance of the Act and the Regulations.

PROHIBITION ON CARRY FORWARD TRANSACTION, DERIVATIVE TRANSACTIONS, SHORT SELLING

Regulation 45 provides that the funds of scheme shall not in any manner be used in carry forward transaction. However, a mutual funds may enter into derivative transactions on a recognised stock exchange, subject of framework specified by SEBI. A mutual fund may enter into short selling transactions on a recognised stock exchange, subject to the framework relating to short selling and securities lending and borrowing specified by SEBI.

UNDERWRITING

Regulation 46 permits mutual funds to enter into underwriting agreement after obtaining a certificate of registration in terms of SEBI Underwriters Rules and SEBI Underwriters Regulations. The Underwriting obligations will be deemed to be investments made in such securities. The capital adequacy norms for the purpose of underwriting shall be the net asset of the scheme. However the Underwriting obligation of a mutual fund shall not at any time exceed the total NAV of the scheme.

INVESTMENT VALUATION NORMS

Regulation 47 deals with the method of valuation of investments. Every mutual fund shall ensure that the asset

management company computes and carries out valuation of investments made by its scheme(s) in accordance with the investment valuation norms specified in Eighth Schedule, and publishes the same with the valuation norms specified in the Eighth Schedule to the Regulations.

Regulation 48 lays down that every mutual fund shall compute the NAV of each scheme by dividing the net assets of the scheme with a number of units of that scheme outstanding on the valuation date. The Net Asset Value of the scheme shall be calculated on daily basis and published in at least two daily newspapers having circulation all over India.

Regulation 49 deals with pricing of units. The price at which units may be subscribed or sold and the price at which such units may at any time be purchased by the mutual fund shall be made available to the investors. In the case of open ended scheme the mutual fund shall at least once in a week publish in a daily newspaper of all India circulation, the sale and repurchase price of the units. The funds shall ensure that such repurchase price is not lower than 93% of NAV. The difference between repurchase price and sale price is not higher than 107 percent of the NAV.

The price of units shall be determined with reference to the last determined NAV, unless the scheme announces the NAV on a daily basis and the sale price is determined with or without a fixed premium added to the future NAV which is declared in advance.

GENERAL OBLIGATIONS OF THE MUTUAL FUNDS

Regulation 50 lays down that every AMC for each scheme shall keep and maintain proper books of accounts, records and documents, for each scheme so as to explain its transactions and to disclose at any point of time the financial position of each scheme and in particular, give a true and fair view of the state of affairs of the fund and intimate to SEBI the place where such books of accounts, records and documents are maintained. All these documents shall be preserved by the AMC for a period of 8 years.

The AMC shall follow the accounting policies and standards as specified in Ninth Schedule to provide appropriate details of the scheme-wise disposition of the assets of the fund at the relevant accounting date and the performance during that period together with information regarding distribution or accumulation of income accruing to the unit holder in a fair and true manner.

Regulation 51 provides that the financial year for all the schemes shall end as on March, 31 of that financial year.

Regulation 51A provides for the credit of exit load to scheme. The exit load charged, if any, after the commencement of the SEBI (Mutual Funds) (Second Amendment) Regulations, 2012, shall be credited to the scheme.

Regulation 52 lays down that all expenses should be clearly identified and apportioned to the individual schemes. The asset management company may charge the scheme with investment and advisory fees which shall be fully disclosed in the offer document.

Regulation 52A provides that a mutual fund may declare dividends in accordance with the offer document and subject to such guidelines as may be specified by SEBI.

Regulation 53 lays down that every mutual fund and AMC shall despatch to the unit-holders the dividend warrants within 30 days of the declaration of the dividend and despatch the redemption or repurchase proceeds within 10 working days from the date of such redemption or repurchase. If AMC failed to dispatch the redemption or repurchase proceeds within 10 working days from the date of such redemption or repurchase, it shall be liable to pay interest to the unit holders at such rate as may be specified by SEBI for the period of delay. Besides this, the AMC may also be liable for penalty in respect of the delay.

Regulations 54 to 57 deal with the annual report, auditors report, publication thereof and forwarding to SEBI. Every mutual fund or AMC shall prepare in respect of each financial year an annual report and an annual

statement of accounts of the schemes and the fund as specified in these Regulations. Every mutual fund shall have the annual statement of accounts audited by a practising Chartered Accountant who is not in any way associated with the auditor of the AMC. The auditor shall be appointed by the trustees to whom the auditor shall forward his report. It shall be included as part of the annual report of the mutual fund.

Regulation 56 requires that the schemewise Annual Report of a mutual fund or an abridged summary thereof shall be mailed to all unitholders as soon as may be but not later than four months from the date of closure of the relevant accounts year. However, the scheme wise annual report or abridged summary thereof may be sent to investors in electronic form on their registered e-mail address in the manner specified by SEBI. The asset management company shall display the link of the full scheme wise annual reports prominently on their website.

Regulation 57 requires that the mutual funds annual report shall be forwarded to SEBI within 4 months from the date of closure of each financial year.

Regulations 58 and 59 indicate the periodical and continual disclosures as well as half yearly disclosures to be made by the mutual fund, AMC and others closely connected to them.

Regulation 60 enjoins that the trustee shall be bound to make all essential disclosures to unit holders to keep them informed about any information which may have an adverse bearing on their investments.

INSPECTION AND AUDIT

SEBI is empowered to appoint inspecting officer to inspect and investigate the affairs of a mutual fund, the trustees, the AMC etc. SEBI may give a notice to the fund before such inspection or may dispense with it, if it feels the need.

Regulation 63 indicates the obligations of the mutual fund, trustees or AMC when they are taken up for inspection by SEBI.

The inspecting officer shall submit his reports to SEBI and SEBI after considering the same communicate the findings of the inspecting officer to the mutual fund, trustees or AMC and give him an opportunity to be heard.

LIABILITY FOR ACTION IN CASE OF DEFAULT

Chapter IX containing Regulation 68 deals with the above subject. A mutual fund who contravenes any of the provisions of the Act, Rules or Regulations framed there under shall be liable for one or more action specified therein including the action under Chapter V of the SEBI (Intermediaries) Regulations, 2008.

ACTION AGAINST MUTUAL FUND AND/OR ASSET MANAGEMENT COMPANY

Regulation 75A provides that without prejudice to regulation 68, a mutual fund and/or asset management company shall be liable for action under the applicable provisions of the Act and the Regulations framed thereunder, –

- (a) in case the advertisement issued is in contravention with the Advertisement Code specified in Sixth Schedule.
- (b) in case the valuation of securities is in contravention of the Principles of Fair Valuation specified in Eighth Schedule.

INFRASTRUCTURE DEBT FUND SCHEMES

“**Infrastructure debt fund scheme**” means a mutual fund scheme that invests primarily (minimum 90% of scheme assets) in the debt securities or securitized debt instrument of infrastructure companies or infrastructure capital companies or infrastructure projects or special purpose vehicles which are created for the purpose of facilitating or promoting investment in infrastructure, and other permissible assets in accordance with these

regulations or bank loans in respect of completed and revenue generating projects of infrastructure companies or projects or special purpose vehicles.

‘Strategic Investor’ means;

- (i) an Infrastructure Finance Company registered with Reserve bank of India as Non Banking Financial Company;
- (ii) a Scheduled Commercial Bank;
- (iii) International Multilateral Financial Institution.
- (iv) Systematically important NBFCs registered with RBI.
- (v) FII registered with SEBI which are long term investors, subject to their applicable investment limits.

APPLICABILITY

The provisions of chapter VI B of SEBI (Mutual Funds) Regulation, 1996 shall apply to infrastructure debt fund schemes launched by mutual funds.

All other provisions of these regulations and the guidelines and circulars issued thereunder, unless the context otherwise require or repugnant to the provisions of this chapter, shall apply to infrastructure debt fund schemes, trustees and asset management companies in relation to such schemes.

ELIGIBILITY CRITERIA FOR LAUNCHING INFRASTRUCTURE DEBT FUND SCHEME

- (1) An existing mutual fund may launch an infrastructure debt fund schemes if it has an adequate number of key personnel having adequate experience in infrastructure sector.
- (2) A certificate of registration may be granted to an applicant proposing to launch only infrastructure debt fund schemes if the sponsor or the parent company of the sponsor : –
 - (a) has been carrying on activities or business in infrastructure financing sector for a period of not less than five years;
 - (b) fulfils the eligibility criteria as provided in Regulation 7.

OFFERING PERIOD

A scheme of infrastructure debt fund, in case of a public offer, shall be open for subscription for more than forty five days.

CONDITIONS FOR INFRASTRUCTURE DEBT FUND SCHEMES

(1) An infrastructure debt fund scheme shall be launched either as close-ended scheme maturing after more than five years or interval scheme with lock-in of five years and interval period not longer than one month as may be specified in the scheme information document.

However, the tenure of the scheme may be extended to two years subject to approval of two-thirds of the unit holders by value of their investment in the schedule.

(2) Units of infrastructure debt fund schemes shall be listed on a recognized stock exchange, provided that such units shall be listed only after being fully paid up.

(3) Mutual Funds may disclose indicative portfolio of infrastructure debt fund scheme to its potential investors disclosing the type of assets the mutual fund will be investing.

(4) An infrastructure debt fund scheme shall have minimum five investors and no single investor shall hold more than fifty percent of net assets of the scheme.

(5) No infrastructure debt fund scheme shall accept any investment from any investor which is less than ₹ 1 crore.

(6) The minimum size of the unit shall be ₹ 10 lakhs.

(7) Each scheme launched as infrastructure debt fund scheme shall have firm commitment from the strategic investors for contribution of an amount of at least ₹ 25 crores before the allotment of units of the scheme are marketed to other potential investors.

(8) Mutual Funds launching infrastructure debt fund scheme may issue partly paid units to the investors, subject to following conditions:

- (a) The asset management company shall call for the unpaid portions depending upon the deployment opportunities;
- (b) The offer document of the scheme shall disclose the interest or penalty which may be deducted in case of non payment of call money by the investors within stipulated time; and
- (c) The amount of interest or penalty shall be retained in the scheme.

PRIVATE PLACEMENT

The units of an infrastructure debt fund scheme may be offered through private placement to less than fifty persons, subject to approval by the trustees and the board of the asset management company.

The offer made, shall be subject to the following:

- (a) A placement memorandum, in the manner as specified by SEBI, shall be filed by the mutual fund with SEBI at least seven days prior to the launch of the scheme; and
- (b) the mutual fund shall pay to SEBI, filing fee as specified in the Second Schedule.

PERMISSIBLE INVESTMENTS

- (1) Every infrastructure debt fund scheme shall invest at least ninety percent of the net assets of the scheme in the debt securities or securitized debt instruments of infrastructure companies or projects or special purpose vehicles which are created for the purpose of facilitating or promoting investment in infrastructure or bank loans in respect of completed and revenue generating projects of infrastructure companies or special purpose vehicle.

However, the funds received on account of repayment of principal, whether by way of pre-payment or otherwise, with respect to the underlying assets of the scheme shall be invested as specified in this regulation. Further, if the investment specified in this sub-regulations are not available such funds may be invested in bonds of public financial institutions and infrastructure finance companies.

- (2) Every infrastructure debt fund scheme may invest the balance amount in equity shares, convertibles including mezzanine financing instruments of companies engaged in infrastructure, infrastructure development projects, whether listed on a recognized stock exchange in India or not; or money market instruments and bank deposits.
- (3) The investment restrictions shall be applicable on the life-cycle of the infrastructure debt fund scheme and shall be reckoned with reference to the total amount raised by the infrastructure debt fund scheme.
- (4) No mutual fund shall, under all its infrastructure debt fund schemes, invest more than thirty per cent of its net assets in the debt securities or assets of any single infrastructure company or project or special purpose vehicles which are created for the purpose of facilitating or promoting investment in infrastructure or bank loans in respect of completed and revenue generating projects of any single infrastructure company or project or special purpose vehicle.
- (5) An infrastructure debt scheme shall not invest more than 30% of the net assets of the scheme in debt instruments or assets of any single infrastructure company or project or special purpose vehicles which are created for the purpose of facilitating or promoting investment in infrastructure or bank loans in respect of completed and revenue generating projects of any single infrastructure company or project or special purpose vehicle.

- (6) No infrastructure debt fund scheme shall invest in –
 - (i) Any unlisted security of the sponsor or its associate or group company;
 - (ii) Any listed security issued by way of preferential allotment by the sponsor or its associate or group company;
 - (iii) Any listed security of the sponsor or its associate or group company or bank loan in respect of completed and revenue generating projects of infrastructure companies or special purpose vehicles of the sponsor or its associate or group companies, in excess of twenty five per cent of the net assets of the scheme, subject to approval of trustees and full disclosures to investors for investments made within the aforesaid limits; or
- (7) Any asset or securities owned by the sponsor or asset management company or their associates in excess of 30% of the net assets of the scheme, provided that-
 - (a) such investment is in assets or securities not below investment grade;
 - (b) the sponsor or its associates retains atleast 30% of the assets or securities, in which investment is made by the scheme, till the assets or securities are held in the scheme portfolio; and
 - (c) approval for such investment is granted by the trustees and full disclosures are made to the investors regarding such investment.

VALUATION OF ASSETS AND DECLARATION OF NET ASSET VALUE

- (1) The assets held by an infrastructure debt fund scheme shall be valued “in good faith” by the asset management company on the basis of appropriate valuation methods based on principles approved by the trustees.
- (2) The valuation shall be documented and the supporting data in respect of each security so valued shall be preserved at least for a period of five years after the expiry of the scheme.
- (3) The methods used to arrive at values ‘in good faith’ shall be periodically reviewed by the Trustees and by the statutory auditor of the mutual fund.
- (4) The valuation policy approved by the board of asset management company shall be disclosed in the scheme information document.
- (5) The net asset value of every infrastructure debt fund scheme shall be calculated and declared atleast once in each quarter.

DUTIES OF ASSET MANAGEMENT COMPANY

- (1) The asset management company shall lay down an adequate system of internal controls and risk management.
- (2) The asset management company shall exercise due diligence in maintenance of the assets of an infrastructure debt fund scheme and shall ensure that there is no avoidable deterioration in their value.
- (3) The asset management company shall record in writing, the details of its decision making process in buying or selling infrastructure companies’ assets together with the justifications for such decisions and forward the same periodically to trustees.
- (4) The asset management company shall ensure that investment of funds of the Infrastructure Debt Fund schemes is not made contrary to provisions of this chapter and the trust deed.
- (5) The asset management company shall obtain, wherever required under these regulations, prior in-principle approval from the recognized stock exchange(s) where units are proposed to be listed.
- (6) The asset management company shall institute such mechanisms as to ensure that proper care is

taken for collection, monitoring and supervision of the debt assets by appointing a service provider having extensive experience thereof, if required.

DISCLOSURES IN OFFER DOCUMENT AND OTHER DISCLOSURES

1. The offer documents of infrastructure debt fund schemes shall contain disclosures which are adequate for investors to make informed investment decisions and such further disclosures as may be specified by SEBI.
2. The portfolio disclosures and financial results in respect of an infrastructure debt fund schemes shall contain such further disclosures as may be specified by SEBI.
3. Advertisements in respect of infrastructure debt fund schemes shall conform to such guidelines as may be specified by SEBI.

TRANSACTIONS BY EMPLOYEES ETC.

1. All transactions done by the trustees or the employees or directors of the asset management company or the trustee company in the investee companies shall be disclosed by them to the compliance officer within one month of the transaction.
2. The compliance officer shall make a report thereon from the view point of possible conflict of interest and shall submit it to the trustees with his recommendations, if any.
3. The persons covered in sub-regulation (1) may obtain the views of the trustees before entering into the transaction in investee companies, by making a suitable request to them.

GOLD EXCHANGE TRADED FUNDS

Gold Exchange Traded Fund scheme shall mean a mutual fund scheme that invests primarily in gold or gold related instruments.

SEBI (Mutual funds) Regulations, 1996 permits Gold Exchange Traded Fund (GETF) to invest primarily in –

- (a) Gold.
- (b) Gold related instruments i.e. such instruments having gold as underlying, as are specified by SEBI from time to time.

A gold exchange traded fund scheme is subject to the following investment restrictions:

- (a) the funds of any such scheme should be invested only in gold or gold related instruments in accordance with its investment objective, except to the extent necessary to meet the liquidity requirements for honouring repurchases or redemptions, as disclosed in the offer document; and
- (b) pending deployment of funds in accordance with clause (a), the mutual fund may invest such funds in short term deposits of scheduled commercial banks.

Gold Deposit Scheme (GDS)

SEBI has designated Gold Deposit Scheme (GDS) of banks as one such gold related instrument. Investment in GDS of banks by Gold ETFs of mutual funds will be subject to following conditions:

- (a) The total investment in GDS will not exceed 20% of total asset under management of such schemes.
- (b) Before investing in GDS of banks, mutual funds shall put in place a written policy with regard to investment in GDS with due approval from the Board of the Asset Management Company and the Trustees. The policy should have provision to make it necessary for the mutual funds to obtain prior approval of their trustees for each investment proposal in GDS of any Bank. The policy shall be reviewed by mutual funds, at least once a year.

- (c) Gold certificates issued by Banks in respect of investments made by Gold ETFs in GDS shall be held by the mutual funds only in dematerialized form.

1. Valuation

Since physical gold and other permitted instruments linked to gold are denominated in gold tonnage, it will be valued based on the market price of gold in the domestic market and will be marked to market on a daily basis. The market price of gold in the domestic market on any business day would be arrived at as under:

Domestic price of gold = (London Bullion Market Association AM fixing in US\$/ounce X conversion factor for converting ounce into kg for 0.995 fineness X rate for US\$ into INR) + custom duty for import of gold + sales tax/ octroi and other levies applicable.

The Trustees reserve the right to change the source (centre) for determining the exchange rate. The AMC should record in writing the reason for change in the source for determining the exchange rate.

2. Determination of Net Asset Value

NAV of units under the Scheme would be calculated as shown below:

$$\text{NAV (₹)} = \frac{\text{Market or Fair Value of Scheme's investments + Current Assets} - \text{Current Liabilities and Provision}}{\text{No. of Units outstanding under Scheme on the Valuation Date}}$$

The NAV shall be calculated up to four decimals.

3. Recurring Expenses

For a GETF, the limits applicable to equity schemes as specified in SEBI Regulations shall be applicable.

4. Benchmark for GETF

As there are no indices catering to the gold sector/securities GETF shall be benchmarked against the price of Gold.

5. Half Yearly Report by Trustees

Physical verification of gold underlying the Gold ETF Units shall be carried out by statutory auditors of mutual fund schemes and reported to trustees on half yearly basis. The confirmation on physical verification of gold shall form part of half yearly report by trustees to SEBI.

REAL ESTATE MUTUAL FUND SCHEMES (REMFS)

“Real Estate Mutual Fund Scheme” means a mutual fund scheme that invests directly or indirectly in real estate assets or other permissible assets in accordance with SEBI (Mutual Funds) Regulations, 1996.

“Real estate assets” means an identifiable immovable property-

- (i) which is located within India in such city as may be specified by SEBI from time to time or in a special economic zone within the meaning of section 2 of the Special Economic Zones Act, 2005;
- (ii) on which construction is complete and which is usable;
- (iii) which is evidenced by valid title documents;
- (iv) which is legally transferable;
- (v) which is free from all encumbrances;
- (vi) which is not subject matter of any litigation;

but does not include –

- I. a project under construction; or
- II. vacant land; or
- III. deserted property; or
- IV. land specified for agricultural use; or
- V. a property which is reserved or attached by any Government or other authority or pursuant to orders of a court of law or the acquisition of which is otherwise prohibited under any law for the time being in force.

SALIENT FEATURES OF REMFS

Some of the salient features of REMFs are as under:

1. An Existing Mutual Funds are eligible to launch real estate mutual funds if they have adequate number of experienced key personnel/directors having adequate experience in real estate.
2. Sponsors seeking to set up new Mutual Funds, for launching only real estate mutual fund schemes, shall be carrying on business in real estate for a period not less than five years. They shall also fulfill all other eligibility criteria applicable for sponsoring a MF.
3. Every real estate mutual fund scheme shall be close-ended and its units shall be listed on a recognized stock exchange.
4. Net asset value (NAV) of the scheme shall be declared daily.
5. At least 35% of the net assets of the scheme shall be invested directly in real estate assets. Balance may be invested in mortgage backed securities, securities of companies engaged in dealing in real estate assets or in undertaking real estate development projects and other securities. Taken together, investments in real estate assets, real estate related securities (including mortgage backed securities) shall not be less than 75% of the net assets of the scheme.
6. Unless, otherwise disclosed in the offer document, no mutual fund shall, under all its real estate mutual fund schemes, invest more than thirty percent of its net assets in a single city.
7. Unless otherwise stated, the investment restrictions specified in the Seventh Scheme shall apply.
8. No mutual fund shall transfer real estate assets amongst its schemes.
9. No mutual fund shall invest in any real estate asset which was owned by the sponsor or the asset management company or any of its associates during the period of last five years or in which the sponsor or the asset management company or any of its associates hold tenancy or lease rights.
10. A real estate mutual fund scheme shall not undertake lending or housing finance activities.

LESSON ROUND UP

- Mutual Funds, pool their marginal resources, invest in securities and distribute the returns therefrom among them on cooperative principles.
- As in mature markets, mutual funds in emerging markets have been among the fastest growing institutional investors.
- Mutual funds are regulated by SEBI (Mutual Fund) Regulations, 1996
- An investor can subscribe to New fund offers of mutual fund schemes through Application Supported by Block Amount Facility.
- Offer document of mutual funds scheme offering new fund has two parts: Scheme Information Document (SID) and Statement of Additional Information (SAI).
- Various schemes of Mutual Funds are Open ended mutual funds; Close ended mutual funds; Capital Oriented Protection Scheme; Income Oriented Schemes; Growth Oriented Schemes; Hybrid Schemes; High Growth Schemes; Money Market Mutual Funds; Tax Saving Schemes etc.
- Various risks involved in mutual funds are Excessive diversification of portfolio; losing focus on the securities of the key segments; Too much concentration on blue-chip securities; Poor planning of investment with minimum returns; Unresearched forecast on income, profits and Government policies etc.
- The provisions of chapter VI B of SEBI (Mutual Funds) Regulation, 1996 shall apply to infrastructure debt fund schemes launched by mutual funds.
- Gold Exchange Traded Fund (GETF) schemes are permitted to invest primarily in
 - (a) Gold.
 - (b) Gold related instruments i.e. such instruments having gold as underlying, as are specified by SEBI from time to time
- Existing Mutual Funds are eligible to launch real estate mutual funds if they have adequate number of experienced key personnel/directors.

GLOSSARY

Mezzanine Financing	A hybrid of debt and equity financing that is typically used to finance the expansion of existing companies. Mezzanine financing is basically debt capital that gives the lender the rights to convert to an ownership or equity interest in the company if the loan is not paid back in time and in full. It is generally subordinated to debt provided by senior lenders such as banks and venture capital companies.
Parent company of the sponsor	It shall mean a company which holds at least 75% of paid up equity share capital of the sponsor.
New Fund offer	A security offering in which investors may purchase units of a closed-end mutual fund. A new fund offer occurs when a mutual fund is launched, allowing the firm to raise capital for purchasing securities.
Expected Return	The return an investor might expect on an investment if the same investment were made many times over an extended period. The return is found through the use of mathematical analysis.

Lesson 9

Alternative Investment Fund

LESSON OUTLINE

- Introduction
- Existing Venture Capital Fund
- SEBI (Alternative Investment Funds) Regulations, 2012
- Key Features of AIF Categories
- Placement Memorandum
- Listing
- Transparency
- Winding up
- Liability for action in case of default
- SEBI (Venture Capitals Funds) Regulations, 1996
- SEBI (Foreign Venture Capital Investors) Regulations, 2000
- Conditions of Certificate
- Maintenance of books & records
- Obligations of Foreign Venture Capital Investor
- Powers of SEBI
- Appeal to Securities Appellate Tribunal
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

SEBI had earlier framed the SEBI (Venture Capital Funds) Regulations, 1996 (“VCF Regulations”) to encourage investments into start-ups and mid-size companies. Since the introduction of the VCF Regulations, it was observed by SEBI that the venture capital route was being used by several other categories of funds also such as private equity funds, real estate funds etc. Accordingly, SEBI notified the Alternative Investment Fund (AIF) Regulations, 2012 to govern unregulated entities and create a level playing ground for existing venture capital investors.

Keeping this in view, this lesson is designed to enable the students to have the basic understanding of the Alternative Investment Fund, Regulatory Framework governing AIF in India, Angel Fund and Scheme of Angel Fund, their working mechanism, types of AIF, their winding up etc. Further the student will also have the overview of Venture Capital Regulations.

INTRODUCTION

SEBI had earlier framed the SEBI (Venture Capital Funds) Regulations, 1996 (“VCF Regulations”) to encourage investments into start-ups and mid-size companies. Since the introduction of the VCF Regulations, it was observed by SEBI that the venture capital route was being used by several other categories of funds such as private equity funds, real estate funds etc. Further since registration as a venture capital fund (“VCF”) was not mandatory under the VCF Regulations, not all private equity or other categories of funds were registering with the SEBI. While these funds did not enjoy certain exemptions that were available to VCFs, they were not subjected to any investment restrictions either.

Currently, while retail investors such as mutual funds and collective investment schemes are well regulated, SEBI noted the need for comprehensive regulations to deal with investments that are sourced from diverse parts of the private pool of capital.

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

The AIF Regulations aim to regulate funds involved in the pooling or raising of private capital from institutional investors or high net worth investors (“HNI”) with a view to invest such funds in accordance with a defined investment policy for benefit of the investors and the manager of such fund, irrespective of their legal domicile. These regulations provide that an entity, seeking to pool and manage such private pool of capital for investing in securities or acting as an Alternative Investment Fund (“AIF”), should be registered with the SEBI under these regulations.

EXISTING VENTURE CAPITAL FUNDS

Existing VCFs will be permitted to continue and shall be governed by the VCF Regulations till such fund or scheme managed by the fund is wound up. VCFs will not be permitted to raise any fresh funds after notification of these regulations, as aforesaid, except for commitments already made by investors as on the date of the notification. These VCFs may seek re-registration under AIF Regulations, subject to approval of two-thirds of their investors by value. Existing funds (falling within the definition of an AIF) not registered with SEBI may continue to operate for 6 months from the date of commencement of the AIF Regulations or if it has already made an application for registration under these regulations within those 6 months then till the disposal of its application (extendable up to 12 months in special cases with the permission of SEBI). These funds will not be allowed to float any new scheme without registration under the AIF Regulations. Schemes floated by such funds before coming into force of AIF Regulations, shall only be allowed to continue till maturity. Further existing funds that are currently not registered with SEBI but wish to seek registration under the AIF Regulations may apply to SEBI for exemption from the strict compliance with the AIF Regulations if they are not able to comply with all provisions of these regulations.

SEBI (ALTERNATIVE INVESTMENT FUNDS) REGULATIONS, 2012

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

REPEAL OF THE SEBI (VENTURE CAPITAL FUNDS) REGULATIONS, 1996

This Regulation has replaced the existing SEBI (Venture Capital Funds) Regulations, 1996 (“VCF Regulations”). Funds registered under the VCF Regulations shall continue to be regulated by the said regulations till the existing fund or scheme is wound up.

For the benefit of students, SEBI (Venture Capital Funds) Regulations, 1996 is also covered in this lesson.

IMPORTANT DEFINITIONS

Alternative Investment Fund

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

- (i) is a privately pooled investment vehicle that collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors; and
- (ii) is not covered under the SEBI (Mutual Funds) Regulations, 1996, SEBI (Collective Investment Schemes) Regulations, 1999 or any other regulations of SEBI, which aims to regulate fund management activities.

The following are specifically excluded from the purview of AIF Regulations (subject to conditions in certain cases):

- Family Trusts;
- ESOP Trusts;
- Employee Welfare Trusts;
- Holding Companies within the meaning of section 2(46) of Companies Act, 2013;
- Other Special Purpose Vehicles not established by fund managers, including securitization trusts, regulated under a specific regulatory framework;
- Funds managed by registered securitization company or reconstruction company; and
- Any such pool of funds which is directly regulated by any other Indian regulator.

Angel Fund

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

Company with family connection

Company with family connection means:

- (a) if the angel investor is an individual,
 - (i) any company which is promoted by such an individual or his relative; or
 - (ii) any company where the individual or his relative is a director; or
 - (iii) any company where the person or his relative has control, or shares or voting rights which entitle them to fifteen percent or more of the shares or voting rights in the company.

Explanation I: For the purpose of this clause, “relative” means a person as defined under section 2 (77) of the Companies Act, 2013.

Explanation II: For the purpose of this clause, “control” shall have the same meaning as assigned to it under sub-regulation (1) of regulation 2 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

- (b) if the angel investor is a body corporate,
 - (i) any company which is a subsidiary or a holding company of the investor; or
 - (ii) any company which is part of the same group or under the same management of the investor; or

Explanation: For the purpose of this clause, “part of the same group” and “under the same management” shall have the same meaning as assigned to it under regulation 23 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

- (iii) any company where the body corporate or its directors/partners have control, or shares or voting rights which entitle them to fifteen percent or more of the shares or voting rights in the company.

Debt Funds

These funds will primarily make investments in debt or debt securities of listed or unlisted investee companies.

Hedge Funds

Hedge Funds will employ diverse or complex trading strategies and invests and trades in securities having diverse risks or complex products, including listed and unlisted derivatives.

Infrastructure Funds

These funds will primarily invest in unlisted securities or partnership interest or listed debt or securitized debt instruments of investee companies or special purpose vehicles engaged in or formed for, the purpose of operating or holding infrastructure projects.

Investible Fund

It means corpus of the Alternative Investment Fund net of estimated expenditure for administration and management of the fund.

Private Equity (“PE”) Funds

PE funds will invest primarily in equity or equity linked instruments or partnership interests of investee companies.

Small and medium enterprises (“SME”) Funds

These funds will invest primarily in unlisted securities of investee companies which are SMEs or securities of those SMEs which are listed or proposed to be listed on a SME exchange or SME segment of an exchange.

Social Venture Funds

These funds will invest primarily in securities or units of social ventures and which satisfy social performance norms laid down by the fund and whose investors may agree to receive restricted or muted returns.

Sponsor

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

Venture Capital Funds

These funds will primarily invest in unlisted securities of start ups, emerging or early stage venture capital undertakings mainly involved in new products, new services, technology or intellectual property rights based activities or a new business model and shall include an angel fund as defined under Chapter III-A

Venture Capital Undertaking

“venture capital undertaking” means a domestic company:

- (i) which is not listed on a recognised stock exchange in India at the time of making investment; and
- (ii) which is engaged in the business for providing services, production or manufacture of article or things and does not include following activities or sectors:
 - (1) non-banking financial companies;

- (2) gold financing;
- (3) activities not permitted under industrial policy of Government of India;
- (4) any other activity which may be specified by SEBI in consultation with Government of India from time to time.

CATEGORIES OF AIF

SEBI has classified AIF into the following three broad categories:

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

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

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

REGISTRATION OF AIF

- All AIFs are required to be mandatorily registered under any one of the above mentioned categories.
- AIF Regulations permit launch of multiple schemes under an AIF without separate registration from SEBI subject to filing of Information Memorandum with SEBI.
- The certificate of registration, once granted, shall be valid till the concerned AIF is wound up.

INVESTMENT STRATEGY

All Alternative Investment Funds shall state investment strategy, investment purpose and its investment methodology in its placement memorandum to the investors.

Any material alteration to the fund strategy shall be made with the consent of atleast two-thirds of unit holders by value of their investment in the Alternative Investment Fund.

INVESTMENT IN ALTERNATIVE INVESTMENT FUND

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

- (a) the Alternative Investment Fund may raise funds from any investor whether Indian, foreign or non-resident Indians by way of issue of units;
- (b) each scheme of the Alternative Investment Fund shall have corpus of atleast twenty crore rupees;
- (c) the Alternative Investment Fund shall not accept from an investor, an investment of value less than one crore rupees.

However, in case of investors who are employees or directors of the Alternative Investment Fund or employees or directors of the Manager, the minimum value of investment shall be 25 lakh rupees.

- (d) the Manager or Sponsor shall have a continuing interest in the Alternative Investment Fund of not less than two and half percent of the corpus or 5 crore rupees, whichever is lower, in the form of investment in the Alternative Investment Fund and such interest shall not be through the waiver of management fees.

However, for Category III Alternative Investment Fund, the continuing interest shall be not less than five percent of the corpus or ten crore rupees, whichever is lower.

- (e) the Manager or Sponsor shall disclose their investment in the Alternative Investment Fund to the investors of the Alternative Investment Fund;
- (f) no scheme of the Alternative Investment Fund shall have more than 1000 investors;

Provided that the provisions of Companies Act, 2013 shall apply to the Alternative Investment Fund, if it is formed as a company.

- (g) the fund shall not solicit or collect funds except by way of private placement.

Investment in Angel Funds

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

Investment by Angel Funds

Angel funds shall invest only in venture capital undertakings which:

- (a) have been incorporated during the preceding three years from the date of such investment;
- (b) have a turnover of less than twenty five crore rupees;
- (c) are not promoted or sponsored by or related to an industrial group whose group turnover exceeds three hundred crore rupees; and

Explanation I: For the purpose of this clause, "industrial group" shall include a group of body corporates with the same promoter(s)/promoter group, a parent company and its subsidiaries, a group of body corporates in which the same person/ group of persons exercise control, and a group of body corporates comprised of associates/subsidiaries/holding companies.

Explanation II: For the purpose of this clause, "group turnover" shall mean combined total revenue of the industrial group.

- (d) are not companies with family connection with any of the angel investors who are investing in the company.
- (e) Investment by an angel fund in any venture capital undertaking shall not be less than fifty lakh rupees and shall not exceed five crore rupees.
- (f) Investment by an angel fund in the venture capital undertaking shall be locked-in for a period of three years.
- (g) Angel funds shall not invest in associates.
- (h) Angel funds shall not invest more than twenty-five per cent of the total investments under all its schemes in one venture capital undertaking;

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

General Investment Conditions and Restrictions

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

- (a) Alternative Investment Fund may invest in securities of companies incorporated outside India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and SEBI from time to time;

(b) Co-investment in an investee company by a Manager or Sponsor shall not be on terms more favourable than those offered to the Alternative Investment Fund;

(c) Category I and II Alternative Investment Funds shall invest not more than twenty five percent of the investible funds in one Investee Company;

(d) Category III Alternative Investment Fund shall invest not more than ten percent of the investible funds in one Investee Company;

(e) Alternative Investment Fund shall not invest in associates except with the approval of seventy five percent of investors by value of their investment in the Alternative Investment Fund;

(f) 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, CBLOs, Commercial Papers, Certificates of Deposits, etc. till deployment of funds as per the investment objective;

(g) Alternative Investment Fund may act as Nominated Investor as specified in clause (b) of sub-regulation (1) of regulation 106N of the SEBI (ICDR) Regulations, 2009.

KEY FEATURES OF AIF CATEGORIES

Category I	Category II	Category III
<ul style="list-style-type: none"> • Minimum tenure of 3 year • Close ended fund • The tenure may be extended for a further period of 2 years only with the approval of two-third of the the unit holders by value of their investment. 		<ul style="list-style-type: none"> • No minimum tenure prescribed. • Open-ended or close ended fund. • The tenure may be extended for a further period of 2 years in case of close-ended fund subject to approval of two-third of the the unitholders by value of their investment.
Leverage / Hedging		
<ul style="list-style-type: none"> • Shall not borrow/leverage except for meeting temporary funding requirements, which shall not exceed 30 days. • The borrowing cannot be on more than four occasions in a year and cannot exceed 10% of the investible funds. 	<ul style="list-style-type: none"> • Shall not borrow/leverage except for meeting temporary funding requirements, which shall not exceed 30 days. • The borrowing cannot be on more than four occasions in a year and cannot exceed 10% of the investible funds. • Funds may engage in hedging subject to guidelines as spceified by SEBI. 	<ul style="list-style-type: none"> • May leverage or borrow (Subject to consent from investors and maximum limit specified by SEBI)
Investment in one investor company		
<ul style="list-style-type: none"> • Shall not invest more than 25% of its investible funds in one investee company 		<ul style="list-style-type: none"> • Maximum 10% of the investible funds in one investee company

Tax "Pass Through"	
<ul style="list-style-type: none"> • Category I AIFs will be considered as venture capital funds/companies for the purpose of Section 10(23FB) of the Income Tax Act, 1961 	<ul style="list-style-type: none"> • The income from Category II and III funds will not be exempt under section 10(23FB) of the Income Tax Act, 1961 • Taxation of such hands would depend on the legal status of the fund i.e. company limited liability partnership or trust.

Valuation	
<ul style="list-style-type: none"> • AIF must disclose to the investors the valuation procedure and the methodology for valuing assets. • Valuation should be carried out by an independent valuers once in every 6 months. This period can be extended to one year with the approval of 75% of the investors by value. 	<ul style="list-style-type: none"> • AIF must disclose the valuation procedure and the methodology for valuing assets • AIF to ensure that calculation of net asset value is independent from the fund management function of the AIF; NAV to be disclosed to investors as per the regulations.

Reporting	
<ul style="list-style-type: none"> • Within 180 days from the end of the year, an annual report is required to be presented to the investor. 	<ul style="list-style-type: none"> • Within 180 days from the end of the year an annual report is required to be presented to the investors • Within 60 days from the end of the quarter, AIF is also required to provide a quarterly report to the investors.

PLACEMENT MEMORANDUM

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

Such information memorandum or placement memorandum must contain all material information about the Alternative Investment Fund and the Manager, background of key investment team of the Manager, targeted investors, fees and all other expenses proposed to be charged, tenure of the Alternative Investment Fund or scheme, conditions or limits on redemption, investment strategy, risk management tools and parameters employed, key service providers, conflict of interest and procedures to identify and address them, disciplinary history, the terms and conditions on which the Manager offers investment services, its affiliations with other intermediaries, manner of winding up of the Alternative Investment Fund or the scheme and such other information as may be necessary for the investor to take an informed decision on whether to invest in the Alternative Investment Fund.

Schemes

The angel fund may launch schemes subject to filing of a scheme memorandum at least ten working days prior to launch of the scheme with SEBI. Such scheme memorandum shall contain all material information about the investments proposed under such scheme. No scheme of the angel fund shall have more than forty-nine angel investors.

LISTING

Units of close ended Alternative Investment Fund may be listed on stock exchange subject to a minimum

tradable lot of one crore rupees. Listing of Alternative Investment Fund units shall be permitted only after final close of the fund or scheme. Units of angel funds shall not be listed on any recognised stock exchange.

TRANSPARENCY

All Alternative Investment Funds shall ensure transparency and disclosure of information to investors on the following:

- (a) financial, risk management, operational, portfolio, and transactional information regarding fund investments shall be disclosed periodically to the investors;
- (b) any fees prescribed to the Manager or Sponsor; and any fees charged to the Alternative Investment Fund or any investee company by an associate of the Manager or Sponsor shall be disclosed periodically to the investors;
- (c) any inquiries/ legal actions by legal or regulatory bodies in any jurisdiction, as and when occurred;
- (d) any material liability arising during the Alternative Investment Fund's tenure shall be disclosed, as and when occurred;
- (e) any breach of a provision of the placement memorandum or agreement made with the investor or any other fund documents, if any, as and when occurred;
- (f) change in control of the Sponsor or Manager or Investee Company;
- (g) Alternative Investment Fund shall provide at least on an annual basis, within 180 days from the year end, reports to investors including the following information, as may be applicable to the Alternative Investment Fund:-
 - A. financial information of investee companies.
 - B. material risks and how they are managed which may include:
 - (i) concentration risk at fund level;
 - (ii) foreign exchange risk at fund level;
 - (iii) leverage risk at fund and investee company levels;
 - (iv) realization risk (i.e. change in exit environment) at fund and investee company levels;
 - (v) strategy risk (i.e. change in or divergence from business strategy) at investee company level;
 - (vi) reputation risk at investee company level;
 - (vii) extra-financial risks, including environmental, social and corporate governance risks, at fund and investee company level.
- (h) Category III Alternative Investment Fund shall provide quarterly reports to investors in respect of clause (g) within 60 days of end of the quarter;
- (i) any significant change in the key investment team shall be intimated to all investors;
- (j) alternative Investment Funds shall provide, when required by SEBI, information for systemic risk purposes (including the identification, analysis and mitigation of systemic risks).

GENERAL OBLIGATIONS

(1) All Alternative Investment Funds shall review policies and procedures, and their implementation, on a regular basis, or as a result of business developments, to ensure their continued appropriateness.

(2) The Sponsor or Manager of Alternative Investment Fund shall appoint a custodian registered with SEBI for safekeeping of securities if the corpus of the Alternative Investment Fund is more than 500 crore rupees. However, the Sponsor or Manager of a Category III Alternative Investment Fund shall appoint such custodian irrespective of the size of corpus of the Alternative Investment Fund.

(3) All Alternative Investment Funds shall inform SEBI in case of any change in the Sponsor, Manager or designated partners or any other material change from the information provided by the Alternative Investment Fund at the time of application for registration.

(4) In case of change in control of the Alternative Investment Fund, Sponsor or Manager, prior approval from SEBI shall be taken by the Alternative Investment Fund.

(5) The books of accounts of the Alternative Investment Fund shall be audited annually by a qualified auditor.

OBLIGATION OF MANAGER

The Manager shall be obliged to:

- (a) address all investor complaints;
- (b) provide to SEBI any information sought by SEBI;
- (c) maintain all records as may be specified by SEBI;
- (d) take all steps to address conflict of interest as specified in these regulations;
- (e) ensure transparency and disclosure as specified in the regulations.

MAINTENANCE OF RECORDS

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

- (a) the assets under the scheme/fund;
- (b) valuation policies and practices;
- (c) investment strategies;
- (d) particulars of investors and their contribution;
- (e) rationale for investments made.

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

WINDING UP

(1) An Alternative Investment Fund set up as a trust shall be wound up:

- (a) when the tenure of the Alternative Investment Fund or all schemes launched by the Alternative Investment Fund, as mentioned in the placement memorandum is over; or
- (b) if it is the opinion of the trustees or the trustee company, as the case may be, that the Alternative Investment Fund be wound up in the interests of investors in the units; or
- (c) if seventy five percent of the investors by value of their investment in the Alternative Investment Fund pass a resolution at a meeting of unitholders that the Alternative Investment Fund shall be wound up; or
- (d) if SEBI so directs in the interests of investors.

(2) An Alternative Investment Fund set up as a limited liability partnership shall be wound up in accordance with the provisions of the Limited Liability Partnership Act, 2008:

- (a) when the tenure of the Alternative Investment Fund or all schemes launched by the Alternative Investment Fund, as mentioned in the placement memorandum is over; or
- (b) if seventy five percent of the investors by value of their investment in the Alternative Investment Fund pass a resolution at a meeting of unitholders that the Alternative Investment Fund shall be wound up; or
- (c) if SEBI so directs in the interests of investors.

(3) An Alternative Investment Fund set up as a company shall be wound up in accordance with the provisions of the Companies Act, 2013.

(4) An Alternative Investment Fund set up as a body corporate shall be wound up in accordance with the provisions of the statute under which it is constituted.

(5) The trustees or trustee company or the Board of Directors or designated partners of the Alternative Investment Fund, as the case maybe, shall intimate SEBI and investors of the circumstances leading to the winding up of the Alternative Investment Fund.

(6) On and from the date of intimation, no further investments shall be made on behalf of the Alternative Investment Fund so wound up.

(7) Within one year from the date of intimation, the assets shall be liquidated, and the proceeds accruing to investors in the Alternative Investment Fund shall be distributed to them after satisfying all liabilities.

(8) Subject to the conditions, if any, contained in the placement memorandum or contribution agreement or subscription agreement, as the case may be, in specific distribution of assets of the Alternative Investment Fund, shall be made by the Alternative Investment Fund at any time, including on winding up, as per the preference of investors, after obtaining approval of at least 75 % of the investors by value of their investment in the Alternative Investment Fund.

(9) Upon winding up of the Alternative Investment Fund, the certificate of registration shall be surrendered to SEBI.

LIABILITY FOR ACTION IN CASE OF DEFAULT

An Alternative Investment Fund shall be dealt with in the manner provided under the SEBI (Intermediaries) Regulations, 2008, if –

- (a) contravenes any of the provisions of the Act or these regulations;
- (b) fails to furnish any information relating to its activity as an Alternative Investment Fund as required by SEBI;
- (c) furnishes to SEBI information which is false or misleading in any material particular;
- (d) does not submit periodic returns or reports as required by SEBI;
- (e) does not co-operate in any enquiry, inspection or investigation conducted by SEBI;
- (f) fails to resolve the complaints of investors or fails to give a satisfactory reply to SEBI in this behalf,

SEBI (VENTURE CAPITAL FUNDS) REGULATIONS, 1996

These Regulations were notified by SEBI in exercise of the powers conferred by section 30 of SEBI Act, 1992 and took effect from 4th December, 1996.

DEFINITIONS

Venture capital fund under the Regulations means a fund established in the form of a trust or a company including a body corporate and registered under these regulations which—

- (i) has a dedicated pool of capital,

- (ii) raised in a manner specified in the regulations, and
- (iii) invests in venture capital undertaking in accordance with the regulations.

Trust for the purpose means a trust established under the Indian Trusts Act, 1882 or under an Act of Parliament or State Legislation.

Unit means beneficial interest of the investors in the scheme or fund floated by trust or shares issued by a company including a body corporate.

Venture capital undertaking means a domestic company –

- (i) whose shares are not listed on a recognised stock exchange in India;
- (ii) which is engaged in the business for providing services, production or manufacture of article or things or does not include such activities or sectors which are specified in the negative list by SEBI with the approval of the Central Government by notification in the Official Gazette in this behalf.

REGISTRATION OF VENTURE CAPITAL FUNDS

Any company or trust or a body corporate in order to carry on any activity as a venture capital fund on or after the commencement of the regulations have to make an application to SEBI for grant of a certificate. An application for grant of certificate should be made to SEBI in the prescribed form accompanied by a non-refundable application fee as specified. Any company or a body corporate who fails to make an application for grant of a certificate within the period specified should cease to carry on any of its activity as a venture capital fund.

ELIGIBILITY CRITERIA

The applicant for registration as Venture Capital Fund should fulfill the following conditions:

(1) if the application is made by a company, –

- (a) memorandum of association has as its main objective, the carrying on of the activity of a venture capital fund;
- (b) it is prohibited by its memorandum and articles of association from making an invitation to the public to subscribe to its securities;
- (c) its director or principal officer or employee is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant;
- (d) its director, principal officer or employee has not at any time been convicted of any offence involving moral turpitude or any economic offence;
- (e) it is a fit and proper person.

(2) if the application is made by a trust, –

- (a) the instrument of trust is in the form of a deed and has been duly registered under the provisions of the Indian Registration Act, 1908;
- (b) the main object of the trust is to carry on the activity of a venture capital fund;
- (c) the directors of its trustee company, if any, or any trustee is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant;
- (d) the directors of its trustee company, if any, or a trustee has not at any time, been convicted of any offence involving moral turpitude or of any economic offence;
- (e) the applicant is a fit and proper person.

(3) if the application is made by a body corporate –

- (a) it is set up or established under the laws of the Central or State Legislature;
- (b) the applicant is permitted to carry on the activities of a venture capital fund;
- (c) the applicant is a fit and proper person;
- (d) the directors or the trustees, as the case may be, of such body corporate have not been convicted of any offence involving moral turpitude or of any economic offense;
- (e) the directors or the trustees, as the case may be, of such body corporate, if any, is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant.

(4) the applicant has not been refused a certificate by SEBI or its certificate has not been suspended or cancelled.

SEBI may require the applicant to furnish further information, if it considers necessary.

CONSIDERATION OF APPLICATION

An application, which is not complete in all respects should be rejected by SEBI. However before rejecting any such application, the applicant should be given an opportunity to remove, within thirty days of the date of receipt of communication, the objections indicated by SEBI. On being satisfied that it is necessary to extend the period, SEBI can extend such period by such further time not exceeding ninety days.

PROCEDURE FOR GRANT OF CERTIFICATE

SEBI after getting satisfied that the applicant is eligible for the grant of certificate should send intimation to the applicant and after the receipt of intimation, the applicant should pay the registration fee as specified. SEBI on receipt of the registration fee grants a certificate of registration. The venture capital fund should abide by the provisions of the Act. It should not carry on any other activity other than that of a venture capital fund and should forthwith inform SEBI in writing. If any information or particulars previously submitted to SEBI are found to be false or misleading in any material particular or if there is any change in the information already submitted. After considering an application, if SEBI is of the opinion that a certificate should not be granted, it can reject the application after giving the applicant a reasonable opportunity of being heard. The decision of SEBI to reject the application should be communicated to the applicant within thirty days.

EFFECT OF REFUSAL TO GRANT CERTIFICATE

Any applicant whose application has been rejected cannot carry on any activity as a venture capital fund. Thus any company or trust or a body corporate whose application for grant of certificate has been rejected by SEBI should on and from the date of the receipt of the communication ceases to carry on any activity as a venture capital fund. SEBI in the interest of the investors has the right to issue directions with regard to the transfer of records, documents or securities or disposal of investments relating to its activities as a venture capital fund and can also appoint any person to take charge of records, documents, securities and for this purpose also determine the terms and conditions of such an appointment.

INVESTMENT CONDITIONS AND RESTRICTIONS

A venture capital fund can raise monies from any investor whether Indian, foreign or non-resident Indians by way of issue of units. No venture capital fund set up as a company or any scheme of a venture capital fund or set up as a trust can accept any investment from any investor which is less than five lakh rupees. However nothing

applies to investors who are the employees or the principal officer or directors of the venture capital fund, or directors of the trustee company or trustees where the venture capital fund has been established as a trust; or the employees of the fund manager or asset management company. Each scheme launched or fund set up by a venture capital fund should have firm commitment from the investors for contribution of an amount of at least Rupees five crores before the start of operations by the venture capital fund.

Venture capital fund is required to disclose the investment strategy at the time of application for registration and should not invest more than 25% corpus of the fund in one venture capital undertaking. Venture capital fund may invest in Securities of foreign companies subject to such conditions or guidelines that may be stipulated or issued by RBI and SEBI from time to time. It should also not invest in the associated companies. Venture capital fund shall make the investment in the venture capital undertaking as given below:

- (i) at least 66.67% of the investible funds shall be invested in unlisted equity shares or equity linked instruments of venture capital undertaking.
- (ii) not more than 33.33% of the investible funds can be invested by way of subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed; debt or debt instrument of a venture capital undertaking in which the venture capital fund has already made an investment by way of equity, preferential allotment of equity shares of a listed company subject to lock-in period of one year, equity shares or equity linked instrument of financing weak company or a sick individual company whose shares are listed and special purpose vehicles created by VCF for the purpose of facilitating or promoting investment in accordance with these regulations. Venture capital fund shall disclose the duration of life cycle of the fund.

PROHIBITION ON LISTING

No venture capital fund is entitled to get its units listed on any recognized stock exchange till the expiry of three years from the date of the issuance of units by the venture capital fund.

GENERAL OBLIGATIONS AND RESPONSIBILITIES

No venture capital fund can issue any document or advertisement inviting offers from the public for the subscription or purchase of any of its units. A venture capital fund can receive monies for investment in the venture capital fund only through private placement of its units.

MAINTENANCE OF BOOKS AND RECORDS

Every venture capital fund is required to maintain for a period of eight years books of accounts, records and documents which shall give a true and fair picture of the state of affairs of the venture capital fund. Every venture capital fund should intimate SEBI, in writing, the place where the books, records and documents are being maintained.

POWERS OF SEBI

SEBI can at any time call for any information from a venture capital fund with respect to any matter relating to its activity as a venture capital fund. Where any information is called for, it should be furnished within the time specified by SEBI. SEBI may at any time call upon the venture capital fund to file such reports as SEBI may desire with regard to the activities carried on by the venture capital fund.

WINDING UP

A scheme of a venture capital fund set up as a trust should be wound up if –

- (a) the period of the scheme, if any, mentioned in the placement memorandum is over;

- (b) in the opinion of the trustees or the trustee company, that the scheme should be wound up in the interests of investors in the units;
- (c) if seventy five percent of the investors in the scheme pass a resolution at a meeting of unit holders that the scheme be wound up or if SEBI so directs in the interests of investors.

A venture capital fund set up as a company should be wound up in accordance with the provisions of the Companies Act, 2013. It should be wound up in accordance with the provisions of the statute under which it is constituted. The trustees or trustee company of the venture capital fund set up as a trust or Board of Directors in the case of the venture capital fund is set up as a company (including body corporate) should intimate SEBI and investors of the circumstances leading to the winding up of the Fund or Scheme.

No further investments should be made on behalf of the scheme so wound up on and from the date of intimation. Within three months from the date of intimation, the assets of the scheme should be liquidated, and the proceeds accruing to investors in the scheme be distributed to them after satisfying all liabilities.

PLACEMENT MEMORANDUM

The venture capital fund established as a trust before issuing any units file a placement memorandum with SEBI which should give details of the terms subject to which monies are proposed to be raised from investors. A venture capital fund established as a company should before making an offer inviting any subscription to its securities, file with SEBI a placement memorandum which shall give details of the terms subject to which monies are proposed to be raised from the investors.

The placement memorandum should contain the following, namely:

- (i) details of the securities that are being offered;
- (ii) details of investments that are proposed to be made;
- (iii) details of directors of the company;
- (iv) tax implications that are likely to apply to investors;
- (v) manner of subscription to the securities that are to be issued;
- (vi) manner in which the benefits accruing to investors in the securities are to be distributed; and
- (vii) details of the asset management company (AMC), if any, and of fees to be paid to such a company.

The placement memorandum is to be issued for private circulation only after the expiry of twenty-one days of its submission to SEBI. However it has been provided that if within twenty one days of submission of the placement memorandum, SEBI communicates any amendments to the placement memorandum, the venture capital fund should carry out such amendments in the placement memorandum before such memorandum is circulated to the investors.

Amendments or changes to any placement memorandum already filed with SEBI can be made only if a copy of the placement memorandum indicating the changes is filed with SEBI and secondly within twenty one days of such filing, SEBI has not communicated any objections or observations on the said amendments or changes.

INSPECTION AND INVESTIGATION

SEBI can appoint one or more persons as inspecting or investigating officer to undertake inspection or investigation of the books of accounts, records and documents relating to a venture capital fund for any of the following reasons:

- (a) to ensure that the books of account, records and documents are being maintained by the venture capital fund in the manner specified in these regulations;

- (b) to inspect or investigate into complaints received from investors, clients or any other person, on any matter having a bearing on the activities of the venture capital fund;
- (c) to ascertain whether the provisions of the Act and regulations are being complied with by the venture capital fund; and
- (d) to inspect or investigate *suo moto* into the affairs of a venture capital fund, in the interest of the securities market or in the interest of investors.

NOTICE BEFORE INSPECTION OR INVESTIGATION

Before ordering an inspection or investigation SEBI should give notice to the venture capital fund. Where SEBI is satisfied that it is in the interest of the investors no such notice should be given, it can through order in writing direct that the inspection or investigation of the affairs of the venture capital fund be taken up without such notice. During the course of an inspection or investigation, the venture capital fund against whom the inspection or investigation is being carried out should be bound to discharge its obligations as provided in regulation.

OBLIGATION OF VENTURE CAPITAL FUND ON INSPECTION OR INVESTIGATION

It is the duty of every officer of the Venture Capital Fund in respect of whom an inspection or investigation has been ordered and any other associate person who is in possession of relevant information pertaining to conduct and affairs of such Venture Capital Fund including fund manager or asset management company, if any, to produce to the Investigating or Inspecting Officer such books, accounts and other documents in his custody or control and furnish him with such statements and information as the said Officer may require for the purposes of the investigation or inspection. Every officer of the Venture Capital Fund and any other associate person who is in possession of relevant information pertaining to conduct and affairs of the Venture Capital Fund required to give to the Inspecting or Investigating Officer all such assistance and should extend all such co-operation as required in connection with the inspection or investigations and should also furnish such information sought by the inspecting or investigating officer in connection with the inspection or investigation.

The Investigating or Inspecting Officer for the purposes of inspection or investigation has the power to examine and record the statement of any employees, directors or person responsible for or connected with the activities of venture capital fund or any other associate person having relevant information pertaining to such Venture Capital Fund. The Inspecting or Investigating Officer should for the purposes of inspection or investigation, have power to obtain authenticated copies of documents, books, accounts of Venture Capital Fund, from any person having control or custody of such documents, books or accounts.

SUBMISSION OF REPORT

The inspecting or investigating officer as soon as possible on completion of the inspection or investigation submits an inspection or investigation report to SEBI. However if directed by SEBI, he may submit an interim report.

COMMUNICATION OF FINDINGS

SEBI after consideration of the investigation or inspection report and after giving reasonable opportunity of hearing to the venture capital fund or its trustees, directors issue such direction as it deems fit in the interest of securities market or the investors including directors in the nature of:

- (a) requiring a venture capital fund not to launch new schemes or raise money from investors for a particular period;

- (b) prohibiting the person concerned from disposing of any of the properties of the fund or scheme acquired in violation of these regulations;
- (c) requiring the person connected to dispose of the assets of the fund or scheme in a manner as specified in the directions;
- (d) requiring the person concerned to refund any money or the assets to the concerned investors along with the requisite interest or otherwise, collected under the scheme;
- (e) prohibiting the person concerned from operating in the capital market or from accessing the capital market for a specified period.

PROCEDURE FOR ACTION IN CASE OF DEFAULT

A venture capital fund which –

- (a) contravenes any of the provisions of the Act or these regulations;
- (b) fails to furnish an information relating to its activity as venture capital fund as required by SEBI;
- (c) furnishes to SEBI information which is false or misleading in any material particular;
- (d) does not submit periodic returns or reports as required by SEBI;
- (e) does not co-operate in any enquiry, inspection or investigation conducted by SEBI;
- (f) fails to resolve the complaints of investors or fails to give a satisfactory reply to SEBI in this behalf, should be dealt with in the manner provided in Chapter V of SEBI (Intermediaries) Regulations, 2008.

SEBI (FOREIGN VENTURE CAPITAL INVESTORS) REGULATIONS, 2000

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

APPLICATION FOR GRANT OF CERTIFICATE

The applicant is required to make an application along with the registration fee to SEBI for the purposes of seeking registration in the form specified.

ELIGIBILITY CRITERIA

SEBI assesses the application of VCF on the following criteria:

- (i) the applicants track record, professional competence, financial soundness, experience, general reputation of fairness and integrity;
- (ii) whether the applicant has been granted necessary approval by the Reserve Bank of India for making investments in India;
- (iii) whether the applicant is an investment company, investment trust, investment partnership, pension fund, mutual fund, endowment fund, university fund, charitable institution or any other entity incorporated outside India; or
- (iv) whether the applicant is an asset management company, investment manager or investment management company or any other investment vehicle incorporated outside India;
- (v) whether the applicant is authorised to invest in venture capital fund or carry on activity as a foreign venture capital investors;

- (vi) whether the applicant is regulated by an appropriate foreign regulatory authority or is an income tax payer; or submits a certificate from its banker of its or its promoter's track record where the applicant is neither a regulated entity nor an income tax payer;
- (vii) the applicant has not been refused a certificate by SEBI;
- (viii) whether the applicant is a fit and proper person.

SEBI may require the applicant to furnish further information, if it considers necessary. An application which is not complete in all respects is rejected by SEBI. However before rejecting any such application, it has been provided in the Regulations that the applicant should be given an opportunity to remove, within thirty days of the date of receipt of communication, the objections indicated by SEBI. SEBI may, on being satisfied that it is necessary to extend the period specified above may extend such period but not beyond ninety days.

PROCEDURE FOR GRANT OF CERTIFICATE

If SEBI is satisfied that the applicant is eligible for the grant of certificate, it should send intimation to the applicant and on the receipt of intimation, the applicant has to pay the registration fee specified in Part A of the second schedule in the manner specified in Part B thereof. SEBI on receipt of the registration fee grants a certificate of registration in Form B.

PROCEDURE WHERE CERTIFICATE IS NOT GRANTED

However after considering an application, if SEBI is of the opinion that a certificate should not be granted, it may reject the application after giving the applicant a reasonable opportunity of being heard. The decision of SEBI to reject the application should be communicated to the applicant. Any applicant whose application has been rejected should not carry on any activity as a Foreign Venture Capital Investor.

CONDITIONS OF CERTIFICATE

The certificate to be granted to the foreign venture capital is subject to the the conditions that:

- (i) it should abide by the provisions of the Act, and these regulations;
- (ii) it should appoint a domestic custodian for purpose of custody of securities;
- (iii) it should enter into arrangement with a designated bank for the purpose of operating a special non-resident rupee or foreign currency account;
- (iv) it should forthwith inform SEBI in writing if any information or particulars previously submitted to SEBI are found to be false or misleading in any material particular or if there is any change in the information already submitted.

INVESTMENT CRITERIA FOR A FOREIGN VENTURE CAPITAL INVESTOR

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

- (a) it should disclose to SEBI its investment strategy.
- (b) it can invest its total funds committed in one venture capital fund.
- (c) it shall make investments as enumerated below:
 - (i) atleast 66.67% of the investible funds should be invested in unlisted equity shares or equity linked instruments of venture capital undertaking.

- (ii) not more than 33.33% of the investible funds may be invested by way of:
- (a) subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed;
 - (b) debt or debt instrument of a venture capital undertaking in which the foreign venture capital investor has already made an investment by way of equity.
 - (c) preferential allotment of equity shares of a listed company subject to lock in period of one year.
 - (d) the equity shares or equity linked instruments of a financially weak company or a sick industrial company whose shares are listed.
 - (e) Special Purpose Vehicles which are created for the purpose of facilitating or promoting investment in accordance with these Regulations.

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

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

MAINTENANCE OF BOOKS AND RECORDS

Every Foreign Venture Capital Investor is required to maintain for a period of eight years, books of accounts, records and documents which should give a true and fair picture of the state of affairs of the Foreign Venture Capital Investor. Every Foreign Venture Capital Investor should intimate to SEBI, in writing, the place where the books, records and documents are being maintained.

POWER TO CALL FOR INFORMATION

SEBI may at any time call for any information from a Foreign Venture Capital Investor with respect to any matter relating to its activity as a Foreign Venture Capital Investor. In case any information is called for, it should be furnished within the time specified by SEBI.

GENERAL OBLIGATIONS AND RESPONSIBILITIES

Foreign Venture Capital Investor or a global custodian acting on behalf of the foreign venture capital investor should enter into an agreement with the domestic custodian to act as a custodian of securities for Foreign Venture Capital Investor. Foreign Venture Capital Investor should ensure that domestic custodian takes steps for monitoring of investment of Foreign Venture Capital Investors in India, furnishing of periodic reports to SEBI and furnishing such information as may be called for by SEBI.

APPOINTMENT OF DESIGNATED BANK

Foreign Venture Capital Investor is required to appoint a branch of a bank approved by Reserve Bank of India as designated bank for opening of foreign currency denominated accounts or special non-resident rupee account.

INSPECTION OR INVESTIGATION

SEBI may, *suo moto* or upon receipt of information or complaint, cause an inspection or investigation to be made in respect of conduct and affairs of any foreign venture capital investor by an Officer whom SEBI considers fit:

- (i) to ensure that the books of account, records and documents are being maintained by the foreign venture capital investor in the manner specified in these regulations and to inspect or investigate into complaints received from investors, clients or any other person, on any matter having a bearing on the activities of the foreign venture capital investor;

- (ii) to ascertain whether the provisions of the Act and these regulations are being complied with by the foreign venture capital investor and to inspect or investigate *suo moto* into the affairs of a foreign venture capital investor in the interest of the securities market or in the interest of investors.

OBLIGATIONS OF FOREIGN VENTURE CAPITAL INVESTOR

It should be the duty of every Foreign Venture Capital Investor in respect of whom an inspection or investigation has been ordered and any other person associated who is in possession of relevant information pertaining to conduct and affairs of such Foreign Venture Capital Investor including asset management company or fund manager, to produce to the Inspecting or Investigating Officer such books, accounts and other documents in his custody or control and furnish him with such statements and information as the said officer may require for the purposes of the inspection or investigation. It should be the duty of Foreign Venture Capital Investor and any other person associated who is in possession of relevant information pertaining to conduct and affairs of the Foreign Venture Capital Investor to give to the Inspecting or Investigating Officer all such assistance and shall extend all such co-operation as may be required in connection with the inspections or investigations and shall furnish such information sought by the Inspecting or Investigating Officer in connection with the inspections or investigations. The Inspecting or Investigating Officer have the power to examine on oath and record the statement of any person responsible for or connected with activities of Foreign Venture Capital Investor or any other person associated having relevant information pertaining to such Foreign Venture Capital Investor. The Inspecting or Investigating Officer has the power to get authenticated copies of documents, books, accounts of Foreign Venture Capital Investor, from any person having control or custody of such documents, books or accounts. The Inspecting or Investigating Officer submits a report to SEBI after the completion of inspection or investigations.

POWERS OF SEBI

SEBI after considering investigation report and giving a reasonable opportunity of hearing to the Foreign Venture Capital Investor, require the Venture Capital Fund to take such measure or issue such directions as it deems fit in the interest of capital market and investors, including directions requiring the person concerned to dispose of the securities or disinvest in a manner as may be specified in the directions; or requiring the person concerned not to further invest for a particular period; or prohibiting the person concerned from operating in the capital market in India for a specified period.

SUSPENSION/CANCELLATION OF CERTIFICATE

SEBI after considering the investigation report, initiate action for suspension or cancellation of the registration of such Foreign Venture Capital Investor. However no such certificate of registration shall be suspended or cancelled unless the procedure specified in regulation has been complied with.

SEBI may suspend the certificate if the Foreign Venture Capital Investor contravenes any of the provisions of the Act or these regulations or fails to furnish any information relating to its activity as a Foreign Venture Capital Investor as required by SEBI or furnishes to SEBI information which is false or misleading in any material particular or does not submit periodic returns or reports as required by SEBI or does not co-operate in any enquiry or inspection conducted by SEBI.

SEBI may cancel the certificate granted to a Foreign Venture Capital Investor if the Foreign Venture Capital Investor is guilty of fraud or has been convicted of an offence involving moral turpitude. Also SEBI may cancel the certificate if the Foreign Venture Capital Investor has been guilty of repeated defaults of the nature mentioned in the regulation or Foreign Venture Capital Investor does not continue to meet the eligibility criteria laid down in the regulations or contravenes any of the provisions of the Act or regulations.

ENQUIRY UNDER THE REGULATIONS

No order of penalty or cancellation of certificate should be imposed on the Foreign Venture Capital Investor except after holding an enquiry in accordance with the procedure specified in Chapter V of the SEBI (Intermediaries) Regulations, 2008.

APPEAL TO SECURITIES APPELLATE TRIBUNAL

Any person aggrieved by an order of SEBI may prefer an appeal to the Securities Appellate Tribunal.

ACTION AGAINST INTERMEDIARY

SEBI may initiate action for suspension or cancellation of registration of an intermediary holding a certificate of registration under section 12 of the Act who fails to exercise due diligence in the performance of its functions or fails to comply with its obligations under these regulations.

However, no such certificate of registration shall be suspended or cancelled unless the procedure specified in the regulations applicable to such intermediary is complied with.

LESSON ROUND UP

- SEBI notified the Alternative Investment Fund (AIF) Regulations to govern unregulated entities and create a level playing ground for existing venture capital investors.
- This Regulation has replaced the existing SEBI (Venture Capital Funds) Regulations, 1996. Funds registered under the VCF Regulations shall continue to be regulated by the said regulations till the existing fund or scheme is wound up.
- SEBI has classified AIF into the three broad categories i.e. Category I, Category II, Category III.
- All AIFs are required to be mandatorily registered under any one of the above mentioned categories.
- Any AIF/scheme shall not have more than 1,000 investors.
- Alternative Investment Fund can raise funds through private placement by issue of information memorandum or placement memorandum, by whatever name called.
- Listing of Alternative Investment Fund units shall be permitted only after final close of the fund or scheme.
- The records maintained by the Manager/Sponsor is required to be maintained for a period of five years after the winding up of the fund.

GLOSSARY

Corpus	– It means the total amount of funds committed by investors to the Alternative Investment Fund by way of a written contract or any such document as on a particular date.
Investee Company	– It means any company, special purpose vehicle or limited liability partnership or body corporate in which an AIF makes an investment.
Manager	– Manager means any person or entity who is appointed by the Alternative Investment Fund to manage its investments by whatever name called and may also be same as the sponsor of the Fund.
Unit	– Unit means beneficial interest of the investors in the Alternative Investment Fund or a scheme of the Alternative Investment Fund and shall include shares or partnership interests.

Lesson 10

Collective Investment Schemes

LESSON OUTLINE

- Introduction
- SEBI (Collective Investment Schemes) Regulations, 1999 – An Overview
- Application Fee to accompany the Application
- Furnishing of Information
- Conditions for Eligibility
- Grant of Certificate
- Terms and Conditions
- Procedure where registration is not granted
- Restriction on Business Activities
- Obligations of Collective Investment Management Company (CIMC)
- Submission of Information and Documents
- Trustees and their Obligations
- Contents of Trust Deed
- Eligibility for Appointment as Trustee
- Termination of Trusteeship
- Termination of the Agreement with the CIMC
- Procedure for Launching of Schemes
- Disclosures in the Offer Document
- Allotment of Units and Refunds of Money
- Unit Certificates
- Transfer of Units
- Investments and Segregation of Funds
- Listing of schemes
- Winding up of schemes
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

A collective investment scheme is a trust based scheme that comprises a pool of assets that is managed by a collective investment scheme manager and is governed by the Collective Investment Schemes Regulations given by SEBI. Collective Investment Schemes provide a relatively secure means of investing on the Stock Exchange and other financial instruments. The sums of money that are exchanged on the Stock Exchange and in the money markets make them too pricy for most people. With a CIS, the money or funds form a group of investors are pooled or collected together to form a CIS portfolio.

This lesson gives the student an overview of the Collective Investment Scheme and Collective Investment Managed Companies (CIMC) with the features, procedure of registration of such company, responsibilities of CIMC, submission of information and documents by CIMC, content of the offer document etc.

INTRODUCTION

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

In order to strengthen the hands of SEBI to protect interests of investors in plantation companies, the Securities Laws (Amendment) Act, 1999 amended the definition of 'securities' in the SCRA so as to include within its ambit the units or any other instruments issued by any CIS to the investors in such schemes. The Act also inserted a definition of the CIS in the Securities and Exchange Board of India Act, 1992.

According to SEBI Act, 1992, 'Collective Investment Scheme' means any scheme or arrangement which satisfies the conditions specified in section 11AA.

Section 11AA provides that any scheme or arrangement which satisfies the conditions referred to in sub-section (2) or sub-section (2A) shall be a collective investment scheme.

Provided that any pooling of funds under any scheme or arrangement, which is not registered with SEBI or is not covered under sub-section (3), involving a corpus amount of one hundred crore rupees or more shall be deemed to be a collective investment scheme.

Sub-section (2) lays down that any scheme or arrangement made or offered by any person under which,—

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

Sub-section 2A provides that any scheme or arrangement made or offered by any person satisfying the conditions as may be specified in accordance with the regulations made under this Act.

(3) Notwithstanding anything contained in sub-section (2) or sub-section (2A) any scheme or arrangement –

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

- (iii) being a contract of insurance to which the Insurance Act, 1938, applies;
- (iv) providing for any Scheme, Pension Scheme or the Insurance Scheme framed under the Employees Provident Fund and Miscellaneous Provisions Act, 1952;
- (v) under which deposits are accepted under section 74 of the Companies Act, 2013;
- (vi) under which deposits are accepted by a company declared as a Nidhi or a mutual benefit society under section 406 of the Companies Act, 2013;
- (vii) falling within the meaning of Chit business as defined in clause (d) of section 2 of the Chit Fund Act, 1982;
- (viii) under which contributions made are in the nature of subscription to a mutual fund;
- (ix) such other scheme or arrangement which the Central Government may, in consultation with SEBI, notify, shall not be a collective investment scheme.

SEBI (COLLECTIVE INVESTMENT SCHEMES) REGULATIONS, 1999 – AN OVERVIEW

SEBI (Collective Investment Schemes) Regulations, 1999 defines Collective Investment Management Company to mean a company incorporated under the Companies Act, 2013 and registered with SEBI under these regulations, whose object is to organize, operate and manage a collective investment.

No person other than a Collective Investment Management Company which has obtained a certificate under the regulations should carry on or sponsor or launch a collective investment scheme. Any person proposing to carry any activity as a Collective Investment Management Company on or after the commencement of the regulations should make an application to SEBI for the grant of registration in the specified form.

APPLICATION FEE TO ACCOMPANY THE APPLICATION

Every application for registration should be accompanied by a non-refundable application fee as specified in Schedule Second. An application, which is not complete in all respects or does not conform to the requirements, should be rejected by SEBI. However, before rejecting any such application, the applicant is given an opportunity to remove within one month such objections as indicated by SEBI. The regulation further provides that SEBI can extend the time where sufficient reason is being given by the applicant that efforts have been taken to remove such deficiency.

FURNISHING OF INFORMATION

SEBI can direct the applicant to furnish such further information or clarification as may be required by it, for the purpose of processing the application. SEBI, if it so desires can also ask the applicant or its authorised representative to appear before SEBI for personal representation in connection with the grant of a certificate.

CONDITIONS FOR ELIGIBILITY

The applicant should satisfy the following eligibility criteria:

- (a) the applicant is set up and registered as a company under the Companies Act, 2013;
- (b) the applicant has specified the managing of collective investment scheme as one of its main objects in its Memorandum of Association;
- (c) the applicant has a net worth of not less than rupees five crores. However, at the time of making the application, the applicant shall have a minimum net worth of rupees three crores which has to be increased to rupees five crores within the time period of three years from the date of grant of registration;
- (d) the applicant is a fit and proper person for the grant of such certificate;

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- (e) the applicant has adequate infrastructure to operate collective investment scheme in accordance with the provision of these regulations;
- (f) the directors or key personnel of the applicant should consist of persons of honesty and integrity having adequate professional experience in related field and have not been convicted for an offence involving moral turpitude or for any economic offence or for the violation of any securities laws;
- (g) at least fifty per cent of the directors of such Collective Investment Management Company shall consist of independent directors and are not directly or indirectly associated with the persons who have control over the Collective Investment Management Company;
- (h) no person, directly or indirectly connected with the applicant has in the past been refused registration by SEBI under the Act;
- (i) at least one of the directors on the board of the Collective Investment Management Company, who is not subject to retirement, is a representative of the trustee;
- (j) the Collective Investment Management Company is not a trustee of any collective investment scheme.
- (k) in case the applicant is an existing collective investment scheme, it complies with the provisions of Chapter IX of the these regulations.

GRANT OF CERTIFICATE

SEBI shall grant certificate of registration to the applicant on such terms and conditions as in the interest of investors and specified, in case the following is fulfilled:

- An application without deficiencies has been received,
- Applicant has complied with specified requirements,
- Registration fees has been called upon by SEBI and duly paid by the applicant.

TERMS AND CONDITIONS

The certificate granted should be subject to following conditions:

- (a) any director of the CIMC should not be a director in any other CIMC unless such person is an independent director and approval of the Board of CIMC of which such person is an independent director, has been obtained;
- (b) the CIMC should forthwith inform SEBI of any material change in the information or particulars previously furnished, which have a bearing on the certificate granted by it;
- (c) appointment of a director of a CIMC should be made with the prior approval of the trustee;
- (d) the CIMC should comply with provisions of the Act and these regulations;
- (e) no change in the controlling interest of the CIMC shall be made without obtaining prior approval of SEBI, the trustee and the unit holders holding at-least one-half of the nominal value of the unit capital of the scheme.
- (f) CIMC should take adequate steps to redress the grievances of the investors within one month from the date of receipt of the complaint from the aggrieved investor.

PROCEDURE WHERE REGISTRATION IS NOT GRANTED

SEBI may reject the application, if it does not satisfy the conditions specified in regulation. It gives a reasonable opportunity of being heard to the applicant. The decision should be communicated to the applicant by SEBI within 30 days of such decision, stating therein the grounds on which the application has been rejected.

RESTRICTIONS ON BUSINESS ACTIVITIES

The Collective Investment Management Company should not:

- (i) undertake any activity other than that of managing the scheme;
- (ii) act as a trustee of any scheme;
- (iii) launch any scheme for the purpose of investing in securities;
- (iv) invest in any schemes floated by it.

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

OBLIGATIONS OF COLLECTIVE INVESTMENT MANAGEMENT COMPANY

Every Collective Investment Management Company should:

- (i) be responsible for managing the funds or properties of the scheme on behalf of the unit holders and take all reasonable steps and exercise due diligence to ensure that the scheme is managed in accordance with the provisions of these regulations, the offer document and the trust deed;
- (ii) exercise due diligence and care in managing assets and funds of the scheme and also responsible for the acts of commissions and omissions by its employees or the persons whose services have been availed by it;
- (iii) remain liable to the unit holders for its acts of commission or omissions, notwithstanding anything contrary contained in any contract or agreement and be incompetent to enter into any transaction with or through its associates, or their relatives relating to the scheme. However, in case the CIMC enters into any transactions relating to the scheme with any of its associates, a report to that effect should immediately be sent to the trustee and to SEBI;
- (iv) appoint registrar and share transfer agents and should also abide by their respective Code of Conducts as specified in the Third Schedule;
- (v) give receipts for all monies received and report of the receipts and payments to SEBI, on monthly basis;
- (vi) hold a meeting of Board of Directors to consider the affairs of scheme, at least twice in every three months and also ensures that its officers or employees do not make improper use of their position or information to gain, directly or indirectly, an advantage for themselves or for any other person or to cause detriment to the scheme;
- (vii) obtain adequate insurance against the properties of the schemes and comply with such guidelines, directives, circulars and instructions as may be issued by SEBI from time to time on the subject of Collective Investment Scheme i.e. as the end of March, June, September and December.

SUBMISSION OF INFORMATION AND DOCUMENTS

The Collective Investment Management Company should prepare quarterly reports of its activities and the status of compliance of SEBI regulations and submit the same to the trustees within one month of the expiry of each quarter. The Collective Investment Management Company should file with the trustees and SEBI, particulars of all its directors along with their interest in other companies within fifteen days of their appointment. It should furnish a copy of the Balance Sheet, Profit and Loss Account; a copy of the summary of the yearly appraisal report and such other information as may be required, to the unit holders, to SEBI and the trustees within two months from the closure of financial year.

TRUSTEES AND THEIR OBLIGATIONS

A scheme should be constituted in the form of a trust and the instrument of trust should be framed in the form of a deed duly registered under the provisions of the Indian Registration Act, 1908 executed by the CIMC in favour of the trustees named in such an instrument. It can appoint a trustee under the deed to hold the assets of the scheme for the benefit of unit holders.

CONTENTS OF TRUST DEED

The trust deed should contain such clauses as are specified and other clauses as are necessary for safeguarding the interests of the unit holders. No trust deed should contain a clause which has the effect of limiting or extinguishing the obligations and liabilities of the Collective Investment Management Company in relation to any scheme or the unit holders; or indemnifying the trustee or the Collective Investment Management Company for loss or damage caused to the unit holders by their acts of negligence or acts of commissions or omissions.

ELIGIBILITY FOR APPOINTMENT AS TRUSTEE

The persons registered with SEBI as Debenture Trustee under SEBI (Debenture Trustee) Regulations, 1993 are only eligible to be appointed as trustees of collective investment schemes. However, no person is eligible to be appointed as trustee, if he is directly or indirectly associated with the persons who have control over the CIMC. The CIMC shall furnish to SEBI particulars in respect of trustees appointed in the prescribed form.

No person should be appointed as trustee of a scheme, if he has been found guilty of an offence under the securities laws or SEBI or any authority to which SEBI has delegated its power has passed against such person, an order under the Act for violation of any provision of the Act or of regulations made hereunder.

The trustee and the Collective Investment Management Company should enter into an agreement for managing the schemes' property. The agreement for managing the scheme property should contain clauses as specified and such other clauses as are necessary for the purpose of fulfilling the objectives of the scheme.

RIGHTS AND OBLIGATIONS OF THE TRUSTEE

The trustee have a right to obtain from the CIMC such information as is considered necessary by the trustee and to inspect the books of accounts and other records relating to the scheme. The trustee should ensure that the CIMC has;

- (i) the necessary office infrastructure;
- (ii) appointed all key personnel including managers for the schemes and submitted their bio-data which shall contain the educational qualifications and past experience in the areas relevant for fulfilling the objectives of the schemes;
- (iii) appointed auditors from the list of auditors approved by SEBI to audit the accounts of the scheme;
- (iv) appointed a compliance officer to comply with the provisions of the Act and these regulations and to redress investor grievances;
- (v) appointed registrars to an issue and share transfer agent.
- (vi) prepared a compliance manual and designed internal control mechanisms including internal audit systems;
- (vii) taken adequate insurance for the assets of the scheme;
- (viii) not given any undue or unfair advantage to any associates of the company or dealt with any of the associates in any manner detrimental to the interest of the unit holders;
- (ix) operated the scheme in accordance with the provisions of the trust deed, these regulations and the offer document of the scheme(s);

- (x) undertaken the activity of managing schemes only;
- (xi) taken adequate steps to ensure that the interest of investors of one scheme are not compromised with the object of promoting the interest of investors of any other scheme;
- (xii) minimum networth on a continuous basis and shall inform SEBI immediately of any shortfall;
- (xiii) been diligent in empanelling the marketing agents and in monitoring their activities.

The trustee should forthwith take such remedial steps as are necessary and immediately inform SEBI of the action taken where the trustee believes that the conduct of business of the scheme is not in accordance with the regulations. The trustee should be accountable for, and act as the custodian of the funds and property of the respective schemes and should hold the same in trust for the benefit of the unit holders in accordance with these regulations and the provisions of trust deed. The trustee should be responsible for the calculation of any income due to be paid to the scheme and also for any income received in the scheme to the unit holders. The trustee is required to convene a meeting of the unit holders on requisition of SEBI or unit holders holding at least one-tenth of nominal value of the unit capital of any scheme or when any change in the fundamental attributes of any scheme which affects the interest of the unit holders is proposed to be carried out. However, no such change should be carried out unless the consent of unit holders holding at least three-fourths of nominal value of the unit capital of the scheme is obtained.

The trustee should review on a quarterly basis i.e. by the end of March, June, September, and December every year :

- all activities carried out by the CIMC;
- periodically all service contracts relating to registrars to an issue and share transfer agents and satisfy itself that such contracts are fair and reasonable in the interest of the unit holders;
- investor complaints received and the redressal of the same.

The trustee should ensure that net worth of CIMC is not deployed in a manner which is detrimental to interest of unit holders and also that the property of each scheme is clearly identifiable as scheme property and held separately from property of the CIMC. Clearances or no objection certificate should be obtained, in respect of transactions relating to property of the scheme from such authority as is competent to grant such clearance or no objection certificate. The trustee should abide by the Code of Conduct as specified in the Third Schedule. The trustee is required to furnish to SEBI on a quarterly basis every year, a report on the activities of the scheme and a certificate stating that the trustee has satisfied himself that affairs of the Collective Investment Management Company and of the various schemes are conducted in accordance with these regulations and investment objective of each scheme.

The trustee should cause:

- (a) the profit and loss accounts and balance sheet of the schemes to be audited at the end of each financial year by an auditor empanelled with SEBI.
- (b) each scheme to be appraised at the end of each financial year by an appraising agency.
- (c) scheme to be rated by a credit rating agency.

A meeting of the trustees to discuss the affairs of the scheme should be held at least twice in every three months. The trustee should report to SEBI any breach of these regulations that has, or is likely to have, made materially adverse effect on the interests of unit holders, as soon as they become aware of the breach. The trustee should ensure that the fees and expenses of the scheme are within the limits as specified and the accounts of the schemes are drawn up in accordance with the accounting norms as specified and should comply with accounts of the scheme and the format of the balance sheet and the profit and loss account as specified in these regulation.

TERMINATION OF TRUSTEESHIP

The trusteeship of a trustee should come to an end –

- (a) If the trustee ceases to be trustee under SEBI (Debentures Trustees) Regulations, 1993; or
- (b) if the trustee is in the course of being wound up; or
- (c) if unit holders holding at least three-fourths of the nominal value of the unit capital of the scheme pass a resolution for removing the trustee and SEBI approves such resolution; or
- (d) if in the interest of the unit holders, SEBI, for reasons to be recorded in writing decides to remove the trustee for any violation of the Act or these regulations committed by them or the trustee should be afforded reasonable opportunity of being heard before action is taken under this clause;
- (e) if the trustee serves on the Collective Investment Management Company, a notice of not less than three months expressing intention of not to continue as trustee.

In such cases, another trustee should be appointed by the CIMC on the termination of the trusteeship. The appointment of the new trustee should be completed within three months from the date of termination of the previous trusteeship. If CIMC is unable to appoint trustee in requisite time period of three months, then SEBI can appoint any person as a trustee from its empanelled list. The new trustee appointed should stand substituted as trustee in all the documents, to which the trustee so removed was a party. A trust deed in the prescribed form as specified in these regulation shall be executed by the CIMC in favour of the trustee so appointed and from the date of such appointment trustees shall be subject to all the rights and duties as specified in these regulations. The trustees so removed shall from such date be discharged from complying with the obligations under the trust deed but shall remain liable for any action taken by them before such removal. The person appointed by SEBI should apply to the Court for an order directing the CIMC to wind up the scheme.

TERMINATION OF THE AGREEMENT WITH THE COLLECTIVE INVESTMENT MANAGEMENT COMPANY

The agreement entered into by the trustee with the Collective Investment Management Company may be terminated –

- (a) if the CIMC is in the course of being wound up as per the provisions of the Companies Act, 2013 or;
- (b) if unit holders holding at least three-fourth of the nominal value of the unit capital of the scheme pass a resolution for terminating the agreement with the CIMC and the prior approval of SEBI has been obtained, or
- (c) if in the interest of the unit holders, SEBI or the trustee after obtaining prior approval of SEBI, and after giving an opportunity of being heard to the Collective Investment Management Company, decide to terminate the agreement with the CIMC.

Another CIMC registered with SEBI, should be appointed upon the termination of agreement by the trustee within three months from the date of such termination. The CIMC so removed continues to act as such at the discretion of trustee or the trustee itself may act as CIMC till such time as new CIMC is appointed. The CIMC appointed should stand substituted as a party in all the documents to which the CIMC so removed was a party. The CIMC so removed should continue to be liable for all acts of omission and commissions notwithstanding such termination. If, none of the CIMC, registered under the regulations, consent to be appointed as CIMC within a further period of three months, then the trustee may wind up the scheme. An agreement for managing scheme property should be executed in favour of the new CIMC subject to all the rights and duties as specified in the regulations.

PROCEDURE FOR LAUNCHING OF SCHEMES

No scheme should be launched by the CIMC unless such scheme is approved by the Trustee and rated by a registered credit rating agency and appraised by an appraising agency.

DISCLOSURES IN THE OFFER DOCUMENT

The CIMC shall before launching any scheme file a copy of the offer document of the scheme with SEBI and pay filing fees as specified. The offer document should contain such information as specified. The offer document should also contain true and fair view of the scheme and adequate disclosures to enable the investors to make informed decision. SEBI may in the interest of investors require the CIMC to carry out such modifications in the offer document as it deems fit. In case no modifications are suggested by SEBI in the offer document within 21 days from the date of filing, the Collective Investment Management Company may issue the offer document to public.

ALLOTMENT OF UNITS AND REFUNDS OF MONEY

The Collective Investment Management Company should specify in the offer document the minimum and the maximum subscription amount it seeks to raise under the scheme; and in case of oversubscription, the process of allotment of the amount oversubscribed. The CIMC should refund the application money to the applicants, if the scheme fails to receive the minimum subscription amount. Any amount refundable should be refunded within a period of six weeks from the date of closure of subscription list, by Registered A.D. and by cheque or demand draft. In the event of failure to refund the amounts within the period specified, the CIMC has to pay interest to the applicants at a rate of fifteen percent per annum on the expiry of six weeks from the date of closure of the subscription list. A Scheme shall not be open for more than 90 days.

UNIT CERTIFICATES

The Collective Investment Management Company should issue to the applicant whose application has been accepted, unit certificates as soon as possible but not later than six weeks from the date of closure of the subscription list. However, if the units are issued through a depository, a receipt in lieu of unit certificate will be issued as per provisions of SEBI (Depositories and Participants) Regulations, 1996 and bye-laws of the depository.

TRANSFER OF UNITS

A unit certificate issued under the scheme should be freely transferable. The CIMC on production of instrument of transfer together with relevant unit certificates, register the transfer and return the unit certificate to the transferee within thirty days from the date of such production. However, if the units are held in a depository such units shall be transferable in accordance with the provisions of the SEBI (Depositories and Participants) Regulations, 1996 and bye-laws of the depository.

The subscription amount received should be kept in a separate bank account in the name of the scheme and utilised for –

- (1)(a) adjustment against allotment of units only after the trustee has received a statement from the registrars to the issue and share transfer agent regarding minimum subscription amount, as stated in the offer document, having been received from the public, or
- (b) for refund of money in case minimum subscription amount, as stated in the offer document, has not been received or in case of over-subscription.
- (2) The minimum subscription amount as specified in the offer document couldn't be less than the minimum amount, as specified by the appraising agency, needed for completion of the project for which the scheme is being launched.
- (3) The moneys credited to the account of the scheme should be utilised for the purposes of the scheme and as specified in the offer document.
- (4) Any unutilised amount lying in the account of the scheme should be invested in the manner as disclosed in the offer document.

INVESTMENTS AND SEGREGATION OF FUNDS

The Collective Investment Management Company should:

- (a) not invest the funds of the scheme for purposes other than the objective of the scheme as disclosed in the offer document.
- (b) segregate the assets of different schemes.
- (c) not invest corpus of a scheme in other schemes.
- (d) not transfer funds from one scheme to another scheme.

However, it has been provided that inter scheme transfer of scheme property may be permitted at the time of termination of the scheme with prior approval of the trustee and SEBI.

LISTING OF SCHEMES

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

WINDING UP OF SCHEME

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

- (a) on the happening of any event which, in the opinion of the trustee, requires the scheme to be wound up and the prior approval of SEBI is obtained; or
- (b) if unit holders of a scheme holding at least three-fourth of the nominal value of the unit capital of the scheme, pass a resolution that the scheme be wound up and the approval of SEBI is obtained thereto; or
- (c) if in the opinion of SEBI, the continuance of the scheme is prejudicial to the interests of the unit-holders; or
- (d) if in the opinion of the CIMC, the purpose of the scheme cannot be accomplished and it obtains the approval of the trustees and that of the unit holders of the scheme holding at least three-fourth of the nominal value of the unit capital of the scheme with a resolution that the scheme be wound up and the approval of SEBI is obtained thereto.

Where a Scheme is to be wound up, the trustee shall give notice disclosing the circumstances leading the winding up of the Scheme in a daily newspaper having nationwide circulating and in the newspaper published in the language of the region where the CIMC is registered.

The trustee should dispose of the assets of the scheme concerned in the best interest of the unit holders of that scheme. The proceeds of sale realised, should be first utilised towards the discharge of such liabilities as are due and payable under the scheme and after making appropriate provision for meeting the expenses connected with such winding up, the balance shall be paid to the unit holders in proportion to their unit holding. After the completion of the winding up, the trustee should forward to SEBI and the unit holders –

- (a) a report on the steps taken for realisation of assets of the scheme, expenses for winding up and net assets available for distribution to the unit holders, and
- (b) a certificate from the auditors of the scheme to the effect that all the assets of the scheme are realised and the details of the distribution of the proceeds.

The unclaimed money, if any at the time of winding up, should be kept separately in a bank account by the

trustee for a period of three years for the purpose of meeting investors' claims and thereafter, should be transferred to investor protection fund, as may be specified by SEBI. On and from the date of the publication of notice, the trustee or the CIMC as the case may be, shall cease to carry on any business activities in respect of the Scheme so wound up.

LESSON ROUND UP

- The CIS is any scheme or arrangement made or offered by any person under which (a) the contributions, or payments made by the investors, by whatever name called, are pooled and utilised solely for the purposes of the scheme or arrangement; (b) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable from such scheme or arrangement; (c) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors; and (d) the investors do not have day to day control over the management and operation of the scheme or arrangement.
- A scheme should be constituted in the form of a trust and the instrument of trust should be in the form of a deed duly registered under the provisions of the Indian Registration Act, 1908 executed by the Collective Investment Management Company in favour of the trustees named in such an instrument.
- Collective Investment Management Company is regulated by SEBI (Collective Investment Schemes) Regulations, 1999.
- SEBI (Collective Investment Schemes) Regulations, 1999 defines Collective Investment Management Company to mean a company incorporated under the Companies Act, 2013 and registered with SEBI under these regulations, whose object is to organize, operate and manage a collective investment scheme.
- The trustee have a right to obtain from the Collective Investment Management Company such information as is considered necessary by the trustee and to inspect the books of accounts and other records relating to the scheme.
- The units of every scheme shall be listed immediately after the date of allotment of units and not later than six weeks from the date of closure of the scheme on each of the stock exchanges as mentioned in the offer document.
- A scheme should be wound up on the expiry of duration specified in the scheme or on the accomplishment of the purpose of the scheme.

GLOSSARY

Fundamental Attributes	It means the investment objective and terms of a scheme.
Pooling	Pooling is the basic concept behind collective investments. The money of thousands of individual investors, who share a common investment objective, is pooled together to form a CIS portfolio.
Portfolio Manager	The portfolio or investment manager acts as the channel through which the investors invest their money. The portfolio manager is therefore responsible for investing the pool of investors' money. He or she will decide which securities to hold, when to buy or when to sell.
Trustee	The persons registered with SEBI as Debenture Trustee under SEBI (Debenture Trustee) Regulations, 1993 are only eligible to be appointed as trustees of collective investment scheme.

Lesson 11

Resource Mobilisation In International Capital Market

LESSON OUTLINE

- Introduction
- Regulatory Framework in India
- Depository Receipts
- ADR and GDR
- Sponsored ADR/GDR Issue
- Two-Way Fungibility Scheme
- Provisions of Companies Act, 2013 relating to issue of GDR
- Companies (Issue of Global Depository Receipts) Rules, 2014
- Procedure for Issuance of GDR/FCCBs
- Approvals Required
- Appointment of Intermediaries
- Principal Documentation
- Pre and Post Launch – Additional Key Actions
- Foreign Currency Exchangeable Bonds
- Difference Between FCCB and FCEB
- Issue of Foreign Currency Exchangeable Bonds (FCEB) Scheme, 2008
- Foreign Currency Convertible Bonds
- FCCB and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993
- External Commercial Borrowing
- Automatic Route
- Approval Route
- Conversion of ECB Into Equity
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

With the advent of globalization in securities markets, the walls of domestic capital markets got eroded, facilitating the companies to tap foreign sources of capital that demanded lower rates of return. India being an emerging market has been following the trend and the reforms has started since 1991. The Government of India has taken various policies initiatives to allow India companies to raised funds from International Market. It includes implementation of FCCB and Ordinary Share (through Depository Receipt Mechanism) Scheme 1993, Foreign Currency Exchangeable Bonds Scheme 2008 and the Consolidated FDI Policy. The Ministry of Corporate Affairs has notified Companies (Issue of Global Depository Receipts) Rules, 2014 for Issue of GDR. These policy initiatives have lead to the introduction of International Instruments like American Depository Receipts (ADR), Global Depository Receipts (GDR), Foreign Currency Convertible Bonds (FCCBs) and Foreign currency Exchangeable Bonds (FCEBs) etc.

A student should know about the choice of instruments through which a company can mobilise funds from foreign market to have optimum capital structure.

Keeping this in view this lesson will explain the basics of different modes of Euro issue like ADR, FDR, FCCB, FCEB, their advantages, the regulatory framework governing such type of fund raising, documentation required in this procedure, key intermediaries involved, approval required for such fund raising External Commercial Borrowings etc.

INTRODUCTION

Increased globalization and investor appetite for diversification, offer a unique opportunity to companies looking to tap a new investor base, awareness or raise capital. Indian companies are allowed to raise equity capital in the international market through the issue of GDR/ADR/FCCB/FCEB.

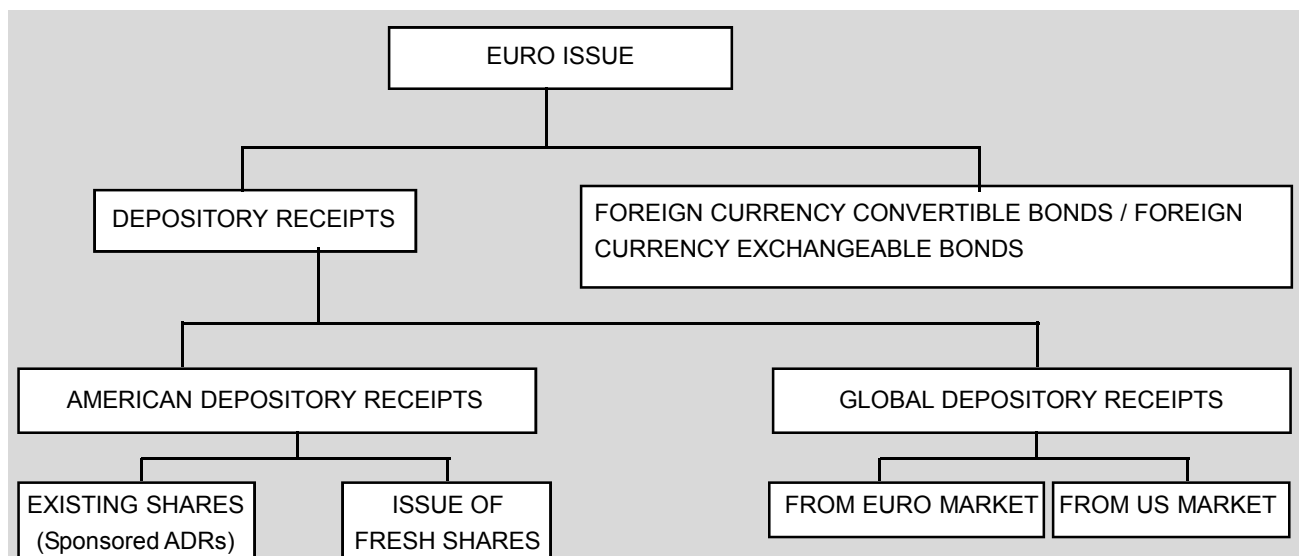
REGULATORY FRAMEWORK IN INDIA

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

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

EURO ISSUE

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



DEPOSITORY RECEIPTS

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

Why do Company Issue Depository Receipts

Company issues DRs as a tool to access Global capital markets. Following are the some reason for issuing DRs by a company –

- To raise Capital
- Diversify Shareholder base into extended geographies
- Increase visibility & recognition in international market
- Global Image
- Set Up Employee Stock Option Plans
- Facilitate Merger & Acquisition activity by creating a desirable acquisition currency.

Purpose of Investors to Invest in Depository Receipts

- Diversify Portfolio
- Convenience of holding foreign securities in their markets
- Simplification of trading and settlements(DRs trade and settle just like US or EURO securities)
- No restrictions on dealing: DRs are recognized as domestic securities
- Avoid Currency risk.

ADR & GDR

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.

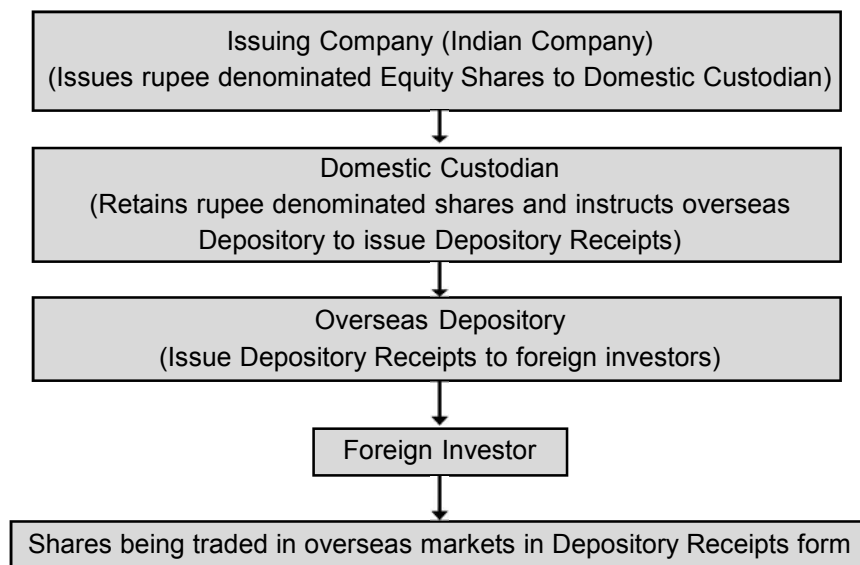
GDRs have access usually to Euro market and US market. The US portion of GDRs to be listed on US exchanges to comply with SEC requirements and the European portion are to be complied with EU directive. Listing of GDR may take place in international stock exchanges such as London Stock Exchange, New York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

Difference between American Depository Receipts (ADR) and Global Depository Receipts (GDR)

ADR are US \$ denominated and traded in US.

GDRs are traded in various places such as New York Stock Exchange, London Stock Exchange, etc.

PROCESS INVOLVED IN ISSUE OF DEPOSITORY RECEIPTS



ISSUE OF ADR/GDR

Depository Receipts (DRs) are negotiable securities issued outside India by a Depository bank, on behalf of an Indian company, which represent the local Rupee denominated equity shares of the company held as deposit by a Custodian bank in India. DRs are traded on Stock Exchanges in the US, Singapore, Luxembourg, London, etc. DRs listed and traded in the US markets are known as American Depository Receipts (ADRs) and those listed and traded elsewhere are known as Global Depository Receipts (GDRs). In the Indian context, DRs are treated as FDI.

- (i) Indian companies can raise foreign currency resources abroad through the issue of FCCB/DR (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.
- (ii) A company can issue ADRs / GDRs, if it is eligible to issue shares to 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 the Securities and Exchange Board of India (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) The Companies shall file a copy of the return which they submit 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 unlisted company raising funds through ADRs/GDRs shall be as prescribed by 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. There is no monetary limit up to which an Indian company can raise ADRs / GDRs.
- (v) The ADR / GDR proceeds can be utilised 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 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 of 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.
- (ix) The pricing of sponsored ADRs/GDRs would be determined under the provisions of the Scheme of 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.

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.

TERM 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.

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

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

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

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

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 issue of depository receipts:

- (1) The Board of Directors of the company intending to issue depository receipts shall pass a resolution authorising the company to do so.
- (2) The company shall take prior approval of its shareholders by a special resolution to be passed at a general meeting. Provided that a special resolution passed under section 62 for issue of shares underlying the depository receipts, shall be deemed to be a special resolution for the purpose of section 41 as well.
- (3) The depository receipts shall be issued by an overseas depository bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank.
- (4) The company shall ensure that all the applicable provisions of the Scheme and the rules or regulations or guidelines issued by the Reserve Bank of India are complied with before and after the issue of depository receipts.
- (5) The company shall appoint a merchant banker or a practising chartered accountant or a practising cost accountant or a practising company secretary to oversee all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practising chartered accountant or practising cost accountant or practising company secretary, as the case may be, shall be placed at the meeting of the Board of Directors of the company or of the committee of the Board of directors authorised by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts.

Provided that the committee of the Board of directors referred to above shall have at least one independent director in case the company is required to have independent directors.

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 provisions 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 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.

PROCEDURE FOR ISSUANCE OF GDR/FCCBS

APPROVALS REQUIRED

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

Approval of Board of Directors

A meeting of Board of Directors is required to be held for approving the proposal to raise money from Euro Capital market. A board resolution is to be passed to approve the raising of finance by issue of GDRs/FCCBs. The resolution should indicate therein specific purposes for which funds are required, quantum of the issue, country in which issue is to be launched, time of the issue etc. A director/Sub-Committee of Board of Directors is also to be authorised for seeking Government approval in connection with Euro issue and signing agreements with depository, organising road shows for fixation of price of GDRs. The Board meeting shall also decide and approve the notice of Extraordinary general meeting of shareholders at which special resolution is to be considered.

Approval of Shareholders

Proposal for making Euro issue, as proposed by Board of Directors require approval of shareholders. A special

resolution under Section 62 of the Companies Act, 2013 is required to be passed at a duly convened general meeting of the shareholders of the company.

Approval of Ministry of Finance – “In Principle and Final”

In case of FCCB issue exceeding US \$ 100 million, the company needs to apply to Ministry of Finance for approval.

With respect to ADR/GDR, guidelines issued on the subject dated 19-1-2000 brought ADR/GDR under the automatic route and therefore the requirement of obtaining approval of Ministry of Finance, Department of Economic Affairs has been dispensed with.

Further, private placement of ADR/GDR will also not require prior approval provided the issue is managed by investment banker.

Procedure for Getting Approval

Where the approval is required, the following procedure is required to be followed:

An eligible issuing company shall make an application to the Government of India, Ministry of Finance, Deptt. of Economic Affairs, New Delhi, for obtaining 'In-principle' approval.

The application should set out in detail the following points:

- (a) Proposed project or expansion or diversification programme with details of cost of project and means of financing.
- (b) The proposed security viz. Global Depository Receipts (GDRs) or American Depository Receipts (ADRs) against underlying shares or Foreign Currency Convertible Bonds.
- (c) In the case of Bonds, particulars of redemption period, rate of interest, time of conversion of bonds to equity shares of the company, price at which such conversion will take place.
- (d) In the case of GDRs/ADRs, the price at which the equity shares will be issued.
- (e) Justification for the foreign issue.
- (f) Other details about the company such as management, financial date, capacity and its utilisation, financial results and management ratios, statutory liabilities, default in respect of interest/installments, of loans from Banks/Financial Institutions. Exports and imports and salient features of the prospective corporate plans and diversification proposals with special reference to foreign exchange requirements.

The Government of India will, if satisfied with the company's proposals, issue an approval in principle granting permission to the company to mobilise foreign currency resources for a specified amount.

On completion of finalisation of issue structure in consultation with the Lead Manager to the issue, the company should obtain the final approval from the Government.

However, in some cases Foreign Investment Promotion Board (FIPB) clearance is necessary before final approval is given by the Finance Ministry.

Both 'in principle and final' approvals are valid for 3 months respectively from the date of issue.

Approval of Reserve Bank of India

The issuer company has to obtain approvals from Reserve Bank of India under circumstances specified under the guidelines issued by the concerned authorities from time to time.

RBI vide its press release dated January 20, 2000 granted general permissions to make an international offering of rupee denominated equity shares of the company by way of issue of ADR/GDR.

FCCB covered under the automatic route requires no RBI approval. FCCB issue which exceeds USD 50 million but does not exceed 100 million need to apply to RBI.

In-principle consent of Stock Exchanges for listing of underlying shares

The issuing company has to make a request to the domestic stock exchange for in-principle consent for listing of underlying shares which shall be lying in the custody of domestic custodian. These shares, when released by the custodian after cancellation of GDR, are traded on Indian stock exchanges like any other equity shares

In-principle consent of Financial Institutions

Where term loans have been obtained by the company from the financial institutions, the agreement relating to the loan contains a stipulation that the consent of the financial institution has to be obtained. The company must obtain in-principle consent on the broad terms of the proposed issue.

APPOINTMENT OF INTERMEDIARIES

The following agencies are normally involved in the Euro issue:

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

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.

Co-Lead/Co-Manager

In consultation with the lead manager, the company has to appoint co-lead/co-manager to coordinate with the issuing company/lead manager to make the smooth launching of the Euro issue.

Overseas Depository Bank

It is the bank which is authorised by the issuing company to issue Depository Receipts against issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company.

Domestic Custodian Bank

This is a banking company which acts as custodian for the ordinary shares or Foreign Currency Convertible Bonds of an Indian company, which are issued by it. The domestic custodian bank functions in co-ordination with the depository bank. When the shares are issued by a company the same are registered in the name of depository and physical possession is handed over to the custodian. The beneficial interest in respect of such shares, however, rests with the investors.

Listing Agent

One of the conditions of Euro-issue is that it should be listed at one or more Overseas Stock Exchanges. The appointment of listing agent is necessary to coordinate with issuing company for listing the securities on Overseas Stock Exchanges.

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.

Printers

The issuing company should appoint printers of international repute for printing Offer Circular.

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.

Underwriters

It is desirable to get the Euro issue underwritten by banks and syndicates. Usually, the underwriters subscribe for a portion of the issue with arrangements for tie-up for the balance with their clients. In addition, they will interact with the influential investors and assist the lead manager to complete the issue successfully

PRINCIPAL DOCUMENTATION

The following principal documents are involved: (i) Subscription Agreement (ii) Depository Agreement (iii) Custodian Agreement (iv) Agency Agreement (v) Trust Deed

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.

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.

Custodian Agreement

Custodian works in co-ordination with the depository and has to observe all obligations imposed on it including those mentioned in the depository agreement. The custodian is responsible solely to the depository. In the case of the depository and the custodian being same legal entity, references to them separately in the depository agreement or otherwise may be made for convenience and the legal entity will be responsible for discharging both functions directly to the holders and the company.

Whenever the depository in its discretion determines that it is in the best interests of the holders to do so, it may, after prior consultation with the company terminate, the appointment of the custodian and in such an event the depository shall promptly appoint a successor custodian, which shall, upon acceptance of such appointment, become the custodian under the depository agreement. The depository shall notify holders of such change promptly. Any successor custodian so appointed shall agree to observe all the obligations imposed on him.

Agency Agreement

In case of FCCBs, the company has to enter into an agency agreement with certain persons known as conversion agents. In terms of this agreement, these agents are required to make the principal and interest payments to the holders of FCCBs from the funds provided by the company. They will also liaise with the company at the time of conversion/redemption option to be exercised by the investor at maturity.

Trust Deed

In respect of FCCBs the company enters into a Covenant (known as Trust Deed) with the Trustee for the holders of FCCBs, guaranteeing payment of principal and interest amount on such FCCBs and to comply with the obligations in respect of such FCCBs.

PRE AND POST LAUNCH – ADDITIONAL KEY ACTIONS

Apart from obtaining necessary approvals, appointment of various agencies and proper documentation, the following additional key actions are necessary for making the Euro-issue a success.

(i) Constitution of a Board Sub-Committee; (ii) Selection of Syndicate Members; (iii) Constitution of a task force for due diligence; (iv) Listing; (v) Offering Circular; (vi) Research papers; (vii) Pre-marketing; (viii) Timing, pricing and size of the issue; (ix) Roadshows; (x) Book building and pricing of the issue; (xi) Closing of the issue; (xii) Allotment; (xiii) Investor Relation Programme; and (xiv) Quarterly Statement.

Constitution of a Board Sub-Committee

To launch a Euro-issue, the issuing company has to take a large number of decisions in time. These decisions normally fall within the power of Board of Directors. It is usually difficult to call Board Meetings frequently and to ensure presence of adequate Board Members. Thus, it is normally advisable to constitute a sub-committee of the Board with full delegation of powers with regard to Euro-issue. The delegation of powers to the Board sub-committee should normally include the following:

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- Appointment of agencies
- Authority to make applications for seeking various approvals
- Authority to finalise and execute documents and agreements.
- Decisions about the timing, size and pricing of the issue
- Allotment of shares

Selection of Syndicate Members

The success of any Euro-issue depends upon the well planned and coordinated efforts of the syndicate members and the company. The selection of the Syndicate members should be made depending upon the strength and capabilities of each member in different areas of specialisation such as marketing, financial research, distribution etc. The lead manager may be entrusted with the work of selection of syndicate members. The lead manager while selecting the above members, in addition to their strength and capability, should also evaluate their standing, image, reputation, infrastructure, past experience in handling Indian Euro-issue, etc.

Constitution of a task force for due diligence

The due diligence is a process in which a team consisting of legal, technical and financial experts of the lead manager meets top executives of the company and visits the sites of the company in order to understand the strengths, weaknesses, problems and opportunities of the company. The team also studies and analyses the balance sheet of the company and its subsidiaries, its financial arrangement with the group, investment pattern and also the future prospects of the company.

It also scrutinise the minutes of the company, various arrangements entered into by the company with regard to marketing, purchase, technology, ancillary units, employment, etc. and analyse the impact of litigations on the profitability of the company.

The purpose of above exercise is to draft the offering circular (prospectus) and work out marketing strategies for the Euro-issue.

Listing

One of the conditions of Euro-issues is that the securities are to be listed on one or more Overseas Stock Exchanges. The issuing company has to fulfill all the requirements particularly disclosure and documentation as prescribed by the Overseas Stock Exchanges. The company shall take the help of the listing agent in getting its Euro-issue instruments listed on the Overseas Stock Exchanges.

The issuing company shall prepare the requisite documents as prescribed by the Overseas Stock exchange authorities and submit the same along with application to it after scrutinizing the application and obtain the formal listing approval shall be issued by the Overseas Stock Exchange.

The underlying shares against GDRs are to be listed on one or more Indian Stock Exchange(s) on which the company's existing shares are already listed. For this purpose, the company has to apply to the stock exchange authorities to get the shares represented by GDRs listed on the Indian Stock Exchanges. Trading of such shares on Indian Stock Exchange(s) will not commence until the period specified in the guidelines after the date of issue of the GDRs.

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.

Research Papers

Research analysts team of lead manager/co-lead manager prepares research papers on the company before the issue. These papers are very important marketing tools as the international investors normally depend a lot on the information provided by the research analysts for making investment decisions.

Pre-marketing

Pre-marketing exercise is a tool through which the syndicate members evaluate the prospects of the issue. This is normally done closer to the issue. The research analysts along with the sales force of the syndicate members meet the prospective investors during pre marketing roadshows. This enables the syndicate members to understand the market and the probable response from the prospective investors. The pre-marketing exercise helps in assessing the depth of investors' interest in the proposed issue, their view about the valuation of the

share and the geographical locations of the investors who are interested in the issue. The response received during pre-marketing provides vital information for taking important decisions relating to timing, pricing and size of the issue. This would also help the syndicate members in evolving strategies for marketing the issue.

Timing, pricing and size of the Issue

After pre-marketing exercise, the important decisions of timing, pricing and size of the issue are taken. The proper time of launching the issue is when the fundamentals of the company and the industry are strong and the market price of the shares are performing well at Indian Stock Exchanges. The timing should also not clash with some other major issues of the Indian as well as other country companies. The decision regarding the size of issue is inversely linked with the pricing i.e. larger the size, the comparatively lower the price or vice-versa.

Roadshows

Roadshows represent meetings of issuers, analysts and potential investors. Details about the company are presented in the roadshows and such details usually include the following information about the company making the issue:

- History
- Organisational structure
- Principal objects
- Business lines
- Position of the company in Indian and international market
- Past performance of the company
- Future plans of the company
- Competition - domestic as well as foreign
- Financial results and operating performance
- Valuation of shares
- Review of Indian stock market and economic situations.

Thus at road shows, series of information presentations are organised in selected cities around the world with analysts and potential institutional investors. It is, in fact, a conference by the issuer with the prospective investors.

Road show is arranged by the lead manager by sending invitation to all prospective investors.

Book building and pricing of the Issue

During road shows, the investors give indication of their willingness to buy a particular quantity at particular terms. Their willingness is booked as orders by the marketing force of lead manager and co-lead manger. This process is known as book building.

Price is a very critical element in the market mix of any product or service. This is more so in case of financial assets like stocks and bonds and specially in case of Euro issues. The market price abroad has a strong correlation to the near future earnings potential, fundamentals governing industry and the basic economic state of the country. Several other factors like prevalent practices, investor sentiment, behaviour towards issues of a particular country, domestic market process etc., are also considered in determination of issue price. Other factors such as the credit rating of the country, interest rate and the availability of an exit route are important.

Closing of the Issue and Allotment

Closing is essentially an activity confirming completion of all legal documentation and formalities based on which the company issues the share certificate to the depository and deposits the same with the domestic custodian. Once the issue is closed and all legal formalities are over, the allotment is finalised. Thereafter, the company issues shares in favour of the Overseas Depository Bank and deposits the same with the domestic custodian for custody. The particulars of the Overseas Depository Bank are required to be entered into the Register of Members of the company.

Investor Relation Programme

The international investors expect that the issuing company maintains contact with them after the issue. These investors always like to be informed by the company about the latest developments, the performance of the company, the factors affecting performance and the company's plans. It is, therefore, essential for the GDR issuing company to set up an investor relation programme. Good investor relation ensures goodwill towards the company and it would help the company in future fund raising efforts.

FOREIGN CURRENCY EXCHANGEABLE BONDS

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

What is FCEB?

- (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.

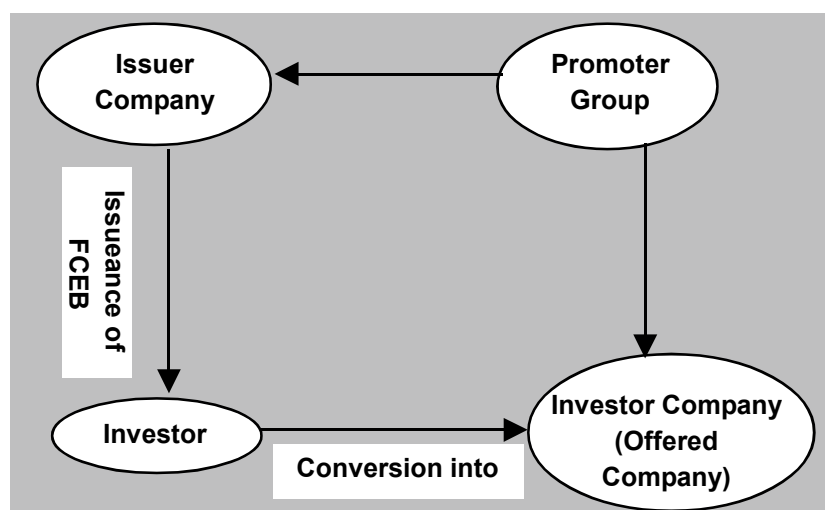
It may be noted that issuing company to be the part of promoter group of offered company and the offered company is to be listed and is to be eligible to receive foreign investment.

The launch of the Foreign Currency Exchangeable Bonds (FCEB) scheme affords a unique opportunity for Indian promoters to unlock value in group companies. FCEBs are another arrow in the quiver of Indian promoters to raise money overseas to fund their new projects and acquisitions, both Indian and global, by leveraging a part their shareholding in listed group entities.

An FCEB involves three parties –

- (i) The issuer company (issuer),
- (ii) The offered company (OC) and
- (iii) Investor.

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. For Example, 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 OC. Also, relatively, FCEB has an inherent advantage that it does not result in dilution of shareholding at the OC level.



DIFFERENCE BETWEEN FCCB AND FCEB

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

ISSUE OF FOREIGN CURRENCY EXCHANGEABLE BONDS (FCEB) SCHEME, 2008

In Financial Year 2007-08, the Indian Government notified the Foreign Currency Exchangeable Bonds Scheme, 2008 for the issue of FCEBs. The provisions of the scheme is as under:

Eligible Issuer: The Issuing Company shall be part of the promoter group of the Offered Company and shall hold the equity share/s being offered at the time of issuance of FCEB.

Offered Company: The Offered Company shall be a listed company, which is engaged in a sector eligible to receive Foreign Direct Investment and eligible to issue or avail of Foreign Currency Convertible Bond (FCCB) or External Commercial Borrowings (ECB).

Entities not eligible to issue FCEB: An Indian company, which is not eligible to raise funds from the Indian securities market, including a company which has been restrained from accessing the securities market by the SEBI shall not be eligible to issue FCEB.

Eligible subscriber: Entities complying with the Foreign Direct Investment policy and adhering to the sectoral caps at the time of issue of FCEB can subscribe to FCEB. Prior approval of the Foreign Investment Promotion Board, wherever required under the Foreign Direct Investment policy, should be obtained.

Entities not eligible to subscribe to FCEB: Entities prohibited to buy, sell or deal in securities by the SEBI will not be eligible to subscribe to FCEB.

End-use of FCEB proceeds

Issuing Company:

- (i) The proceeds of FCEB may be invested by the issuing company overseas by way of direct investment including in Joint Ventures or Wholly Owned Subsidiaries abroad, subject to the existing guidelines on overseas investment in Joint Ventures / Wholly Owned Subsidiaries.

(ii) The proceeds of FCEB may be invested by the issuing company in the promoter group companies.

Promoter Group Companies: Promoter group companies receiving investments out of the FCEB proceeds may utilize the amount in accordance with end-uses prescribed under the ECB policy.

End-uses not permitted

The promoter group company receiving such investments will not be permitted to utilise the proceeds for investments in the capital market or in real estate in India.

All-in-cost: The rate of interest payable on FCEB and the issue expenses incurred in foreign currency shall be within the all-in-cost ceiling as specified by Reserve Bank under the ECB policy.

Pricing of FCEB: At the time of issuance of FCEB the exchange price of the offered listed equity shares shall not be less than the higher of the following two:

(i) The average of the weekly high and low of the closing prices of the shares of the offered company quoted on the stock exchange during the six months preceding the relevant date; and (ii) The average of the weekly high and low of the closing prices of the shares of the offered company quoted on a stock exchange during the two week preceding the relevant date.

Average Maturity: Minimum maturity of FCEB shall be five years. The exchange option can be exercised at any time before redemption. While exercising the exchange option, the holder of the FCEB shall take delivery of the offered shares. Cash (Net) settlement of FCEB shall not be permissible.

Parking of FCEB proceeds abroad: The proceeds of FCEB may be retained and / or deployed overseas by the issuing / promoter group companies in accordance with the policy for the ECB or repatriated to India for credit to the borrowers' Rupee accounts with AD Category I banks in India pending utilization for permissible end-uses. It shall be the responsibility of the issuing company to ensure that the proceeds of FCEB are used by the promoter group company only for the permitted end-uses prescribed under the ECB policy. The issuing company should also submit audit trail of the end-use of the proceeds by the issuing company / promoter group companies to the Reserve Bank duly certified by the designated AD bank.

Operational Procedure: Issuance of FCEB shall require prior approval of the Reserve Bank under the Approval Route for raising ECB. The Reporting arrangement for FCEB shall be as per the extant ECB policy.

FOREIGN CURRENCY CONVERTIBLE BONDS

The FCCBs are unsecured, carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company. Interest and redemption price (if conversion option is not exercised) is payable in dollars. 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 at a discount on prevailing Indian market price.

In addition, 25% of the FCCB proceeds can be used for general corporate restructuring.

The major drawbacks of FCCBs are that the issuing company cannot plan its capital structure as it is not assured of conversion of FCCBs. Moreover, the projections for cash outflow at the time of maturity cannot be made.

Benefits to the Issuer Company

- Being Hybrid instrument, the coupon rate on FCCB is particularly lower than pure debt instrument there by reducing the debt financing cost.

- FCCBs are book value accretive on conversion. It saves risks of immediate equity dilution as in the case of public shares. Unlike debt, FCCB does not require any rating nor any covenant like securities, cover etc.
- It can be raised within a month while pure debt takes a longer period to raise. Because the coupon is low and usually payable at the time of redeeming the instrument, the cost of withholding tax is also lower for FCCBs compared with other ECB instruments.

Benefits to Investors

- It has advantage of both equity and debt.
- It gives the investor much of the upside of investment in equity, and the debt portion protects the downside.
- Assured return on bond in the form of fixed coupon rate payments.
- Ability to take advantage of price appreciation in the stock by means of warrants attached to the bonds, which are activated when price of a stock reaches a certain point.
- Significant Yield to maturity (YTM) is guaranteed at maturity.
- Lower tax liability as compared to pure debt instruments due to lower coupon rate.

FCCB AND ORDINARY SHARES (THROUGH DEPOSITORY RECEIPT MECHANISM) SCHEME, 1993

DEFINITIONS

Domestic Custodian Bank

It means a banking company which acts as a custodian for the ordinary shares or Foreign Currency Convertible Bonds of an Indian Company which are issued by it against Global Depository Receipts or certificates.

Foreign Currency Convertible Bonds

It means bonds issued in accordance with this scheme and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments.

Global Depository Receipts

It mean any instrument in the form of a Depository receipt or certificate (by whatever name it is called) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company.

Issuing Company

It means an Indian Company permitted to issue Foreign Currency Convertible Bonds or ordinary shares of that company against Global Depository Receipts.

Overseas Depository Bank

It means a bank authorised by the issuing company to issue Global Depository Receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company.

FCCBs are governed by the 'Issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993' as amended from time to time and Notification FEMA No.120/RB-2004 dated July 7, 2004. The issuance of FCCBs was brought under the ECB guidelines in August 2005 In addition to the requirements of (i) having the maturity of the FCCB not less than 5 years, (ii) the call & put option, if any, shall not be exercisable prior to 5 years, (iii) issuance of FCCBs only without any warrants attached, (iv) the issue related expenses not exceeding 4% of issue size and in case of private placement, shall not exceed

2% of the issue size, etc. as required in terms of Notification FEMA No. 120/RB-2004 dated July 7, 2004, FCCBs are also subject to all the regulations which are applicable to ECBs.

Redemption of FCCBs

Keeping in view the need to provide a window to facilitate refinancing of FCCBs by the Indian companies which may be facing difficulty in meeting the redemption obligations, Designated AD Category - I banks have been permitted to allow Indian companies to refinance the outstanding FCCBs, under the automatic route, subject to compliance with the terms and conditions set out hereunder:

- (i) Fresh ECBs/ FCCBs shall be raised with the stipulated average maturity period and applicable all-in-cost being as per the extant ECB guidelines;
- (ii) The amount of fresh ECB/FCCB shall not exceed the outstanding redemption value at maturity of the outstanding FCCBs;
- (iii) The fresh ECB/FCCB shall not be raised six months prior to the maturity date of the outstanding FCCBs ;
- (iv) The purpose of ECB/FCCB shall be clearly mentioned as 'Redemption of outstanding FCCBs' in Form 83 at the time of obtaining Loan Registration Number from the Reserve Bank;
- (v) The designated AD - Category I bank should monitor the end-use of funds;
- (vi) ECB / FCCB beyond USD 500 million for the purpose of redemption of the existing FCCB will be considered under the approval route; and
- (vii) ECB / FCCB availed of for the purpose of refinancing the existing outstanding FCCB will be reckoned as part of the limit of USD 750 million available under the automatic route as per the extant norms.

Restructuring of FCCBs involving change in the existing conversion price is not permissible. Proposals for restructuring of FCCBs not involving change in conversion price will, however, be considered under the approval route depending on the merits of the proposal.

EXTERNAL COMMERCIAL BORROWING

Indian Companies are allowed to access funds from the abroad through ECB, FCEBs, Preference share and FCCBs.

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

ECB for investment in real sector-industrial sector, infrastructure sector-in India, and specified service sectors are under Automatic Route, i.e. do not require Reserve Bank / Government of India approval. In case of doubt as regards eligibility to access the Automatic Route, applicants may take recourse to the Approval Route.

Infrastructure sector is defined as (i) power, (ii) telecommunication, (iii) railways, (iv) roads including bridges, (v) sea port and airport, (vi) industrial parks, (vii) urban infrastructure (water supply, sanitation and sewage projects), (viii) mining, exploration and refining and (ix) cold storage or cold room facility, including for farm level pre-cooling, for preservation or storage of agricultural and allied produce, marine products and meat.

AUTOMATIC ROUTE

The following types of proposals for ECBs are covered under the Automatic Route.

i) Eligible Borrowers

- (a) Corporates, including those in the hotel, hospital, software sectors (registered under the Companies Act, 2013), Non-Banking Finance Companies (NBFCs) - Infrastructure Finance Companies (IFCs), NBFCs - Asset Finance companies (AFCs), Small Industries Development Bank of India (SIDBI) except financial intermediaries, such as banks, financial institutions (FIs), Housing Finance Companies (HFCs) and Non-Banking Financial Companies (NBFCs), other than those specifically allowed by Reserve Bank, are eligible to raise ECB. Individuals, Trusts (other than those engaged in Micro-finance activities) and Non-Profit making organizations are not eligible to raise ECB.
- (b) Units in Special Economic Zones (SEZ) are allowed to raise ECB for their own requirement. However, they cannot transfer or on-lend ECB funds to sister concerns or any unit in the Domestic Tariff Area (DTA).
- (c) NBFCs-IFCs are permitted to avail of ECBs for on-lending to the infrastructure sector as defined under the ECB policy.
- (d) NBFCs-AFCs are permitted to avail of ECBs for financing the import of infrastructure equipment for leasing to infrastructure projects.
- (e) Non-Government Organizations (NGOs) engaged in micro finance activities are eligible to avail of ECB.
- (f) Micro Finance Institutions (MFIs) engaged in micro finance activities are eligible to avail of ECBs. MFIs registered under the Societies Registration Act, 1860, MFIs registered under Indian Trust Act, 1882, MFIs registered either under the conventional state-level cooperative acts, the national level multi-state cooperative legislation or under the new state-level mutually aided cooperative acts (MACS Act) and not being a co-operative bank, Non-Banking Financial Companies (NBFCs) categorized as 'Non Banking Financial Company-Micro Finance Institutions' (NBFC-MFIs) and complying with the norms prescribed as per Circular DNBS.CC.PD.No. 250/03.10.01/2011-12 dated December 02, 2011 and Companies registered under Section 8 of the Companies Act, 2013 and are involved in micro finance activities.
- (g) NGOs engaged in micro finance and MFIs registered as societies, trusts and co-operatives and engaged in micro finance (i) should have a satisfactory borrowing relationship for at least 3 years with a scheduled commercial bank authorized to deal in foreign exchange in India and (ii) would require a certificate of due diligence on 'fit and proper' status of the Board/ Committee of management of the borrowing entity from the designated AD bank.
- (h) Small Industries Development Bank of India (SIDBI) can avail of ECB for on-lending to MSME sector, as defined under the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006.
- (i) Corporates in the services sector viz. hotels, hospitals and software sector.
- (j) Companies in miscellaneous services sector (only from direct / indirect equity holders and group companies). Companies in miscellaneous services mean companies engaged in training activities (but not educational institutes), research and development activities and companies supporting infrastructure sector. Companies doing trading business, companies providing logistics services, financial services and consultancy services are, however, not covered under the facility).
- (k) Holding Companies / Core Investment Companies (CICs) coming under the regulatory framework

of the Reserve Bank are permitted to raise ECB for project use in Special Purpose Vehicles (SPVs) provided the business activity of the SPV is in the infrastructure sector where “infrastructure” is defined as per the extant ECB guidelines. The infrastructure project is required to be implemented by the SPV established exclusively for implementing the project and is subject to conditions. In case of Holding Companies that come under the Core Investment Company (CIC) regulatory framework of the Reserve Bank, the ECB availed should be within the ceiling of leverage stipulated for CICs and in case of CICs with asset size below Rs. 100 crore, the ECB availed of should be on fully hedged basis.

ii) Recognised Lenders

- (1) Borrowers can raise ECB from internationally recognized sources, such as (a) international banks, (b) international capital markets, (c) multilateral financial institutions (such as IFC, ADB, CDC, etc.) / regional financial institutions and Government owned development financial institutions, (d) export credit agencies, (e) suppliers of equipments, (f) foreign collaborators and (g) foreign equity holders [other than erstwhile Overseas Corporate Bodies (OCBs).
- (2) NGOs engaged in micro finance and MFIs registered as societies, trusts and co-operatives can avail of ECBs from (a) international banks, (b) multilateral financial institutions, (c) export credit agencies (d) overseas organisations and (e) individuals.
- (3) NBFC-MFIs will be permitted to avail of ECBs from multilateral institutions, such as IFC, ADB etc./ regional financial institutions/international banks / foreign equity holders and overseas organizations.
- (4) Companies registered under Section 8 of the Companies Act, 2013 and are engaged in micro finance will be permitted to avail of ECBs from international banks, multilateral financial institutions, export credit agencies, foreign equity holders, overseas organizations and individuals.
- (5) A “foreign equity holder” to be eligible as “recognized lender” under the automatic route would require minimum holding of paid-up equity in the borrower company as set out below:
 - i. For ECB up to USD 5 million - minimum paid-up equity of 25 per cent held directly by the lender (all outstanding ECBs including the proposed one),
 - ii. For ECB more than USD 5 million - minimum paid-up equity of 25 per cent held directly by the lender and ECB liability-equity ratio not exceeding 4:1 (all outstanding ECBs including the proposed one),

ECB from indirect equity holders is permitted provided the indirect equity holding in the Indian company by the lender is at least 51 per cent.

ECB from a group company is permitted provided both the borrower and the foreign lender are subsidiaries of the same parent.

Besides the paid-up capital, free reserves (including the share premium received in foreign currency) as per the latest audited balance sheet shall be reckoned for the purpose of calculating the ‘equity’ of the foreign equity holder in the term ECB liability-equity ratio. 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 ECB liability-equity ratio for reckoning quantum of permissible ECB.

For calculating the ‘ECB liability’, not only the proposed borrowing but also the outstanding ECB from the same foreign equity holder lender shall be reckoned.

- (6) Overseas organizations and individuals providing ECB need to comply with the following safeguards:
 - i. Overseas Organizations proposing to lend ECB would have to furnish to the AD bank of the

borrower a certificate of due diligence from an overseas bank, which, in turn, is subject to regulation of host-country regulator and adheres to the Financial Action Task Force (FATF) guidelines. The certificate of due diligence should comprise the following (i) that the lender maintains an account with the bank for at least a period of two years, (ii) that the lending entity is organised as per the local laws and held in good esteem by the business/local community and (iii) that there is no criminal action pending against it.

- ii. Individual Lender has to obtain a certificate of due diligence from an overseas bank indicating that the lender maintains an account with the bank for at least a period of two years. Other evidence /documents such as audited statement of account and income tax return which the overseas lender may furnish need to be certified and forwarded by the overseas bank. Individual lenders from countries wherein banks are not required to adhere to Know Your Customer (KYC) guidelines are not eligible to extend ECB.

iii). Amount and Maturity

- a. The maximum amount of ECB which can be raised by a corporate other than those in the hotel, hospital and software sectors, and corporate in miscellaneous services sector is USD 750 million or its equivalent during a financial year.
- b. Corporates in the services sector viz. hotels, hospitals and software sector and miscellaneous services sector are allowed to avail of ECB up to USD 200 million or its equivalent in a financial year for meeting foreign currency and/ or Rupee capital expenditure for permissible end-uses. The proceeds of the ECBs should not be used for acquisition of land.
- c. NGOs engaged in micro finance activities and Micro Finance Institutions (MFIs) can raise ECB up to USD 10 million or its equivalent during a financial year. Designated AD bank has to ensure that at the time of drawdown the forex exposure of the borrower is fully hedged.
- d. NBFC-IFCs can avail of ECB up to 75 per cent of their owned funds (ECB including outstanding ECBs) and must hedge 75 per cent of their currency risk exposure.
- e. NBFC-AFCs can avail of ECBs up to 75 per cent of their owned funds (ECB including outstanding ECBs) subject to a maximum of USD 200 million or its equivalent per financial year with a minimum maturity of 5 years and must hedge the currency risk exposure in full.
- f. SIDBI can avail of ECB to the extent of 50 per cent of their owned funds including the outstanding ECB, subject to a ceiling of USD 500 million per financial year.
- g. ECB up to USD 20 million or its equivalent in a financial year with minimum average maturity of three years. An illustration of average maturity period calculation is provided at Annex VI.
- h. ECB above USD 20 million or equivalent and up to USD 750 million or its equivalent with a minimum average maturity of five years.
- i. ECB up to USD 20 million or equivalent can have call/put option provided the minimum average maturity of three years is complied with before exercising call/put option.
- j. All eligible borrowers can avail of ECBs designated in INR from 'foreign equity holders' as per the extant ECB guidelines.
- k. NGOs engaged in micro finance activities can avail of ECBs designated in INR, from overseas organizations and individuals as per the extant guidelines.

iv) All-in-cost ceilings

All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment

fee, pre-payment fee, and fees payable in Indian Rupees. The payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost. The all-in-cost ceilings for ECB are reviewed from time to time.

v) End-use

- a. ECB can be raised for investment such as import of capital goods (as classified by DGFT in the Foreign Trade Policy), new projects, modernization/expansion of existing production units in real sector - industrial sector including small and medium enterprises (SME), infrastructure sector and specified service sectors, viz. hotel, hospital and software and miscellaneous services sector as given at I(A)(i)(j) above. Infrastructure sector is defined as (a) Energy which will include (i) electricity generation, (ii) electricity transmission, (iii) electricity distribution, (iv) oil pipelines, (v) oil/gas/liquefied natural gas (LNG) storage facility (includes strategic storage of crude oil) and (vi) gas pipelines (includes city gas distribution network);(b) Communication which will include (i) mobile telephony services / companies providing cellular services, (ii) fixed network telecommunication (includes optic fibre / cable networks which provide broadband / internet) and (iii) telecommunication towers;(c) Transport which will include (i) railways (railway track, tunnel, viaduct, bridges and includes supporting terminal infrastructure such as loading / unloading terminals, stations and buildings), (ii) roads and bridges, (iii) ports, (iv) inland waterways, (v) airport and (vi) urban public transport (except rolling stock in case of urban road transport);(d) Water and sanitation which will include (i) water supply pipelines, (ii) solid waste management, (iii) water treatment plants, (iv) sewage projects (sewage collection, treatment and disposal system), (v) irrigation (dams, channels, embankments, etc.) and (vi) storm water drainage system;(e) (i) mining, (ii) exploration and (iii) refining;(f) Social and commercial infrastructure which will include (i) hospitals (capital stock and includes medical colleges and para medical training institutes), (ii) Hotel Sector which will include hotels with fixed capital investment of Rs. 200 crore and above, convention centres with fixed capital investment of Rs. 300 crore and above and three star or higher category classified hotels located outside cities with population of more than 1 million (fixed capital investment is excluding of land value), (iii) common infrastructure for industrial parks, SEZs, tourism facilities, (iv) fertilizer (capital investment), (v) post harvest storage infrastructure for agriculture and horticulture produce including cold storage, (vi) soil testing laboratories and (vii) cold chain (includes cold room facility for farm level pre-cooling, for preservation or storage or agriculture and allied produce, marine products and meat.
- b. Overseas Direct Investment in Joint Ventures (JV)/ Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/ WOS abroad.
- c. Utilization of ECB proceeds is permitted for first stage as well as subsequent stages of acquisition of shares in the disinvestment process to the public under the Government's disinvestment programme of PSU shares.
- d. Interest during Construction (IDC) for Indian companies which are in the infrastructure sector, where "infrastructure" is defined as per the extant ECB guidelines, subject to IDC being capitalized and forming part of the project cost.
- e. For lending to self-help groups or for micro-credit or for bonafide micro finance activity including capacity building by NGOs engaged in micro finance activities.
- f. NBFC-IFCs can avail of ECBs only for on-lending to the infrastructure sector as defined under the ECB policy.
- g. NBFC-AFCs can avail of ECBs only for financing the import of infrastructure equipment for leasing to infrastructure projects.

- h. Maintenance and operations of toll systems for roads and highways for capital expenditure provided they form part of the original project.
- i. SIDBI can on lend to the borrowers in the MSME sector for permissible end uses, having natural hedge by way of foreign exchange earnings. SIDBI may on-lend either in INR or in foreign currency (FCY). In case of on-lending in INR, the foreign currency risk shall be fully hedged by SIDBI.
- j. Refinancing of Bridge Finance (including buyers' / suppliers' credit) availed of for import of capital goods by companies in Infrastructure Sector
- k. ECB is allowed for Import of services, technical know-how and payment of license fees. The companies in the manufacturing and infrastructure sectors may import services, technical know-how and payment of license fees as part of import of capital goods subject to certain conditions.
- l. ECB for general corporate purposes from direct foreign equity holders by companies in manufacturing, infrastructure, hotels, hospitals and software sector: Eligible borrowers can avail ECB from their direct foreign equity holder company with a minimum average maturity of 7 years for general corporate purposes (which includes working capital) subject to the following conditions:
 - i. Minimum paid-up equity of 25 per cent should be held directly by the lender;
 - ii. Such ECBs would not be used for any purpose not permitted under extant the ECB guidelines (including on-lending to their group companies / step-down subsidiaries in India); and Repayment of the principal shall commence only after completion of minimum average maturity of 7 years.
 - iii. No prepayment will be allowed before maturity.

vii) End-uses not permitted

Other than the purposes specified hereinabove, the borrowings shall not be utilized for any other purpose including the following purposes, namely:

- (a) For on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate [investment in Special Purpose Vehicles (SPVs), Money Market Mutual Funds (MMMFs), etc., are also considered as investment in capital markets].
- (b) for real estate sector,
- (c) for general corporate purpose which includes working capital (other than what has been given at I(A)(v)(l) above) and repayment of existing rupee loans.

Note: The proceeds of the ECBs should not be used for acquisition of land.

viii) Guarantees

Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, Financial Institutions and Non-Banking Financial Companies (NBFCs) from India relating to ECB is not permitted.

ix) Security

The choice of security to be provided to the lender/supplier is left to the borrower. However, creation of charge over immovable assets and financial securities, such as shares, in favour of the overseas lender is subject to Regulation 8 of Notification No. FEMA 21/RB-2000 dated May 3, 2000 and Regulation 3 of Notification No. FEMA 20/RB-2000 dated May 3, 2000, respectively, as amended from time to time. AD Category - I banks have been delegated powers to convey 'no objection' under the Foreign Exchange Management Act (FEMA), 1999 for creation of charge on immovable assets, financial securities and issue of corporate or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised by the borrower.

x) Parking of ECB proceeds

Borrowers are permitted to either keep ECB proceeds abroad or to remit these funds to India, pending utilization for permissible end-uses.

The proceeds of the ECB raised abroad meant for Rupee expenditure in India, such as, local sourcing of capital goods, on-lending to Self-Help Groups or for micro credit, payment for spectrum allocation, etc. should be repatriated immediately for credit to the borrowers' Rupee accounts with AD Category I banks in India. In other words, ECB proceeds meant only for foreign currency expenditure can be retained abroad pending utilization. The rupee funds, however, will not be permitted to be used for investment in capital markets, real estate or for inter-corporate lending.

ECB proceeds parked overseas can be invested in the following liquid assets (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/Fitch IBCA or Aa3 by Moody's (b) Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above, and (c) deposits with overseas branches / subsidiaries of Indian banks abroad. The funds should be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

The primary responsibility to ensure that the ECB proceeds meant for Rupee expenditure in India are repatriated to India for credit to their Rupee accounts with AD Category-I banks in India is that of the borrower concerned and any contravention of the ECB guidelines will be viewed seriously and will invite penal action under the Foreign Exchange Management Act (FEMA), 1999. The designated AD bank is also required to ensure that the ECB proceeds meant for Rupee expenditure are repatriated to India immediately after drawdown.

xi) Prepayment

Prepayment of ECB up to USD 500 million may be allowed by AD banks without prior approval of Reserve Bank subject to compliance with the stipulated minimum average maturity period as applicable to the loan.

xii) Refinancing of an existing ECB

The existing ECB may be refinanced by raising a fresh ECB subject to the condition that the fresh ECB is raised at a lower all-in-cost and the outstanding maturity of the original ECB is maintained.

xiii) Debt Servicing

The designated AD bank has the general permission to make remittances of installments of principal, interest and other charges in conformity with the ECB guidelines issued by Government / Reserve Bank of India from time to time.

xiv) Corporates Under Investigation

All entities against which investigations / adjudications / appeals by the law enforcing agencies are pending may avail of ECBs as per the current norms, if they are otherwise eligible, notwithstanding the pending investigations / adjudications / appeals, without prejudice to the outcome of such investigations / adjudications / appeals. Accordingly, in case of all applications where the borrowing entity has indicated about the pending investigations / adjudications / appeals, Authorised Dealers while approving the proposal shall intimate the concerned agencies by endorsing the copy of the approval letter.

xv) Procedure

Borrowers may enter into loan agreement complying with the ECB guidelines with recognised lender for raising ECB under the Automatic Route without the prior approval of the Reserve Bank. The borrower must obtain a Loan Registration Number (LRN) from the Reserve Bank of India before drawing down the ECB.

APPROVAL ROUTE

i) Eligible Borrowers

The following types of proposals for ECB are covered under the Approval Route:

- a. On lending by the EXIM Bank for specific purposes will be considered on a case by case basis.
- b. Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the Government are also permitted to the extent of their investment in the package and assessment by the Reserve Bank based on prudential norms. Any ECB availed for this purpose so far will be deducted from their entitlement.
- c. ECB with minimum average maturity of 5 years by Non-Banking Financial Companies (NBFCs) from multilateral financial institutions, reputable regional financial institutions, official export credit agencies and international banks to finance import of infrastructure equipment for leasing to infrastructure projects.
- d. NBFCs-IFCs are permitted to avail of ECB, beyond 75 per cent of their owned funds (including the outstanding ECBs) for on-lending to the infrastructure sector as defined under the ECB policy.
- e. NBFCs-AFCs are permitted to avail of ECB, beyond 75 per cent of their owned funds (including outstanding ECBs) to finance the import of infrastructure equipment for leasing to infrastructure projects.
- f. Foreign Currency Convertible Bonds (FCCBs) by Housing Finance Companies satisfying the following minimum criteria: (i) the minimum net worth of the financial intermediary during the previous three years shall not be less than Rs. 500 crore, (ii) a listing on the BSE or NSE, (iii) minimum size of FCCB is USD 100 million and (iv) the applicant should submit the purpose / plan of utilization of funds.
- g. Special Purpose Vehicles, or any other entity notified by the Reserve Bank, set up to finance infrastructure companies / projects exclusively, will be treated as Financial Institutions and ECB by such entities will be considered under the Approval Route.
- h. Multi-State Co-operative Societies engaged in manufacturing activity and satisfying the following criteria i) the Co-operative Society is financially solvent and ii) the Co-operative Society submits its up-to-date audited balance sheet.
- i. SEZ developers can avail of ECBs for providing infrastructure facilities within SEZ, as defined in the extant ECB policy (as given at I(A)(v)(a) above).
- j. Developers of National Manufacturing Investment Zones (NMIZs) can avail of ECB for providing infrastructure facilities within SEZ, as defined in the extant ECB policy (as given at I(A)(v)(a) above).
- k. Eligible borrowers under the automatic route other than corporates in the services sector viz. hotel, hospital and software can avail of ECB beyond USD 750 million or equivalent per financial year.
- l. Corporates in the services sector viz. hotels, hospitals, and software sectors and in miscellaneous services (as given at I(A)(i)(l) above) can avail of ECB beyond USD 200 million or equivalent per financial year. ECB for corporates in miscellaneous services is permitted only from direct / indirect equity holders and group companies Small Industries Development Bank of India (SIDBI) is eligible to avail of ECB for on-lending to MSME sector, as defined under the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, beyond 50 per cent of their owned funds, subject to a ceiling of USD 500 million per financial year provided such on-lending by SIDBI shall be to the borrowers' for permissible end-use and having natural hedge by way of foreign exchange earnings.

SIDBI may on-lend either in INR or in foreign currency (FCY). In case of on-lending in INR, the foreign currency risk shall be fully hedged by SIDBI.

- m. Low Cost Affordable Housing Projects: Developers/builders / Housing Finance Companies (HFCs) / National Housing Bank (NHB) may avail of ECB for low cost affordable housing projects [refer to para I B (vii) *ibid*]. Corporates under Investigation: All entities against which investigations / adjudications / appeals by the law enforcing agencies are pending, may avail of ECBs as per the current norms, if they are otherwise eligible, notwithstanding the pending investigations / adjudications / appeals, without prejudice to the outcome of such investigations / adjudications / appeals. Accordingly, in case of all applications where the borrowing entity has indicated about the pending investigations / adjudications / appeals, the Reserve Bank of India while approving the proposal shall intimate the concerned agencies by endorsing the copy of the approval letter.
- n. Holding Companies / Core Investment Companies (CICs) coming under the regulatory framework of the Reserve Bank are permitted to raise ECB for project use in Special Purpose Vehicles (SPVs) provided the business activity of the SPV is in the infrastructure sector where “infrastructure” is defined as per the extant ECB guidelines. The infrastructure project is required to be implemented by the SPV established exclusively for implementing the project and is subject to conditions In case of Holding Companies that come under the Core Investment Company (CIC) regulatory framework of the Reserve Bank, the ECB availed should be within the ceiling of leverage stipulated for CICs and in case of CICs with asset size below Rs. 100 crore, the ECB availed of should be on fully hedged basis.
- o. Cases falling outside the purview of the automatic route limits and maturity period as indicated at paragraph I A (iii).

ii) Recognised Lenders

- (a) Borrowers can raise ECB from internationally recognised sources, such as (i) international banks, (ii) international capital markets, (iii) multilateral financial institutions (such as IFC, ADB, CDC, etc.)/ regional financial institutions and Government owned development financial institutions, (iv) export credit agencies, (v) suppliers’ of equipment, (vi) foreign collaborators and (vii) foreign equity holders (other than erstwhile OCBs).Overseas branches / subsidiaries of Indian banks are not recognised as lenders in case the end use is repayment / refinance of Rupee loans raised from domestic banking system under any of the schemes under the ECB policy..
- (b) A “foreign equity holder” to be eligible as “recognized lender” under the approval route would require minimum holding of paid-up equity in the borrower company as set out below:
 - (i) For ECB up to USD 5 million - minimum paid-up equity of 25 per cent held directly by the lender (all outstanding ECBs including the proposed one);
 - (ii) For ECB more than USD 5 million - minimum paid-up equity of 25 per cent held directly by the lender and ECB liability-equity ratio not exceeding 7:1 (all outstanding ECBs including the proposed one);
- (c) ECB from indirect equity holders provided the indirect equity holding by the lender in the Indian company is at least 51 per cent;
- (d) ECB from a group company provided both the borrower and the foreign lender are subsidiaries of the same parent.

Besides the paid-up capital, free reserves (including the share premium received in foreign currency) as per the latest audited balance sheet shall be reckoned for the purpose of calculating the ‘equity’ of the foreign equity holder in the term ECB liability-equity ratio. Where there are more than one foreign equity

holder 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 ECB liability-equity ratio for reckoning quantum of permissible ECB.

For calculating the 'ECB liability', not only the proposed borrowing but also the outstanding ECB from the same foreign equity holder lender shall be reckoned.

The total outstanding stock of ECBs (including the proposed ECBs) from a foreign equity lender should not exceed seven times the equity holding, either directly or indirectly of the lender (in case of lending by a group company, equity holdings by the common parent would be reckoned).

iii) Amount and Maturity

Eligible borrowers under the automatic route other than corporates in the services sector viz. hotel, hospital, software and miscellaneous services can avail of ECB beyond USD 750 million or equivalent per financial year. Corporates in the services sector viz. hotels, hospitals, software sector and miscellaneous services are allowed to avail of ECB beyond USD 200 million or its equivalent in a financial year for meeting foreign currency and/ or Rupee capital expenditure for permissible end-uses. The proceeds of the ECBs should not be used for acquisition of land.

iv) All-in-cost ceilings

All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee and fees payable in Indian Rupees. The payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost. The all-in-cost ceilings for ECB are reviewed from time to time.

v) End-use

- a. ECB can be raised only for investment [such as import of capital goods (as classified by DGFT in the Foreign Trade Policy), implementation of new projects, modernization/expansion of existing production units] in the real sector - industrial sector including small and medium enterprises (SME) and infrastructure sector - in India. Infrastructure sector is as given at I(A)(v)(a) above.
- b. Overseas Direct Investment in Joint Ventures (JV)/Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/WOS abroad.
- c. Interest During Construction (IDC) for Indian companies which are in the infrastructure sector, as defined under the extant ECB guidelines subject to IDC being capitalized and forming part of the project cost.
- d. The payment by eligible borrowers in the Telecom sector, for spectrum allocation may, initially, be met out of Rupee resources by the successful bidders, to be refinanced with a long-term ECB, under the approval route, subject to the following conditions:
 - i. The ECB should be raised within 12 months from the date of payment of the final instalment to the Government;
 - ii. The designated AD - Category I bank should monitor the end-use of funds;
 - iii. Banks in India will not be permitted to provide any form of guarantees; and
 - iv. All other conditions of ECB, such as eligible borrower, recognized lender, all-in-cost, average maturity, etc. should be complied with.
 - v. ECB should not be raised from overseas branches / subsidiaries of Indian banks.
- e. The first stage as well as subsequent stages of acquisition of shares in the disinvestment process to the public under the Government's disinvestment programme of PSU shares.

f. Repayment of Rupee loans availed of from domestic banking system: Indian companies which are in the infrastructure sector (except companies in the power sector), as defined under the extant ECB guidelines, are permitted to utilise 25 per cent of the fresh ECB raised by them towards refinancing of the Rupee loan/s availed by them from the domestic banking system, subject to the following conditions:

- (i) at least 75 per cent of the fresh ECB proposed to be raised should be utilised for capital expenditure towards a 'new infrastructure' project(s)
- (ii) in respect of remaining 25 per cent, the refinance shall only be utilized for repayment of the Rupee loan availed of for 'capital expenditure' of earlier completed infrastructure project(s); and
- (iii) the refinance shall be utilized only for the Rupee loans which are outstanding in the books of the financing bank concerned.
- (iv) ECB should not be raised from overseas branches / subsidiaries of Indian banks.

Companies in the power sector are permitted to utilize up to 40 per cent of the fresh ECB raised by them towards refinancing of the Rupee loan/s availed by them from the domestic banking system subject to the condition that at least 60 per cent of the fresh ECB proposed to be raised should be utilized for fresh capital expenditure for infrastructure project(s).

- g. ECB is allowed for Import of services, technical know-how and payment of license fees. The companies in the manufacturing and infrastructure sectors may import services, technical know-how and payment of license fees as part of import of capital goods subject to certain conditions.
- h. **Bridge Finance:** Indian companies which are in the infrastructure sector, as defined under the extant ECB policy are permitted to import capital goods by availing of short term credit (including buyers' / suppliers' credit) in the nature of 'bridge finance', with RBI's prior approval provided the bridge finance shall be replaced with a long term ECB as per extant ECB guidelines.
- i. **ECB for working capital for civil aviation sector:** Airline companies registered under the Companies Act, 2013 and possessing scheduled operator permit license from DGCA for passenger transportation are eligible to avail of ECB for working capital. Such ECBs will be allowed based on the cash flow, foreign exchange earnings and the capability to service the debt and the ECBs can be raised with a minimum average maturity period of three years.

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. The scheme will be available upto March 31, 2015.

- j. **ECB for general corporate purposes from direct foreign equity holders:** Eligible borrowers can avail ECB under approval route from their direct foreign equity holder company with a minimum average maturity of 7 years for general corporate purposes (which includes working capital) subject to the following conditions:
 - i. Minimum paid-up equity of 25 per cent should be held directly by the lender;
 - ii. Such ECBs would not be used for any purpose not permitted under extant the ECB guidelines (including on-lending to their group companies / step-down subsidiaries in India); and

- iii. Repayment of the principal shall commence only after completion of minimum average maturity of 7 years. No prepayment will be allowed before maturity.
- iv. Repayment of Rupee loans and/or fresh Rupee capital expenditure for companies with consistent forex earnings – USD 10 billion scheme
 - a) 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 avail of ECBs for repayment of outstanding Rupee loans availed of for capital expenditure from the domestic banking system and/or fresh Rupee capital expenditure provided they are consistent foreign exchange earners during the past three financial years and not in the default list/caution list of the Reserve Bank of India.

vi) End-uses not permitted

Other than the purposes specified hereinabove, the borrowings shall not be utilised for any other purpose including the following purposes, namely:

- (a) For on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate except Infrastructure Finance Companies (IFCs), banks and financial institutions eligible.
- (b) For real estate.
- (c) For and general corporate purpose which includes working capital [except as stated at I(B)(v)(i) and (j)] and repayment of existing Rupee loans.

vii) Guarantee

Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, financial institutions and NBFCs relating to ECB is not normally permitted. Applications for providing guarantee/ standby letter of credit or letter of comfort by banks, financial institutions relating to ECB in the case of SME will be considered on merit subject to prudential norms.

With a view to facilitating capacity expansion and technological upgradation in Indian textile industry, issue of guarantees, standby letters of credit, letters of undertaking and letters of comfort by banks in respect of ECB by textile companies for modernization or expansion of textile units will be considered under the Approval Route subject to prudential norms.

viii) Security

The choice of security to be provided to the lender / supplier is left to the borrower. However, creation of charge over immovable assets and financial securities, such as shares, in favour of the overseas lender is subject to Regulation 8 of Notification No. FEMA 21/RB-2000 dated May 3, 2000 and Regulation 3 of Notification No. FEMA 20/RB-2000 dated May 3, 2000 as amended from time to time, respectively. Powers have been delegated to Authorised Dealer Category I banks to issue necessary NOCs under FEMA Regulations.

ix) Parking of ECB proceeds

Borrowers are permitted to either keep ECB proceeds abroad or to remit these funds to India, pending utilization for permissible end-uses.

The proceeds of the ECB raised abroad meant for Rupee expenditure in India, such as, local sourcing of capital goods, on-lending to Self-Help Groups or for micro credit, payment for spectrum allocation, repayment of rupee loan availed from domestic banks, etc. should be repatriated immediately for credit to their Rupee accounts with AD Category I banks in India. In other words, ECB proceeds meant only for foreign currency expenditure can be retained abroad pending utilization. The rupee

funds, however, will not be permitted to be used for investment in capital markets, real estate or for inter-corporate lending.

ECB proceeds parked overseas can be invested in the following liquid assets (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/ Fitch IBCA or Aa3 by Moody's; (b) Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above and (c) deposits with overseas branches / subsidiaries of Indian banks abroad. The funds should be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.

The primary responsibility to ensure that the ECB proceeds meant for Rupee expenditure in India are repatriated to India for credit to their Rupee accounts with AD Category- I banks in India is that of the borrower concerned and any contravention of the ECB guidelines will be viewed seriously and will invite penal action under the Foreign Exchange Management Act (FEMA), 1999. The designated AD bank is also required to ensure that the ECB proceeds meant for Rupee expenditure are repatriated to India immediately after drawdown.

x) Prepayment

(a) Prepayment of ECB beyond USD 500 million will be considered by the Reserve Bank subject to compliance with the stipulated minimum average maturity period as applicable to the loan. would be considered by the Reserve Bank under the Approval Route.

xi) Refinancing/rescheduling of an existing ECB

The cases where the existing ECB is proposed to be refinanced by raising a fresh ECB at a lower all-in-cost are considered under the approval route if the average maturity period of the fresh ECB is more than the residual maturity of the existing ECB.

xii) Debt Servicing

The designated AD bank has general permission to make remittances of installments of principal, interest and other charges in conformity with the ECB guidelines issued by Government / Reserve Bank from time to time.

xiii) Procedure

Applicants are required to submit an application in form ECB through designated AD bank to the Chief General Manager-in-Charge, Foreign Exchange Department, Reserve Bank of India, Central Office, External Commercial Borrowings Division, Mumbai – 400 001, along with necessary documents.

xiv) Empowered Committee

Reserve Bank has set up an Empowered Committee to consider proposals coming under the Approval Route.

CONVERSION OF ECB INTO EQUITY

(i) Conversion of ECB into equity is permitted subject to the following conditions:

- a. The activity of the company is covered under the Automatic Route for Foreign Direct Investment or Government (FIPB) approval for foreign equity participation has been obtained by the company, wherever applicable.
- b. The foreign equity holding after such conversion of debt into equity is within the sectoral cap, if any.
- c. Pricing of shares is as per the pricing guidelines issued under FEMA, 1999 in the case of listed/ unlisted companies.

d. Conversion of ECB and Lumpsum Fee / Royalty into Equity: In case the ECB liability, denominated in foreign currency and /or import of capital goods, etc. is sought to be converted by the company, it will be in order to apply the exchange rate prevailing on the date of the agreement between the parties concerned for such conversion. Reserve Bank will have no objection if the borrower company wishes to issue equity shares for a rupee amount less than that arrived at as mentioned above by a mutual agreement with the ECB lender. It may be noted that the fair value of the equity shares to be issued shall be worked out with reference to the date of conversion only. The principle of calculation of INR equivalent for a liability denominated in foreign currency as mentioned above shall apply, mutatis mutandis, to all cases where any payables/liability by an Indian company such as, lump sum fees/royalties, etc. are permitted to be converted to equity shares or other securities to be issued to a non-resident subject to the conditions stipulated under the respective Regulations.

(ii) Conversion of ECB may be reported to the Reserve Bank as follows:

- a. Borrowers are required to report full conversion of outstanding ECB into equity in the form FC-GPR to the Regional Office concerned of the Reserve Bank as well as in form ECB-2 submitted to the DSIM, RBI within seven working days from the close of month to which it relates. The words "ECB wholly converted to equity" should be clearly indicated on top of the ECB-2 form. Once reported, filing of ECB-2 in the subsequent months is not necessary.
- b. In case of partial conversion of outstanding ECB into equity, borrowers are required to report the converted portion in form FC-GPR to the Regional Office concerned as well as in form ECB-2 clearly differentiating the converted portion from the unconverted portion. The words "ECB partially converted to equity" should be indicated on top of the ECB-2 form. In subsequent months, the outstanding portion of ECB should be reported in ECB-2 form to DSIM.

LESSON ROUND UP

- Indian companies are allowed to raise equity capital in the international market through the issue of GDR/ADR/FCCB/FCEB.
- In the Year 2007-2008, the Indian Government notified the Foreign Currency Exchangeable Bonds Scheme, 2008 for the issue of FCEBs.
- FCCB are regulated by the FCCB and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993.
- The FCCBs are unsecured, carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company.
- The issue of GDRs/FCCBs requires the Approval of a Board of Directors, shareholders, "In principle and Final" approval of Ministry of Finance, Approval of Reserve Bank of India, In-principle consent of Stock Exchange for listing of underlying shares and In-principle consent of Financial institutions.
- External Commercial Borrowings (ECB) include commercial bank loans, buyers' credit, suppliers credit, securitised instruments such as floating rate notes and fixed rate bonds.
- External Commercial Borrowings (ECB) can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route.

GLOSSARY

CEDEL

One of the two major organizations in the Eurobond market which clears or handles the physical exchange of, securities and stores securities. Based in Luxembourg,

	the company is owned by several shareholding banks and operates through a network of agents.
Eurobond	Eurobonds are issued in a specific currency outside the currency's domicile. They are not subject to withholding tax and fall outside the jurisdiction of any one country. The Eurobond market is based in London. Not to be confused with euro-denominated bonds.
Renminbi (RMB)	It is the official currency of China. The primary unit of renminbi is the yuan.
Bridge Finance	Bridging finance is a short-term loan that allows the borrower a period to time, before refinancing the loan. That is, it provides a 'bridge' for the borrower.
DTAA	DTAA or Double Taxation Avoidance Agreement is a tax treaty that India has with other countries. In plain language, what this means for an NRI is, if he/she is a resident in any of those countries and is paying taxes on the income earned in that country, then he/she is eligible for a lower deduction of tax on income earned in India in that financial year.

SELF TEST QUESTIONS

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

1. What is FCCB? Briefly explain the benefits available to the investors by investing in FCCB.
2. What do you mean by FCEB? What are the eligibility conditions for issuing FCEB?
3. Differentiate between FCCB and FCEB?
4. Describe the procedure for accessing External Commercial Borrowing through approval route?
5. Write short notes on
 - (a) Sponsored ADR/GDR issue
 - (b) Two Way Fungibility Scheme
6. What are the provisions relating to transfer/redemption of GDRs?
7. Who are eligible to access ECBs through automatic route?

Lesson 12

Indian Depository Receipts

LESSON OUTLINE

- Introduction
- Advantages of IDRs
- Regulatory Framework of IDRs- An overview
- Rule 13 of the Companies (Registration of Foreign Companies) Rules, 2014
- SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009
- Rights Issue of Indian Depository Receipts
- Compliances under Listing Agreement for Indian Depository Receipts (IDRs)
- Compliances under Model Listing Agreement for IDRs
- Lesson Round-Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

Investment in Indian Depository Receipts (IDRs) is an interesting opportunity for the Indian Investors who are looking for investing their funds in foreign equity. Just like American Depository Receipts or Global Depository Receipts, which are instruments used by Indian Companies to raise money abroad, IDRs are meant for foreign companies looking to raise capital in India.

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

This lesson will enable the students understanding the basic concepts of Indian Depository Receipts (IDRs), Overview of legal framework governing IDRs, Procedures for making an issue of Indian Depository Receipts and Listing Companies required for issuance of Indian Depository Receipts under listing agreement.

INTRODUCTION

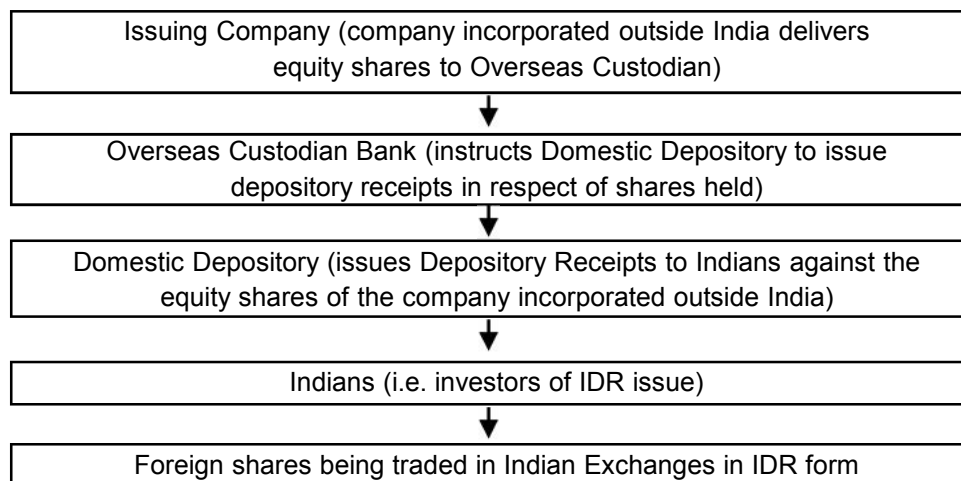
The world has become global village due to the technology advancement and as a result the Securities Market have become international. Companies that previously had to raise capital in the domestic market can now tap foreign sources of capital through ADR/GDR/FCCB/FCEB in overseas market to raise fund from international market. As India is a preferred investment destination among international investors, the Government of India has introduced the concept of Indian Depository Receipts (IDRs) to facilitate listing by foreign companies on India Stock Exchanges. Global banking giant Standard Chartered PLC was came out with the first issue of IDR and listed itself on the Indian stock exchanges in the year 2010. The IDR issue by Standard Chartered PLC was not only the first IDR offering but it was also the first public offering to complete listing and trading within the reduced timelines of 12 working days as notified by SEBI vide its circular dated April 22, 2010.

Indian Depository Receipt means any instrument in the form of a depository receipt created by Domestic Depository in India against the underlying equity shares of issuing company. "Domestic Depository" means custodian of securities registered with SEBI and authorised by the issuing company to issue Indian Depository Receipts.

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

Process involved in issue of India Depository Receipts (IDRs)

The following flowchart describes the IDRs process :



ADVANTAGES OF THE IDR

Benefits to the Issuing Company

- It provides access to a large pool of capital to the issuing capita.
- It gives brand recognition in India to the issuing company.
- It facilitates acquisitions in India.
- Provides an exit route for existing shareholders.

Benefits to Investors

- It provides portfolio diversification to the investor.
- It gives the facility of ease of investment.
- There is no need to know your customer norms.
- No resident Indian individual can hold more than \$200,000 worth of foreign securities purchased per

year as per Indian foreign exchange regulations. However, this will not be applicable for IDRs which gives Indian residents the chance to invest in an Indian listed foreign entity.

REGULATORY FRAMEWORK OF IDRs – AN OVERVIEW

Regulatory Bodies

- The Securities and Exchange Board of India
- The Ministry of Corporate Affairs
- The Reserve Bank of India

Statutes Governing IDRs

- Section 390 of the Companies Act, 2013
- Rule 13 of the Companies (Registration of Foreign Companies) Rules, 2014
- Chapter X & XA of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

Date	Issuing authority	Legislation	Effect
December 13, 2000	Ministry of Corporate Affairs, Government of India, (MCA)	Insertion of section 605 A to the Companies Act, 1956	Enabling section to permit foreign companies to issue IDR's as a security to investors in India
February 23, 2004	MCA	IDR Rules	Created Framework for issue of IDR's
April 3, 2006	SEBI	DIP Guidelines	Disclosure requirements for listing IDR's specified
April 3, 2006	SEBI	SEBI Circular SEBI/CFD/DIL/DIP/20/2006/3/4 Model Listing Agreement	Provided the model terms and conditions of an agreement between the issuing company and the stock exchanges for listing IDR's on Indian stock exchange
July 11, 2007	MCA	IDR Rules	Relaxation of eligibility criteria for issue of IDR's
November 29, 2007	SEBI	DIP Guidelines	Permitting retail investors to subscribe to IDR's
January 19, 2009 (January 2009 Amendments)	MCA	IDR Rules	<ul style="list-style-type: none"> • Removal of one (1) year lock in for conversion from IDR to Equity Shares • Permitting issue of IDRs to persons other than persons resident in India. • Overseas Custodian Bank need not have a place of business in India.
April 13, 2009	SEBI	Approving proposal in its Board Meeting	Enable a) mutual funds and FII's to invest in IDRs subject to the Foreign Exchange Management Act, 1999 ("FEMA"); (b) electronic holding of IDRs; and

			(c) issue of IDRs by custodians on behalf of issuers.
June 9, 2009	SEBI	SEBI Circular SEBI/IMD/CIR No. 1/165935/2009 dated June 9, 2009	Clarification for Mutual Funds for investing in IDRs
June 16, 2009	SEBI	SEBI Circular SEBI/CFD/DIL/IDR/1/2009/16/06 dated June 16, 2009	Simplified Model Listing Agreement for Issuing Companies, whose securities market regulators are signatories to the Multilateral Memorandum of Understandings of International Organization of Securities commission
June 19, 2009	SEBI	SEBI (Facilitation of Issuance of Indian Depository Receipts) (Amendment) Regulations, 2009	<ul style="list-style-type: none"> • Permitting FII's to invest in IDRs; • Enabling electronic holding of IDRs; and • Enabling issue of IDRs by Custodians on behalf of Issuing Company
July 22, 2009	RBI	RBI Circular RBI/2009-10/106 AP (DIR Series) Circular No. 05 dated July 22, 2009	<ul style="list-style-type: none"> • Prior approval required for banking/ finance companies having presence in India • Clarity on procedure for repatriation of IDR proceeds • One year lock-in on redemption of IDRs • Permitting Investment by FII's / NRIs in IDRs; • Guideline for redemption/ conversion of IDRs.
July 31, 2009	SEBI	SEBI/CFD/DIL/DIP/37/2009/31/07 dated July 31, 2009	<ul style="list-style-type: none"> • Pro rata allotment of IDRs • Audited Financial Statements to be prepared in accordance with Indian GAAP or with the International Financial Reporting Standards or US GAAP, for a period of three (3) financial years immediately preceding the date of prospectus
September 3, 2009	SEBI	ICDR	Replace the DIP guidelines in entirety
September 22, 2009	SEBI	Approving proposal in its board meeting	Permitting issue of IDR's to anchor investor
August 28, 2012	RBI	RBI/2012-13/178 AP (DIR Series) Circular No. 19	(SEBI) has allowed partial fungibility of Indian Depository Receipts (IDRs) – redemption or conversion of IDRs into underlying equity shares – in a financial year to the extent of 25 per cent of the IDRs originally issued.

March 01, 2013	SEBI	SEBI Circular No. CIR/CFD/6/2013	Broad Guidelines for fungibility of future IDR issuance and the existed listed IDRs.
March 31, 2014	MCA	GSR 266 (E), dated 31-3-2014	Companies (Registration of Foreign Companies) Rules, 2014
April 1, 2014	MCA	Section 390 of the Companies Act, 2013	Offer of Indian Depository Receipts

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

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

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

ELIGIBILITY FOR ISSUE OF IDRs

Sub-rule 2 stipulates that the issuing company shall not issue IDRs unless –

- (a) its pre-issue paid-up capital and free reserves are at least US\$ 50 million and it has a minimum average market capitalization (during the last three years) in its parent country of at least US\$ 100 million;
- (b) it has been continuously trading on a stock exchange in its parent or home country (the country of incorporation of such company) for at least three immediately preceding years;
- (c) it has a track record of distributable profits in terms of section 123 of the Act, for at least three out of immediately preceding five years;
- (d) it fulfills such other eligibility criteria as may be laid down by the Securities and Exchange Board of India from time to time in this behalf.

PROCEDURE FOR MAKING AN ISSUE OF IDRs

Sub-rule 3 lays down the procedure for making an issue of IDRs. The issuing company shall follow the following procedure for making an issue of IDRs:

- (a) the issuing company shall, where required, obtain the necessary approvals or exemptions from the appropriate authorities from the country of its incorporation under the relevant laws relating to issue of capital and IDRs.
- (b) issuing company shall obtain prior written approval from SEBI on an application made in this behalf for issue of IDRs along with the issue size.
- (c) an application under clause (b) shall be made to SEBI (along with draft prospectus) at least ninety days prior to the opening date of the IDRs issue, in such form, along with such fee and furnishing such information as may be specified by the Securities and Exchange Board of India from time to time:

However, the issuing company shall also file with SEBI, through a Merchant Banker, a due diligence report along with the application under clause (b) in the form specified by SEBI.

- (d) SEBI may, within a period of thirty days of receipt of an application under clause (c), call for such further

information, and explanations, as it may deem necessary, for disposal of such application and shall dispose the application within a period of thirty days of receipt of further information or explanation.

However, if within a period of sixty days from the date of submission of application or draft prospectus, SEBI specifies any changes to be made in the draft prospectus, the prospectus shall not be filed with SEBI or Registrar of Companies unless such changes have been incorporated therein.

- (e) the issuing company shall on approval being granted by the Securities and Exchange Board of India to an application under clause (b), pay to the Securities and Exchange Board of India an issue fee as may be prescribed from time to time by the Securities and Exchange Board of India.
- (f) the issuing company shall file a prospectus, certified by two authorized signatories of the issuing company, one of whom shall be a whole-time director and other the Chief Financial Officer, stating the particulars of the resolution of the Board by which it was approved with SEBI and Registrar of Companies, New Delhi before such issue.

However, at the time of filing of said prospectus with the Registrar of Companies, New Delhi, a copy of approval granted by SEBI and the statement of fees paid by the Issuing Company to SEBI shall also be attached.

- (g) the prospectus to be filed with SEBI and the Registrar of Companies, New Delhi shall contain the particulars as prescribed in sub-rule (8) and shall be signed by all the whole-time directors of the issuing company, and the Chief Financial Officer.
- (h) the issuing company shall appoint an overseas custodian bank, a Domestic Depository and a Merchant Banker for the purpose of issue of IDRs.
- (i) the issuing company may appoint underwriters registered with SEBI to underwrite the issue of IDRs.
- (j) the issuing company shall deliver the underlying equity shares or cause them to be delivered to an Overseas Custodian Bank and the said bank shall authorize the domestic depository to issue IDRs.
- (k) the issuing company shall obtain in-principle listing permission from one or more stock exchanges having nationwide trading terminals in India.

REGISTRATION OF DOCUMENTS

Sub-rule 4 provides that the Merchant Banker to the issue of IDRs shall deliver for registration the following documents or information to SEBI and Registrar of Companies at New Delhi, namely:-

- (a) instrument constituting or defining the constitution of the issuing company;
- (b) the enactments or provisions having the force of law by or under which the incorporation of the Issuing company was effected, a copy of such provisions attested by an officer of the company be annexed;
- (c) if the issuing company has established place of business in India, address of its principal office in India;
- (d) if the issuing company does not establish a principal place of business in India, an address in India where the said instrument, enactments or provision or copies thereof are available for public inspection, and if these are not in English, a translation thereof certified by a key managerial personnel of the Issuing company shall be kept for public inspection;
- (e) a certified copy of the certificate of incorporation of the issuing company in the country in which it is incorporated;
- (f) the copies of the agreements entered into between the issuing company, the overseas custodian bank, the Domestic Depository, which shall inter alia specify the rights to be passed on to the IDR holders;
- (g) if any document or any portion thereof required to be filed with SEBI or the Registrar of Companies is

not in English language, a translation of that document or portion thereof in English, certified by a key managerial personnel of the company to be correct and attested by an authorized officer of the Embassy or Consulate of that country in India, shall be attached to each copy of the document.

CONDITIONS FOR ISSUE OF PROSPECTUS AND APPLICATION

Sub-rule 5 deals with conditions required to be fulfilled for issue of prospectus which is as under:

- (a) No application form for the securities of the issuing company shall be issued unless the form is accompanied by a memorandum containing the salient features of prospectus in the specified form.
- (b) An application form can be issued without the memorandum as specified in clause (a), if it is issued in connection with an invitation to enter into an underwriting agreement with respect to the IDRs.
- (c) The prospectus for subscription of IDRs of the Issuing company which includes a statement purporting to be made by an expert shall not be circulated, issued or distributed in India or abroad unless a statement that the expert has given his written consent to the issue thereof and has not withdrawn such consent before the delivery of a copy of the prospectus to SEBI and the Registrar of Companies, New Delhi, appears on the prospectus.
- (d) The provisions of the Act shall apply for all liabilities for mis-statements in prospectus or punishment for fraudulently inducing persons to invest money in IDRs.
- (e) The person(s) responsible for issue of the prospectus shall not incur any liability by reason of any non-compliance with or contravention of any provision of this rule, if –
 - (i) as regards any matter not disclosed, he proves that he had no knowledge thereof; or
 - (ii) the contravention arose in respect of such matters which in the opinion of the Central Government or SEBI were not material.

PROCEDURE FOR TRANSFER AND REDEMPTION

Sub-rule 6 narrates the procedure for transfer and redemption of IDRS.

- (a) A holder of IDRs may transfer the IDRs, may ask the Domestic Depository to redeem them or any person may seek reissuance of IDRs by conversion of underlying equity shares, subject to the provisions of the Foreign Exchange Management Act, 1999, the SEBI Act, 1992, or the rules, regulations or guidelines issued under these Acts, or any other law for the time being in force;
- (b) In case of redemption, Domestic Depository shall request the Overseas Custodian Bank to get the corresponding underlying equity shares released in favour of the holder of IDRs for being sold directly on behalf of holder of IDRs, or being transferred in the books of Issuing company in the name of holder of IDRs and a copy of such request shall be sent to the issuing company for information.
- (c) A holder of IDRs may, at any time, nominate a person to whom his IDRs shall vest in the event of his death and Form FC-5 may be used for this purpose.

REPATRIATION

Sub-rule 7 provides for repatriation of issue proceeds of IDRS.

- (a) The repatriation of the proceeds of issue of IDRs shall be subject to laws for the time being in force relating to export of foreign exchange.
- (b) The number of underlying equity shares offered in a financial year through IDR offerings shall not exceed twenty five per cent. of the post issue number of equity shares of the company.

- (c) Notwithstanding the denomination of securities of an Issuing company, the IDRs issued by it shall be denominated in Indian Rupees.
- (d) The IDRs issued under this Rule shall be listed on the recognized Stock Exchange(s) in India as specified in clause (k) of sub-rule (3) and such IDRs may be purchased, possessed and freely transferred by a person resident in India as defined in section 2(v) of the Foreign Exchange Management Act, 1999, subject to the provisions of the said Act:

Provided that the IDRs issued by an Issuing company may be purchased, possessed and transferred by a person other than a person resident in India if such Issuing company obtains specific approval from Reserve Bank of India in this regard or complies with any policy or guidelines that may be issued by Reserve Bank of India on the subject matter;
- (e) Every issuing company shall comply with such continuous disclosure requirements as may be specified by SEBI in this regard.
- (f) On the receipt of dividend or other corporate action on the IDRs as specified in the agreements between the Issuing company and the Domestic Depository, the Domestic Depository shall distribute them to the IDR holders in proportion to their holdings of IDRs.

DISCLOSURES

Rule 8 prescribes the disclosures of the following particulars are to be specified in the prospectus or letter of offer:-

- (a) General information
 - (i) Name and address of the registered office of the company;
 - (ii) Name and address of the Domestic Depository, the Overseas Custodian Bank with the address of its office in India, the Merchant Banker, the underwriter to the issue and any other intermediary which may be appointed in connection with the issue of IDRs;
 - (iii) Names and addresses of Stock Exchanges where applications are made or proposed to be made for listing of the IDRs;
 - (iv) The provisions relating to punishment for fictitious applications;
 - (v) Statement/declaration for refund of excess subscription;
 - (vi) Declaration about issue of allotment letters/certificates/ IDRs within the stipulated period;
 - (vii) Date of opening of issue;
 - (viii) Date of closing of issue;
 - (ix) Date of earliest closing of the issue;
 - (x) Declaration by the Merchant Banker with regard to adequacy of resources of underwriters to discharge their respective obligations, in case of being required to do so;
 - (xi) A statement by the issuing company that all moneys received out of issue of IDRs shall be transferred to a separate domestic bank account, name and address of the bank and the nature and number of the account to which the amount shall be credited;
 - (xii) The details of proposed utilisation of the proceeds of the IDR issue.
- (b) Capital Structure of the Company
 - Authorised, issued, subscribed and paid-up capital of the issuing company.

- (c) Terms of the issue
- (i) Rights of the IDR holders against the underlying securities;
 - (ii) Details of availability of prospectus and forms, i.e., date, time, place etc;
 - (iii) Amount and mode of payment seeking issue of IDRs; and
 - (iv) Any special tax benefits for the issuing company and holders of IDRs in India.
- (d) Particulars of Issue
- (i) Objects of the issue;
 - (ii) Cost of the Project, if any; and
 - (iii) Means of financing the projects, if any including contribution by promoters.
- (e) Company, Management and Project
- (i) Main object, history and present business of the company;
 - (ii) The promoters or parent group or owner group and their background. However, in case there are no identifiable promoters, the names, addresses and other particulars as may be specified by SEBI of all the persons who hold 5% or more equity share capital of the company shall be disclosed;
 - (iii) subsidiaries of the company, if any;
 - (iv) particulars of the Management/Board (i.e. Name and complete address(es) of Directors, Manager, Managing Director or other principal officers of the company);
 - (v) location of the project, if any;
 - (vi) details of plant and machinery, infrastructure facilities, technology etc., where applicable;
 - (vii) schedule of implementation of project and progress made so far, if applicable;
 - (viii) nature of product(s), consumer(s), industrial users;
 - (ix) particulars of legal, financial and other defaults, if any;
 - (x) risk factors to the issue as perceived;
 - (xi) consent of Merchant Bankers, overseas custodian bank, the domestic depository and all other intermediaries associated with the issue of IDRs; and
 - (xii) the information, as may be specified by SEBI, in respect of listing, trading record or history of the Issuing Company on all the stock exchanges, whether situated in its parent country or elsewhere.
- (f) Report
- (i) Where the law of a country, in which the Issuing company is incorporated, requires annual statutory audit of the accounts of the Issuing company, a report by the statutory auditor of the Issuing company, in such form as may be prescribed by SEBI on –
 - (A) the audited financial statements of the Issuing Company in respect of three financial years immediately preceding the date of prospectus, and
 - (B) the interim audited financial statements in respect of the period ending on a date which is less than 180 days prior to the date of opening of the issue, if the gap between the ending date of the latest audited financial statements disclosed under item (A) and the date of opening of issue is more than 180 days.

However, if the gap between such date of latest financial statements and the date of opening of issue is 180 days or less, the requirement under item (B) shall be deemed to be complied with if a statement, as may be specified by SEBI, in respect of changes in the financial position of issuing company for such gap is disclosed in the prospectus.

Further, in case of an issuing company which is a foreign bank incorporated outside India and which is regulated by a member of the Bank for International settlements or a member of the International Organization of Securities Commissions which is a signatory to a Multinational Memorandum of Understanding with India, the requirement in respect of period beginning with last date of period for which the latest audited financial statements are made and the date of opening of issue shall be satisfied, if the relevant financial statements are based on limited review report of such statutory auditor.

(ii) Where the law of the country, in which the Issuing company is incorporated, does not require annual statutory audit of the accounts of the Issuing company, a report, in such form as may be specified by SEBI, certified by a Chartered Accountant in practice within the meaning of the Chartered Accountants Act, 1949, on –

(A) the financial Statements of the Issuing Company, in particular on the profits and losses for each of the three financial years immediately preceding the date of prospectus and upon the assets and liabilities of the Issuing Company and

(B) the interim financial statements in respect of the period ending on a date which is less than 180 days prior to the date of opening of the issue have to be included in the report, if the gap between the ending date of the latest financial statements disclosed under item (A) and the date of opening of issue is more than 180 days.

However, if the gap between such date of latest audited financial statements and the date of opening of issue is 180 days or less, the requirement under clause (B) shall be deemed to be complied with if a statement, as may be specified by SEBI, in respect of changes in the financial position of the issuing company for such gap is disclosed in the prospectus.

(iii) The gap between date of opening of issue and date of reports under the said provisions shall not exceed 120 days.

(iv) If the proceeds of the IDR issue are used for investing in other body(ies) corporate, then following details should be given:

(a) Name and address(es) of the bodies corporate;

(b) The reports stated in para (i) & (ii) above in respect of those bodies corporate also.

(g) Other Information

(i) Minimum subscription for the issue.

(ii) Fees and expenses payable to the intermediaries involved in the issue of IDRs.

(iii) the declaration with regard to compliance with the Foreign exchange Management Act, 1999.

(h) Inspection of Documents

The place at which inspection of the offer documents, the financial statements and auditor's report thereof will be allowed during the normal business hours.

Any other information as specified by SEBI or the Income Tax Authorities or the Reserve Bank of India or other regulatory authorities from time to time.

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

The provisions of Chapter X shall apply to an issue of Indian Depository Receipts made in terms of section 390 of the Companies Act, 2013 and Rule 13 of the Companies (Registration of Foreign Companies) Rules, 2014.

ELIGIBILITY

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

- (a) the issuing company is listed in its home country;
- (b) the issuing company is not prohibited to issue securities by any regulatory body;
- (c) the issuing company has track record of compliance with securities market regulations in its home country.

CONDITIONS FOR ISSUE OF IDR

An issue of IDR shall be subject to the following conditions:

- (a) issue size shall not be less than fifty crore rupees;
- (b) procedure to be followed by each class of applicant for applying shall be mentioned in the prospectus;
- (c) minimum application amount shall be twenty thousand rupees;
- (d) at least fifty per cent. of the IDR issued shall be allotted to qualified institutional buyers on proportionate basis;
- (e) the balance fifty per cent. may be allocated among the categories of non-institutional investors and retail individual investors including employees at the discretion of the issuer and the manner of allocation shall be disclosed in the prospectus. Allotment to investors within a category shall be on proportionate basis;

However, atleast thirty percent of IDRs being offered in the public issue shall be available for allocation to retail individual investors and in case of under subscription in retail individual investor category. Spillover to the other categories to the extent of under subscription can be permitted.

- (f) at any given time, there shall be only one denomination of IDR of the issuing company.

PROVISION RELATED TO MINIMUM SUBSCRIPTION***For non-underwritten issues***

- (a) If the issuing company does not receive the minimum subscription of ninety per cent of the offer through offer document on the date of closure of the issue, or if the subscription level falls below ninety per cent. after the closure of issue on account of cheques having being returned unpaid or withdrawal of applications, the issuing company shall forthwith refund the entire subscription amount received.
- (b) If the issuing company fails to refund the entire subscription amount within fifteen days from the date of the closure of the issue, it is liable to pay the amount with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay.

For underwritten issues

If the issuing company does not receive the minimum subscription of ninety per cent. of the offer through offer document including devolvement of underwriters within sixty days from the date of closure of the issue, the issuing company shall forthwith refund the entire subscription amount received with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay beyond sixty days.

FUNGIBILITY

Partial fungibility of IDRs (i.e. redemption/conversion of IDRs into underlying equity shares) in a financial year to the extent of 25 % of the IDRs originally issued is allowed. All the IDRs shall have partial two-way fungibility.

The partial two-way fungibility means that the IDRs can be converted into underlying equity shares and the underlying equity shares can be converted into IDRs within the available headroom. The headroom for this purpose shall be the number of IDRs originally issued minus the number of IDRs outstanding which is further adjusted for IDRs redeemed into underlying equity shares. SEBI has issued broad guidelines for fungibility of future IDR issuances and the existing listed IDRs.

FILING OF DRAFT PROSPECTUS, DUE DILIGENCE CERTIFICATES, PAYMENT OF FEES AND ISSUE ADVERTISEMENT FOR IDRs

1. The issuing company making an issue of IDR shall enter into an agreement with a merchant banker.
2. Where the issue is managed by more than one merchant banker, the rights, obligations and responsibilities, relating inter-alia to disclosures, allotment, refund and underwriting obligations, if any, of each merchant banker shall be predetermined and disclosed in the prospectus.
3. The issuing company shall file a draft prospectus with SEBI through a merchant banker along with the requisite fee, as prescribed in Companies (Issue of Indian Depository Receipts) Rules, 2004.
4. The prospectus filed with SEBI shall also be furnished to SEBI in a soft copy.
5. The lead merchant bankers shall:
 - (a) submit a due diligence certificate in a prescribed format to SEBI along with the draft prospectus.
 - (b) certify that all amendments, suggestions or observations made by SEBI have been incorporated in the prospectus
 - (c) submit a fresh due diligence certificate, at the time of filing the prospectus with the Registrar of the Companies.
 - (d) furnish a certificate, immediately before the opening of the issue, certifying that no corrective action is required on its part.
 - (e) furnish a certificate, after the issue has opened but before it closes for subscription.
6. The issuing company shall make arrangements for mandatory collection centres.
7. The issuing company shall issue an advertisement in one English national daily newspaper with wide circulation and one Hindi national daily newspaper with wide circulation, soon after receiving final observations, if any, on the publicly filed draft prospectus with SEBI and contain the minimum disclosures as prescribed by SEBI.

DISPLAY OF BID DATA

The stock exchanges offering online bidding system for the book building process shall display on their website, the data pertaining to book built IDR issue, from the date of opening of the bids till at least three days after closure of bids.

DISCLOSURES IN PROSPECTUS AND ABRIDGED PROSPECTUS

1. The prospectus shall contain all material disclosures which are true, correct and adequate so as to enable the applicants to take an informed investment decision.
2. Without prejudice to the generality of sub-regulation (1), the prospectus shall contain:

- (a) the disclosures specified in Schedule to Companies (Issue of Indian Depository Receipts) Rules, 2004; and
 - (b) the disclosures in the manner as specified in these regulations.
3. The abridged prospectus for issue of Indian Depository Receipts shall contain the disclosures as specified by SEBI in these regulations.

POST-ISSUE REPORTS

1. The merchant banker shall submit post-issue reports to SEBI.
2. The post-issue reports shall be submitted as follows:
 - (a) initial post issue report, within three days of closure of the issue;
 - (b) final post issue report, within fifteen days of the date of finalisation of basis of allotment or within fifteen days of refund of money in case of failure of issue.

UNDERSUBSCRIBED ISSUE

In case of undersubscribed issue of IDR, the merchant banker shall furnish information in respect of underwriters who have failed to meet their underwriting devolvement to SEBI.

FINALISATION OF BASIS OF ALLOTMENT

The executive director or managing director of the stock exchange, where the IDR are proposed to be listed, along with the post issue lead merchant bankers and registrars to the issue shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified in this behalf by SEBI.

RIGHTS ISSUE OF INDIAN DEPOSITORY RECEIPTS

In the light of the Standard Chartered Rights Issue where rights could not be granted to IDR holders, SEBI amended the ICDR regulations, 2009 on September 23, 2011 by inserting a new chapter viz. Chapter XA in the existing regulations, governing the rights issue of Indian Depository Receipts. The chapter provides for the various governing criteria's for a rights issue of IDR such as applicability, eligibility, disclosures etc.

Eligibility

- Issuer should not be in breach of any ongoing material obligations under the IDR Listing Agreement;
- Application to all recognised stock exchanges, where such IDRs are listed, must have been made, for listing of IDRs to be issued by way of rights, before such issue.

Disclosures

Following disclosures shall be made:

- Disclosures as required in the home country of the issuer;
- An additional wrap (addendum to offer document) attached to the offer document.

The Regulations further provide for:

- Disclosures in Abridged Prospectus;
- Disclosures in Addendum to Offer;
- Disclosures in Abridger Letter of offer;

- Dispatch of abridged letter of offer and application form;
- Pre-Issue Advertisement for rights issue.

Fast Track Issue

- The issuer is in compliance with the provisions of deposit agreement and listing agreement for a period of at least 3 (Three) years immediately preceding the date of filing of the offer document;
- The offer document has been filled and reviewed by the securities regulator in the home country of the issuer;
- There are no pending show-cause notices or prosecutions proceedings against the issuer or its promoter, or wholtime directors on the reference date by SEBI or the regulatory authorities in its home country restricting them from accessing the capital markets; and
- Issuer has redressed at least 95% (Ninety Five per cent) of the complaints received from the IDR holders before the end of 3 (Three) months period preceding the filing of letter of offer.

Other Relevant Provisions

The Regulations further provide that:

- The rights offering must include a right exercisable by the person concerned to renounce the IDRs offered in favour of any other person subject to applicable laws;
- If an issuer withdraws the rights issue after announcing the record date, he is restricted from making an application for offering of IDRs on a rights basis for a period of 12 (Twelve) months from the said record date;
- A rights issue shall be open for subscription for a period as applicable under the laws of its home country but in no case less than 10 (Ten) days;
- Issuer shall utilize funds raised in relation to the IDRs pursuant to the rights offering only upon completion of the allotment process.

COMPLIANCES UNDER LISTING AGREEMENT FOR INDIAN DEPOSITORY RECEIPTS (IDRs)

Every issuer of an IDR has to comply with the conditions stipulated in the listing agreement for IDRs issued by SEBI. The highlights of the same are enumerated in the following table.

Reference	Subject matter	Requirement
Clause 1	Share allotment; advices of rights entitlement	Allotment should be made simultaneously and that in the event of its being impossible to issue letters of regret at the same time, a notice to that effect will be inserted in the press so that it will appear on the morning after the letters of allotment have been posted; advices of rights entitlement, wherever applicable, should be issued simultaneously.
Clause 2	Intimation of date of Board Meeting	The Issuer is required to notify stock exchange at least 7 days in advance of the date of the meeting of its Board of Directors at which the recommendation or declaration of a dividend or a rights issue or convertible debentures, proposal for declaration of any bonus issue etc.

Clause 3	Intimation after Board Meeting	The Issuer is required to, immediately after the meeting of its Board of Directors has been held to consider or decide the same, intimate to the Stock Exchange, (within 15 minutes of the closure of the board meeting) by phone, fax, telegram, e-mail about decision on recommendation/declaration of dividend, matters such as the total turnover, gross profit/loss, provision for depreciation, tax provisions and net profits for the year etc.,
Clause 4	Intimation to stock exchange on dividend payment	The Issuer is required to notify the stock exchange at least twenty-one days in advance of the date on and from which the dividend on shares will be payable .
Clause 6	Intimation to Stock Exchange about increase of capital, re-issue of forfeited shares etc.,	The Issuer is required to within 15 minutes of the closure of any board meeting intimate to the Stock Exchanges by phone, fax, telegram, e-mail about short particulars of any increase of capital, short particulars of the reissues of forfeited shares or securities, or the issue of shares or securities held in reserve for future issue or the creation in any form or manner of new shares or securities or any other rights, privileges or benefits to subscribe thereto, short particulars of any other alterations of capital, including calls, any other information necessary to enable the holders of the IDRs to appraise the issuer's position and to avoid the establishment of a false market.
Clause 8	In-principal Approval	The issuer is required to obtain 'in-principle' approval for listing from the exchanges where its IDRs are listed, before issuing further IDRs.
Clause 11	Intimation to Stock exchange on matters pertaining to constitution of Board, Auditor, Compliance Officer etc.	The issuer is required to notify promptly to the stock exchange about change in the constitution of Board, Managing Director, Compliance officer, Auditor, Domestic Depository etc.,
Clause 12	Forwarding copies of notices, annual reports etc to stock exchange	Copies of all notices, resolutions and circulars relating to new issue of capital prior to their dispatch to the equity shareholders or IDR holders; copies of all the notices, call letters or any other circulars including notices of meetings at the same time as they are sent to the equity shareholders, IDR holders, debenture holders or creditors or any class of them or as they are advertised in the Press; copy of the proceedings at all Annual and Extraordinary General Meetings of the Issuer; copy of the deposit agreement as soon as it is executed; copies of all notices, circulars, etc., issued or advertised in the press etc.,
Clause 14	Filing of shareholding pattern	The issuer is required to file with the Exchange the shareholding pattern on a quarterly basis within 15 days of end of the quarter in the prescribed form.

Clause 15	Intimation of events as well as price sensitive information	The Issuer is required to intimate to the Stock Exchanges, immediately of events such as strikes, lock outs, closure on account of power cuts, etc. and all events which will have a bearing on the performance/ operations of the company as well as price sensitive information.
Clause 20	Intimation on Variation on projected and actual profitability statement	The Issuer is required furnish on a quarterly basis a statement to the stock exchange indicating the variations between projected utilisation of funds and/ or projected profitability statement made by it in its prospectus or letter of offer and the actual utilisation of funds and/or actual profitability.
Clause 23	Appointment of Company Secretary, undertaking of due diligence etc.	<p>The Issuer is required to :</p> <p>(a) appoint the Company Secretary of the Issuer as Compliance Officer who will directly liaise with the authorities such as SEBI, Stock Ex-changes, ROC etc., and investors with respect to implementation of various clause, rules, regulations and other directives of such authorities and investor service & complaints related matter.</p> <p>(b) undertake a due diligence survey to ascertain whether the RTA is sufficiently equipped with infrastructure facilities such as adequate manpower, computer hardware and software, office space, documents handling facility etc., to serve the IDR holders.</p> <p>(c) furnish a copy of agreement or MOU entered into with overseas custodian bank, domestic depository, merchant banker and RTA to the stock exchange</p>
Clause 24	Corporate Governance	<p>Requirements on</p> <p>(a) Composition of the Board</p> <p>(b) Non-executive directors' compensation and disclosures</p> <p>(c) Other provisions as to Board and Committees</p> <p>(d) Code of Conduct for the Board</p> <p>(e) Audit Committee, its meeting powers, role</p> <p>(f) Subsidiary companies</p> <p>(g) Disclosures</p> <p>(h) CEO/CFO Certification</p> <p>(i) Report on Corporate Governance</p> <p>(j) Compliance Certificate from Practising Company Secretary or auditors</p>

COMPLIANCES UNDER MODEL LISTING AGREEMENT FOR INDIAN DEPOSITORY RECEIPTS

SEBI has issued Model Listing Agreement for listing of Indian Depository Receipts (IDRs) issued by issuing companies whose securities market regulators are signatories to the Multilateral Memorandum of Understanding (MMOU) of International Organization of Securities Commissions (IOSCO).

Highlights

1. The Company should for all corporate actions (except those which are not permitted by Indian laws), will treat holders of IDRs, in a manner equitable with the holders of its equity shares in the home country;
2. The issuing company is required to notify the stock exchange at the same time it intimates to any other exchange, where its equity shares are listed, regarding the meeting, at which matters such as the recommendation or declaration of dividend or rights issue or issue of convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of the dividend and any decision on buy back of equity shares of the issuing company, are due to be considered.
3. The issuing company is required to intimate to the stock exchange after the meeting of its Board of Directors has been held to consider or decide the following, at the same time and to the extent it intimates the same to the listing authority in its home country or other jurisdictions where its securities may be listed, by electronic filing:
 - (a) all dividends and/or cash bonuses recommended or declared or the decision to pass any dividend or cash bonus; and
 - (b) the total turnover, gross profit/loss, provision for depreciation, tax provisions and net profits for the year (with comparison with the previous year) and the amounts appropriated from reserves, capital profits, accumulated profits of past years or other special source to provide wholly or partly for any dividend, even if this calls for qualification that such information is provisional or subject to audit.
4. The issuing company is required to notify the stock exchange at least seven working days in advance of the record date for the corporate actions like rights, bonus, splits and payment of any dividend to IDR Holders. The issuing company further agrees that the process for setting a record date for any corporate action will be disclosed in the offer document and prior intimation will be provided to the stock exchange and in the media if this process changes.
5. The issuing company is required to pay the dividend as per the timeframe applicable in its home country or other jurisdictions where its securities are listed, whichever is earlier, so as to reach the IDR Holders on or before the date fixed for payment of dividend to holders of its equity share or other securities.
6. The issuing company is required to promptly disclose to the stock exchanges the following by electronic filing:
 - (a) short particulars of any increase of capital whether by issue of bonus shares through capitalization, or by rights issue of equity shares, or in any other manner;
 - (b) short particulars of the reissues of forfeited shares or securities, or the issue of shares or securities held in reserve for future issue or the creation in any form or manner of new shares or securities or any other rights, privileges or benefits to subscribe thereto;
 - (c) short particulars of any other alterations of capital, including calls; and
 - (d) any other information necessary to enable the IDR Holders to appraise the issuing company's position and to avoid the establishment of a false market in IDRs;
7. The issuing company is required to declare that the underlying equity shares, against which the IDRs are issued, have been/will be listed in its home country before the listing of IDRs in the stock exchange;
8. The issuing company is required to obtain 'in-principle' approval for listing from the stock exchanges

where its IDRs are listed, before issuing further IDRs and to make an application to the stock exchange for the listing such further IDRs;

9. The issuing company agrees that it will promptly notify the stock exchange at the same time where it notifies to comply with listing requirements of home country or other jurisdictions where its securities may be listed any change in the Board, Auditors etc.
10. The company is to required to forward the Annual Report/notices etc at the same time and as to the extent that it discloses to holders of securities in its home country or in other jurisdictions where such securities are listed.
11. The issuing company agrees to file with the stock exchange the pattern of IDR Holders on a quarterly basis within 15 days of end of the quarter in the prescribed form.
12. The issuing company is required to comply with the Corporate Governance provisions as applicable in its home country and other jurisdictions in which its equity shares are listed. Further the issuing company hereby agrees to file a comparative analysis of the corporate governance provisions that are applicable in its home country and in the other jurisdictions in which its equity shares are listed along with the compliance of the same vis-à-vis the corporate governance provisions applicable to Indian listed companies. The said report shall be filed at the time of filing the annual reports with stock exchange.
13. The Company is required to comply with Indian GAAP or International Financial Reporting Standards (IFRS) or US GAAP in the preparation and disclosure of its financial results.

Further the Model Listing Agreement authorizes a Company Secretary to act as a Compliance Officer of the Issuing Company to directly liaise with various authorities and investors. Clause 26 of Model Listing Agreement read as under:

26. The issuing company agrees:

- (a) to appoint a company secretary in India who is a registered member of Institute of Company Secretaries of India to act as the Compliance Officer of the issuing company who would directly liaise with the authorities such as SEBI, the stock exchanges, Registrar of Companies etc., and investors with respect to implementation of various rules, regulations, guidelines, circulars and other directives or order of such authorities and investor service & complaints related matters;

LESSON ROUND UP

- Indian Depository Receipt means any instrument in the form of a depository receipt created by Domestic Depository in India against the underlying equity shares of issuing company.
- Issue of IDRs is regulated by section 390 of the Companies Act, 2013, Rule 13 of the Companies (Registration of Foreign Companies) Rules, 2014 and Chapter X of SEBI (ICDR) Regulations, 2009.
- SEBI amended the ICDR regulations by inserting a new chapter XA for governing the provisions for Rights Issue of IDRs.
- The IDRs issued should be listed on the recognized Stock Exchange(s) in India as specified and such IDRs may be purchased, possessed and freely transferred by a person resident in India.
- Issuer of an IDR has to comply with the listing conditions stated in the listing agreement for IDRs
- SEBI has issued Model Listing Agreement for Listing of IDRs issued by issuing companies whose securities market regulators are signatories to MMOU of IOSCO.
- The Model Listing Agreements requires the issuer to appoint a Company Secretary as Compliance Officer.

GLOSSARY

Fungibility	Fungibility of an instrument refers to inter-changeability of such instrument into another. Such fungibility may be one-way fungibility or two-way fungibility.
Deposit Agreement	Agreement entered into between the issuing company and domestic depository.
Home Country	The country where the issuing company is incorporated and listed.
Non-Institutional Investor (NII)	All bidders that are not QIBs or Retail Individual Bidder(s) and who have Bid for IDRs for an amount of more than ₹ 1,00,000.

SELF TEST QUESTIONS

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

1. What is Indian Depository Receipts?
2. What are the eligibility conditions prescribed under SEBI (ICDR) Regulations, 2009 in respect of issue of Indian Depository Receipts?
3. What are the procedures for making an issue of Indian Depository Receipts under Rule 13 of the Companies (Registration of Foreign Companies) Rules, 2014?
4. What are the compliances relating to corporate governance to be complied by companies issuing Indian Depository Receipts?
5. What are the disclosures required to be made for Rights Issue of IDRs under SEBI (ICDR) Regulations, 2009?



Lesson 13

Regulatory Framework Governing Stock Exchanges

LESSON OUTLINE

- Introduction
- Securities Contracts (Regulation) Act, 1956
- Definitions
- Corporatisation and Demutualisation of Stock Exchanges
- Contracts in Securities
- Public Issue and Listing of Securities
- Right to Legal Representation
- Penalties and Procedures
- Offences
- Rights of investors
- Securities Contract (Regulation) (Stock Exchange and Clearing Corporations) Regulations, 2012
- Securities Contracts (Regulation) Rules, 1957
- Requirements of listing of securities with recognised stock exchanges
- Continuous Listing Requirement
- Delisting of securities
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

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

After going through this lesson the student will be able to know about the Powers of Stock Exchange and SEBI under the SCRA Act, the penal provisions, procedures, offences, procedure for appeal to SAT, Right of Investors, Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 and Securities Contract (Regulation) Rules, 1957 etc.

INTRODUCTION

The Securities Contracts (Regulation) Act, 1956 provides for direct and indirect control of all aspects of the securities trading including the running of stock exchanges which aims to prevent undesirable transaction in securities. It gives the Central Government regulatory jurisdiction over (a) Stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. As a condition of recognition, a stock exchange complies with the requirements prescribed by the Central Government. The stock exchange frame their own listing regulations in consonance with the minimum listing criteria set out in Securities contracts (Regulation) Rules, 1957.

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

SEBI also issued the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 to regulate the recognition, ownership and governance in stock exchanges and clearing corporations.

SECURITIES CONTRACTS (REGULATION) ACT, 1956

The Securities Contracts (Regulation) Act, 1956 was enacted by Parliament to prevent undesirable transactions in securities by regulating the business of dealing therein, by providing for certain other matters connected therewith. The Act extends to the whole of India and came into force on 28th February, 1957. The Act defines various terms in relation to securities and provides the detailed procedure for the stock exchanges to get recognition from Government/SEBI, procedure for listing of securities of companies and operations of the brokers in relation to purchase and sale of securities on behalf of investors.

However, the provisions of this Act shall not apply to –

- (a) the Government, the Reserve Bank of India, any local authority or any corporation set up by a special law or any person who has effected any transaction with or through the agency of any such authority as is referred to in this clause;
- (b) any convertible bond or share warrant or any option or right in relation thereto, in so far as it entitles the person in whose favour any of the foregoing has been issued to obtain at his option from the company or other body corporate, issuing the same or from any of its shareholders' or duly appointed agents, shares of the company or other body corporate, whether by conversion of the bond or warrant or otherwise, on the basis of the price agreed upon when the same was issued.

If the Central Government is satisfied that in the interest of trade and commerce or the economic development of the country, it is necessary or expedient so to do, it may, by notification in the Official Gazette, specify any class of contracts as contracts to which this Act or any provision contained therein shall not apply, and also the conditions, limitations or restrictions, if any, subject to which it shall not so apply.

DEFINITIONS

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

Securities

Securities include –

- (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or body corporate.
- (ii) derivative.
- (iii) units or any other instrument issued by any collective investment scheme to the Investors in such schemes.
- (iv) security receipt as defined in clause (zg) of Section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
- (v) units or any other such instrument issued to the investors under any mutual fund scheme.

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

- (vi) any certificate or instrument (by whatever name called) issued to an investor by any issuer being a special purpose distinct entity which possess any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be.
- (vii) government securities.
- (viii) such other instruments as may be declared by the Central Government to be securities and,
- (ix) rights or interests in securities.

Spot delivery contract

Spot delivery contract means a contract which provides for –

- (a) actual delivery of securities and the payment of a price therefore either on the same day as the date of the contract or on the next day, the actual period taken for the dispatch of the securities or the remittance of money therefore through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality;
- (b) transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository.

Stock Exchange

Stock Exchange means –

- (a) any body of individuals, whether incorporated or not, constituted before corporatisation and demutualisation under Sections 4A and 4B, or
- (b) a body corporate incorporated under the Companies Act, 2013 whether under a scheme of corporatisation or otherwise, for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

Recognised Stock Exchange

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

Government security

Government security means a security created and issued whether before or after the commencement of this Act, by the Central Government or a State Government for the purpose of raising a public loan and having one of the forms specified in clause (2) of section 2 of the Public Debt Act, 1944.

Derivative

A derivative includes –

- (a) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security and;
- (b) a contract which derives its value from the prices or index of prices, of underlying securities.

RECOGNITION OF STOCK EXCHANGES

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

Every application shall contain such particulars as may be prescribed, and shall be accompanied by a copy of the bye-laws of the stock exchange for the regulation and control of contracts and also a copy of the rules relating in general to the constitution of the stock exchange and in particular to –

- (a) the governing body of such stock exchange, its constitution and powers of management and the manner in which its business is to be transacted;
- (b) the powers and duties of the office bearers of the stock exchange;
- (c) the admission into the stock exchange of various classes of members, the qualifications, for membership, and the exclusion, suspension, expulsion and re-admission of members therefrom or there into;
- (d) the procedure for the registration of partnerships as members of the stock exchange in cases where the rules provide for such membership; and the nomination and appointment of authorized representatives and clerks.

Section 4 lays down that if the Central Government is satisfied (powers are exercisable by SEBI also) after making such inquiry as may be necessary in this behalf and after obtaining such further information, if any, as it may require;

- (a) that the rules and bye-laws of a stock exchange applying for registration are in conformity with such conditions as may be prescribed with a view to ensure fair dealing and to protect investors;
- (b) that the stock exchange is willing to comply with any other conditions (including conditions as to the number of members) which the Central Government, after consultation with the governing body of the stock exchange and having regard to the area served by the stock exchange and its standing and the nature of the securities dealt with by it, may impose for the purpose of carrying out the objects of this Act; and
- (c) that it would be in the interest of the trade and also in the public interest to grant recognition to the stock exchange;

It may grant recognition to the stock exchange subject to the conditions imposed upon it as aforesaid and in such form as may be prescribed.

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

- (i) the qualifications for membership of stock exchanges;
- (ii) the manner in which contracts shall be entered into and enforced as between members;
- (iii) the representation of the Central Government on each of the stock exchanges by such number of persons not exceeding three as the Central Government may nominate in this behalf; and
- (iv) the maintenance of accounts of members and their audit by chartered accountants whenever such audit is required by the Central Government.

Every grant of recognition to a stock exchange under this section shall be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the stock exchange is situated, and such recognition shall have effect as from the date of its publication in the Gazette of India.

No application for the grant of recognition shall be refused except after giving an opportunity to the stock exchange concerned to be heard in the matter; and the reasons for such refusal shall be communicated to the stock exchange in writing. No rules of a recognised stock exchange relating to any of the matter specified in sub-section (2) of section 3 shall be amended except with the approval of the Central Government.

CORPORATISATION AND DEMUTUALISATION OF STOCK EXCHANGES

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

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

Section 4B provides for procedure for corporatization and demutualization. All recognized stock exchanges referred to in Section 4A shall, within such time as may be specified by SEBI submit a scheme for corporatization and demutualization for its approval.

SEBI may, by notification in the Official Gazette, specify name of the recognized stock exchange, which had already been corporatized and demutualised, and such stock exchange shall not be required to submit the scheme under this Section.

On receipt of the scheme SEBI may, after making such enquiry as may be necessary in this behalf and obtaining such further information, if any, as it may require and if it is satisfied that it would be in the interest of the trade and also in the public interest, approve the scheme with or without modification.

No scheme shall be approved by SEBI if the issue of shares for a lawful consideration or provision of trading rights in lieu of membership card of the members of a recognized stock exchange or payment of dividends to members have been proposed out of any reserves or assets of that stock exchange.

Where the scheme is approved, the scheme so approved shall be published immediately by SEBI in the Official Gazette; and by the recognized stock exchange in such two daily newspapers circulating in India, as may be specified by SEBI.

Upon such publication, the scheme shall have effect and be binding on all persons and authorities including all members, creditors, depositors and employees of the recognized stock exchange and on all persons having any contract, right, power, obligation or liability with, against, over, to, or in connection with, the recognized stock exchange or its members.

However, where the SEBI is satisfied that it would not be in the interest of the trade and also in the public interest to approve the scheme, it may, by an order, reject the scheme and such order of rejection shall be published by it in the Official Gazette.

SEBI shall give a reasonable opportunity of being heard to all the persons concerned and the recognized stock exchange concerned before passing an order rejecting the scheme.

SEBI may, while approving the scheme by an order in writing, restrict –

- (a) the voting rights of the shareholders who are also stock brokers of the recognized stock exchange;
- (b) the right of shareholders or a stock broker of the recognized stock exchange to appoint the representatives on the governing board of the stock exchange;
- (c) the maximum number of representatives of the stock brokers of the recognized stock exchange to be appointed on the governing board of the recognized stock exchange, which shall not exceed one-fourth of the total strength of the governing board.

The order shall be published in the Official Gazette.

Every recognized stock exchange, in respect of which the scheme for corporatization or demutualization has been approved, shall, either by fresh issue of equity shares to the public or in any other manner as may be specified by the regulations made by the SEBI, ensure that at least fifty-one per cent. of its equity share capital is held, within twelve months from the date of publication of the order by the public other than shareholders having trading rights:

SEBI on sufficient cause being shown to it and in the public interest, may extend the said period by another twelve months.

WITHDRAWAL OF RECOGNITION

Section 5 lays down that if the Central Government is of opinion that the recognition granted to a stock exchange should in the interest of the trade or in the public interest, be withdrawn, the Central Government may serve on the governing body of the stock exchange a written notice that the Central Government is considering the withdrawal of the recognition for the reasons stated in the notice and after giving an opportunity to the governing body to be heard in the matter, the Central Government may withdraw, by notification in the Official Gazette, the recognition granted to the stock exchange;

However, the withdrawal shall not affect the validity of any contract entered into or made before the date of the notification, and the Central Government may, after consultation with the stock exchange, make such provision as it deems fit in the notification of withdrawal or in any subsequent notification similarly published for the due performance of any contracts outstanding on that date.

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

However, such withdrawal shall not affect the validity of any contract entered into or made before the date of the notification, and SEBI may, after consultation with the stock exchange, make such provisions as it deems fit in the order rejecting the scheme published in the Official Gazette under sub-Section (5) of Section 4B.

It is to be noted that the powers under Section 4 (3), 4(5) and Section 5 have been delegated concurrently to SEBI also. Hence, SEBI may exercise these powers.

POWER OF CENTRAL GOVERNMENT TO CALL FOR PERIODICAL RETURNS AND MAKE DIRECT ENQUIRIES

Section 6 enjoins that every recognised stock exchange shall furnish to SEBI, such periodical returns relating to its affairs as may be prescribed. Every such exchange and every member thereof shall maintain and preserve for such periods not exceeding five years such books of accounts, and other documents as the Central Government, after consultation with the stock exchange concerned, may prescribe in the interest of the trade or in the public interest, and such books of account, and other documents shall be subject to inspection to all reasonable times by SEBI.

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

- (a) call upon a recognised stock exchange or any member thereof to furnish in writing such information or explanation relating to the affairs of the stock exchange or of the member in relation to the stock exchange as SEBI may require; or
- (b) appoint one or more persons to make an inquiry in the prescribed manner in relation to the affairs of the governing body of a stock exchange or the affairs of any of the members of the stock exchange in relation to the stock exchange and submit a report of the result of such inquiry to the 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 to SEBI.

Where an inquiry in relation to the affairs of a recognised stock exchange or the affairs of any of its members in relation to the stock exchange has been undertaken –

- (a) every director, manager, secretary or other officer of such stock exchange;
- (b) every member of such stock exchange;
- (c) if the member of the stock exchange is a firm, every partner, manager, secretary or other officer of the firm; and
- (d) every other person or body of persons who has had dealings in the course of business with any of the persons mentioned in clauses (a), (b) and (c) whether directly or indirectly; shall be bound to produce before the authority making the inquiry all such books of account, and other documents in his custody or power relating to or having a bearing on the subject-matter of such inquiry and also to furnish the authorities within such time as may be specified with any such statement or information relating thereto as may be required of him.

Every stock exchange shall furnish to the Central Government and to SEBI a copy of its annual report which shall contain such particulars as may be prescribed by Central Government/SEBI.

POWER OF RECOGNISED STOCK EXCHANGE TO MAKE RULES RESTRICTING VOTING RIGHTS ETC.

Section 7A of the Act stipulates that a recognised stock exchange may make rules or amend any rules made by it to provide for all or any of the following matters, namely –

- (a) the restriction of voting rights to members only in respect of any matter placed before the stock exchange at any meeting;
- (b) the regulation of voting rights in respect of any matter placed before the stock exchange at any meeting so that each member may be entitled to have one vote only, irrespective of his share of the paid-up equity capital of the stock exchange;
- (c) the restriction on the right of a member to appoint another person as his proxy to attend and vote at a meeting of the stock exchange; and
- (d) such incidental, consequential and supplementary matters as may be necessary to give effect to any of the matters specified in clauses (a) (b) and (c).

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

POWER OF CENTRAL GOVERNMENT TO DIRECT RULES OR MAKE RULES

Section 8 deals with the power of Central Government to make rules or direct rules to be made in respect of Recognised Stock Exchange. Where after consultation with the governing bodies of stock exchanges generally or with the governing body of any stock exchange in particular, the Central Government is of opinion that it is necessary or expedient so to do, it may, by order in writing together with a statement of the reasons therefor, direct the recognised stock exchanges generally or any recognised stock exchange in particular, as the case

may be, to make any rules or to amend any rules already made in respect of all or any of the matters or to amend any rules already made in respect of all or any of the matters as specified, within a period of two months from the date of the order.

If any recognised stock exchange fails or neglects to comply with any order, within the period specified therein, the Central Government may make the rules for, or amend the rules made by, the recognised stock exchange, either in the form proposed in the order or with such modifications thereof as may be agreed to between the stock exchange and the Central Government.

Where in pursuance of this section any rules have been made or amended, the rules so made or amended shall be published in the Gazette of India and also in the Official Gazette or Gazettes of the State or States in which the principal office or offices of the recognised stock exchange or exchanges is or are situate, and, on the publication thereof in the Gazette of India, the rules so made or amended shall, notwithstanding anything to the contrary contained in the Companies Act, 2013 or in any other law for the time being in force, have effect as if they had been made or amended by the recognised stock exchange or stock exchanges, as the case may be.

Powers have been delegated concurrently to SEBI also.

CLEARING CORPORATION

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

Sub-section (2) provides that every clearing corporation shall, for the purpose of transfer of the duties and functions of a clearing house to a clearing corporation referred to in sub-Section (1), make bye-laws and submit the same to the SEBI for its approval.

Sub-section (3) provides that SEBI may, on being satisfied that it is in the interest of the trade and also in the public interest to transfer the duties and functions of a clearing house to a clearing corporation, grant approval to the bye-laws submitted to it and approve transfer of the duties and functions of a clearing house to a clearing corporation.

POWER OF RECOGNISED STOCK EXCHANGES TO MAKE BYE-LAWS

According to Section 9, any recognised stock exchange may, subject to the previous approval of SEBI, make bye-laws for the regulation and control of contracts. In particular, and without prejudice to the generality of the foregoing power, such bye-laws may provide for:

- (a) the opening and closing of markets and the regulation of the hours of trade;
- (b) a clearing house for the periodical settlement of contracts and differences thereunder, the delivery of and payment for securities, the passing on of delivery orders and the regulation and maintenance of such clearing house;
- (c) the submission to SEBI by the clearing house as soon as may be after each periodical settlement of all or any of the following particulars as SEBI may, from time to time, require, namely:
 - (i) the total number of each category of security carried over from one settlement period to another;
 - (ii) the total number of each category of security, contracts which have been squared up during the course of each settlement period;

- (iii) the total number of each category of security actually delivered at each clearing;
- (d) the publication by the clearing house of all or any of the particulars submitted to SEBI subject to the directions, if any, issued by SEBI in this behalf;
- (e) the regulation or prohibition of blank transfers;
- (f) the number and classes of contracts in respect of which settlements shall be made or differences paid through the clearing house;
- (g) the regulation, or prohibition of *budlas* or carry-over facilities;
- (h) the fixing, altering or postponing of days for settlements;
- (i) the determination and declaration of market rates, including the opening, closing, highest and lowest rates for securities;
- (j) the terms, conditions and incidents of contracts, including the prescription of margin requirements, if any, and conditions relating thereto, and the forms of contracts in writing;
- (k) the regulation of the entering into making, performance, rescission and termination, of contracts, including contracts between members or between a member and his constituent or between a member and a person who is not a member, and the consequences of default or insolvency on the part of a seller or buyer or intermediary, the consequences of a breach or omission by a seller or buyer, and the responsibility of members who are not parties to such contracts;
- (l) the regulation of *taravani* business including the placing of limitations thereon;
- (m) the listing of securities on the stock exchange, the inclusion of any security for the purpose of dealings and the suspension or withdrawal of any such securities, and the suspension or prohibition of trading in any specified securities;
- (n) the method and procedure for the settlement of claims or disputes, including settlement by arbitration;
- (o) the levy and recovery of fees, fines and penalties;
- (p) the regulation of the course of business between parties to contracts in any capacity;
- (q) the fixing of a scale of brokerage and other charges;
- (r) the making, comparing, settling and closing of bargains;
- (s) the emergencies in trade which may arise, whether as a result of pool or syndicated operations or concerning or otherwise, and the exercise of powers in such emergencies including the power to fix maximum and minimum prices for securities;
- (t) the regulation of dealings by members for their own account;
- (u) the separation of the functions of jobbers and brokers;
- (v) the limitations on the volume of trade done by any individual member in exceptional circumstances;
- (w) the obligation of members to supply such information or explanation and to produce such documents relating to the business as the governing body may require.

PUNISHMENTS FOR CONTRAVENTIONS

The bye-laws made under Section 9 may;

- (a) specify the bye-laws, the contravention of which shall make a contract entered into otherwise than in accordance with the bye-laws void under sub-section (1) of section 14 (which specifies contract in notified areas to be void).

- (b) provide that the contravention of any of the bye-laws shall render the member concerned liable to one or more of the following punishments, namely;
- (i) fine,
 - (ii) expulsion from membership,
 - (iii) suspension from membership for a specified period,
 - (iv) any other penalty of a like nature not involving the payment of money.

Any bye-laws made under this section shall be subject to such conditions in regard to previous publication as may be prescribed, and, when approved by SEBI, shall be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the recognised stock exchange is situated, and shall have effect as from the date of its publication in the Gazette of India:

However, if SEBI is satisfied in any case that in the interest of the trade or in the public interest any bye-laws should be made immediately, it may, by order in writing specify the reasons therefor, dispense with the condition of previous publication.

POWER OF SEBI TO MAKE OR AMEND BYE-LAWS OF RECOGNISED STOCK EXCHANGES

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

Where in pursuance of this section any bye-laws have been made or amended, the bye-laws so made or amended shall be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the recognised stock exchange is situated, and on the publication thereof in the Gazette of India, the bye-laws so made or amended shall have effect as if they had been made or amended by the recognised stock exchange concerned.

Where the governing body of a recognised stock exchange objects to any bye-laws made or amended by SEBI on its own motion, it may, within two months of the publication thereof in the Gazette of India apply to SEBI for revision thereof and SEBI may, after giving an opportunity to the governing body of the stock exchange to be heard in the matter, revise the bye-laws so made or amended, and where any bye-laws so made or amended are revised as a result of any action taken under this sub-section, the bye-laws so revised shall be published and shall become effective as provided in sub-section (2) of Section 10.

The making or the amendment or revision of any bye-laws shall in all cases be subject to the condition of previous publication.

However, if SEBI is satisfied in any case that in the interest of the trade or in the public interest any bye-laws should be made, amended or revised immediately, it may, by order in writing specifying the reasons therefor, dispense with the condition of previous publication.

POWER OF CENTRAL GOVERNMENT TO SUPERSEDE COMPANIES OF STOCK EXCHANGES OR SUSPEND BUSINESS THEREOF

Without prejudice to any other powers vested in the Central Government under this Act, where the Central Government is of opinion that the governing body of any recognised stock exchange should be superseded, then, notwithstanding anything contained in any other law for the time being in force, the Central Government may serve on the governing body a written notice that the Central Government is considering the 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, the following consequences shall ensure, namely –

- (a) the members of the governing body which has been superseded shall, as from the date of the notification of super session, cease to hold office as such members;
- (b) the person or persons appointed may exercise and perform all the powers and duties of the governing body which has been superseded;
- (c) all such property of the recognised stock exchange as the person or persons appointed may, by order in writing, specify in this behalf as being necessary for the purpose of enabling him or them to carry on the business of the stock exchange, shall vest in such person or persons.

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

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

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

Power to Suspend Business of Recognised Stock Exchange

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

Provided that where the period of suspension is to be extended beyond the first period, no notification extending the period of suspension shall be issued unless the governing body of the recognised stock exchange has been given an opportunity of being heard in the matter.

Power to Issue Directions

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

Section 12A provides that if, after making or causing to be made an inquiry, SEBI is satisfied that it is necessary –

- (a) in the interest of investors, or orderly development of securities market; or
- (b) to prevent the affairs of any recognised stock exchange, or, clearing corporation, or such other agency or person, providing trading or clearing or settlement facility in respect of securities, being conducted in a manner detrimental to the interests of investors or securities market; or

- (c) to secure the proper management of any such stock exchange or clearing corporation or agency or person, referred to in clause (b), it may issue such directions –
 - (i) to any stock exchange or clearing corporation or agency or person referred to in clause (b) or any person or class of persons associated with the securities market; or
 - (ii) to any company whose securities are listed or proposed to be listed in a recognised stock exchange, as may be appropriate in the interests of investors in securities and the securities market.

CONTRACTS IN SECURITIES

If the Central Government is satisfied, having regard to the nature or the volume of transactions in securities in any State or States or area, that it is necessary so to do, it may, by notification in the Official Gazette, declare that section 13 to apply to such State or States or area, and thereupon every contract in such State or States or area which is entered into after date of the notification otherwise than between members of a recognised stock exchange or recognized stock exchanges in such State or States or area or through or with such member shall be illegal.

Provided that any contract entered into between members of two or more recognised stock exchanges in such State or States or area, shall –

- (i) be subject to such terms and conditions as may be stipulated by the respective stock exchanges with prior approval of SEBI;
- (ii) require prior permission from the respective stock exchanges if so stipulated by the stock exchanges with prior approval of SEBI.

Additional Trading Floor

A stock exchange may establish additional trading floor with the prior approval of SEBI in accordance with the terms and conditions stipulated by SEBI.

Additional trading floor means a trading ring or trading facility offered by a recognised stock exchange outside its area of operating to enable the investors to buy and sell securities through such trading floor under the regulatory framework of that stock exchange.

Contract in certain areas to be void

Any contract entered into in any State or area specified in the notification under section 13 which is in contravention of any of the bye-laws specified in that behalf under clause(a) of sub-section (3) of section 9 shall be void:

- (i) as respects the rights of any member of the recognised stock exchange who has entered into such contract in contravention of any such bye-laws, and also
- (ii) as respects the rights of any other person who has knowingly participated in the transaction entailing such contravention.

Nothing in sub-section (1) shall be construed to affect the right of any person other than a member of the recognised stock exchange to enforce any such contract or to recover any sum under or in respect of such contract if such person had no knowledge that the transaction was in contravention of any of the bye-laws specified in clause (a) of sub-section (3) of section 9.

Members may not act as principals in certain circumstances

No member of a recognised stock exchange shall in respect of any securities enter into any contract as a principal with any person other than a member of a recognised stock exchange, unless he has secured the consent or authority of such person and discloses in the note, memorandum or agreement of sale or purchase that he is acting as a principal.

Provided that where the member has secured the consent or authority of such person otherwise than in writing he shall secure written confirmation by such person or such consent or authority within 3 days from the date of contract.

Provided further that no such written consent or authority of such person shall be necessary for closing out any outstanding contract entered into by such person in accordance with the bye-laws, if the member discloses in the note, memorandum or agreement of sale or purchase in respect of such closing out that he is acting as a principal.

Power to Prohibit Contracts in Certain Cases

If the Central Government is of opinion that it is necessary to prevent undesirable speculation in specified securities in any State or area, it may, by notification in the Official Gazette, declare that no person in the State or area specified in the notification shall, save with the permission of the Central Government, enter into any contract for the sale or purchase of any security specified in the notification except to the extent and in the manner, if any, specified therein.

All contracts in contravention of the provisions of sub-section (1) entered into after the date of the notification issued thereunder shall be illegal.

LICENSING OF DEALERS IN CERTAIN AREAS

Subject to the provision of sub-section (3) and to the other provisions contained in this Act, no person shall carry on or purport to carry on, whether on his own behalf or on behalf of any other person, the business of dealing in securities in any State or area to which section 13 has not been declared to apply and to which the Central Government may, by notification in the Official Gazette, declare this section to apply, except under the authority of a license granted by SEBI in this behalf.

No notification under sub-section (1) shall be issued with respect to any State or area unless the Central Government is satisfied, having regard to the manner in which securities are being dealt with in such State or area, that it is desirable or expedient in the interest of the trade or in the public interest that such dealings should be regulated by a system of licensing.

The restrictions imposed by sub-section (1) in relation to dealings in securities shall not apply to the doing of anything by or on behalf of a member of any recognised stock exchange.

PUBLIC ISSUE AND LISTING OF SECURITIES

Section 17A provides for public issue and listing of securities.

Without prejudice to the provisions contained in this Act or any other law for the time being in force, no securities of the nature referred to in sub-clause (ie) of clause (h) of section 2 shall be offered to the public or listed on any recognized stock exchange unless the issuer fulfils such eligibility criteria and complies with such other requirements as may be specified by regulations made by SEBI.

Every issuer intending to offer the certificates or instruments referred therein to the public shall make an application, before issuing the offer document to the public, to one or more recognized stock exchanges for permission for such certificates or instruments to be listed on the stock exchange or each such stock exchange.

Where the permission applied for listing has not been granted or refused by the recognized stock exchanges or any of them, the issuer shall forthwith repay all moneys, if any, received from applicants in pursuance of the offer document, and if any such money is not repaid within eight days after the issuer becomes liable to repay it, the issuer and every director or trustee thereof, as the case may be, who is in default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at the rate of fifteen per cent per annum.

In reckoning the eighth day after another day, any intervening day which is a public holiday under the Negotiable Instruments Act, 1881, shall be disregarded, and if the eighth day (as so reckoned) is itself such a public holiday, there shall for the said purposes be substituted the first day thereafter which is not a holiday.

All the provisions of this Act relating to listing of securities of a public company on a recognized stock exchange shall, *mutates mutandis*, apply to the listing of the securities of the nature referred to in sub-clause (ie) of clause (h) of section 2 by the issuer, being a special purpose distinct entity.

EXCLUSION OF SPOT DELIVERY CONTRACTS

If the Central Government is of opinion that in the interest of the trade or in the public interest, it is expedient to regulate and control the business of dealing in spot delivery contracts also in any State or area (whether section 13 has been declared to apply to that State or area or not), it may, by notification in the Official Gazette, declare that the provisions of section 17 shall also apply to such State or area in respect of spot delivery contracts generally or in respect of spot delivery contract for the sale or purchase of such securities as may be specified in the notification, and may also specify the manner in which, and the extent to which, the provisions of that section shall so apply.

CONTRACTS IN DERIVATIVES

Notwithstanding anything contained in any other law for the time being in force, contracts in derivative shall be legal and valid if such contracts are –

- (a) traded on a recognised stock exchange;
- (b) settled on the clearing house of the recognised stock exchange, in accordance with the rules and bye-laws of such stock exchange.

CONDITIONS FOR LISTING

Section 21 of the Act provides that where securities are listed on the application of any person in any recognised stock exchange, such person shall comply with the conditions of the listing agreement with that stock exchange.

DELISTING OF SECURITIES

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

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

A listed company or an aggrieved investor may file an appeal before the Securities Appellate Tribunal against the decision of the recognised stock exchange delisting the securities within fifteen days from the date of the decision of the recognized stock exchange delisting the securities and the provisions of Sections 22B to 22E of this Act, shall apply, as far as may be, to such appeals.

The Securities Appellate Tribunal may, if it is satisfied that the company was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding one month.

RIGHT OF APPEAL TO SAT AGAINST REFUSAL TO LIST SECURITIES OF PUBLIC COMPANIES BY STOCK EXCHANGES

Where a recognised stock exchange, acting in pursuance of any power given to it by its bye-laws, refuses to list the securities of any company, the company shall be entitled to be furnished with reasons for such refusal, and may, –

- (a) within fifteen days from the date on which the reasons for such refusal are furnished to it, or

- (b) where the stock exchange has omitted or failed to dispose of, within the time specified in sub-section (1A) of section 40 of the Companies Act, 2013, the application for permission for the shares or debentures to be dealt with on the stock exchange, within fifteen days from the date of expiry of the specified time or within such further period, not exceeding one month, as the Securities Appellate Tribunal may, on sufficient cause being shown, allow appeal to the Securities Appellate Tribunal having jurisdiction in the matter against such refusal, omission or failure, as the case may be, and thereupon the Securities Appellate Tribunal may, after giving the stock exchange, an opportunity of being heard, –
- (i) vary or set aside the decision of the stock exchange; or
 - (ii) where the stock exchange has omitted or failed to dispose of the application within the specified time, grant or refuse the permission, and where the Securities Appellate Tribunal sets aside the decision of the recognised stock exchange or grants the permission, the stock exchange shall act in conformity with the orders of the Securities Appellate Tribunal.

Every appeal under sub-section (1) shall be in such form and be accompanied by such fee as may be prescribed. The Securities Appellate Tribunal shall send a copy of every order made by it to SEBI and parties to the appeal.

The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

PROCEDURE AND POWERS OF SAT AND APPEAL AGAINST ITS ORDERS

The Securities Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules, the Securities Appellate Tribunal shall have powers to regulate their own procedure including the places at which they shall have their sittings.

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

- (a) summoning and enforcing the attendance of any person and examining him on oath;
- (b) requiring the discovery and production of documents;
- (c) receiving evidence on affidavits;
- (d) issuing commissions for the examination of witnesses or documents;
- (e) reviewing its decisions;
- (f) dismissing an application for default or deciding it *ex parte*;
- (g) setting aside any order of dismissal of any application for default or any order passed by it *ex parte*; and
- (h) any other matter which may be prescribed.

Every proceeding before the Securities Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code, 1860 and the Securities Appellate Tribunal shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

RIGHT TO LEGAL REPRESENTATION

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

APPEAL TO SUPREME COURT

Any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of fact or law arising out of such order;

Provided that the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

PENALTIES AND PROCEDURES

The Act prescribes various penalties against persons who might be found guilty of offences under section 23 the Act. These offences are listed below –

Any person who –

- (a) without reasonable excuse (the burden of proving which shall be on him) fails to comply with any requisition made under sub-section (4) of section 6; or
- (b) enters into any contract in contravention of any of the provisions contained in section 13 or section 16; or
- (c) contravenes the provisions contained in section 17 or section 17A or section 19; or
- (d) enters into any contract in derivative in contravention of section 18A or the rules made under section 30; or
- (e) owns or keeps a place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act and knowingly permits such place to be used for such purposes; or
- (f) manages, controls, or assists in keeping any place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act or at which contracts are recorded or adjusted or rights or liabilities arising out of contracts are adjusted, regulated or enforced in any manner whatsoever; or
- (g) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17 willfully represents to or induces any person to believe that contracts can be entered into or performed under this Act through him; or
- (h) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17, canvasses, advertises or touts in any manner either for himself or on behalf of any other person for any business connected with contracts in contravention of any of the provisions of this Act; or
- (i) joins, gathers or assists in gathering at any place other than the place of business specified in the bye-laws of a recognised stock exchange any person or persons for making bids or offers or for entering into or performing any contracts in contravention of any of the provisions of this Act,

shall, without prejudice to any award of penalty by the Adjudicating Officer under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees or with both.

Any person who enters into any contract in contravention of the provisions contained in section 15 or who fails to comply with the provisions of section 21 or section 21A or with the orders of or the Central Government under section 22 or with the Orders of the Securities Appellate Tribunal shall, without prejudice to any award of penalty by the Adjudicating Officer under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty five crore rupees, or with both.

PENALTY FOR FAILURE TO FURNISH INFORMATION, RETURN, ETC.

Any person, who is required under this Act or any rules made thereunder, –

- (a) to furnish any information, document, books, returns or report to a recognized stock exchange, fails to furnish the same within the time specified therefor in the listing agreement or conditions or bye-laws of the recognised stock exchange, shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less for each such failure;
- (b) to maintain books of account or records, as per the listing agreement or conditions, or bye-laws of a recognised stock exchange, fails to maintain the same, shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less. [section 23A]

PENALTY FOR FAILURE BY ANY PERSON TO ENTER INTO AN AGREEMENT WITH CLIENTS

If any person, who is required under this Act or any bye-laws of a recognized stock exchange made thereunder, to enter into an agreement with his client, fails to enter into such an agreement, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less for every such failure. [section 23B]

PENALTY FOR FAILURE TO REDRESS INVESTORS' GRIEVANCES

If any stock broker or sub-broker or a company whose securities are listed or proposed to be listed in a recognised stock exchange, after having been called upon by SEBI or a recognised stock exchange in writing, to redress the grievances of the investors, fails to redress such grievances within the time stipulated by SEBI or a recognised stock exchange, he or it shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less. [section 23C]

PENALTY FOR FAILURE TO SEGREGATE SECURITIES OR MONEYS OF CLIENT OR CLIENTS

If any person, who is registered under Section 12 of SEBI Act, 1992 as a stock broker or sub-broker, fails to segregate securities or moneys of the client or clients or uses the securities or moneys of a client or clients for self or for any other client, he shall be liable to a penalty not exceeding one crore rupees. [section 23D]

PENALTY FOR FAILURE TO COMPLY WITH LISTING CONDITIONS OR DELISTING CONDITIONS OR GROUNDS

If a company or any person managing collective investment scheme or mutual fund, fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof, it or he shall be liable to a penalty not exceeding twenty-five crore rupees. [section 23E]

PENALTY FOR EXCESS DEMATERIALISATION OR DELIVERY OF UNLISTED SECURITIES

If any issuer dematerialises securities more than the issued securities of a company or delivers in the stock exchanges the securities which are not listed in the recognised stock exchange or delivers securities where no trading permission has been given by the recognised stock exchange, he shall be liable to a penalty not exceeding twenty-five crore rupees. [section 23F]

PENALTY FOR FAILURE TO FURNISH PERIODICAL RETURNS, ETC.

If a recognized 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. [section 23G]

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. [section 23H]

POWER TO ADJUDICATE

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

(1) For the purpose of adjudging, SEBI shall appoint any officer not below the rank of a Division Chief of SEBI to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.

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

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

Provided further that nothing contained in this sub-section shall be applicable after an expiry of a period of three months from the date of the order passed by the adjudicating officer or disposal of the appeal under section 23L, whichever is earlier.

FACTORS TO BE TAKEN INTO ACCOUNT BY THE ADJUDICATING OFFICER

Section 23J provides for the factors to be taken into account by the adjudicating officer. While adjudging the quantum of penalty, the adjudicating officer shall have due regard to the following factors, namely –

- (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 and Civil Proceedings

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

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

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

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

Recovery of Amounts

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

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

and for this purpose, the provisions of section 221 to 227, 228A, 229, 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 Ordinance [**Securities Laws (Amendment) Ordinance, 2014**] instead of to income-tax under the Income-tax Act, 1961.

CREDITING SUM REALISED BY WAY OF PENALTIES TO CONSOLIDATED FUND OF INDIA

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

APPEAL TO SECURITIES APPELLATE TRIBUNAL (SAT)

Section 23L lays down the procedure for appeal to SAT.

(1) Any person aggrieved, by the order or decision of the recognised stock exchange or the adjudicating officer or any order made by SEBI under Section 4B, may prefer an appeal before the Securities Appellate Tribunal.

(2) Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order or decision is received by the appellant and it shall be in such form and be accompanied by such fee as may be prescribed.

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

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

(4) The Securities Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned adjudicating officer.

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

OFFENCES

(1) Without prejudice to any award of penalty by the adjudicating officer under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations or byelaws made thereunder, for which no punishment is provided elsewhere in this Act, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both.

(2) If any person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years, or with fine, which may extend to twenty-five crore rupees, or with both. [Section 23M]

COMPOSITION OF CERTAIN OFFENCES

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending. [Section 23N]

POWER TO GRANT IMMUNITY

Section 23-O deals with the power to grant immunity.

(1) The Central Government may, on recommendation by SEBI, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder or also from the imposition of any penalty under this Act with respect to the alleged violation.

No such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity.

Further that the recommendation of the SEBI under this sub-Section are not binding upon the Central Government.

(2) An immunity granted to a person under sub-Section (1) may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

OFFENCES BY COMPANIES

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

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

(2) Where an offence under this Act has been committed by a company and is proved that the offence has been committed with the consent or connivance of, or is attributable to any gross negligence on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer of the company shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

(3) The provisions of this section shall be in addition to and not in derogation of, the provisions of section 22A.

CERTAIN OFFENCES TO BE COGNIZABLE

Notwithstanding anything contained in the Code of Criminal Procedure, 1898, any offence punishable under section 23 shall be deemed to be cognizable offence within the meaning of that Code.

COGNIZANCE OF OFFENCES BY COURTS

(1) No court shall take cognizance of any offence punishable under this Act or any rules or regulations or bye-laws made thereunder, save on a complaint made by the Central Government or State Government or SEBI or a recognised stock exchange or by any person.

Establishment of Special Courts

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

(1) 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.

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

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

Offences triable by Special Courts

Section 26B provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, all offences under this Act committed prior to the date of commencement of the Securities Laws (Amendment) Ordinance, 2014 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.

RIGHTS OF INVESTORS

Entitlement of the Investors to Dividend declared by the Company

It shall be lawful for the holder of any security whose name appears on the books of the company issuing the said security to receive and retain any dividend declared by the company in respect thereof for any year, notwithstanding that the said security has already been transferred by him for consideration, unless the transferee who claims the dividend from the transferor has lodged the security and all other documents relating to the transfer which may be required by the company with the company for being registered in his name within fifteen days of the date on which the dividend became due.

Explanation. – The period specified in this section shall be extended –

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the dividend;
- (ii) in case of loss of the transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and
- (iii) in case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

Nothing contained in sub-section (1) shall affect –

- (a) the right of a company to pay any dividend which has become due to any person whose name is for the time being registered in the books of the company as the holder of the security in respect of which the dividend has become due; or
- (b) the right of the transferee of any security to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security in the name of the transferee.

Right to Receive Income From Collective Investment Scheme

It shall be lawful for the holder of any securities, being units or other instruments issued by collective investment scheme, whose name appears on the books of the collective investment scheme issuing the said security to receive and retain any income in respect of units or other instruments issued by the collective investment scheme declared by the collective investment scheme in respect thereof for any year, though the said security, being units or other instruments issued by collective investment scheme, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units or other instruments issued by collective investment scheme from the transfer or has lodged the security and all other documents relating to the transfer which may be required by the collective investment scheme with the collective investment scheme for being registered in his name within fifteen days of the date on which the income in respect of units or other instruments issued by the collective investments scheme became due.

Explanation – The period specified in this section shall be extended –

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the income in respect of units or other instruments issued by collective investment scheme;
- (ii) in case of loss of the transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and
- (iii) in case of delay in the lodging of any security, being units or other instruments issued by the collective investment scheme, and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

This shall not affect –

- (a) the right of a collective investment scheme to pay any income from units or other instruments issued by collective investment scheme which has become due to any person whose name is for the time being registered in the books of the collective investment scheme as the registered holder in the books of the collective investment scheme being units or other instruments issued by collective investment scheme in respect of which the income in respect of units or other instruments issued by collective scheme has become due; or
- (b) the right of transferee of any security, being units or other instruments issued by collective investment scheme, to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security being units or other instruments issued by the collective investment scheme in the name of the transferee.

Right to receive Income from Mutual Fund

Section 27B provides that it shall be lawful for the holder of any securities, being units or other instruments issued by any mutual fund, whose name appears on the books of the mutual fund issuing the said security to receive and retain any income in respect of units or other instruments issued by the mutual fund declared by the mutual fund in respect thereof for any year, notwithstanding that the said security, being units or other instruments issued by the mutual fund, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units or other instruments issued by the mutual fund from the transferor has lodged the security and all other documents relating to the transfer which may be required by the mutual fund with the mutual fund for being registered in his name within fifteen days of the date on which the income in respect of units or other instruments issued by the mutual fund became due.

The period specified in this Section may be extended –

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the income in respect of units or other instrument issued by the mutual fund;
- (ii) in case of loss of the transfer deed by theft or any other cause beyond the control of transferee, by the actual period taken for the replacement thereof;

- (iii) in case of delay in the lodging of any security, being units or other instruments issued by the mutual fund, and other documents relating to the transfer due to cause connected with the post, by the actual period of the delay.

Sub-section (2) provides that nothing contained in Sub-section (1) shall affect –

- (a) the right of a mutual fund to pay any income from units or other instruments issued by the mutual fund which has become due to any person whose name is for the time being registered in the books of the mutual fund as the holder of the security being units or other instruments issued by the mutual fund in respect of which the income in respect of units or other instruments issued by mutual fund has become due; or
- (b) the right of transferee of any security, being units or other instruments issued by the mutual fund, to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the mutual fund has refused to register the transfer of the security being units or other instruments issued by the mutual fund in the name of the transferee.

POWER OF CENTRAL GOVERNMENT TO DELEGATE OR TO MAKE RULES

Section 29A of the Securities Contracts (Regulation) Act, 1956 provides that the Central Government may, by order published in the Official Gazette, direct that the powers (except the power under section 30) exercisable by it under any provision of this Act shall, in relation to such matters and subject to such conditions, if any, as may be specified in the order, be exercisable also by SEBI or the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934.

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

In particular, and without prejudice to the generality of the foregoing power, such rules may provide for,

- (a) the manner in which applications may be made, the particulars which they should contain and the levy of a fee in respect of such applications;
- (b) the manner in which any inquiry for the purpose of recognizing any stock exchange may be made, the conditions which may be imposed for the grant of such recognition, including conditions as to the admission of members if the stock exchange concerned is to be the only recognised stock exchange in the area; and the form in which such recognition shall be granted;
- (c) the particulars which should be contained in the periodical returns and annual reports to be furnished to the Central Government;
- (d) documents which should be maintained and preserved under section 6 and the periods for which they should be preserved;
- (e) manner in which any inquiry by the governing body of a stock exchange shall be made under section 6;
- (f) the manner in which the bye-laws to be made or amended under this Act shall before being so made or amended be published for criticism;
- (g) the manner in which applications may be made by dealers in securities for licences under section 17, the fee payable in respect thereof and the period of such licences, the conditions subject to which licences may be granted, including conditions relating to the forms which may be used in making contracts, the documents to be maintained by licensed dealers and the furnishing of periodical information to such authority as may be specified and the revocation of licences for breach of conditions;
- (h) the requirements which shall be complied with –
 - (A) by public companies for the purpose of getting their securities listed on any stock exchange;
 - (B) by collective investment scheme for the purpose of getting their units listed on any stock exchange;

- (ha) the grounds on which the securities of a company may be delisted from any recognised stock exchange under sub-Section (1) of Section 21A;
- (hb) the form in which an appeal may be filed before the Securities Appellate Tribunal under sub-Section (2) of Section 21A and the fees payable in respect of such appeal;
- (hc) the form in which an appeal may be filed before the Securities Appellate Tribunal under Section 22A and the fees payable in respect of such appeal;
- (hd) the manner of inquiry under sub-Section (1) of Section 23-I;
- (he) the form in which an appeal may be filed before the Securities Appellate Tribunal under Section 23L and the fees payable in respect of such appeal.
 - (i) any other matter which is to be or may be prescribed.

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

POWER OF SEBI TO MAKE REGULATIONS

Section 31 provides that without prejudice to the provisions contained in Section 30 of SEBI Act, 1992, SEBI may, by notification in the Official Gazette, make regulations consistent with the provisions of this Act and the rules made thereunder to carry out the purposes of this Act.

In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matter namely : (a) the manner, in which at least fifty-one per cent. of equity share capital of a recognised stock exchange is held, within twelve months from the date of publication of the order under sub-section (7), of Section 4B by the public other than shareholders having trading rights under sub-section (8) of that section; (b) and the eligibility criteria and other requirements under Section 17A.

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

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

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

With the notification of these Regulations, The Securities Contracts (Regulations) (Manner of Increasing and Maintaining Public shareholding in recognized Stock Exchanges) Regulations, 2006, which dealt only with the Stock Exchanges stand repealed.

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 recognitions is disposed of.

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

Shareholder	Equity share holding limit
Equity Share Capital to be held by Public	Atleast 51% total
Individual resident in India (either directly or indirectly and either individually or with person acting in concert (PAC))	Not more than 5% individually
Further <ul style="list-style-type: none"> • 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
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 as similar to the aforesaid provisions as applicable to recognized Stock Exchanges except for as 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 Regulation broadly covering the following:

- Composition of Governance 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
- Constitution of Advisory Committee
- 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.

SECURITIES CONTRACTS (REGULATION) RULES, 1957

These rules were made by the Central Government in exercise of the powers conferred by Section 30 of the Securities Contracts (Regulation) Act, 1956 and notified on 21st February, 1957.

Under rules 3, it is laid down that an application under section 3 of the SCRA for recognition of a stock exchange shall be made to SEBI in Form A. This form is to be used for seeking recognition as well as renewal of recognition of a stock exchange. The annexure to form A requires the applicant stock exchange to furnish general information

about itself and also details about its membership, governing body, trading and miscellaneous matters.

The application shall be accompanied by 4 copies of the rules (including the memorandum and articles of association where the applicant stock exchange is an incorporated body) and bye-laws of the stock exchange applying for recognition and the receipt obtained for payment of fees.

Before granting recognition to a stock exchange, SEBI may make such enquiries and require such further information to be furnished as it deems necessary, in relation to the information furnished in the Annexure to the application.

Form of Recognition

Rule 6 provides that the recognition granted to a stock exchange shall be in Form B and subject to the following conditions, namely –

- (a) that the recognition unless granted on a permanent basis, shall be for such period not less than one year as may be specified in the recognition;
- (b) that the stock exchange shall comply with such conditions as are or may be prescribed or imposed under the provisions of the Act and these rules from time to time.

In case of a recognised stock exchange, renewal of such recognition should be sought from SEBI not later than 3 months before expiry of the period of recognition.

In case SEBI desires to withdraw recognition from a stock exchange, SEBI shall first issue a show-cause notice in Form C and obtain information. Only after considering the submissions of the stock exchange SEBI can take a decision on withdrawal of recognition.

Qualification prescribed for Membership of a recognised Stock Exchange

Rule 8 contains detailed provisions on this subject and they are as follows:

No person shall be liable to be elected as a member if–

- (a) he is less than twenty-one years of age;
- (b) he is not a citizen of India;
However the governing body may in suitable cases relax this condition with the prior approval of SEBI;
- (c) he has been adjudged bankrupt or a receiving order in bankruptcy has been made against him or he has been proved to be insolvent even though he has obtained his final discharge;
- (d) he has compounded with his creditors unless he has paid 100 paise in the rupee;
- (e) he has been convicted of an offence involving fraud or dishonesty;
- (f) he is engaged as principal or employee in any business other than that of securities or commodity derivatives except as a broker or agent not involving any personal financial liability unless he undertakes on admission to sever his connection with such business;

However no member may conduct business in commodity derivatives, except by setting up a separate company which shall comply with the regulatory requirements, such as, networth, capital adequacy, margins and exposure norms as may be specified by the Forward Market Commission, from time to time:

Provided further that nothing herein shall be applicable to any corporations, bodies corporate, companies or institutions referred to in items (a) to (n) of the proviso to sub-rule (4).

- (g) he has been at any time expelled or declared a defaulter by any other stock exchange;
- (h) he has been previously refused admission to membership unless a period of one year has elapsed since the date of such rejection.

No person eligible for admission as a member under sub-rule (1) shall be admitted as a member unless:

- (a) he has worked for not less than two years as a partner with, or as an authorised assistant or authorised clerk or remisier or apprentice to, a member; or
- (b) he agrees to work for a minimum period of two years as a partner or representative member with another member and to enter into bargains on the floor of the stock exchange and not in his own name but in the name of such other member; or
- (c) he succeeds to the established business of a deceased or retiring member who is his father, uncle, brother or any other person who is, in the opinion of the governing body, a close relative;

However the rules of the stock exchange may authorise the governing body to waive compliance with any of the foregoing conditions if the person seeking admission is in respect of means, position, integrity, knowledge and experience of business in securities, considered by the governing body to be otherwise qualified for membership;

No person who is a member at the time of application for recognition or subsequently admitted as a member shall continue as such if—

- (a) he ceases to be a citizen of India;

However this shall not affect those who are not citizens of India but who were members at the time of such application or were admitted subsequently under the provisions of clause (b) of sub- rule (1) of this rule, subject to their complying with all other requirements of this rule;

- (b) he is adjudged bankrupt or a receiving order in bankruptcy is made against him or he is proved to be insolvent;
- (c) he is convicted of an offence involving fraud or dishonesty;
- (d) he engages either as principal or employee in any business other than that of securities or commodity derivatives except as a broker or agent not involving any personal financial liability, provided that—
 - (i) the governing body may, for reasons, to be recorded in writing, permit a member to engage himself as principal or employee in any such business, if the member in question ceases to carry on business on the stock exchange either as an individual or as a partner in a firm.
 - (ii) in the case of those members who were under the rules in force at the time of such application permitted to engage in any such business and were actually so engaged on the date of such application, a period of three years from the date of the grant of recognition shall be allowed for severing their connection with any such business,
 - (iii) nothing herein shall affect members of a recognised stock exchange which are corporations, bodies corporate, companies or institution referred to in item (a) to (n) of the proviso to sub-rule (4).

Corporate Membership

Sub-rule 4 provides that a company as defined in the Companies Act, 2013, shall be eligible to be elected as a member of a stock exchange if –

- (i) such company is formed in compliance with the provisions of Companies Act, 2013.
- (ii) a majority of the directors of such company are shareholders of such company and also members of that stock exchange; and
- (iii) the directors of such company, who are members of that stock exchange, have ultimate liability in such company;

However where SEBI makes a recommendation in this regard, the governing body of a stock exchange shall, in

relaxation of the requirements of this clause, admit as member the following corporations, bodies corporate companies or institutions, namely—

- (a) the Industrial Finance Corporation, established under the Industrial Finance Corporation Act, 1948;
- (b) the Industrial Development Bank of India, established under the Industrial Development Bank Act, 1964;
- (c) the Life Insurance Corporation of India, established under the Life Insurance Corporation Act, 1956;
- (d) the Unit Trust of India, established under the Unit Trust of India Act, 1963;
- (e) the Industrial Credit and Investment Corporation of India, a company registered under the Companies Act, 2013;
- (f) the subsidiaries of any of the corporations or companies specified in (a) to (f) and any subsidiary of the State Bank of India or any nationalised bank set up for providing merchant banking services, buying and selling securities and other similar activities;
- (g) any bank included in the second schedule to RBI Act, 1934;
- (h) the Export Import Bank of India, established under the Export Import Bank of India Act, 1981;
- (i) the National Bank for Agriculture and Rural Development, established under the National Bank for Agriculture and Rural Development Act, 1981 and
- (j) the National Housing Bank, established under the National Housing Bank Act, 1987.
- (k) Central Board of Trustees, Employees' Provident Fund, established under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.
- (l) any pension fund registered or appointed or regulated by the Pension Fund Regulatory and Development Authority under the Pension Fund Regulatory And Development Authority Act, 2013; and
- (m) any Standalone Primary Dealers authorised by the Reserve Bank of India constituted under the Reserve Bank of India Act, 1934.

According to sub-rule 4A a company as defined in the Companies Act, 2013, shall also be eligible to be elected as a member of a Stock Exchange if –

- (i) such company is formed in compliance with the provisions of section 3 of the said Act;
- (ii) such company undertakes to comply with such financial requirements and norms as may be specified by SEBI for the registration of such company under sub-section (1) of section 12 of SEBI Act, 1992;
- (iii) the directors of the company are not disqualified for being members of a stock exchange except clause (1) of sub-clause (b) and sub-clause (f) thereof or clause (3) except sub-clause (a) and sub-clause (f) thereof and the Director of the company had not held the offices of the Director in any company which had been a member of the stock exchange and had been declared defaulter or expelled by the stock exchange; and
- (iv) not less than two directors of the company are persons who possess a minimum two years' experience—
 - (a) in dealing in securities; or
 - (b) as portfolio managers; or
 - (c) as investment consultants.

Sub-rule 5 provides that where any member of a stock exchange is a firm, the provisions of sub-rules (1), (3) and (4), shall, so far as they can, apply to the admission or continuation of any partner in such firm.

Sub-rule 6 lays down that a limited liability partnership as defined in the Limited Liability Partnership Act, 2008, shall also be eligible to be elected its a member of a stock exchange if:

- (i) such “limited liability partnership” undertakes to comply with such financial requirements and norms as may be provided by SEBI for registration of such limited liability partnerships under subsection (1) of section 12 of the SEBI Act, 1992;
- (ii) the designate partners of the ‘limited liability partnership’ are not disqualified from being members of a stock exchange under sub-rule (1) [except clause (b) and (f) thereof or sub-rule (3) except clause (a) and clause (f) thereof and the designated partners of the ‘limited liability partnership’ had not held the offices of Directors in any company or body corporate or partner in any firm or ‘limited liability partnership’, which had been a member of the stock exchange and had been declared defaulter or expelled by the stock exchange; and
- (iii) not less than two designated partners of the ‘limited liability partnership’ are persons who possess a minimum experience of two years:-
 - (a) in dealing in securities; or
 - (b) as portfolio managers; or
 - (c) as investment consultants.

Regulation of transaction in the stock exchange

All contracts between the members of a recognised stock exchange shall be confirmed in writing and shall be enforced in accordance with the rules and bye-laws of the stock exchange of which they are members.

SEBI may nominate one or more persons not exceeding three in number, as member or members of the governing body of every recognised stock exchange. Such member or members shall enjoy the same status and powers as other members of the governing body.

After receiving the report of the result of an enquiry made under clause (b) of sub-section (3) of Section 6 of the Act, SEBI may take such action as they deem proper and, in particular, may direct the governing body of the stock exchange to take such disciplinary action against the offending member, including fine, expulsion, suspension or any other penalty of a like nature not involving the payment of money, as may be specified by SEBI; notwithstanding anything to the contrary contained in the rules or bye-laws of the stock exchange concerned, the governing body shall give effect to the directions of SEBI in this behalf and shall not in any manner commute, revoke or modify the action taken in pursuance of such directions, without the prior approval of SEBI. SEBI may however, either on its own motion or on the representation of the member concerned, modify or withdraw its direction to the governing body.

Every member shall get his accounts audited by a chartered accountant whenever such audit is required by SEBI.

Books and documents to be maintained and preserved

(A) By every recognised stock exchange

Every recognised stock exchange shall maintain and preserve the following books of account and documents for a period of five years;

- (1) Minute books of the meetings of –
 - (a) members;
 - (b) governing body;
 - (c) any standing committee or committees of the governing body or of the general body of members.

Register of members showing their full names and addresses. Where any member of the –

- (1) Stock exchange is a firm,
- (2) Full names and addresses of all partners shall be shown.
- (3) Register of authorised clerks.
- (4) Register of remisiers of authorised assistants.
- (5) Record of security deposits.
- (6) Margin deposits book.
- (7) Ledgers.
- (8) Journals.
- (9) Cash Book.
- (10) Bank pass-book.

(B) By every member of a recognised stock exchange

Every member of a recognised stock exchange shall maintain and preserve the following books of account and documents for a period of five years;

- (a) Register of transactions (Sauda book).
- (b) Clients' ledger.
- (c) General ledger.
- (d) Journals.
- (e) Cash book.
- (f) Bank pass-book.
- (g) Documents register showing full particulars of shares and securities received and delivered.

Every member of a recognised stock exchange shall maintain and preserve the following documents for a period of two years;

- (a) Members' contract books showing details of all contracts entered into by him with other members of the same exchange or counter-foils or duplicates of memos of confirmation issued to such other members.
- (b) Counter-foils or duplicates of contract notes issued to clients.
- (c) Written consent of clients in respect of contracts entered into as principals.

Manner of Enquiry in the Affairs of Stock Exchange

Rule 16 lays down that any enquiry in relation to the affairs of the governing body of a recognised stock exchange or the affairs of any member in relation to the stock exchange can be conducted only by the person or persons appointed by SEBI under section 6(3)(b) of the Act. The person or persons so appointed are referred to as the inquiring authority.

The procedure relating to the conduct of inquiry is stated below –

- where the inquiring authority consists of two or more persons, one of them shall be appointed as the chairman or senior member thereof;
- the inquiring authority shall hand over a statement of issues to be inquired into to the governing body or

the member concerned, as the case may be, who will be given a reasonable opportunity to state their or his side of the case;

- if any witness is called for examination, an opportunity shall be provided to the governing body or the member whose affairs are being inquired into, as the case may be, to cross-examine such witness;
- where the inquiring authority consists of more than one person, the views of the majority shall be deemed to represent the findings of such authority and, in the event of an equality of votes, the chairman or senior member shall have a casting vote;
- the inquiring authority shall submit its report in writing to the SEBI within the period specified in the order of appointment;
- temporary absence from any hearing or hearings of any member of the inquiring authority shall not vitiate its proceedings.

Where SEBI has directed the governing body of a stock exchange to make an inquiry SEBI, the governing body concerned shall appoint one or more members thereof to make the inquiry.

Submission of annual reports and periodical returns by stock exchanges to SEBI

These matters are regulated under rule 17 & 17A respectively.

Every recognised stock exchange shall (before the 31st day of January in each year or within such extended time as SEBI may, from time to time, allow), furnish to SEBI annually with a report about its activities during the (proceeding calendar year), which shall *inter alia* contain detailed information about the following matters:

- (a) changes in rules and bye-laws, if any;
- (b) changes in the composition of the governing body;
- (c) any new sub-committees set up and changes in the composition of existing ones;
- (d) admissions, re-admissions, deaths or resignations of members;
- (e) disciplinary action against members;
- (f) arbitration of disputes (nature and number) between members and non-members;
- (g) defaults;
- (h) action taken to combat any emergency in trade;
- (i) securities listed and de-listed; and
- (j) securities brought on or removed from the forward list.

Every recognised stock exchange shall within one month of the date of the holding of its annual general meeting, furnish to SEBI with a copy of its audited balance sheet and profit and loss account for its preceding financial year.

Rule 17A necessitated that every recognised stock exchange shall furnish to SEBI periodical returns relating to –

- (i) the official rates for the securities enlisted thereon;
- (ii) the number of shares delivered through the clearing house;
- (iii) the making-up prices;
- (iv) the clearing house programmes;
- (v) the number of securities listed and de-listed during the previous three months;

- (vi) number of securities brought on or removed from the forward list during the previous three months; and
- (vii) any other matter as may be specified by the SEBI.

Requirements of listing of securities with recognised stock exchanges

This is one of the most important provision of the Securities Contracts (Regulation) Rules, 1957. Rule 19 provides for the complete procedure in this regard.

A public company as defined under the Companies Act, 2013, desirous of getting its securities listed on a recognised stock exchange, shall apply for the purpose to the stock exchange and forward along with its application the following documents and particulars:

- (a) Memorandum and articles of association and, in the case of a debenture issue, a copy of the trust deed.
- (b) Copies of all prospectuses or statements in lieu of prospectuses issued by the company at any time.
- (c) Copies of offers for sale and circulars or advertisements offering any securities for subscription or sale during the last five years.
- (d) Copies of balance sheets and audited accounts for the last five years, or in the case of new companies, for such shorter period for which accounts have been made up.
- (e) A statement showing –
 - (i) dividends and cash bonuses, if any, paid during the last ten years (or such shorter period as the company has been in existence, whether as a private or public company),
 - (ii) dividends or interest in arrears, if any.
- (f) Certified copies of agreements or other documents relating to arrangements with or between –
 - (i) vendors and/or promoters,
 - (ii) underwriters and sub-underwriters,
 - (iii) brokers and sub-brokers.
- (g) Certified copies of agreements with –
 - (i) managing agents and secretaries and treasurers.
 - (ii) selling agents,
 - (iii) managing directors and technical directors,
 - (iv) general manager, sales manager, managers or secretary.
- (h) Certified copy of every letter, report, balance sheet, valuation contract, court order or other document, part of which is reproduced or referred to in any prospectus, offer for sale, circular or advertisement offering securities for subscription or sale, during the last five years.
- (i) A statement containing particulars of the dates of, and parties to all material contracts, agreements (including agreements for technical advice and collaboration), concessions and similar other documents (except those entered into in the ordinary course of business carried on or intended to be carried on by the company) together with a brief description of the terms, subject-matter and general nature of the documents.
- (j) A brief history of the company since its incorporation giving details of its activities including any reorganization, reconstruction or amalgamation, changes in its capital structure (authorised, issued and subscribed) and debenture borrowings, if any.

- (k) Particulars of shares and debentures issued (i) for consideration other than cash, whether in whole or part, (ii) at a premium or discount, or (iii) in pursuance of an option.
- (l) A statement containing particulars of any commission, brokerage, discount or other special terms including an option for the issue of any kind of the securities granted to any person.
- (m) Certified copies of –
 - (i) acknowledgment card or the receipt of filing offer document with the SEBI;
 - (ii) agreements, if any, with the Industrial Finance Corporation, Industrial Credit and Investment Corporation and similar bodies.
- (n) Particulars of shares forfeited.
- (o) A list of highest ten holders of each class or kind of securities of the company as on the date of application along with particulars as to the number of shares or debentures held by and the address of each such holder.
- (p) Particulars of shares or debentures for which permission to deal is applied for;

Provided that a recognised stock exchange may either generally by its bye-laws or in any particular case call for such further particulars or documents as it deems proper.

Sub-rule 2 of Rule 19 provides that apart from complying with such other terms and conditions as may be laid down by a recognised stock exchange, an applicant company shall satisfy the stock exchange that;

- (a) Its articles of association provide for the following among others –
 - (i) that the company shall use a common form of transfer;
 - (ii) that the fully paid shares will be free from all lien, while in the case of partly paid shares, the company's lien, if any, will be restricted to moneys called or payable at a fixed time in respect of such shares;
 - (iii) that any amount paid-up in advance of calls on any share may carry interest but shall not entitle the holder of the share to participate in respect thereof, in a dividend subsequently declared;
 - (iv) there will be no forfeiture of unclaimed dividends before the claim becomes barred by law;
 - (v) that option or right to call of shares shall not be given to any person except with the sanction of the company in general meeting;

Provided that a recognised stock exchange may provisionally admit to dealings the securities of a company which undertakes to amend its articles of association at its next general meeting so as to fulfill the foregoing requirements and agrees to act in the meantime strictly in accordance with the provisions of this clause.

- (b) (i) At least 25 % of each class or kind of equity shares or debentures convertible into equity shares issued by the company was offered and allotted to public in terms of an offer document; or
- (ii) At least 10 % of each class or kind of equity shares or debentures convertible into equity shares issued by the company was offered and allotted to public in terms of an offer document if the post issue capital of the company calculated at offer price is more than four thousand crore rupees.

However, the requirement of post issue capital being more than four thousand crore rupees shall not apply to a company whose draft offer document is pending with SEBI on or before the commencement of the Securities Contracts (Regulation) (Amendment) Rules, 2010, if it satisfies the conditions prescribed in clause (b) of sub-rule 2 of rule 19 of the Securities Contracts (Regulation) Rules, 1956 as existed prior to the date of such commencement.

Further a company, referred above shall increase its public shareholding to at least twenty five per cent,

within a period of three years from the date of listing of the securities, in the manner specified by SEBI.

- (c) A public sector company, shall offer and allot at least ten per cent, of each class or kind of equity shares or debentures convertible into equity shares to public in terms of an offer document.

Conditions precedent to submission of application for listing by stock exchange

Sub-rule 2 of Rule 19 deals with the conditions required to be fulfilled by a company precedent to listing company applying for listing shall, as conditions precedent, undertake *inter alia* –

- (a) (i) that letters of allotment will be issued simultaneously and that, in the event of its being impossible to issue letters of regret at the same time, a notice to that effect will be inserted in the press so that it will appear on the morning after the letters of allotment have been posted.
- (ii) that letters of right will be issued simultaneously,
- (iii) that letters of allotment, acceptance or rights will be serially numbered, printed on good quality paper and, examined and signed by a responsible officer of the company and that whenever possible, they will contain the distinctive numbers of the securities to which they relate.
- (iv) that letters of allotment and renounceable letters of right will contain a proviso for splitting and that, when so required by the exchange, the form of renunciation will be printed on the back of or attached to the letters of allotment and letters of right.
- (v) that letters of allotment and letters of right will state how the next payment of interest or dividend on the securities will be calculated;
- (b) to issue, when so required, receipts for all securities deposited with it whether for registration, sub-division, exchange or for other purposes; and not to charge any fees for registration of transfers, for sub-division and consolidation of certificates and for sub-division of letters of allotment, renounceable letters of right, and split consolidation, renewal and transfer receipts into denominations of the market unit of trading;
- (bb) to issue, when so required, consolidation and renewal certificates in denominations of the market unit of trading, to split certificates, letters of allotment, letters of right, and transfer, renewal, consolidation and split receipts into smaller units, to split call notices, issue duplicates thereof and not require any discharge on call receipts and to accept the discharge of members of stock exchange on split, consolidation and renewal receipts as good and sufficient without insisting on the discharge of the registered holders;
- (c) when documents are lodged for sub-division or consolidation (or renewal) through the clearing house of the exchange;
- (i) to accept the discharge of an official of the stock exchange clearing house on the company's split receipts and (consolidation receipts and renewal receipts) as good and sufficient discharge without insisting on the discharge of the registered holders; and
- (ii) to verify when the company is unable to issue certificates or split receipt or (consolidation receipts or renewal receipts) immediately on lodgement whether the discharge of the registered holders, on the documents lodged for sub-division or consolidation (or renewal) and their signatures on the relative transfers are in order;
- (d) on production of the necessary documents by shareholders or by members of the exchange, to make on transfers an endorsement to the effect that the power of attorney or probate or letters of administration or death certificate or certificate of the Controller of Estate Duty or similar other document has been duly exhibited to and registered by the company;
- (e) to issue certificates in respect of shares or debentures lodged for transfer within a period of one month

of the date of lodgement of transfer and to issue balance certificates within the same period where the transfer is accompanied by a larger certificate;

- (f) to advise the stock exchange of the date of the board meeting at which the declaration or recommendation of a dividend (or the issue or right or bonus share) will be considered;
- (g) to recommend or declare all dividends and/or cash bonuses at least five days before the commencement of the closure of its transfer books or the record date fixed for the purpose and so advise the stock exchange in writing of all dividends and/or cash bonuses recommended or declared immediately after a meeting of the board of the company has been held to finalise the same;
- (h) to notify the stock exchange of any material change in the general character or nature of the company's business;
- (i) to notify the stock exchange of any change –
 - (i) in the company's directorate by death, resignation, removal or otherwise,
 - (ii) of managing director, managing agent or secretaries and treasurers,
 - (iii) of auditors appointed to audit the books and accounts of the company;
- (j) to forward to the stock exchange copies of statutory and annual reports and audited accounts as soon as issued, including directors' reports;
- (k) to forward to the stock exchange as soon as they are issued, copies of all other notices and circulars sent to the shareholders including proceedings of ordinary and extraordinary general meetings of the company and to file with the stock exchange certified copies of resolutions of the company as soon as such resolutions become effective;
- (l) to notify the stock exchange prior to intimating the shareholders, of any new issue of securities whether by way of right, privilege, bonus or otherwise and the manner in which it is proposed to offer or allot the same;
- (m) to notify the stock exchange in the event of re-issue of any forfeited securities or the issue of securities held in reserve for future issue;
- (n) to notify the stock exchange of any other alteration of capital including calls;
- (o) to close the transfer books only for the purpose of declaration of dividend or issue of right or bonus shares or for such other purposes as the stock exchange may agree and to give notice to the stock exchange as many days in advance as the exchange may from time to time reasonably prescribe, stating the dates of closure of its transfer books (or, when the transfer books are not to be closed, the date fixed for taking a record of its shareholders or debenture holders) and specifying the purpose or purposes for which the transfer books are to be closed (or the record is to be taken) and in the case of a right or bonus issue to so close the transfer books or fix a record date only after the sanctions of the competent authority subject to which the issue is proposed to be made have been duly obtained, unless the exchange agrees otherwise;
- (p) to forward to the stock exchange an annual return immediately after each annual general meeting of at least ten principal holders of each class of security of the company along with particulars as to the number of shares or debentures held by, and address of, each such holder;
- (q) to grant to shareholders the right of renunciation in all cases of issue of rights, privileges and benefits and to allow them reasonable time not being less than four weeks within which to record, exercise, or renounce such rights, privileges and benefits, and to issue, where necessary, coupons or fractional certificates or provide for the payment of the equivalent of the value of the fractional right in cash unless the company in general meeting or the stock exchange agrees otherwise;

- (r) to promptly notify the stock exchange—
 - (i) of any action which will result in the redemption, cancellation or retirement in whole or in part of any securities listed on the exchange,
 - (ii) of the intention to make a drawing of such securities, intimating at the same time the date of the drawing and the period of the closing of the transfer books (or the date of the striking of the balance) for the drawing;
 - (iii) of the amount of securities outstanding after any drawing has been made;
- (s) to intimate the stock exchange any other information necessary to enable the shareholders to appraise the position of the company and to avoid the establishment of a false market in the shares of the company;
- (t) that in the event of the application for listing being granted, such listing shall be subject to the rules and bye-laws of the exchange in force from time to time and that the company will comply within a reasonable time, with such further listing requirements as may be promulgated by the exchange as a general condition for new listings.

Application for listing of new securities

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

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

Suspension or withdrawal of admission to dealings in securities on stock exchange

A recognised stock exchange may suspend or withdraw admission to dealings in the securities of a company or body corporate either for a breach of or non-compliance with, any of the conditions of admission to dealings or for any other reason, to be recorded in writing, which in the opinion of the stock exchange justifies such action;

However, no such action shall be taken by a stock exchange without according to the company or body corporate concerned a reasonable opportunity by a notice in writing, stating the reasons, to show cause against the proposed action;

Farther that where a recognised stock exchange has withdrawn admission to dealings in any security, or where suspension of admission to dealings has continued for a period exceeding three months, the company or body corporate concerned may prefer an appeal to the Securities Appellate Tribunal constituted under section 15K of the SEBI Act, 1992 and the procedure laid down under the Securities Contracts (Regulation) (Appeal to Securities Appellate Tribunal) Rules, 2000 shall apply to such appeal. The Securities Appellate Tribunal may, after giving the stock exchange an opportunity of being heard, vary or set aside the decision of the stock exchange and its orders shall be carried out by the stock exchange.

A recognised stock exchange may, either at its own discretion or shall in accordance with the orders of the Securities Appellate Tribunal restore or re-admit to dealings any securities suspended or withdrawn from the list.

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

SEBI may, at its own discretion or on the recommendation of a recognised stock exchange, waive or relax the strict enforcement of any or all of the requirements with respect to listing prescribed by these rules. [Rule 19(5)]

Continuous Listing Requirement

Rule 19A (1) stipulates that every listed company other than public sector company shall maintain public shareholding of at least 25%.

However, any listed company which has public shareholding below 25%, shall increase its public shareholding to at least twenty five per cent, within a period of three years from the date of commencement of amendment to the said rules in 2010, in the manner specified by SEBI.

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

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

According to Sub rule 3, every listed public sector company shall maintain public shareholding of at least 10%. However, a listed public sector company-

- (a) which has public shareholding below 10%, on the date of commencement of the Securities Contracts (Regulation) (Second Amendment) Rules, 2010 shall increase its public shareholding to at least 10 %, in the manner specified by SEBI, within a period of three years from the date of such commencement;
- (b) whose public shareholding reduces below ten per cent, after the date of commencement of the Securities Contracts (Regulation) (Second Amendment) Rules, 2010 shall increase its public shareholding to at least ten per cent, in the manner specified by the Securities and Exchange Board of India, within a period of twelve months from the date of such reduction,.

Delisting of securities

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

- (a) the company has incurred losses during the preceding three consecutive years and it has negative networth;
- (b) trading in the securities of the company has remained suspended for a period of more than six months;
- (c) the securities of the company have remained infrequently traded during the preceding three years;
- (d) the company or any of its promoters or any of its director has been convicted for failure to comply with any of the provisions of the Act or SEBI Act, 1992 or the Depositories Act, 1996 or rules, regulations, agreements made thereunder, as the case may be and awarded a penalty of not less than rupees one crore or imprisonment of not less than three years;
- (e) the addresses of the company or any of its promoter or any of its directors, are not known or false addresses have been furnished or the company has changed its registered office in contravention of the provisions of the Companies Act, 2013, or;
- (f) shareholding of the company held by the public has come below the minimum level applicable to the company as per the listing agreement under the Act and the company has failed to raise public holding to the required level within the time specified by the recognized stock exchange.

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

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

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

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

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

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

LESSON ROUND UP

- The Securities Contracts (Regulation) Act, 1956 was enacted by Parliament to prevent undesirable transactions in securities by regulating the business of dealing therein, and by providing for certain other matters connected therewith.
- Section 2 of this Act contains definitions of various terms used in the Act.
- Section 17A of the Act provides for public issue and listing of securities.
- The Act prescribes various penalties against persons who might be found guilty of offences under the Act.
- Section 21 of the Act provides that where securities are listed on the application of any person in any recognised stock exchange, such person shall comply with the conditions of the listing agreement with that stock exchange.
- With an Intent to regulate recognition, ownership, and governance in stock exchange and cleaning corporations, SEBI on June 20, 2012 issued the Securities Contracts (Regulation) (Stock Exchanges and Clear Corporations) Regulations, 2012.
- The Government promulgated the Securities Contracts (Regulation) Rules, 1957 for carrying into effect the object of the SCRA Act, 1956.
- Rule 19 dealt with the requirement with respect to the listing of securities on a recognised stock exchange. Rule 19A provides the detailed provision regarding continuous listing agreement.
- Section 31 provides that without prejudice to the provisions contained in Section 30 of SEBI Act, 1992, SEBI may, by notification in the Official Gazette, make regulations consistent with the provisions of this Act and the rules made thereunder to carry out the purposes of this Act.

GLOSSARY

Demutualization	Process from “mutually owned” association to a Company “owned by shareholders”. In other words, transformation of the legal structure from a mutual from to a business corporation form and privatisation of the corporations so constituted is referred to as demutualization.
Stock Exchange	Anybody of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating controlling the business of buying, selling or dealing in securities.

Lesson 14

Securities and Exchange Board of India

LESSON OUTLINE

- Introduction
- Objectives
- Securities and Exchange Board of India Act, 1992
- Powers and functions of Securities and Exchange Board of India
- Investigation Procedure
- Penalties for failure, default, contravention
- Securities Appellate Tribunal
- Establishment, Composition of Securities Appellate Tribunal
- Procedures & Powers of Securities Appellate Tribunal
- Legal representation
- Appeal to Supreme Court
- Power of Central Government
- SEBI's (Settlement of Administrative & Civil Proceedings) Regulations, 2014
- SEBI (Procedure for Search and Seizure) Regulations, 2014
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

Securities and Exchange Board of India (SEBI) has been established with twin objective of protecting the interest of investors and to promote the development of and to regulate the Securities Market. Since its establishment in 1992 lot of initiatives have been taken to protect the interests of Indian investors.

In this Lesson the student will be able to know the powers and functions of SEBI; provisions relating to regulation of financial intermediaries, penalties for insider trading and fraudulent practices, promoting investors education and training and inspection of various regulated entities procedure for filing appeal with the Securities Appellate Tribunal. Establishment special court for speedy trial of offences consent order mechanism and procedure for search and seizure by SEBI etc.

INTRODUCTION

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

(a) the Capital Issues (Control) Act, 1947, which restricted issuer's access to the securities market and controlled the pricing of issues; (b) the Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; and (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges. The Capital Issues (Control) Act, 1947 had its origin during the war in 1943 when the objective was to channel resources to support the war effort. The Act was retained with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were channelled into proper lines, i.e., for desirable purposes to serve goals and priorities of the government, and to protect the interests of investors. Under the Act, any firm wishing to issue securities had to obtain approval from the Central Government, which also determined the amount, type and price of the issue.

Major part of the liberalisation process was the repeal of the Capital Issues (Control) Act, 1947 in May 1992. With this, Government's control over issue of capital, pricing of the issues, fixing of premia and rates of interest on debentures etc. ceased. The office which administered the Act was abolished and the market was allowed to allocate resources to competing uses. However to ensure effective regulation of the market, SEBI Act, 1992 was enacted to empower SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. SEBI can specify the matters to be disclosed and the standards of disclosure required for the protection of investors in respect of issues; can issue directions to all intermediaries and other persons associated with the securities market in the interest of investors or of orderly development for securities market; and can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. In short, it has been given necessary autonomy and authority to regulate and develop an orderly securities market.

OBJECTIVE OF SEBI

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

SEBI ACT, 1992

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

COMPOSITION OF SEBI

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

- (a) a Chairman;
- (b) two members from amongst the officials of the Ministry of the Central Government dealing with Finance and administration of the Companies Act, 2013;
- (c) one member from amongst the officials of the Reserve Bank;

- (d) five other members of whom at least three shall be the whole time members, to be appointed by the Central Government.

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

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

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

POWERS AND FUNCTIONS OF SEBI

Chapter IV of SEBI Act, 1992 deals with the powers and functions of SEBI. Section 11 of the Act lays down that it shall be the duty of SEBI to protect the interests of the investors in securities and to promote the development of, and to regulate the securities markets by such measures as it thinks fit. Section 11(2) provides that these measures would include:

- (a) regulating the business in stock exchanges and any other securities markets;
- (b) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;
- (ba) registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as SEBI may, by notification, specify in this behalf;
- (c) registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds;
- (d) promoting and regulating self-regulatory organisations;
- (e) prohibiting fraudulent and unfair trade practices relating to securities markets;
- (f) promoting investors' education and training of intermediaries of securities markets;
- (g) prohibiting insider trading in securities;
- (h) regulating substantial acquisition of shares and takeover of companies;
- (i) calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organisations in the securities market;
- (ia) calling for information and records from any person including any bank or any authority or board or corporation established or constituted by or under any central or state Act, which in the opinion of SEBI, shall be relevant to any investigation or inquiry by SEBI in respect of any transaction in securities.
- (ib) calling for information from or furnishing information to other authorities. Whether in India, or outside India having functions similar to those of SEBI, in the matters relating to the prevention or detection of violation in respect of securities laws, subject to the provisions of other laws for the time being in force in this regard.
- (ic) Provided that SEBI for the purpose of furnishing any information to any authority outside India, may

enter into an arrangement or agreement or understanding with such authority with approval of the Central Government.

- (j) performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government;
- (k) levying fees or other charges for carrying out the purposes of this section;
- (l) conducting research for the above purposes;
- (la) calling from or furnishing to any such agencies, as may be specified by SEBI, such information as may be considered necessary by it for the efficient discharge of its functions;
- (m) performing such other functions as may be prescribed.

Section 11(2A) prescribed that SEBI may take measures to undertake inspection of any book, or register, or other document or record of any listed public company or a public company (not being intermediaries referred to in section 12) which intends to get its securities listed on any recognised stock exchange where SEBI has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.

Section 11(3) of SEBI Act provides that for carrying out the duties assigned to it under the Act, SEBI has been vested with the same powers as are available to a Civil Court under the Code of Civil Procedure, 1908 for trying a suit in respect of the following matters:

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

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

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

Provides that SEBI may take any of the measures specified in clause (d) or clause (e) or clause (f) in respect of any listed public company or a public company not being an intermediary referred to in section (2) which intends to get its securities listed on any recognised stock exchange where SEBI has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market, provided further that SEBI shall, either before or after passing such orders, give an opportunity of hearing to such intermediaries or persons concerned.

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

TO REGULATE OR PROHIBIT ISSUE OF PROSPECTUS, OFFER DOCUMENT OR ADVERTISEMENT SOLICITING MONEY FOR ISSUE OF SECURITIES

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

(a) specify, by regulations –

(i) the matters relating to issue of capital, transfer of securities and other matters incidental thereto; and

(ii) the manner in which such matters shall be disclosed by the companies;

(b) by general or special orders –

(i) prohibit any company from issuing prospectus, any offer document, or advertisement soliciting money from the public for the issue of securities;

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

Sub-section 2 specifies that without prejudice to the provisions of section 21 of the Securities Contracts (Regulation) Act, 1956, SEBI may specify the requirements for listing and transfer of securities and other matters incidental thereto.

POWER TO ISSUE DIRECTIONS

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

(i) in the interest of investors, or orderly development of securities market; or

(ii) to prevent the affairs of any intermediary or other persons referred to in section 12 being conducted in a manner detrimental to the interests of investors or securities market; or

(iii) to secure the proper management of any such intermediary or person,

SEBI may issue such directions, –

(a) to any person or class of persons referred to in section 12, or associated with the securities market; or

(b) to any company in respect of matters relating to issue of capital, transfer of securities and other matter incidental thereto, as may be appropriate in the interests of investors in securities and the securities market.

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

INVESTIGATIONS

Section 11C of the Act provides that where SEBI has reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market; or any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the regulations made or directions issued by the Board thereunder. It may, at any time by order in writing, direct any person specified in the order to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to SEBI.

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

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

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

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

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

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

Sub-section 7 lays down that notes of any examination under sub-section (5) shall be taken down in writing and shall be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him.

Sub-section 8 lays down that where in the course of an investigation, the Investigating Authority has reason to believe that any person or enterprise, as the case may be, to whom a notice under sub-section (3) has been issued or might be issued, –

- (a) has omitted or failed to provide the information or produce documents as required in the notice; or

- (b) may not provide the information or produce documents which shall be useful for, or relevant to, the investigation; or
- (c) may destroy, mutilate, alter, falsify or secrete the information or documents useful for, or relevant to, the investigation, then, the Chairman may, after being satisfied that it is necessary so to do, after recording the reasons thereof in writing, authorize the Investigating Authority or any other officer of SEBI (the officer so authorized being hereinafter referred to as the authorised officer), to –
 - (i) enter and search, with such assistance, as may be required, the building, place, vessel, vehicle or aircraft where such information or documents are expected or believed to be kept;
 - (ii) break open the lock of any door, box, locker, safe, almirah or other receptacle for exercising the powers conferred by sub-clause (i), where the keys thereof are not available;
 - (iii) search any person who has got out of, or is about to get into, or is in, the building, place, vessel, vehicle or aircraft, if the authorized officer has reason to suspect that such person has secreted about his person any such books of account or other documents;
 - (iv) require any person who is found to be in possession or control of any books of account or other documents, maintained in the form of electronic record, to provide the authorised officer the necessary facility to inspect such books of account or other documents.
 - (v) seize any such books of account or other documents found as a result of such search;
 - (vi) place marks of identification on any books of account or other documents or make or cause to be made extracts or copies therefrom;
 - (vii) record on oath the statement of any person who is found to be in possession or in control of the information or documents referred to in sub-clauses (i), (iii) and (iv).

Sub-section 8A stipulates that the authorised officer may requisition the services of any police officer or any office of the central Government, or of both, to assist him for all or any of the purposes specified in sub section (8) and it shall be the duty of every such officer to comply with such requisition.

Sub-section (9) empowered SEBI to make regulations in relation to any search or seizure under this section and in particular, such regulations may provide for the procedure to be followed by the authorised Officer-

- (a) for obtaining ingress into any building, place, vessel, vehicle or aircraft to be searched where free ingress thereto is not available;
- (b) for ensuring safe custody of any books of account or other documents or assets seized.

Sub-section 10 provides that the Investigating Authority shall keep in its custody the books, registers, other documents and record seized under this section for such period not later than the conclusion of the investigation as it considers necessary and thereafter shall return the same to the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person, from whose custody or power they were seized. The Investigating Authority may, before returning such books, registers, other documents and record as aforesaid, place identification marks on them or any part thereof. Every search or seizure made under this section shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1973 relating to searches or seizures made under that Code as per sub-section 11.

CEASE AND DESIST PROCEEDINGS

Section 11D deals with the cease and desist powers of SEBI. If SEBI finds, after causing an inquiry to be made, that any person has violated, or is likely to violate any provisions of this Act, or any rules or regulations made thereunder, it may pass an order requiring such person to cease and desist from committing or causing such violation. SEBI shall not pass such order in respect of any listed public company or a public company which

intends to get its securities listed on any recognized stock exchange unless SEBI has reasonable grounds to believe that such company has indulged in insider trading or market manipulation.

REGISTRATION OF INTERMEDIARIES

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

Section 12(1) of the Act provides that no stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market shall buy, sell or deal in securities except under, and in accordance with, the conditions of a certificate of registration obtained from SEBI in accordance with the regulations made under this Act.

A person buying or selling securities or otherwise dealing with the securities market as a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market immediately before the establishment of SEBI for which no registration certificate was necessary prior to such establishment, may continue to do so for a period of three months from such establishment or, if he has made an application for such registration within the said period of three months, till the disposal of such application.

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

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

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

PROHIBITION OF MANIPULATIVE AND DECEPTIVE DEVICES, INSIDER TRADING AND

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

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

- (a) use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations made thereunder;
- (b) employ any device, scheme or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed on a recognized stock exchange;
- (c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognized stock exchange, in contravention of the provisions of this Act or the rules or the regulations made thereunder;

- (d) engage in insider trading;
- (e) deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations made thereunder;
- (f) acquire control of any company or securities more than the percentage of equity share capital of a company whose securities are listed or proposed to be listed on a recognized stock exchange in contravention of the regulations made under this Act.

FINANCE, ACCOUNTS AND AUDIT OF SEBI

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

Fund

The Central Government may, after due appropriation made by Parliament by law in this behalf, make to SEBI grants of such sums of money as the Central Government may think fit for being utilised for the purposes of this Act. There shall be constituted a fund to be called the Securities and Exchange Board of India General Fund and there shall be credited thereto all grants, fees and charges received by SEBI under this Act; all sums received by SEBI from such other sources as may be decided upon by the Central Government. The Fund shall be applied for meeting the salaries, allowances and other remuneration of members, officers and other employees of SEBI, the expenses of SEBI in the discharge of its functions and the expenses on objects and for purposes authorised by this Act.

Account and Audit

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

PENALTIES FOR FAILURES

Chapter VIA of SEBI Act deals with penalties which can be imposed under the Act for various failures, defaults, non-disclosure and other offences.

It may be recalled that Section 11(2)(i) empowers SEBI to call for information and conduct enquiries and audits of the stock exchanges, mutual funds, other persons associated with securities markets, intermediaries and self regulatory organisations in the security market. Also Section 11(ia) of the Act requires calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any central, state or provincial Act in respect of any transaction in securities which is under investigation or inquiry by SEBI.

Penalty for failure to furnish information, return, etc.

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

- (a) to furnish any document, return or report to SEBI, fails to furnish the same;
- (b) to file any return or furnish any information, books or other documents within the time specified therefor in the regulations, fails to file return or furnish the same within the time specified therefor in the regulations;
- (c) to maintain books of accounts or records, fails to maintain the same.

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

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

Penalty for failure to redress investors' grievances.

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

Penalties for Default

Section 15D and 15F provide for penalties for default in case of mutual funds :

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

- (a) required under this Act or any rules or regulations made thereunder to obtain a certificate of registration from SEBI for sponsoring or carrying on any collective investment scheme, including mutual funds, sponsors or carries on any collective investment scheme, including mutual funds, without obtaining such certificate of registration, he shall be liable to a penalty of one lakh rupees for each day during which he sponsors or carries on any such collective investment scheme, including mutual funds, or one crore rupees, whichever is less;
- (b) registered with SEBI as a collective investment scheme, including mutual funds, for sponsoring or carrying on any investment scheme, fails to comply with the terms and conditions of certificate of registration, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (c) registered with SEBI as a collective investment scheme, including mutual funds, fails to make an application for listing of its schemes as provided for in the regulations governing such listing, he shall be liable to penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (d) registered as a collective investment scheme, including mutual funds, fails to dispatch unit certificates of any scheme in the manner provided in the regulation governing such despatch, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (e) registered as a collective investment scheme, including mutual funds, fails to refund the application

monies paid by the investors within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;

- (f) registered as a collective investment scheme, including mutual funds, fails to invest money collected by such collective investment schemes in the manner or within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

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

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

Penalties for default in case of stock brokers

Section 15F provides if any person registered as a stock broker under SEBI Act -

- (a) fails to issue contract notes in the form and in the manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty not exceeding five times the amount for which the contract note was required to be issued by that broker;
- (b) fails to deliver any security or fails to make payment of the amount due to the investor in the manner within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (c) charges an amount of brokerage which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty of one lakh rupees or five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

Penalty for Insider Trading

Section 15G lays down that if any insider:

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

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

Penalty for Non-Disclosure of Acquisition of Shares and Takeovers

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

- (i) disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate; or
- (ii) make such a public announcement to acquire shares at a minimum price; or

- (iii) make a public offer by sending letter of offer to the shareholders of the concerned company; or
- (iv) make payment of consideration to the shareholders who sold their shares pursuant to Letter of offer.

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

Penalty for fraudulent and unfair trade practices

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

Penalty for contravention where no separate penalty has been provided

Section 15HB Whoever fails to comply with any provision of this Act, the rules or regulations made or directions issued by SEBI thereunder for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.

Adjudications

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

- (1) For the purpose of adjudging the penalties for failure, SEBI appoints any of its officers not below the rank of Division Chief to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.
- (2) While holding an inquiry, the adjudicating officer has powers to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the adjudicating officer, may be useful for or relevant to the subject matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions, he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.
- (3) SEBI may call for and examine the record of any proceedings under this section and if it considers that the order passed by the adjudicating officer is erroneous to the extent it is not in the interests of the securities market, it may, after making or causing to be made such inquiry as it deems necessary, pass an order enhancing the quantum of penalty, if the circumstances of the case so justify:

However, no such order shall be passed unless the person concerned has been given an opportunity of being heard in the matter. Further that nothing contained in this sub-section shall be applicable after an expiry of a period of three months from the date of the order passed by the adjudicating officer or disposal of the appeal under section 15T, whichever is earlier.

Factors to be taken into account by the adjudicating officer

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

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

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

SECURITIES APPELLATE TRIBUNAL (SAT)

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

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

Composition of SAT

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

Qualification for Appointment as Presiding Officer or Member

Section 15M prescribes that a person shall not be qualified for appointment as the Presiding Officer of Securities Appellate Tribunals unless he is a sitting or retired Judge of the Supreme Court or a sitting or retired Chief Justice of a High Court or is a sitting or retired Judge of a High Court who has completed not less than seven years of service as a Judge in a High Court. It has also been prescribed that the presiding officer of the Securities Appellate Tribunal shall be appointed by the Central Government in consultation with chief justice of India or his nominee. A person shall not be qualified for appointment as a member of Securities Appellate Tribunal unless he is a person of ability, integrity and standing who has shown capacity in dealing with problems relating to securities market and has qualification and experience of corporate law, securities laws, finance, economics or accountancy.

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

Tenure of Officer of Presiding Officer and Other Members

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

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

Orders Constituting Appellate Tribunal to be Final and not to Invalidate its Proceedings

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

Requirements for Appeal to the Tribunal

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

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

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

(2) Every appeal shall be filed within a period of 45 days from the date on which a copy of the order made by SEBI or the Adjudicating Officer, as the case may be, is received by him and it shall be in such form and be accompanied by prescribed fee.

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

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

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

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

PROCEDURE OF SECURITIES APPELLATE TRIBUNAL

As regards the procedure and powers of Securities Appellate Tribunal, Section 15U lays down that the Securities Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules, the Securities Appellate Tribunal shall have powers to regulate their own procedure including the places at which they shall have their sittings.

POWERS OF SECURITIES APPELLATE TRIBUNAL

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

- (a) summoning and enforcing the attendance of any person and examining him on oath;
- (b) requiring the discovery and production of documents;
- (c) receiving evidence on affidavits;
- (d) issuing commissions for the examination of witnesses or documents;
- (e) reviewing its decisions;
- (f) dismissing an application for default or deciding it *ex parte*;
- (g) setting aside any order of dismissal of any application for default or any order passed by it *ex parte*;
- (h) any other matter which may be prescribed.

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

Legal representation

Section 15V permits the appellant either to appear in person or authorise one or more Practising Company

Secretaries or Chartered Accountants or Cost Accountants or Legal practitioners or any of its officers to present his or its case before the Securities Appellate Tribunal.

Limitation

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

Public Servants

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

JURISDICTION OF CIVIL COURT

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

APPEAL TO SUPREME COURT

Section 15Z lays down that any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of fact or law arising out of such order;

It has been provided that the Supreme Court may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding 60 days.

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

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

POWERS OF CENTRAL GOVERNMENT

(a) To issue directions

Section 16 empowers Central Government to issue directions in writing to SEBI on questions of policy as it may deem fit from time to time. However the Central Government shall as far as practicable, give an opportunity to SEBI to express its views before any such directions is given by the Central Government. The decision of the Central Government as to whether a question is one of policy or not shall be final.

(b) To Supercede SEBI

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

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

(c) circumstances exist which render it necessary in the public interest so to do, it may, by notification, supersede SEBI for such period, not exceeding six months, as may be specified in the notification.

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

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

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

Returns and Reports

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

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

Delegation of Powers

In accordance with Section 19 of SEBI Act, SEBI may, by general or special order in writing delegate to any member, officer of SEBI or any other person subject to such conditions, if any as may be specified in the order, such of its powers and functions under the Act as it may deem necessary.

Appeal to the Central Government

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

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

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

Bar of Jurisdiction

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

Public Servants

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

Offences and Punishments

Section 24 lays down that:

- (1) Without prejudice to any award of penalty by the Adjudicating Officer under SEBI Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations made thereunder, he shall be punishable with imprisonment for a term which may extend to ten years or with fine which may extend to twenty five crore rupees or with both.
- (2) If any person fails to pay the penalty imposed by the Adjudicating Officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years or with fine which may extend to twenty-five crore rupees or with both.

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

Power to grant Immunity

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

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

Cognizance of Offences by Courts

Section 26 lays down that:

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

Establishment of Special Courts

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

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

Application of Code to proceedings before Special Court

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

The person conducting prosecution referred to in sub-section (1) 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.[26(2)]

Transitional provisions

Section 26E provides that Any offence committed under this Act, which is triable by a Special Court shall, until a Special Court is established, be taken cognizance of and tried by a Court of Session exercising jurisdiction over the area, notwithstanding anything contained in the Code of Criminal Procedure, 1973. However, nothing contained in this section shall affect the powers of the High Court, under section 407 of the Code of Criminal Procedure, 1973 to transfer any case or class of cases taken cognizance by a Court of Session under this Section.

Offences by Companies

Section 27 on offences by company lays down that:

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

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

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

Recovery of amounts

Section 28A(1) provides that if a person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any direction of SEBI for refund of monies or fails to comply with a direction of disgorgement order issued under section 11B 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, 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 made thereunder were the provisions of this Act and referred to the amount due under this Ordinance instead of to income-tax under the Income-tax Act, 1961.

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

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

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

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

Sub-section (2) empowered the Recovery Officer to seek the assistance of the local district administration while exercising the powers under sub-section (1).

The recovery of amounts by a Recovery Officer under sub-section (1), pursuant to non compliance with any direction issued by SEBI under section 11B, shall have precedence over any other claim against such person under sub-section (3)

Power to make Rules

Section 29 empowers the Central Government to make rules for carrying out the purposes of this Act.

Power of SEBI to make Regulations

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

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

- (a) the times and places of meetings of SEBI and the procedure to be followed at such meetings including

quorum necessary for the transaction of business;

- (b) the terms and other conditions of service of officers and employees of SEBI;
- (c) the matters relating to issue of capital, transfer of securities and other matters incidental thereto and the manner in which such matters shall be disclosed by the companies under section 11A.
- (ca) the utilisation of the amount credited under sub-section 5 of section 11;
- (cb) the fulfillment of other conditions relating to Collective Investment scheme under sub-section (2A) of section 11AA;
- (cc) the procedure to be followed by the authorized officer for search or seizure under sub-section (9) of section 11C;
- (d) the conditions subject to which certificate of registration is to be issued, the amount of fee to be paid for certificate of registration and the manner of suspension or cancellation of certificate of registration.
- (da) the terms determined by SEBI for settlement of proceedings under sub-section (2) and the procedure for conducting of settlement proceedings under sub-section (3) of section 15JB.
- (db) any other matter which is required to be, or may be, specified by regulations or in respect of which provision is to be made by regulations.

Rules, Regulations to be laid before the Parliament

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

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

SEBI (SETTLEMENT OF ADMINISTRATIVE & CIVIL PROCEEDINGS) REGULATIONS, 2014

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

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

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

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

The said Ordinance provided that SEBI may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may be determined by SEBI in accordance with the regulations made under SEBI Act. The said Ordinance further provided that the settlement proceedings shall be conducted in accordance with the procedure specified in the regulations made under SEBI Act. In this direction SEBI also placed a draft consultation paper on SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2013 on its website for public comments.

In the light of the above, SEBI framed SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014 and notified it vide Circular No. LAD-NRO/GN/2013-14/37/50 dated 09 January, 2014. These regulations will enable the persons who have defaulted on any SEBI laws & civil proceedings have been initiated against them, to settle the proceedings. These regulations do not provide for settling proceedings which are under criminal in nature.

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

The SEBI (Settlement of Administrative & Civil Proceedings) Regulations, 2014 is divided into VIII chapters and two schedules. Chapter 1 covers the preliminary definitions part. Chapter II deals with the application for settlement and limitations part. Chapter III stipulates the scope of settlement proceedings, withdrawal of application for settlement, effect of pending application on the specified proceedings etc, Chapter V deals with the terms of settlement like monetary and non- monetary terms, factors to be considered to arrive at the settlement terms, Chapter V defined the role of the internal committee and high powered advisory committee in order to impart transparency in the process, Chapter VI provides the procedure of settlement before the internal committee and high powered advisory committee, Chapter VII deals with Settlement orders like settlement of proceeding before the adjudicating officer and SEBI or Settlement proceeding pending before tribunal or any court, Rejection of application in certain eventualities and chapter VIII deals with miscellaneous information like confidentiality of information, power to remove difficulties, SEBI's power to specify procedures, Rescission and savings etc. Schedule I is divided into three parts A, B & C respectively and Schedule II is again divided into seven chapters. The highlights of the Regulations in brief is discussed below:

Scope of Settlement Proceeding

Regulation 5 deals with the scope settlement proceedings. It provides that an application for settlement of any specified proceeding shall not be considered, if:

- (a) the alleged default was committed within a period of 24 calendar months from the date of the last settlement order where the applicant was a party.
- (b) An earlier application with regard to the same alleged default has been rejected;
- (c) the applicant has been party to two settlement orders during the period of thirty six calendar months, prior to the date of applications;
- (d) the audit or investigation, if any, in respect of any alleged default, is not complete.

The following proceedings are out of the scope of this regulations, i.e. a specified proceeding cannot be settled, if it involves any of the following defaults:

- (a) defaults involving insider trading and communication of unpublished price sensitive information ;
- (b) fraudulent and unfair trade practices including front running, which in the opinion of SEBI are serious and have a market wide impact or have caused substantial losses to or affect the rights of investors in securities, especially retail investors and small shareholders:

Explanation.- The expression ' front running' means usage of non-public information to directly or indirectly, buy or sell securities or enter into options or futures contracts, in advance of a substantial order, on an impending transaction, in the same or related securities or futures or options contracts, in anticipation that when the information becomes public; the price of such securities or contracts may change;

- (c) failure to make an open offer except where the applicant agrees to make the open offer or where SEBI is of the opinion that the making of the open offer would not be beneficial to the shareholders or is infructuous;
- (d) defaults or manipulative practices by mutual funds, alternative investment funds, collective investment schemes and their sponsors or asset management companies, collective investment management company, managers, trustees that result in substantial losses to investors, except in cases where the applicant has compensated the investors for the losses, to the satisfaction of SEBI;
- (e) failure to redress investor grievances except where the alleged default is with regard to delayed redressal;
- (f) failure, by issuers of securities or entities who invite investment, to make material disclosures in offer documents;
- (g) raising of monies by issuance of securities or pooling of funds, in violation of securities laws where the remedy is refund of such monies;
- (h) non-compliance of notices and summons issued by SEBI or summons issued by the adjudicating officer;
- (i) non-compliance of any order or direction passed under the securities laws.

So any civil proceedings apart from above can be brought under these regulations & can be settled.

Settlement Terms

Regulation 8 provides for the terms of settlement in monetary as well as non-monetary terms or both. The non-monetary terms may include appropriate directions, such as:

- (a) Voluntary suspension of certificate of registration or closure of business for a specified period;
- (b) Removal from Management;
- (c) Direction in the nature of disgorgement, where it is possible to identify the investors who have incurred losses on account of the action or inaction of the applicant;
- (d) Debarment of certain individuals from acting as a partner or officer or director of an intermediary or as an officer or director of a company that has a class of securities regulated by SEBI, for specified periods;
- (e) Cancellation of securities and reduction in share holding where the securities are issued fraudulently including cancellation of bonus shares received on such securities, if any, and re-imbursalment of any dividends received, etc;
- (f) Voluntary lock-in of securities;
- (g) Implementation of enhanced policies and procedures to prevent future securities laws violations as well as direction to appoint or retain an independent consultant to review policies and procedures;
- (h) Direction to provide enhanced training and education to employees of intermediaries;
- (i) Directions relating to internal audit and reporting requirements;
- (j) Any other directions that may be issued by SEBI under the securities laws in the interest of the investors.

The amount of settlement will be credited in the Consolidated Fund of India and the legal cost will be included in the general fund of SEBI. The ill-gotten profits made (if any) will be credited in SEBI's Investor Protection and Education Fund.

Factors to be considered to arrive at the settlement terms

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

- (a) conduct of the applicant in the investigation;
- (b) the role played by the applicant in case the alleged default is committed by a group of persons;
- (c) nature, gravity and impact of alleged defaults;
- (d) whether any other proceeding against the applicant for non-compliance of securities laws is pending or concluded;
- (e) whether the alleged default is minor or major in nature;
- (f) the extent of amount of harm and/or loss to investors' and/or gain by the applicant;
- (g) processes which have been introduced since the alleged default to minimize future defaults or lapses;
- (h) compliance schedule proposed by the applicant;
- (i) economic benefits accruing to any person from the non-compliance or delayed compliance;
- (j) conditions which are necessary to deter future non-compliance by the same or another person;
- (k) satisfaction of claim of investors regarding payment of money due to them or delivery of securities to them;
- (l) whether the applicant has undergone any other enforcement action for the same violation;
- (m) any other factors necessary in the facts and circumstances of the case.

Procedure

1. The person who wants to have proceedings settled have to make application along with requisite fees.
2. The applicant shall make full & true disclosures.
3. Application should be complete & if not complete it will be returned. The return of application can be resubmitted within 15 days from the day of rejection of application.
4. The Settlement terms include settlement amount &/or non-monetary terms. The Settlement Amount will be calculated in accordance with the guidelines specified in Schedule II of these regulations.
5. The settlement once completed will be published on SEBI website.
6. If there is any non compliance of settlement order then the original proceedings which was settled would be restored.
7. The application may be rejected if applicant refuses to receive or respond to the communications sent by SEBI or non submission or delays the submission of information, document, etc. as required or non appearance before the internal committee on more than one occasion or violates in any manner the undertaking and waivers specified, or non remittance or delays the payment of settlement amount and/or does not abide by the undertaking and waivers.

SEBI (PROCEDURE FOR SEARCH AND SEIZURE) REGULATIONS, 2014

The Securities Laws (Amendment) Second Ordinance, 2013 was promulgated on September 16, 2013 conferring explicit powers on the Chairman, SEBI to authorise Investigating Authority or any other officer of SEBI to conduct search and seizure under sub-section (8) of section 11C of the SEBI Act, 1992.

The said Ordinance vide sub-section (9) of section 11C of the SEBI Act, provides that SEBI may make regulations in relation to search and seizure under section 11C of the SEBI Act. A corresponding provision as clause (cc) has also been inserted in sub-section (2) of section 30 of SEBI Act enabling SEBI to frame regulations providing for the procedure to be followed by the authorised officer for search or seizure under sub-section (8) of section 11C of SEBI Act.

In order to exercise the powers of search and seizure at the time of Investigation, harmonious with the rights of the persons who are subjected to search of their person and property, while pursuing the SEBI's statutory mandate of investor protection, detailed procedures relating to the procedural safeguards during different stages of search and seizure and the rights of those persons subjected to search and the obligations of the authorized persons, SEBI placed a draft regulations titled SEBI (Procedure for Search and Seizure) Regulations, 2013 dated 14.11.2013 and invited comments from the public on the draft regulations.

Keeping the above in perspective, SEBI on January 10, 2014 issued the SEBI (Procedure for Search and Seizure) Regulations, 2014, specifying detailed procedures to be followed at different stages of an investigation. The salient features of the Regulation are as under:

Warrant of Authority

The authorized officer by SEBI is the Investigation authority under these regulations given power to cause search and seizure. If the investigation authority believes that any or all of the grounds specified in Section 11C(8) of the Act exist, he may make a request either in writing or in electronic mode in Form A to the Chairman of the SEBI with the request to issue a warrant of authority specifying the grounds and reasons for multiple execution, if required. In the request the details of the person or enterprise and its building, place, vessel, vehicle or aircraft whose search is required to be authorized.

On receipt of the request from the Authority the Chairman may, after being satisfied that it is necessary to do so, authority the Investigating Authority or any other officer of SEBI as the Authorized Officer by issuing a Warrant of Authority in Form B, duly signed by the Chairman and sealed. The Chairman may authorize multiple execution of the warrant of authority during the period in which it is in force.

Every warrant issued shall remain in force until it is cancelled by the Chairman or until it is executed, or till the expiry of the time limit specified for execution in the warrant of authority, whichever is earlier. A warrant of authority issued to any officer of SEBI shall expire on the date of the order of the transfer of such order. A warrant issued to more than one officer of SEBI, may be executed by all or any one or more of them. The warrant shall be returned to the Chairman after being executed fully along with the seizure memo or if not executed, whether partially or not, within the time authorized, if any, for its execution, on the expiry of such time. The authorized officer shall make an endorsement on the warrant of authority stating as to the powers which have been exercised by him under such authority.

Procedure to search

The following is the procedure in respect of a search:

Relating to witness

- Before making a search, the authorized officer shall call upon two or more independent and respectable inhabitants of the locality in which the place to be searched to situate or any other locality if no such inhabitant of the said locality is availing or is willing to be a witness to the search, to attend and witness the search and

may issue an order in writing to them or any of them so to do;

- If the authorized officer finds that no witness is available, he shall execute the warrant of authority on the execution being video graphed and the search shall not be invalid on the mere ground that no one has stood as witness to the search;
- No person witnessing the search shall be compelled to be a witness in any quasi judicial proceedings under the securities laws except as and when summoned by SEBI or the authority before whom such proceedings are pending;

Relating to places and buildings

- It shall be lawful for the authorized officer executing the warrant of authority to enter into such buildings or place, to break open any outer or inner door or window of any building or place, whether that of the person to be searched or any other person, if after notification, he cannot otherwise obtain admittance;
- If such building or place is an apartment in actual occupancy of a woman, the authorized Officer shall before entering such place give notice to such woman that she is at liberty to withdraw and shall afford her every reasonable facility for withdrawing and may then break open any outer or inner door or window of the apartment and enter it;
- The authorized officer may require any person who is the owner or has the immediate possession or control of any box, locker, safe, almirah or any other receptacle situate in such building, place to open the same and allow access to inspect or examine its contents and where the keys are not available or where such person fails to comply with any such requirement, may cause any action to be taken including the breaking open of such box, locker, safe, almirah or other receptacle which the Authorized Officer may deem necessary for carrying out all or any of the purposes specified under the warrant of authority;
- The Authorized Officer may require, pending the commencement of the search, any person not to remove from such building or place any article or other thing;
- The Authorized Officer may require the service of any police officer or of any officer of the Central Government or State Government or all of them to assist him for all or any of the purposes specified in the Warrant of Authority;
- The Authorized Officer may search, with such assistance, any building or place, authorized to be searched, where such information or documents are expected or believed to be kept;

Relating to vessel, vehicle or aircraft

- The Authorized Officer on production of the warrant of authority to the person in charge of vessel, vehicle or aircraft, shall have the free ingress to vessel, vehicle or aircraft for the execution;
- It shall be lawful for the Authorized Officer to require the person for the time being control of the vehicle, vessel or aircraft to stop any such of them from moving; if it is in move compel them to stop;
- The Authorized Officer shall have the authority to break open any outer or inner door or window of any such of them, if after notification of the authority and purpose and demand of admittance duly made, he cannot obtain otherwise;
- If the same is occupied by a woman who according to custom does not appear in public, the Authorized Officer shall, before entering such of them, give notice to such woman that she is at liberty to withdraw and shall afford her every reasonable facility for withdrawing;
- The authorized officer may require any person who is the owner or has the immediate possession or control of any box, locker, safe, almirah or any other receptacle situate in such of them, place to open the same and allow access to inspect or examine its contents and where the keys are not available or where such person

fails to comply with any such requirement, may cause any action to be taken including the breaking open of such box, locker, safe, almirah or other receptacle which the Authorized Officer may deem necessary for carrying out all or any of the purposes specified under the warrant of authority;

- If the same is found unsuitable for the search the Authorized Officer shall require the person in charge to take the same to the place which is considered suitable for the search and require that person to accompany with them;
- The Authorized Officer may require the person in charge of the vessel, vehicle or aircraft not to remove from them any article or other thing, pending the commencement of the search;
- The Authorized Officer may taken the services of the any police officer or any officer of the Central or State Government or all of them to assist him for all or any of the purposes;
- The Authorized officer may search with such assistance the vehicle, vessel or aircraft where such information or documents are expected or believed to be kept.

Search of person

- Any person who has got out of or is about to get into or is in the building, place, vessel, vehicle or aircraft authorized to be searched is suspected that he has secreted any books of account or other documents then the Authorized Officer shall made a search for that person;
- If such a person is a female, the search shall be made by a female officer with strict regard to decency;
- The Authorized Officer may require the services of any police officer or of any officer of the Central or State Government or all of them to assist him in the search.

Search of Computer

- The Authorized Officer, in the process of search may use reasonable measures to access a computer system that the person being searched is carrying or that is in the person's physical possession or immediate control;
- He may operate any computer or other device or cause any such computer or other devices to be operated by a person accompanying the Authorized Officer; and
- He may require any person to facilitate access, to provide access to the information held in any such computer or other device which can be accessed by the use of that computer or data storage device-
 - o To get any password necessary to operate; or
 - o Otherwise to enable to examine the information accessible by the computer in a form in which the information is visible and legible.

Power of Inspection

The Authorized Officer if so authorized shall have the power of inspection of the documents found in any place, building, vessel, vehicle and aircraft.

Power of seizure

The Authorized Officer shall have the power to seize any such books of account or other documents found as a result of such search, or get the signature of such persons. If it is not practicable to seize he may serve an order in Form C or Form D on the person who has the owner or having the control, part with or otherwise deal with it except with the previous permission of the Authorized Officer and such person shall there upon take such steps as may be necessary for ensuring compliance with the order.

Seizure Memo

In the seizure process the Authorized Officer may prepare a seizure memo in the prescribed Form signed by two witnesses, containing a list of all documents seized or copied in the course of such search and of the place in which they were respectively found and verify the inventory of any such documents seized. In seizing the electronic storage media he shall enter in Form F the description of the physical storage media that were seized or copied. The seizure memo shall contain the following details –

- The time of entry into and exit from place, building, vessel, vehicle or aircraft;
- The identity of the persons searched;
- The address of place and building and details of vessel, vehicle or aircraft searched;
- The details of officers present, if any, at the time of seizure;
- The details of other persons present, if any, at the time of seizure;
- The signature of the authorized officer;
- The signature of the witnesses with thumb impression and date;
- The description of identification mark, if any, placed by any person from whose possession or control the documents are seized;
- The signature of the owner or the person who is in immediate possession or control of premises, building, vehicle or aircraft, if available therein;
- The signature of the person from whom the seizure is effected.

Powers of Authorized Officer

The following are the powers of the Authorized Officer-

- To place identification mark on any books of account or other documents;
- To make or cause to be made extracts or copy of documents of any books of account;
- To record on oath the statement of any person in the presence of two witnesses.

Obligations of the Authorized Officer

The Authorized Officer, before executing the warrant of Authority shall-

- Identify himself either by name or by official identification documents;
- Show the warrant of authority to the person concerned;
- Conduct search and seizure in the presence of the witnesses and prepare panchnama as prescribed in Form G;
- Deliver a copy of the seizure memo to any person from whose possession or control the documents are seized;
- Not enter at any place of business or profession after day time;
- Execute the warrant of authority within the time limit prescribed, if any, in the warrant of authority.

Rights of persons under search and persons in charge

The following are the rights of the persons under search and persons in charge –

- To see the warrant of authority and authorized officer and to obtain a copy thereof;

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- To verify the identity of the authorized officer and officials assisting him;
- To be present during the search and seizure;
- To put his own mark of identification on the documents seized along with his signature, stamp, seal, etc.,;
- To have copy of document seized or take extracts in the presence of Authorized Officer ;
- To have a copy of any statement recorded during search and seizure.

Obligations of persons under search and persons in charge

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

- Any person in charge of any building, place shall identify any person as may be required;
- Any person in charge of vessel, vehicle or aircraft on demand locate and identify the vessel, vehicle or aircraft;
- Allow the Authorized Officer free ingress and afford all reasonable facilities for a search;
- Stop the vessel or vehicle or stop and cause to be landed any aircraft on communication of the Authorized Officer;
- Bound to disclose the password and such other information in case of computer devices;
- Provide necessary facility to inspect books of account or other documents;
- Identify the locker etc., and to hand over keys of the same to the Authorized Officer;
- No officer shall be prevented from execution of Warrant of Authority.

Safe Custody of seized documents

The seized documents shall be transmitted in safe manner to the place of custody. The Authorized Officer shall hand over the documents seized along with the seizure memo to the Investigating Authority, who shall keep the same in his custody for such period not later than the conclusion of the investigation as he considers necessary. The same shall not be retained more than 180 days from the date of seizure except with the approval of the Chairman. It shall be ensured that records in physical form are not altered, damaged, mutilated and the records in electronic form is not altered or erased. It is also ensured that the seized articles are stored, maintained in suitable physical and environmental conditions.

Return of documents

The Investigating Authority shall return the documents to the person from whom the same were seized. Before returning such documents identification marks are to be recorded. Any person information severable from any documents shall be returned to the person to whom such information relates on a written request being made in this behalf by him.

Protection of Personal Information

The personal information contained in any document seized shall not be divulged to any third person except for the compliance of any law for the time being in force, without the consent of the person to whom the information relates.

Retention of forensic copy

The forensic copy of the data or mirror image of the storage device and any copy thereof may be retained, on being satisfied that such data or image has evidentiary value. Any copy made or generated from any other document may be retained.

Liability for non compliance of obligations

Any intermediary who fails to comply with any of the obligations shall be liable for any one or more of the following actions –

- Adjudication under Section 15HB of SEBI Act;
- Proceedings under chapter V of SEBI (Intermediaries) Regulations, 2008;
- Prosecution under Section 24 of the Act.

Any person other than an intermediary who fails to comply with any of the obligations shall be liable for any one or more of the following actions-

- Adjudication under Section 15HB of SEBI Act;
- Action under Section 11B and Section 11(4) of the Act;
- Prosecution under Section 24 of the Act.

LESSON ROUND UP

- SEBI has twin objectives of protecting the interests of the investors and to promote the development of, and to regulate the securities markets by such measures as it thinks fit.
- SEBI regulates the securities market and SAT acts as a watchdog to ensure justice.
- Section 15 Y of the SEBI Act provides that no civil court shall have jurisdiction to entertain a suit or proceeding in respect of any matter in which an adjudicating officer ('AO') is appointed under the Act or SAT is empowered by or under the Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under the Act.
- The SEBI Act, 1992 empowers for appellate remedies against SEBI's order or penalties by establishing Securities Appellate Tribunal.
- Any person aggrieved by any decision or order of the SAT can file an appeal to Supreme Court.
- Appearance before SAT may be either in person or through authorized person being a Chartered Accountant, Company Secretary, Cost Accountant or Legal Practitioner.
- The Central Government may, for the purpose of providing speedy trial of offences under this Act, by notification, established or designate as many special courts as may be necessary.
- The SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014 is divided into VIII chapters and two schedules.
- SEBI, by virtue of power conferred under section 11C(9) and section 30 of SEBI Act made the regulations called as 'SEBI (Procedure for Search and Seizure) Regulations, 2014.

GLOSSARY

Compounding of offences	Compounding of offence allows the accused to avoid a lengthy process of criminal prosecution, which would save cost, time, mental agony, etc in return for payment of compounding charges.
Injunction	A court order by which an individual is required to perform, or is restrained from performing, a particular act.

Lesson 15

Depositories

LESSON OUTLINE

- Introduction
- Benefits of Depository System
- Depository System – An Overview
- Legal framework for depository system in India
- Legal Framework
- The Depositories Act, 1996
- Bye-laws of a Depository
- SEBI (Depositories and Participants) Regulations, 1996
- Internal Audit of Depository Participants
- Concurrent Audit
- Establishment of connectivity with NSDL & CDSL
- Appointment of Common Agency for Share Registry Work
- In person Verification
- Designated Depository Participants
- Basic Services Demat Account
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

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

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

INTRODUCTION

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

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

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

There are two Depositories functioning in India, namely the National Securities Depository Limited (NSDL) and the Central Depository Services (India) Limited (CDSL). Under the provisions of the Depositories Act, these Depositories provide various services to investors and other Participants in the capital market, such as, clearing members, stock exchanges, investment institutions, banks and issuing corporates. These include basic facilities like account opening, dematerialization, dematerialization, settlement of trades and advanced facilities like pledging, distribution of non-cash corporate actions, distribution of securities to allottees in case of public issues, etc.

All the securities held by a depository shall be dematerialized and shall be in a fungible form. To utilize the services offered by a depository, the investor has to open an account with the depository through a participant, similar to the opening of an account with any of the bank branches to utilize services of that bank. Registration of the depository is required under SEBI (Depositories and Participants) Regulations, 1996 and is a precondition to the functioning of the depository. Depository and depository participant both are regulated by SEBI.

Difference between Depository and Custodian

Both depository and custodial services are responsible for safe keeping of securities but they are different in the sense that the Depository can legally transfer beneficial ownership, which a custodian cannot. The main objective of a Depository is to minimize the paper work involved with the ownership, trading and transfer of securities.

BENEFITS OF DEPOSITORY SYSTEM

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

Elimination of bad deliveries - In the depository environment, once holdings of an investor are dematerialised, the question of bad delivery does not arise i.e. they cannot be held "under objection". In the physical environment, buyer of shares was required to take the risk of transfer and face uncertainty of the quality of assets purchased. In a depository environment good money certainly begets good quality of assets.

Elimination of all risks associated with physical certificates - Dealing in physical securities have associated security risks of theft of stocks, mutilation of certificates, loss of certificates during movements through and from the registrars, thus exposing the investor to the cost of obtaining duplicate certificates and advertisements, etc. This problem does not arise in the depository environment.

Immediate transfer and registration of securities - In the depository environment, once the securities are credited to the investors account on pay out, he becomes the legal owner of the securities. There is no further need to send it to the company's registrar for registration. Having purchased securities in the physical environment, the investor has to send it to the company's registrar so that the change of ownership can be registered. This process usually takes around three to four months and is rarely completed within the statutory framework of two

months thus exposing the investor to opportunity cost of delay in transfer and to risk of loss in transit. To overcome this, the normally accepted practice is to hold the securities in street names i.e. not to register the change of ownership. However, if the investors miss a book closure the securities are not good for delivery and the investor would also stand to lose his corporate entitlements.

Faster disbursement of non cash corporate benefits like rights, bonus, etc. – Depository system provides for direct credit of non cash corporate entitlements to an investor's account, thereby ensuring faster disbursement and avoiding risk of loss of certificates in transit.

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

Reduction in handling of huge volumes of paper and periodic status reports to investors on their holdings and transactions, leading to better controls.

Elimination of problems related to change of address of investor, transmission, etc. - In case of change of address or transmission of demat shares, investors are saved from undergoing the entire change procedure with each company or registrar. Investors have to only inform their DP with all relevant documents and the required changes are effected in the database of all the companies, where the investor is a registered holder of securities.

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

DEPOSITORY SYSTEM - AN OVERVIEW

The Depository System functions very much like the banking system. A bank holds funds in accounts whereas a Depository holds securities in accounts for its clients. A Bank transfers funds between accounts whereas a Depository transfers securities between accounts. In both systems, the transfer of funds or securities happens without the actual handling of funds or securities. Both the Banks and the Depository are accountable for the safe keeping of funds and securities respectively.

In the depository system, share certificates belonging to the investors are to be dematerialized and their names are required to be entered in the records of depository as beneficial owners. Consequent to these changes, the investors' names in the companies' register are replaced by the name of depository as the registered owner of the securities. The depository, however, does not have any voting rights or other economic rights in respect of the shares as a registered owner. The beneficial owner continues to enjoy all the rights and benefits and is subject to all the liabilities in respect of the securities held by a depository. Shares in the depository mode are fungible and cease to have distinctive numbers. The transfer of ownership changes in the depository is done automatically on the basis of delivery v. payment.

In the Depository mode, corporate actions such as IPOs, rights, conversions, bonus, mergers/amalgamations, subdivisions & consolidations are carried out without the movement of papers, saving both cost & time. Information of beneficiary owners is readily available. The issuer gets information on changes in shareholding pattern on a regular basis, which enables the issuer to efficiently monitor the changes in shareholdings.

The Depository system links the issuing corporates, Depository Participants (DPs), the Depositories and clearing corporation/ clearing house of stock exchanges. This network facilitates holding of securities in the soft form and effects transfers by means of account transfers.

Following presentation about depositories reveal all about depositories, its concepts and trading, i.e. models of depositories, Depository functions, Legal linkage, depository participant, Registrars and issuers, dematerialisation, rematerialisation, electronic credit in new issues, trading system, corporate action.

MODELS OF DEPOSITORY

Immobilisation – Where physical share certificates are kept in vaults with the depository for safe custody. All subsequent transactions in these securities take place in book entry form. The actual owner has the right to withdraw his physical securities as and when desired. The immobilization of fresh issue may be achieved by issuing a jumbo certificate representing the entire issue in the name of depository, as nominee of the beneficial owners.

Dematerialisation – No Physical scrip in existence, only electronic records maintained by depository. This type of system is cost effective and simple and has been adopted in India.

Dematerialization

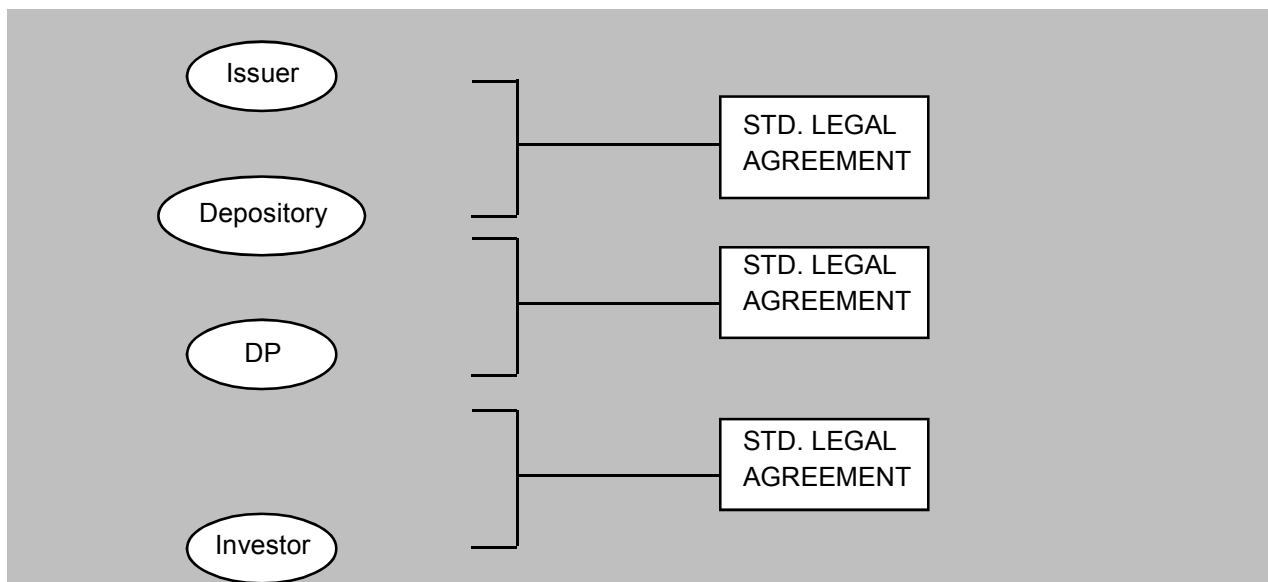
Dematerialization is a process by which the physical share certificates of an investor are taken back by the Company and an equivalent number of securities are credited his account in electronic form at the request of the investor. An investor will have to first open an account with a Depository Participant and then request for the dematerialization of his share certificates through the Depository Participant so that the dematerialized holdings can be credited into that account. This is very similar to opening a Bank Account.

Dematerialization of shares is optional and an investor can still hold shares in physical form. However, he/she has to demat the shares if he/she wishes to sell the same through the Stock Exchanges. Similarly, if an investor purchases shares from the Stock Exchange, he/she will get delivery of the shares in demat form. Odd lot share certificates can also be dematerialized.

Depository Functions

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

LEGAL LINKAGE



DEPOSITORY PARTICIPANT

Just as a brokers act an agent of the investor at the Stock Exchange; a Depository Participant (DP) is the representative (agent) of the investor in the depository system providing the link between the Company and investor through the Depository. The Depository Participant maintains securities account balances and intimate the status of holding to the account holder from time to time. According to SEBI guidelines, Financial Institutions like banks, custodians, stockbrokers etc. can become participants in the depository. A DP is one with whom an investor needs to open an account to deal in shares in electronic form. While the Depository can be compared to a Bank, DP is like a branch of that bank with which an account can be opened. The main characteristics of a depository participant are as under:

- Acts as an Agent of Depository
- Customer interface of Depository
- Functions like Securities Bank
- Account opening
- Facilitates dematerialisation
- Instant transfer on pay-out
- Credits to investor in IPO, rights, bonus
- Settles trades in electronic segment

REGISTRAR/ISSUER

- Dematerialisation
- Confirmation of Beneficiary Holdings
- Corporate Actions – Rights, Bonus, etc.
- Reconciliation of Depository Holdings
- Rematerialisation

DEMATERIALISATION

- Investor opens account with DP
- Fills Dematerialisation Request Form (DRF) for registered shares
- Investor lodges DRF and certificates with DP
- DP intimates the Depository
- Depository intimates Registrar/Issuer
- DP sends certificates and DRF to Registrar/Issuer
- Registrar/Issuer confirms demat to Depository
- Depository credits investor a/c

REMATERIALISATION

- Client submits Rematerialisation Request Form (RRF) to DP
- DP intimates Depository
- Depository intimates the Registrar/Issuer

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- DP sends RRF to the Registrar/Issuer
- Registrar/Issuer prints certificates and sends to Investor
- Registrar/Issuer confirms remat to Depository
- Investor's account with DP debited

ELECTRONIC CREDIT IN NEW ISSUES

- Investor opens account with DP
- Submits application with option to hold securities in depository giving DP-Id and Client-Id
- Registrar uploads list of allottees to Depository
- Depository credits allottee's account with DP
- Refunds sent by Registrar as usual

TRADING SYSTEM

- Separate quotes in Book Entry
- Trading Member to have Clearing Account with DP
- Settlement as per Settlement Calendar of Stock Exchange
- Trading can be introduced in any Stock exchange if settlement is guaranteed

CORPORATE ACTIONS

- Dividends/cash benefits – these benefits are directly forwarded to the investors by the company or its registrar and transfer agent.
- Non-cash benefits, viz. Bonus, Rights Issue, etc. – these benefits are electronically credited to the beneficial owner's account through Depository.

LEGAL FRAMEWORK

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

- The Depositories Act, 1996
- The SEBI (Depositories and Participants) Regulations, 1996
- Bye-laws of Depository
- Business Rules of Depository.

Apart from the above, Depositories are also governed by certain provisions of:

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

The legal framework for depository system in the Depositories Act, 1996 provides for the establishment of 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 seek registration with SEBI and obtain a Certificate of Commencement of Business from SEBI on fulfillment of the prescribed conditions. The investors opting to join depository mode are required to enter into an agreement with depository through a participant who acts as an agent of depository. The agencies such as custodians, banks, financial institutions, large corporate brokerage firms, non-banking financial companies etc. act as participants of depositories. The companies issuing securities are also required to enter into an agreement with the Depository.

THE DEPOSITORIES ACT, 1996

OBJECTIVES

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

- A legal basis for establishment of depositories to conduct the task of maintenance of ownership records of securities and effect changes in ownership records through book entry;
- Dematerialisation of securities in the depositories mode as well as giving option to an investor to choose between holding securities in physical mode and holding securities in a dematerialized form in a depository;
- Making the securities fungible;
- Making the shares, debentures and any interest thereon of a public limited company freely transferable; and
- Exempting all transfers of shares within a depository from stamp duty.

ELIGIBILITY CONDITION FOR DEPOSITORY SERVICES

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

- be formed and registered as a company under the Companies Act, 2013.
- be registered with SEBI as a depository under SEBI Act, 1992.
- has framed bye-laws with the previous approval of SEBI.
- has one or more participants to render depository services on its behalf.
- has adequate systems and safeguards to prevent manipulation of records and transactions to the satisfaction of SEBI.
- complies with Depositories Act, 1996 and SEBI (Depositories and Participants) Regulations, 1996.
- meets eligibility criteria in terms of constitution, network, etc.

ELIGIBLE SECURITIES REQUIRED TO BE IN THE DEPOSITORY MODE

Section 8 of the Depositories Act gives the option to the investors to receive securities in physical form or in depository mode.

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

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

after that investor will also have the freedom to switch from depository mode to non-depository mode and vice versa. The decision as to whether or not to hold securities within the depository mode and if in depository mode, which depository or participant, would be entirely with the investor.

FUNGIBILITY

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

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

Immobilisation of securities in a depository mode refers to a situation where the depository holds securities in the form of physical paper side by side with electronic evidence of ownership. In such a case the transfers are not accompanied by physical movement of securities but securities are in existence in the custody of the depository. However, the Depositories Act, envisages dematerialisation in the depository mode. In such a case the securities held in a depository shall be dematerialized and the ownership of the securities shall be reflected through book entry only. The securities outside the depository shall be represented by physical scrips. Hence, the depository legislation envisages partial dematerialisation, i.e. a portion of the securities in dematerialized form and the other portion in physical form. (Sections 89 and 186 of Companies Act, 2013 shall not apply to a depository in respect of shares held on behalf of beneficial owners in depositories).

RIGHTS OF DEPOSITORIES AND BENEFICIAL OWNER

A depository should be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner. The depository as a registered owner should not have any voting rights or any other rights in respect of securities held by it. The beneficial owner is entitled to all the rights and benefits and 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 participant and such depository is required to make entries in its records accordingly. Any entry in the records of a depository should be evidence of a pledge or hypothecation.

FURNISHING OF INFORMATION AND RECORDS BY DEPOSITORY AND ISSUER

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

OPTION TO OPT OUT IN RESPECT OF ANY SECURITY

Section 14 of the Act provides that if a beneficial owner seeks to opt out of a depository in respect of any security he should inform the depository accordingly. After the receipt of intimation the depository should make appropriate entries in its records and also inform the issuer. Every issuer may, within thirty days of the receipt of intimation from the depository and on fulfillment of such conditions and on payment of such fees as may be specified by the regulations, issue the certificate of securities to the beneficial owner or the transferee, as the case may be.

DEPOSITORIES TO INDEMNIFY LOSS IN CERTAIN CASES

Any loss caused to the beneficial owner due to the negligence of the depository or the participant, would be indemnified by the depository to such beneficial owner. Where the loss due to the negligence of the participant is indemnified by the depository, the depository has the right to recover the same from such participant.

POWER OF SEBI

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

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

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 SEBI after making or causing to be made an enquiry or inspection SEBI is 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 interests 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

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

PENALTY FOR FAILURE TO FURNISH INFORMATION/RETURN ETC.

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

- (a) to furnish any information, document, books, returns or report to the Board, fails to furnish the same within the time specified therefor fails to furnish the same within specified time;
- (b) to file any return or furnish any information, books or other documents within the time specified therefor in the regulations or bye-laws, fails to file return or furnish the same within the time specified therefor, fails to file such return or furnish the required information within the specified time;
- (c) to maintain books of account or records, fails to maintain the same;

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

PENALTY FOR FAILURE TO ENTER INTO AGREEMENT

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

PENALTY FOR FAILURE TO REDRESS INVESTORS' GRIEVANCES

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

PENALTY FOR DELAY IN DEMATERIALISATION OR ISSUE OF CERTIFICATE OF SECURITIES

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

PENALTY FOR FAILURE TO RECONCILE RECORDS

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

PENALTY FOR FAILURE TO COMPLY WITH DIRECTIONS ISSUED BY 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.

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.

Section 19H (3) empowered SEBI to call for and examine the record of any proceedings under this section and if it considers that the order passed by the adjudicating officer is erroneous to the extent it is not in the interest of the securities market, it may, after making or causing to be made such inquiry as it deems necessary, pass an order enhancing the quantum of penalty, if the circumstances of the case so justify.

Provided that no such order shall be passed unless the person concerned has been given an opportunity of being heard in the matter. Further nothing contained in this sub-section shall be applicable after an expiry of a period of three months from the date of the order passed by the adjudicating officer or disposal of the appeal under section 23A, whichever is earlier.

FACTORS TO BE TAKEN INTO ACCOUNT BY ADJUDICATING OFFICER

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

Settlement of Administrative Civil Proceedings

Section 19-IA provides that any person, against whom any proceedings have been initiated or may be initiated under section 19, section 19H, as the case may be, may 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.

Sub-section 3 lays down that for the purpose of settlement under this section, the procedure specified by SEBI under the SEBI Act, 1992 shall apply. Further Sub-section 4 provides that 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.

Recovery of amounts

Section 19-IB deals with recovery of amounts by SEBI.

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, 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 to income-tax under the Income-tax Act, 1961.

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 XVIII 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.

Sub-section (2) empowers the Recovery Officer to seek the assistance of the local district administration while exercising the powers under sub-section (1).

Sub-section (3) provides that the recovery of amounts by a Recovery Officer under sub-section (1), pursuant to noncompliance with any direction issued by SEBI under section 19, shall have precedence over any other claim against such person.

The expression "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.

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

OFFENCES BY COMPANIES

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

COGNIZANCE OF OFFENCES BY COURTS

Section 22 provides that no court shall take cognizance of any offence punishable under this Act or any rules or regulations or bye-laws made there under except on a complaint made by the Central Government or State Government or the SEBI or by any person.

COMPOSITION OF CERTAIN OFFENCES

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

POWER TO GRANT IMMUNITY

Section 22B empowers the Central Government to grant immunity, on recommendation by the 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 there under or also from the imposition of any penalty under this Act with respect to the alleged violation. No such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity. Recommendation of SEBI under this sub-section is not binding upon the Central Government.

The immunity granted to a person may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

Establishment of Special Courts

Section 22C 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 provides that all offences under this Act committed 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 22 lays down 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 under this section 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

Section 22G stipulates that any offence committed under this Act, which is triable by a Special Court shall, until a Special Court is established, be taken cognizance of and tried by a Court of Session exercising jurisdiction over the area, notwithstanding anything contained in the Code of Criminal Procedure, 1973. However, 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 by a Court of Session under this Section.

Appeals

Section 23 deals with appeal to Central Govt. Any person aggrieved by an order of SEBI 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. Provided that 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. Provided that 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 regulations 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:

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

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

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

PROCEDURE AND POWERS OF SECURITIES APPELLATE TRIBUNAL

Section 23B provides that the Securities Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other

provisions of this Act and of any rules, the Securities Appellate Tribunal shall have powers to regulate their own procedure including the places at which they shall have their sittings. The Securities Appellate Tribunal shall have, for the purpose of discharging their functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely—

- (a) summoning and enforcing the attendance of any person and examining him on oath;
- (b) requiring the discovery and production of documents;
- (c) receiving evidence on affidavits;
- (d) issuing commissions for the examination of witnesses or documents;
- (e) reviewing its decisions;
- (f) dismissing an application for default or deciding it ex parte;
- (g) setting aside any order of dismissal of any application for default or any order passed by it ex parte; and
- (h) any other matter which may be prescribed.

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

APPEAL TO SUPREME COURT

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

RIGHT TO LEGAL REPRESENTATION

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

LIMITATIONS

Section 23 D provides that the provisions of the Limitation Act, 1963 shall, as far as may be, apply to an appeal made to a Securities Appellate Tribunal.

CIVIL COURT NOT TO HAVE JURISDICTION

Section 23 E provides that no Civil Court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Securities Appellate Tribunal is empowered by or under this Act to determine and no injunction can be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

AREAS ON WHICH RULES MAY BE FRAMED BY THE CENTRAL GOVERNMENT

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

- the manner of inquiry under Section 19H(1).
- the time within which an appeal may be preferred from the orders of SEBI under Section 23(1).

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

POWER OF SEBI TO MAKE REGULATIONS

Section 25 of the Depositories Act, 1996 read with Section 30 of SEBI Act, 1992 empowers SEBI to make regulations for carrying out the purposes of the Act, by notification in the Official Gazette. The regulations may, inter alia, provide for :

The form in which record is to be maintained under section 2(1)(i) –

- The form in which the certificate of commencement of business has to be issued.
- The manner in which the certificate of security shall be surrendered to the issuer by any investor who is desirous of availing depository services.
- The requirements to be complied with by a beneficial owner for creating with the previous approval of depository, pledge or hypothecation in respect of a security owned by him through depository.
- The conditions and the fees payable with respect to the issue of certificate of securities to the beneficial owner where the beneficial owner seeks to opt out of the depository.
- The rights and obligations of the depositories, participants, and the issuers whose securities are dealt with by a depository.
- The eligibility criteria for admission of securities into the depository.

BYE-LAWS OF A DEPOSITORY

Section 26 deals with the power of depository to make bye-law. Depository is required to frame its bye-laws with the prior approval of SEBI, consistent with the provisions of the Act and the regulations made by SEBI thereunder. SEBI has, however, the power to direct the depository to amend or revoke any bye-laws already made, wherever it considers expedient to do so. If the depository fails or neglects to comply with the directions of SEBI, SEBI may make the bye-laws or amend or revoke the bye-laws on its own.

CONTENTS OF THE BYE-LAWS

As per Sub-section 2 of Section 26 of the Act, the bye-laws of a depository would include:

- the eligibility criteria for admission and removal of securities in the depository.
- the conditions subject to which the securities shall be dealt with.
- the eligibility criteria for admission of any person as a participant.
- the manner and procedure for dematerialisation of securities.
- the procedure for transactions within the depository.
- the manner in which securities are to be dealt with or withdrawn from a depository.
- the procedure for ensuring safeguards to protect the interests of participants and beneficial owners.
- the conditions of admission into and withdrawal from a participant by a beneficial owner.
- the procedure for conveying information to the participants and beneficial owners on dividend declaration, shareholder meetings and other matters of interest to the beneficial owners.

- the manner of distribution of dividends, interest and monetary benefits received from the company among beneficial owners.
- the manner of creating pledge or hypothecation in respect of securities held with a depository.
- *inter-se* rights and obligations among the depository, issuer, participants and beneficial owners.
- the manner and the periodicity of furnishing information to SEBI, issuer and other persons.
- the procedure for resolving disputes involving depository, issuer company or a beneficial owner.
- the procedure for proceeding against the participant committing breach of the regulations and provisions for suspension and expulsion of participants from the depository and cancellation of agreements entered with the depository.
- the internal control standards including procedure for auditing, reviewing and monitoring.

MEMBERSHIP RIGHTS IN RESPECT OF SECURITIES HELD BY A DEPOSITORY

The depository as a registered owner shall not have any voting rights or any other rights in respect of securities held by it on behalf of the beneficial owners. The beneficial owner shall be entitled to all the rights and benefits (including the right to vote) and be subjected to all the liabilities in respect of securities held by a depository.

EVIDENCIARY VALUE OF THE RECORDS OF THE DEPOSITORY

Section 15 of the Act treats depository as a bank for the purposes of the Bankers' Books Evidence Act, 1891. The ownership records of securities maintained by depositories, whether maintained in the form of books or machine readable forms, shall be accepted as *prima facie* evidence in all legal proceedings.

SEBI (DEPOSITORIES AND PARTICIPANTS) REGULATIONS, 1996

The Depositories Act requires that the registration of the depository, depository participant and the custodian, is mandatory with the SEBI. These market intermediaries can function or commence business only after registration from SEBI has been obtained and requisite fee paid to SEBI. The requirement of registration is a continuing one and the moment the registration is cancelled or revoked or surrendered, the person shall cease to act as such.

SEBI had issued SEBI (Depositories and Participants) Regulations, 1996 on 16th May, 1996 which apply to depositories and its participants.

These regulations also contain provisions for operations and functioning of depositories, form for application and certificates used and schedule of fees for participants, etc. It also contains provisions for registration of depository and depository participants, rights and obligations of various users and constituents, inspection and procedure for action in case of default.

Entities desiring to become depository participants must apply to the depository and are required to be recommended to SEBI by the depository. If approved and registered by SEBI, the depository participant can be admitted on the depository. The depository has to formulate its own set of criteria for selection of participants. Every participant holding a certificate is required at all times to abide by the specified Code of Conduct.

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

This Regulations deal with rights and obligations of depositories and every depository has to state in its bye-laws the eligible securities for dematerialisation which include shares, scrips, stock, bonds, debentures stock, Indian Depository Receipts or other marketable securities of a like nature, 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 Government Securities and even unlisted securities.

Every depository is required to enter into an agreement with the issuer in respect of securities disclosed as eligible to be held in demat form. No agreement is required to be entered into where the depository itself is an issuer of securities.

The depository is also required to enter into a tripartite agreement with the issuer, its transfer agent and itself where company has appointed a transfer agent. Every depository is required to maintain continuous connectivity with issuers, registrars and transfer agents, participants and clearing house or clearing corporations. Depositories should take adequate measures including insurance to protect the interest of the beneficial owners.

Every depository is required to maintain the following records and documents namely:

- records of securities dematerialised and rematerialised;
- the names of the transferor, transferee, and the dates of transfer of securities;
- a register and an index of beneficial owners;
- details of holding of the securities of the beneficial owners as at the end of the each day;
- records of instruction(s) received from and sent to participants, issuers' agents and beneficial owners;
- records of approval, notice, entry and cancellation of pledge or hypothecation, as the case may be;
- details of participants;
- details of securities declared to be eligible for dematerialisation in the depository; and
- such other records as may be specified by SEBI for carrying on the activities as a depository.

Every depository has to intimate SEBI the place where the records and documents are maintained.

Subject to the provisions of any other law, the depository shall preserve records and documents for a minimum period of five years.

Participants are required to enter into an agreement with beneficial owners. It is required that separate accounts are to be opened by every participant in the name of each of the beneficial owner and the securities of each beneficial owners are to be segregated and shall not be mixed up with the securities of other beneficial owners or with the participant's own securities. The participants are obliged to reconcile the records with every depository on a daily basis. Participants are required to maintain the following records for a period of five years–

- records of all the transactions entered into with a depository and with a beneficial owner;
- details of security dematerialised, rematerialised on behalf of beneficial owners with whom it has entered into an agreement;
- records of instructions received from beneficial owners
- and statements of account provided to beneficial owners; and
- records of approval, notice, entry and cancellation of pledge or hypothecation as the case may be.

GOVERNANCE OF DEPOSITORY

Governing Board, Disclosures and Corporate Governance

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

- The governing board of every depository is required to include:
 - (a) shareholder directors;
 - (b) public interest directors; and
 - (c) managing director.
- Any employee of a depository may be appointed on the governing board in addition to the managing director, and such director shall be deemed to be a shareholder director.
- The chairperson shall be elected by the governing board from amongst the public interest directors Subject to prior approval of SEBI.
- The number of public interest directors shall not be less than the number of shareholder directors in a depository.
- The managing director shall be an ex-officio director on the governing board and shall not be included in either the category of public interest directors or shareholder directors.

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

Investor Protection Fund

Every depository is required to establish and maintain an Investor Protection Fund for the protection of interest of beneficial owners. However, this fund shall not be used by the depository for the purpose of indemnifying the beneficial owner under section 16 of the Depository Act, 1996. Every depository should credit twenty five per cent of its profits every year to the Investor Protection Fund.

Business Continuity Plan

A depository shall have adequate Business Continuity Plan for data and electronic records to prevent, prepare for and recover from any disaster.

Audit Under SEBI (Depositories and Participants) Regulations, 1996

Regulation 55A of SEBI (Depositories and Participants) Regulations, 1996 provides that every issuer shall submit audit report on a quarterly basis to the concerned stock exchanges audited by a practicing Company Secretary or a qualified Chartered Accountant, for the purposes of reconciliation of the total issued capital, listed capital and capital held by depositories in dematerialized form, the details of changes in share capital during the quarter and the in-principle approval obtained by the issuer from all the stock exchanges where it is listed in respect of such further issued capital.

The audit report is required to give the updated status of the register of members of the issuer and confirm that securities have been dematerialized as per requests within 21 days from the date of receipt of requests by the issuer and where the dematerialization has not been effected within the said stipulated period, the report would disclose the reasons for such delay.

The issuer is under an obligation to immediately bring to the notice of the depositories and the stock exchanges, any difference observed in its issued, listed, and the capital held by depositories in dematerialized form.

INTERNAL AUDIT OF OPERATIONS OF DEPOSITORY PARTICIPANTS

The two Depository service providers in India, viz., National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Limited (CDS) have allowed Company Secretaries in Whole-time Practice to undertake internal audit of the operations of Depository Participants (DPs).

NSDL has vide its circular No. NSDL/SG/II/010/99 dated 26th March 1999 notified amendment of its Bye Law 10.3.1 of Chapter 10 as follows:

10.3.1 "Every Participant shall ensure that an internal audit in respect of the operations of the Depository is conducted at intervals of not more than three months by a qualified Chartered Accountant or a Company Secretary holding a certificate of Practice and a copy of the internal audit report shall be furnished to the Depository."

CDSL has vide its letter dated September 28, 1999 notified amendment of its Bye Laws 16.3.1 as follows:

16.3.1 "Every Participant shall ensure that an internal audit shall be conducted in respect of the participant's operations relating to CDS by a qualified Chartered Accountant in accordance with the provisions of the Chartered Accountants Act, 1949 or by a Company Secretary in practice in accordance with the provisions of the Company Secretaries Act, 1980, at such intervals as may be specified by CDS from time to time. A copy of Internal Audit report shall be furnished to CDS."

CONCURRENT AUDIT

National Securities Depository Limited vide its Circular No. NSDL/POLICY/ 2006/0021 dated June 24, 2006 provides for concurrent audit of the Depository Participants. The Circular provides that w.e.f. August 1, 2006, the process of demat account opening, control and verification of Delivery Instruction Slips (DIS) is subject to Concurrent Audit. Depository Participants have been advised to appoint a firm of qualified Chartered Accountant(s) or Company Secretary(ies) holding a certificate of practice for conducting the concurrent audit. However, the participants in case they so desire, may entrust the concurrent audit to their Internal Auditors.

In respect of account opening, the auditor should verify all the documents including KYC documents furnished by the Clients and verified by the officials of the Participants. The scope of concurrent audit with respect to control and verification of DIS cover the areas given below:

(I) Issuance of DIS

The procedure followed by the Participants with respect to:

- (a) Issuance of DIS booklets including loose slips.
- (b) Existence of controls on DIS issued to Clients including pre-stamping of Client ID and unique pre-printed serial numbers.
- (c) Record maintenance for issuance of DIS booklets (including loose slips) in the back office.

(II) Verification of DIS

The procedure followed by the Participants with respect to:

- (a) Date and time stamping (including late stamping) on instruction slips.
- (b) Blocking of used/reported lost/stolen instruction slips in back office system/ manual record.
- (c) Blocking of slips in the back office system/manual record which are executed in DPM directly.
- (d) Two step verification for a transaction for more than Rs. 5 lakh, especially in case of off-market transactions.
- (e) Instructions received from dormant accounts.

The Concurrent Auditor should conduct the audit in respect of all accounts opened, DIS issued and controls on DIS as mentioned above, during the day, by the next working day. In case the audit could not be completed within the next working day due to large volume, the auditor should ensure that the audit is completed within a week's time.

Any deviation and/or non-compliance observed in the aforesaid areas should be mentioned in the audit report of the Concurrent Auditor. The Management of the Participant should comment on the observations made by the Concurrent Auditor. The Concurrent Audit Report should be submitted to NSDL, on a quarterly basis, in a hard copy form. If the Auditor for Internal and Concurrent Audit is the same, consolidated report may be submitted.

ESTABLISHMENT OF CONNECTIVITY WITH NSDL AND CDSL

To enhance the efficiency of the stock market, rolling settlement were introduced by SEBI. To facilitate the settlement, SEBI prescribed the compulsory dematerialized trading by companies through connectivity with both the depositories NSDL and CDSL.

The stock exchanges may consider shifting the trading of securities of the Companies who have established connectivity with both the depositories to normal rolling settlement subject to the following:

- (a) At least 50% of non-promoter holdings as per clause 35 of Listing Agreement are in demat mode before shifting the trading in the securities of the company from Trade for Trade Settlement (TFTS) to Normal Rolling Settlement.

For this purpose, the listed companies are required to obtain a certificate from its Registrar and Transfer Agent (RTA) and submit the same to the stock exchange/s. However, if an issuer-company does not have a separate RTA, it may obtain a certificate in this regard from a practicing Company Secretary/Chartered Accountant and submit the same to the stock exchange/s.

- (b) There are no other grounds/reasons for continuation of the trading in TFTS.

The Stock Exchanges are also required to report to SEBI, the action taken in this regard in their Monthly/Quarterly Development Report.

APPOINTMENT OF COMMON AGENCY FOR SHARE REGISTRY WORK

In many cases the issuer companies are having an internal department or a division (by whatever name called) for handling of physical share work and an out side agency for handling the work of electronic connectivity. This kind of arrangement is leading to delay in dematerialization, non-reconciliation of share holding due to lack of proper co-ordination among the concerned agencies or departments, which is adversely affecting the interest of the investors.

SEBI therefore vide its circular D&CC/FITTC/CIR-15/2002 dated December 27, 2002 decided that all the work related to share registry in terms of both physical and electronic should be maintained at a single point i.e. either in-house by the company or by a SEBI registered R & T Agent.

Further SEBI vide its circular D&CC/FITTC/CIR – 17/2002 dated December 31, 2002 directed all the registrars and share transfer agents (RSTA) that:

1. They shall maintain records of all the shares dematerialized, rematerialized and details of all securities declared to be eligible for dematerialization in the depositories and ensure that dematerialization of shares shall be confirmed/created only after an in-principle approval of the stock exchange/s where the shares are listed and the admission of the said share with the depositories have been granted.
2. They shall have proper systems and procedures in place to verify that the securities tendered for dematerialization have not been dematerialized earlier.
3. They shall ascertain, reconcile daily and confirm to the depositories that the total number of shares held in NSDL, CDSL and in the physical form tallies with the admitted, issued and listed capital of the issuer company; and
4. They shall confirm that the dematerialization requests have been processed within 21 days and shall also state the reasons for shares pending confirmation for more than 21 days from the date of request.

IN-PERSON VERIFICATION (IPV)

- SEBI has made it mandatory for all the intermediaries including Depository Participant (DP) to carry out IPV of their clients.
- The intermediary shall ensure that the details like name of the person doing IPV, his designation, organization with his signatures and date are recorded on the KYC form at the time of IPV.
- The IPV carried out by one SEBI registered intermediary can be relied upon by another intermediary.

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.

BASIC SERVICES DEMAT ACCOUNT (BSDA)

With a view to achieve wider financial inclusion, encourage holding of demat accounts and to reduce the cost of maintaining securities in demat accounts for retail individual investors, SEBI introduced the concept of basic

services demat account (BSDA). All depository participants (DPs) shall make available a "Basic Services Demat Account" (BSDA) with limited services and reduced costs compared to conventional demat accounts. These BSDA will also offer SMS alert facility for debit transactions.

Eligible Investor

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

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

Charges

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

Valuation of Holding

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

Statements

(a) Transaction statements:

- (a) Transaction statements shall be sent to the beneficial owner (BO) at the end of each quarter. If there are no transactions in any quarter, no transaction statement may be sent for that quarter.
- (b) If there are no transactions and no security balance in an account, then no further transaction statement needs to be provided.
- (c) Transaction statement shall be required to be provided for the quarter in which the account became a zero balance account.

(b) Holding Statement:

- (a) One annual physical statement of holding shall be sent to the stated address of the BO in respect of accounts with no transaction and nil balance.
- b) One annual statement of holding shall be sent in respect of remaining accounts in physical or electronic form as opted for by the BO.

Charges for statements

Electronic statements shall be provided free of cost. However, for physical statements, DPs have to provide two statements free of cost to the account holder during the billing cycle. But additional statements will be charged a fee, which cannot be more than ₹ 25. Holder will get a transaction statement at the end of every quarter, provided there has been at least a single transaction in the quarter. For accounts where there are transactions, account holder will get an annual statement of holding, as per his/her choice, that is electronically or physical. If there are no transactions in any quarter, no transaction statement may be sent for that quarter.

However, in order to reduce the cost of compliance of DPs, the following rationalization measures have been prescribed for regular accounts:

- (a) Accounts with zero balance and nil transactions during the year: The DPs shall send one physical statement of holding annually to such BOs and shall resume sending the transaction statement as and when there is a transaction in the account.
- (b) Accounts which become zero balance during the year: For such accounts, no transaction statement may be sent for the duration when the balance remains nil. However, an annual statement of holding shall be sent to the Beneficiary Owner.
- (c) Accounts with credit balance: For accounts with credit balance but no transactions during the year, one statement of holding for the year shall be sent to the BO.

LESSON ROUND UP

- The legal framework for depository system in the Depositories Act, 1996 provides for the establishment of single or multiple depositories.
- There are two Depositories functioning in India, namely the National Securities Depository Limited (NSDL) and the Central Depository Services (India) Limited (CDSL).
- All the securities held by a depository are dematerialized and are in a fungible form.
- In the depository system, the ownership and transfer of securities takes place by means of electronic book entries.
- A Depository Participant (DP) is the representative (agent) of the investor in the depository system providing the link between the Company and investor through the Depository.
- The Depository Act, 1996 and SEBI (Depositories and Participants) Regulations, 1996 regulates the function of Depositories and participants.
- Regulation 55A of SEBI (Depositories and Participants) Regulations, 1996 provides that every issuer shall submit audit report on a quarterly basis to the concerned stock exchanges audited by a practicing Company Secretary or a qualified Chartered Accountant, for the purposes of reconciliation of the total issued capital, listed capital and capital held by depositories in dematerialized form, the details of changes in share capital during the quarter and the in-principle approval obtained by the issuer from all the stock exchanges where it is listed in respect of such further issued capital.
- Both the Depositories in India have allowed Practising Company Secretaries to undertake internal audit of the operations of Depository Participants (DPs).
- Depository Participants are subject to concurrent audit by a Practising Company Secretary or qualified Chartered Accountant. Concurrent Audit includes audit of process of demat account opening, control and verification of delivery instruction slips.

GLOSSARY

Beneficial owner (BO)	The true owner of a security or property, which may be registered in another name. Means a person whose name appears as such on the records of the depository.
ISIN	International Securities Identification Number (ISIN) is a code that uniquely identifies a specific security, which is allocated at the time of admitting the same in the depository system.
Joint Account	It means a bank or a demat account in the names of more than one person (maximum three in case of a demat account). All the account holders must give their signature to operate a demat account held jointly.

Lesson 16

Listing and Delisting of Securities

LESSON OUTLINE

- Introduction
- Types of Listing
- Benefits of Listing
- Multiple Listing
- Legal Provision on Listing
- Compliances under Listing Agreement
- Corporate Governance through Listing Agreement
- Highlights of Clause 49
- Comparison between Revised Clause 49 and Companies Act, 2013
- Delisting
- SEBI (Delisting of Equity Shares) Regulations, 2009
- Voluntary Delisting
- Special provisions for small companies and delisting by operation of law
- Compulsory delisting
- Lesson Round-Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

The prime objective of admission of securities to dealings on the Stock Exchange is to provide liquidity and marketability and also to provide a mechanism for effective management of trading. Thus, listing is the admission of securities to dealings on a recognized stock exchange. For a company to be listed on a stock exchange, the company has to enter into a listing agreement with the respective stock exchange(s). Listing agreement provides conditions to be complied with including the norms for better corporate Governance. Listing agreement also work as a link between the company and investor because it requires the company to provide basic information to the shareholder and grievance redressal mechanism. Further, a company can delist its securities from the stock exchange.

This lesson will enable the students to have conceptual understanding of Listing of Securities and various clauses of Listing Agreement and Corporate Governance through Listing Agreement, and delisting of securities etc.

INTRODUCTION

Listing of securities with stock exchange is a matter of great importance for companies and investors, because this provides the liquidity to the securities in the market. Any company offering its shares to the public for subscription is required to be listed on the stock exchange and has to comply with the conditions as provided in the SEBI (ICDR) Regulations, 2009. According to Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, [(SEBI (ICDR) Regulations, 2009)], a company has to file a draft offer document along with prescribed fees to SEBI through the lead merchant banker, at least thirty days prior to registering the prospectus with the Registrar of Companies. The company has to obtain in-principle approval from recognised stock exchanges in which the company proposes to get its securities listed. A company is required to complete the allotment of securities offered to the public and/or refund the application moneys within fifteen days from the date of closure of the issue.

In addition, a company intending to have its share listed has to comply with the listing requirements prescribed by the Stock Exchange. A company seeking listing of their securities on the Stock Exchange is required to enter into a formal listing agreement with the Stock Exchange. The listing agreement specifies all the quantitative and qualitative requirements to be continuously complied with by the issuer for continued listing. The Stock Exchange monitors such compliance and companies who do not comply with the provisions of the listing agreement may be suspended from trading on the Stock Exchange. The listing agreement is being increasingly used as a means to improve corporate governance.

Only public companies are allowed to list their securities in the stock exchange. Private Limited companies cannot get listing facility. They should first convert themselves into public limited companies and their Articles of Association should also contain prohibitions as laid down in the listing agreement and as applicable to public limited companies.

According to the Companies Act, 2013 "Listed Company" means a company which has any of its securities listed on any recognized stock exchange

TYPES OF LISTING

Listing of securities falls under 5 groups –

Initial Listing

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

Listing for Public Issue

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

Listing for Rights Issue

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

Listing of Bonus Shares

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

Listing for merger or amalgamation

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

BENEFITS OF LISTING

The following benefits are available when securities are listed by a company in the stock exchange—

- (1) Public image of the company is enhanced.
- (2) The liquidity of the security is ensured making it easy to buy and sell the securities in the stock exchange.
- (3) Tax concessions are made available both to the investors and the companies.
- (4) Listing procedure compels company management to disclose important information to the investors enabling them to make crucial decisions with regard to keeping or disposing of such securities.
- (5) Listed companies command better support such as loans and investments from Banks and FIs.

MULTIPLE LISTING

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

LEGAL PROVISION ON LISTING

According to Section 40(1) of the Companies Act 2013, every company which intends to make public offer of shares or debentures should make an application to one or more recognised stock exchanges before making such offer. Sub section 2 of this Section provides that the company shall state the name of the stock exchanges on which its securities will be dealt with.

Section 24 of the Companies Act, 2013 provides that, any Company which is listed or intend to get their securities listed on any reconganised stock exchange will be administered by regulation prepared by SEBI for matters relating to issue and transfer of securities and non payment of dividend.

As per Section 4 of the Securities Contracts (Regulation) Act, 1956, every recognised stock exchange has the powers to make bye-laws for the listing of securities on the stock exchange, inclusion of any security for the purpose of dealings and suspension or withdrawal of securities and the prohibition of trading in any specified security, subject to SEBI approval.

Every company while submitting its application for listing with the stock exchange(s) should produce a number of documents as enclosures to satisfy the requirements of the concerned stock exchange. It should also give a number of undertakings as a condition precedent before listing as sought by the concerned stock exchange. Finally when the stock exchange(s) agree(s) to list the securities, the company shall execute a listing agreement with the stock exchange(s).

When a company signs a listing agreement with a stock exchange, it means it has entered into a legally binding contract with that stock exchange and it has to ensure compliance of each and every term and condition of the listing agreement. For failure to ensure such compliance the stock exchange can take an action against the company after giving an opportunity of being heard.

Listing of Securities on Indian Stock Exchanges, thus, is governed by the provisions in the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956, the Securities Contracts (Regulation) Rules, 1957, Rules, bye laws, regulations of concerned stock exchange, the listing agreement entered into by the issuer and stock exchange and circulars/guidelines issued by the Central Government and SEBI.

<p>Clause 16</p>	<p>Book closure/Record Date</p>	<p>(a) Atleast once in a year the books should be closed.</p> <p>(b) Gap between two book closures and/or record dates would be atleast 7 days.</p> <p>(c) No delivery period for all types of corporate actions in case of scrips traded in compulsory dematerialized mode</p> <p>(d) Intimate atleast 7 days before corporate actions like mergers, de-mergers, splits and bonus shares in case of company whose stock derivatives are available or whose stocks form part of an Index on which derivatives are available.</p>
<p>Clause 19</p>	<p>Convening of a Board Meeting for Declaration/ Decision regarding:</p> <p>(a) Dividend</p> <p>(b) Bonus shares if forming part of Agenda.</p> <p>(c) Issue of rights shares.</p> <p>(d) Issue of convertible debentures</p> <p>(e) Issue of debentures carrying a right to subscribe to equity shares.</p> <p>(f) Passing over of dividend</p> <p>(g) Buy-back of securities</p> <p>(h) Further public offer to be made through the fixed price route</p>	<p>(a) Intimate atleast 2 days in advance about the convening of a board meeting to decide the matters (a) to (g) alongside. No prior intimation is required about board meeting in respect of issue of bonus shares if the issue is not in the Agenda of board meeting.</p> <p>(b) Undertakes to recommend to declare all dividend and/ or cash bonuses at least 5 days before the commencement of the closure of its transfer books or the record date fixed for that purpose.</p> <p>(c) Prior intimation to the exchange for shares on right basis to the existing shareholders at least two days in advance.</p> <p>(d) Intimation to the exchange at least 48 hours in advance, for determination of issue price.</p>
<p>Clause 20 & 22</p>	<p>Decision regarding declaration of dividend, bonus interest payment buy-back of securities, rights, re-issue of forfeited shares, calls to be made.</p>	<p>Furnish information to the Stock Exchanges within 15 minutes of the closure of the Board Meeting and such intimation made shall also contain the date on which dividend shall be paid/dispatched.</p>
<p>Clause 20A</p>	<p>Uniformity in dividend declaration.</p>	<p>All listed company shall declare their dividend on per share basis only.</p>
<p>Clause 21</p>	<p>Payment of interest on debentures/bonds, redemption amount of redeemable shares or debentures/ bonds</p>	<p>Intimate atleast 21 days in advance, of the date on and from which the amounts will be paid.</p>

Clause 25	Granting options to purchase any shares of the company	Notify all the listed Exchanges (a) Number of shares covered by such options, of the terms thereof and of the time within which they may be exercised. (b) Subsequent changes or cancellation or exercise of such options
Clause 27	Any action resulting in redemption, cancellation or retirement in whole or in part of listed securities, or intention to make withdrawal of such securities	Notify all the listed exchanges : (a) of such action, or (b) of intention to make a drawing. Simultaneously intimate the date of the withdrawal and the period of closing of transfer books (or the date of striking of the balance) for the drawing, and (c) of the amount of securities outstanding after the drawing.
Clause 28	Change in the form or nature of listed securities or change in the rights/ privileges thereof	(a) Give 21 days prior notice to the exchange. (b) Apply to exchange for listing of the securities as changed, if exchange so requires.
Clause 28A	In case of superior rights as to voting or dividend vis-à-vis the rights on equity shares that are listed which may confer on any person.	The company shall not issue shares in any manner.
Clause 29 & 30	(a) Change in general characters or nature of company's business (b) Change in the companies directors (c) Change of Managing Director (d) Change of Auditors	Promptly notify the exchange of these changes.
Clause 31	Further issue of Securities and other documents to be forwarded	To forward to the exchange six copies of Statutory and Directors' Annual Reports along with Form A which contains the Unqualified /Matter of emphasis Report and Form B containing the qualified/ Subject to/ Except for Audit Report, as applicable, Balance sheets and Profit & Loss Accounts, all periodicals and special reports, notices, resolutions and circulars relating to new issue of capital, three copies of all the notices, call letters etc. including notices of meetings convened u/s 230 or section 232 read with section 230 of the Companies Act, 2013, copy of the proceedings at all Annual and Extraordinary General Meetings of the Company, three copies of all notices, circulars, etc., issued or advertised in the press either by the Company, or by any company which the Company proposes to absorb or with

		which the Company proposes to merge or amalgamate, or under orders of the court or any other statutory authority in connection with any merger, amalgamation, re-construction, reduction of capital, scheme or arrangement.
Clause 31A	Restatement of books of accounts	The company agrees to restate its books of accounts on the directions issued by SEBI or by any statutory authority as per the provisions of the extant regulatory framework.
Clause 32	Cash Flow Statement in the Annual Report, Consolidated Financial Statement and related party disclosures	(a) Companies to prepare Cash Flow Statement in accordance with AS-3 of ICAI and present it under the indirect method. Companies to send a statement containing the salient features of the Balance Sheet, P&L A/c and Auditors' Report to each share holder. Unabridged Annual report to be sent to member of listed exchange on his request. Company will publish Consolidated Financial Statements duly audited by the statutory auditors and file the same with Stock Exchange. (b) Company will also make related party disclosures in its Annual Reports.
Clause 35	Shareholding pattern containing details of promoters holding and non-promoters holding	File with the exchange the shareholding pattern in the prescribed form (i) One day prior to listing of its securities on the stock exchange; (ii) Within 21 days from the end of the quarter on a quarterly basis; (iii) Within 10 days of any capital restructuring of the company resulting in a change exceeding +/- 2% of the total paid-up share capital. The format for reporting the shareholding pattern must include details of shares pledged by the promoters and promoters group and is required to be given for each class of security separately. The additional format should disclose the voting right pattern in the company.
Clause 35 A	Details of voting results	The company should submit to the stock exchange, within 48 hours of conclusion of its General Meeting, details regarding the voting results in the prescribed format.
Clause 35 B	E-voting facility to be provided to the shareholders, in respect of all shareholder's resolution to be passed at General Meeting or through postal ballot	The company should continue to ensure- – To enable those shareholders, who do not have access to e-voting facility, to send their assent or dissent in writing on a postal ballot as per the provisions of the Companies (Management and Administration) Rules, 2014 or amendments made there to.

		<ul style="list-style-type: none"> - To utilize the service of any one of the agencies providing e-voting platform, which is in compliance with conditions specified by the Ministry of Corporate Affairs, Government of India, from time to time. - To mention the Internet link of such e-voting platform in the notice to their shareholders.
Clause 35 C	Compliance with SEBI (Employee Stock Option Schemes and Employee Stock Purchase Schemes) Guidelines, 1999	All the employee benefit scheme involving the securities of the company & already framed & implemented employee benefit scheme by the company shall be in compliance with (Employee Stock Option Schemes and Employee Stock Purchase Schemes) Guidelines, 1999
Clause 36	Decision regarding issue of shares, forfeiture of shares, alteration of shares, cancellation of declared dividend, merger, amalgamation, de-merger, hiving off, voluntary delisting and other material decisions.	Immediately disclose all material information simultaneously to all the Stock Exchanges, where the Securities of the company are listed.
Clause 40A	Minimum Level of Public Shareholding	<p>To comply with the requirements specified in Rule 19(2) and Rule 19A of the Securities Contracts (Regulation) Rules, 1957.</p> <p>To raise the public shareholding to the required level, the company should adopt the following methods (a) issuance of shares to public through prospectus or (b) offer for sale of shares held by promoters to public through prospectus or (c) sale of shares held by promoters through the secondary market. (d) Institutional Placement Programme (IPP) in terms of Chapter VIIIA of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, as amended; or (e) Rights Issues to public shareholders, with promoter/ promoter group shareholders forgoing their entitlement to equity shares, whether present or future, that may arise from such issue; or (f) Bonus Issues to public shareholders, with promoter/ promoter group shareholders forgoing their entitlement to equity shares, whether present or future, that may arise from such issue; or (g) any other method as may be approved by SEBI, on a case to case basis.</p>
Clause 40B	Compliance with Takeover Regulations, 2011	The company should comply with SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, in case there is a take over offer made or there is a change in management control.
Clause 41	Preparation and Submission of Financial Results.	<p>To submit quarterly year to date and annual financial results to the stock exchange in the manner prescribed.</p> <p>To submit audited or unaudited quarterly and year to date financial results to the stock exchange within forty five of</p>

	<p>Manner of approval and authentication of the financial results</p>	<p>end of each quarter (other than the last quarter), subject to the following:</p> <ul style="list-style-type: none"> (a) To submit a copy of the limited review report to the stock exchange within sixty days from end of the quarter, in case the company opts to submit unaudited financial results (b) Financial results to be accompanied by auditors report in case the company opts to submit audited financial results <p>To submit unaudited financial results for the quarter within forty five days of end of the financial year or to submit audited financial results for the entire financial year within sixty days of end of the financial year, subject to the following:</p> <ul style="list-style-type: none"> – To submit audited financial results for the entire financial year, as soon as they are approved by the Board, in case the company opts to submit unaudited financial results for the last Quarter – To intimate the option to the stock exchange in writing within one month of end of the financial year, in case the company opts to submit audited financial results for the entire financial year. <p>Companies having subsidiaries may, in addition to submitting quarterly and year to date stand alone financial results to the stock exchange also submit quarterly and year to date consolidated financial results; and while submitting annual audited financial results prepared on stand-alone basis, it shall also submit annual audited consolidated financial results to the stock exchange.</p> <p>To submit financial results to the stock exchange within fifteen minutes of conclusion of the meeting of the Board or Committee in which they were approved.</p> <p>The quarterly financial results submitted shall be approved by the Board of Directors of the company or by a committee thereof, other than the audit committee.</p> <p>Provided that when the quarterly financial results are approved by the Committee they shall be placed before the Board at its next meeting:</p> <p>Provided further than while placing the financial results before the Board, the Chief Executive Officer and Chief Financial Officer of the company, by whatever name called, shall certify that the financial results do not contain any false or misleading statement or figures and do not omit any material fact which may make the statements or figures contained therein misleading.</p>
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	<p>Publication of financial results in newspapers</p>	<p>respect of the financial results of any previous financial year or quarter which has an impact on the profit or loss of the reportable period, the company shall include as a note to the financial results –</p> <ul style="list-style-type: none"> (i) how the qualification or other reservation has been resolved; or (ii) if it has not been resolved, the reason therefor and the steps which the company intends to take in the matter. <p>If the company has changed its name suggesting any new line of business, it shall disclose the net sales or income, expenditure and net profit or loss after tax figures pertaining to the said new line of business separately in the financial results and shall continue to make such disclosures for the three years succeeding the date of change in name.</p> <p>If the company had not commenced commercial production or commercial operations during the reportable period, the company shall, instead of submitting financial results, disclose the details of amount raised, the portions thereof which is utilized and that remaining unutilized, the details of investment made pending utilisation, brief description of the project which is pending completion, status of the project and expected date of commencement of commercial production or commercial operations.</p> <p>The company shall, within 48 hours of conclusion of the Board or Committee meeting at which the financial results were approved, publish a copy of the financial results which were submitted to the stock exchange in at least in one English daily newspaper circulating in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the company is situated:</p> <p>Provided that where the company has opted to submit audited financial results, it shall also publish the qualifications or reservations, if any, expressed by the auditor together with the audited results.</p> <p>Where the company has submitted consolidated financial results in addition to stand-alone financial results, it shall have an option to publish either stand-alone financial results or consolidated financial results in the newspapers, subject to the following:</p> <ul style="list-style-type: none"> (i) If it is desirous of publishing consolidated financial results alone, it shall exercise the option in the first quarter of the financial year and such option shall not be changed during the financial year; (ii) In case the company changes its option in any subsequent year, it shall furnish comparable figures for
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		<p>the previous year in accordance with the option exercised for the current year.</p> <p>(iii) If the company opts to publish only consolidated financial results, it shall give a reference in the newspaper publication, to the places, such as the company's website and stock exchanges' websites, where the standalone results will be available for perusal.</p> <p>(iv) If the company opts to publish only stand-alone financial results, it shall also publish consolidated figures for turnover, net profit after tax and earnings per share.</p>
Clause 43A	Filing of deviations in the use of public issue proceeds	Filing of deviations in the use of public issue proceeds and to appoint monitoring agency to monitor utilisation of proceeds etc.
Clause 47	Appointment of Company Secretary as Compliance Officer	Appoint a Company Secretary to act as compliance officer responsible for monitoring the Share Transfer process and report to the Company's Board in each Meeting. Compliance officer will directly liaise with the authorities such as SEBI, Stock Exchanges, ROC etc. and investors with respect to implementation of various clauses, rules, regulations and other directives of such authorities and investor service and compliances of related matter.
	Registration of share Transfer	<p>(i) Obtain certificate from Company Secretary in Practice, on half yearly basis, that the securities lodged for transfer have been registered and despatched within 30 days from the date of lodgment with the company within 15 days from the end of half year.</p> <p>(ii) Send a copy of the same within 24 hrs of the time of receipt to all listed exchanges.</p> <p>(iii) Intimate all the exchanges within 48 hrs from the time of receipt of information of loss of certificate/closure time of Board (Committee) meeting.</p>
Clause 49	Corporate Governance	<p>(a) Board of Directors and composition of Board.</p> <p>(b) Limit on number of Directorships.</p> <p>(c) Maximum tenure of Independent Directors.</p> <p>(d) Formal letter of appointment and performance evaluation of Independent Directors.</p> <p>(e) Separate meeting of Independent Directors.</p> <p>(f) Non-executive director's compensation and disclosures.</p> <p>(g) Code of conduct of Directors to be published on the website.</p> <p>(h) Whistle blower policy is mandatory.</p> <p>(i) Audit committee and its composition and frequency of its meeting.</p> <p>(j) Mandatory review of certain information by Audit Committee.</p>

		<p>(k) Nomination and Remuneration Committee</p> <p>(l) Subsidiary Companies</p> <p>(m) Risk Management</p> <p>(n) Related Party Transactions</p> <p>(o) Disclosures</p> <p>(p) CEO/CFO Certification</p> <p>(q) Report on Corporate Governance, Quarterly compliance report</p> <p>(r) Compliance Certificate from Practising Company Secretary or auditor of the company</p>
Clause 50	Accounting Standards	Company should comply with all the accounting standards issued by the Institute of Chartered Accountants of India.
Clause 52	CFDS	<p>All the listed companies are required to file information with the stock exchange only through Corporate Filing and Dissemination System (CFDS) which is put in place jointly by BSE and NSE at the www.corpfiling.co.in.</p> <p>The compliance officer, appointed under Clause 47(a) and the company shall be responsible for ensuring the correctness, authenticity and comprehensive-ness of the information, statements and reports filed under this clause and also for ensuring that such information is in conformity with the applicable laws and listing agreement. [Clause 52(1)(b)]</p>
Clause 53	Agreements with Media Companies/Associates	<p>To notify the stock exchange and disseminate through its own website information on disclosures immediately upon entering into agreements with media companies and/or their associates</p> <p>Shareholding (if any) of media companies/associates in issuer the company.</p> <p>Details of nominee of media companies on the Board, any management control or potential conflict of interest arising out of such agreement.</p> <p>Back to back treaties/ contracts/agreements/MoUs or similar instruments entered into by the issuer company with media companies and/or their associates for the purpose of advertising, publicity, etc.</p>
Clause 54	Maintenance of functional website and upload of contents	<p>To maintain a functional website containing basic information about the company.</p> <p>To ensure that the contents of the website are updated at any given point of time.</p>
Clause 55	Submission of Business Responsibility Report	The company must submit to the Stock Exchange, as part of their Annual Reports, Business Responsibility Reports, describing the initiatives taken by the company from an environmental, social and governance perspective, in the prescribed format suggested by SEBI.

CORPORATE GOVERNANCE THROUGH LISTING AGREEMENT

Corporate governance denotes the process, structure and relationship through which the Board of Directors oversees what the management does. It is also about being answerable to different stakeholders.

CII constituted a Committee to recommend a Code of Corporate Governance to be observed by corporates in their functioning. The Committee further recommended a Code popularly known as “Desirable Corporate Governance Code” which defined Corporate Governance as follows:

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

The Kumar Mangalam Birla Committee Constituted by SEBI has observed that:

“Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high-quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure.”

N.R. Narayana Murthy Committee on Corporate Governance constituted by SEBI has observed that:

“Corporate Governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company.”

The Institute of Company Secretaries of India has also defined the term Corporate Governance as under:

Good Governance in capital market has always been high on the agenda of SEBI. Corporate Governance is looked upon as a distinctive brand and benchmark in the profile of Corporate Excellence. This is evident from the continuous updation of guidelines, rules and regulations by SEBI for ensuring transparency and accountability. In the process, SEBI had constituted a Committee on Corporate Governance under the Chairmanship of Shri Kumar Mangalam Birla. The Committee in its report observed that “the strong Corporate Governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure.”

Based on the recommendations of the Committee, the SEBI had specified principles of Corporate Governance and introduced a new clause 49 in the Listing agreement of the Stock Exchanges in the year 2000. These principles of Corporate Governance were made applicable in a phased manner and all the listed companies with the paid up capital of Rs 3 crores and above or net worth of Rs 25 crores or more at any time in the history of the company, were covered as of March 31, 2003.

SEBI, as part of its endeavour to improve the standards of corporate governance in line with the needs of a dynamic market, constituted another Committee on Corporate Governance under the Chairmanship of Shri N. R. Narayana Murthy to review the performance of Corporate Governance and to determine the role of companies in responding to rumour and other price sensitive information circulating in the market in order to enhance the transparency and integrity of the market. The Committee in its Report observed that “the effectiveness of a system of Corporate Governance cannot be legislated by law, nor can any system of Corporate Governance be static. In a dynamic environment, system of Corporate Governance need to be continually evolved.”

With a view to promote and raise the standards of Corporate Governance, SEBI on the basis of recommendations of the Committee and public comments received on the report and in exercise of powers conferred by Section

11(1) of the SEBI Act, 1992 read with section 10 of the Securities Contracts (Regulation) Act 1956, revised the existing clause 49 of the Listing agreement vide its circular SEBI/MRD/SE/31/2003/26/08 dated August 26, 2003.

SEBI vide circular number SEBI/CFD/ DIL/CG/1/2004/12/10 dated October 29, 2004 again revised the existing Clause 49 of the Listing Agreement directing all the Stock Exchanges to amend the Listing Agreement by replacing the existing Clause 49 of the Listing Agreement. As per the Circular, the provisions of the Clause 49 were to be implemented as per the schedule of implementation given below:

- (a) For entities seeking listing for the first time, at the time of seeking in-principle approval for such listing.
- (b) For existing listed entities which were required to comply with Clause 49 which is being revised i.e. those having a paid up share capital of Rs. 3 crores and above or net worth of Rs. 25 crores or more at any time in the history of the company, by April 1, 2005.

However noticing that large number of companies were not in the state of preparedness to be fully compliant with the requirements of revised Clause 49 of the listing agreement, SEBI allowed more time to corporates to conform to Clause 49 of the listing agreement and extended the date for ensuring compliance with the Clause 49 of the listing agreement to December 31, 2005.

The Companies Act, 2013 was enacted on August 30, 2013 which provides for a major overhaul in the Corporate Governance norms for all companies. The rules pertaining to Corporate Governance were notified on March 27, 2014. The requirements under the Companies Act, 2013 and the rules notified there under would be applicable for every company or a class of companies (both listed and unlisted) as may be provided therein. SEBI reviewed the provisions of the Listing Agreement in this regard with the objectives to align with the provisions of the Companies Act, 2013, adopt best practices on corporate governance and to make the corporate governance framework more effective.

SEBI vide its circular dated April 17, 2014, revised new clause 49 in alignment with Companies Act, 2013.

The revised Clause 49 would be applicable to all listed companies with effect from October 01, 2014. However, the provisions of Clause 49(VI)(C) as given in Part-B shall be applicable to top 100 listed companies by market capitalisation as at the end of the immediate previous financial year.

For other listed entities which are not companies, but body corporate or are subject to regulations under other statutes (e.g. banks, financial institutions, insurance companies etc.), the Clause 49 will apply to the extent that it does not violate their respective statutes and guidelines or directives issued by the relevant regulatory authorities.

The Clause 49 is not applicable to Mutual Funds.

HIGHLIGHTS OF CLAUSE 49

COMPOSITION OF BOARD OF DIRECTORS

As per clause 49 (II) (A) of the Listing Agreement, the Board of Directors of the company shall have an optimum combination of executive and non executive directors with atleast one women director. Further—

- not less than 50 per cent of the board of directors shall comprise of non-executive directors;
- the number of independent directors would depend on whether the chairman is executive or non-executive;
- if the Board has a Non-Executive Chairman, at least one third of the Board should comprise of independent directors;
- if the Board has an Executive Chairman, at least half of the Board should comprise of independent directors.

If the non-executive Chairman is a promoter or is related to promoters or persons occupying management positions at the board level or at one level below the board, at least one-half of the board of the company should consist of independent directors. The expression “related to any promoter” means:

- (a) If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;
- (b) If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.

Definition of Independent Director

(i) Under Listing agreement

‘Independent director’ shall mean a non-executive director, other than a nominee director of the company:

- (a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
- (b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;
 - (ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;
- (c) apart from receiving director’s remuneration, has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;
- (d) none of whose relatives has or had pecuniary relationship or transaction with the company, 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 fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
- (e) who, neither himself nor any of his relatives –
 - (i) holds or has held the position of a key managerial personnel or is or has been employee of the company 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;
 - (ii) 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, of –
 - (A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or
 - (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;
 - (iii) holds together with his relatives two per cent or more of the total voting power of the company; or
 - (iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the company;
 - (v) is a material supplier, service provider or customer or a lessor or lessee of the company;
- (f) who is not less than 21 years of age.

(ii) Under Companies Act, 2013

According to Section 149(6) of the Companies Act, 2013 – An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director, – (a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience; (b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company; (ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company; (c) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year; (d) none of whose relatives has or had pecuniary relationship or transaction with the company, 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 fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year; (e) who, neither himself nor any of his relatives (i) holds or has held the position of a key managerial personnel or is or has been employee of the company 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; (ii) 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, of (A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm; (iii) holds together with his relatives two per cent. or more of the total voting power of the company; or (iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or (f) who possesses such other qualifications as may be prescribed.

Limit on number of directorships

(a) A person shall not serve as an independent director in more than seven listed companies.

(b) Further, any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.

Maximum tenure of Independent Directors

(a) An independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the company.

Provided that a person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only.

Provided further that an independent director, who completes his above mentioned term shall be eligible for appointment as independent director in the company only after the expiration of three years of ceasing to be an independent director in the company.

Formal letter of appointment to Independent Directors

(a) The company shall issue a formal letter of appointment to independent directors in the manner as provided in the Companies Act, 2013.

(b) The letter of appointment along with the detailed profile of independent director shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.

Performance evaluation of Independent Directors

- (a) The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors.
- (b) The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report.
- (c) The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated).
- (d) 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.

Separate meetings of the Independent Directors

- (a) The independent directors 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.
- (b) The independent directors in the meeting shall, *inter-alia*:
- (i) review the performance of non-independent directors and the Board as a whole;
 - (ii) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
 - (iii) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

Training of Independent Directors

- (a) The company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc.
- (b) The details of such training imparted shall be disclosed in the Annual Report.

An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director within a period of not more than 180 days from the day of such resignation or removal, as the case may be. However, if the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director within the period of 180 days would not apply.

Non Executive Directors' Compensation and Disclosures

This clause provides that all fees/compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and require previous approval of shareholders in general meeting. The shareholders' resolution shall specify the limits for the number of stock options that can be granted to non-executive directors in any financial year and in aggregate. The requirement of obtaining prior approval of shareholder in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act 2013 for payment of sitting fees, without approval of the Central Government. Further, the independent directors shall not be entitled to any stock option.

BOARD MEETINGS

The Board shall meet at least four times a year with a maximum time gap one hundred and twenty days between any two meetings.

Limits on Membership of Committees

A director shall not be a member in more than 10 committees or act as chairman of more than five committee across all companies in which he is a director. Furthermore, every director shall inform the company about the committees positions he occupies in other companies and notify changes as and when takes place.

For the purpose of considering the limit of committees on which a director can serve, all public limited companies, whether listed or not listed, shall be included and all other companies including private limited companies, foreign companies and companies under section 8 of the Companies Act, 2013 shall be excluded.

For the purpose of considering the limit of the committees on which a director can serve, Chairmanship/ membership of the Audit Committee and the Share-holders' Grievance Committee alone are to be considered.

Other provisions as to Board and Committees

The Board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.

An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later. Provided that where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.

The Board of the company shall satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management.

Code of Conduct

1. The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.
2. All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO.
3. The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013.
4. An independent director shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the Listing Agreement.

Explanation: The term “senior management” shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

Whistle Blower Policy

1. The company shall establish a vigil mechanism for directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy.
2. This mechanism should also provide for adequate safeguards against victimization of director(s) / employee(s) who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases.
3. The details of establishment of such mechanism shall be disclosed by the company on its website and in the Board's report.

AUDIT COMMITTEE

Clause 49(III) deals with Audit Committee, its composition, power etc.

- (i) The requirement of giving terms of reference of the Audit Committee is a must.
- (ii) There should be minimum three directors as members.
- (iii) 2/3rd of the members of audit committee shall be independent directors.
- (iv) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation: (a) The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

(b) A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual’s financial sophistication, including being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities.

- (v) The Chairman of the audit committee shall be an independent director and shall be present at the Annual General Meeting to answer shareholder queries.
- (vi) The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee.
- (vii) The company secretary should act as the secretary to the committee.

Powers of the Audit Committee

The powers of the Audit Committee shall include the following:

- (i) To investigate any activity within its terms of reference.
- (ii) To seek information from any employee.
- (iii) To obtain outside legal or other professional advice.
- (iv) To secure attendance of outsiders with relevant expertise, if it considers necessary.

Meetings and Role of Audit Committee

There is requirement of holding atleast four meetings in a year and not more than four months shall elapse between the two meetings of audit committee. Quorum of the meeting shall be two member or 1/3rd of members of the Audit Committee whichever is greater, but there should be a minimum of two independent members present.

The role of the audit committee shall include the following:

1. Oversight of the company’s financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
2. Recommending for appointment, remuneration and terms of appointment of auditors of the company.
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.

4. Reviewing, with the management, the annual financial statements before submission to the board for approval, with particular reference to:
 - (a) Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (c) of section 134 of the Companies Act, 2013.
 - (b) Changes, if any, in accounting policies and practices and reasons for the same.
 - (c) Major accounting entries involving estimates based on the exercise of judgment by management.
 - (d) Significant adjustments made in the financial statements arising out of audit findings.
 - (e) Compliance with listing and other legal requirements relating to financial statements.
 - (f) Disclosure of any related party transactions.
 - (g) Qualifications in the draft audit report.
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval.
6. Reviewing, with the management, the statement of uses/application of fund raised through an issue (public issue, right issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilization of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take steps in this matter.
7. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.
8. Review and monitor the auditor's independence and performance and effectiveness of audit process.
9. Approval of any subsequent modification of transaction of the company with related parties;
10. Scrutiny of inter-corporate loans and investment.
11. Valuation of undertaking or assets of the company, wherever it is necessary.
12. Evaluation of internal financial control and risk management systems.
13. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
14. Discussion with internal auditors any significant findings and follow up there on.
15. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
16. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
17. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
18. To review the functioning of the Whistle Blower mechanism, in case the same is existing.
19. Approval of appointment of CFO (i.e. the whole-time finance Director or any other person heading the finance function or discharging that function) after assessing the qualification, experience and back of mind, etc. of the candidate.

20. Carrying out any other function as is mentioned in the terms of reference of the Audit Committee

Review of Information by Audit Committee

The Audit Committee is required to mandatorily review the following information:

- (a) Management discussion and analysis of financial condition and results of operations;
- (b) Statement of significant related party transactions (as defined by the audit committee), submitted by the management;
- (c) Management letters/letters of internal control weaknesses issued by statutory auditors;
- (d) Internal audit reports relating to internal control weaknesses; and
- (e) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

Nomination and Remuneration Committee

A. The company shall set up a nomination and remuneration committee which shall comprise at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairman of the committee shall be an independent director.

B. The role of the committee shall, *inter-alia*, include the following:

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, key managerial personnel and other employees;
2. Formulation of criteria for evaluation of Independent Directors and the Board;
3. Devising a policy on Board diversity;
4. Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report.

C. The Chairman of the nomination and remuneration committee could be present at the Annual General Meeting, to answer the shareholders' queries. However, it would be up to the Chairman to decide who should answer the queries.

SUBSIDIARY COMPANY

- (i) At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of material non-listed Indian subsidiary company.
- (ii) The Audit Committee of the listed holding company shall also review the financial statements, in particular the investments made by the unlisted subsidiary company.
- (iii) The minutes of the Board meetings of the unlisted subsidiary company is required to be placed at the Board meeting of the listed holding company.
- (iv) The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.
- (v) The company shall formulate a policy for determining 'material' subsidiaries and such policy shall be disclosed to Stock Exchanges and in the Annual Report.

- (vi) For the purpose of this clause, a subsidiary shall be considered as material if the investment of the company in the subsidiary exceeds twenty per cent of its consolidated net worth as per the audited balance sheet of the previous financial year or if the subsidiary has generated twenty per cent of the consolidated income of the company during the previous financial year.
- (vii) No company shall dispose of shares in its material subsidiary which would reduce its shareholding (either on its own or together with other subsidiaries) to less than 50% or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting.
- (viii) Selling, disposing and leasing of assets amounting to more than twenty percent of the assets of the material subsidiary shall require prior approval of shareholders by way of special resolution

The term “material non-listed Indian subsidiary” means an unlisted subsidiary, incorporated in India, whose turnover or net worth (i.e. paid up capital and free reserves) exceeds 20% of the consolidated turnover or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

The term “significant transaction or arrangement” means any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the material unlisted subsidiary for the immediately preceding accounting year.

Where a listed holding company has a listed subsidiary which is itself a holding company, the above provisions also apply to the listed subsidiary insofar as its subsidiaries are concerned.

Risk Management

- A. The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures.
- B. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company.
- C. The company shall also constitute a Risk Management Committee. The Board shall define the roles and responsibilities 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.

Related Party Transactions

- A. A related party transaction is a transfer of resources, services or obligations between a company and a related party, regardless of whether a price is charged.
- B. A ‘related party’ is a person or entity that is related to the company. Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions and includes the following:
 1. A person or a close member of that person’s family is related to a company if that person:
 - a. is a related party under Section 2(76) of the Companies Act, 2013; or
 - b. has control or joint control or significant influence over the company; or
 - c. is a key management personnel of the company or of a parent of the company; or
 2. An entity is related to a company if any of the following conditions applies:
 - a. The entity is a related party under Section 2(76) of the Companies Act, 2013; or
 - b. The entity and the company are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others); or

- c. One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member); or
- d. Both entities are joint ventures of the same third party; or
- e. One entity is a joint venture of a third entity and the other entity is an associate of the third entity; or
- f. The entity is a post-employment benefit plan for the benefit of employees of either the company or an entity related to the company. If the company is itself such a plan, the sponsoring employers are also related to the company; or
- g. The entity is controlled or jointly controlled by a person identified in (1).
- h. A person identified in (1)(b) has significant influence over the entity (or of a parent of the entity); or

DISCLOSURES

The following disclosures are required to be made under the revised clause:

- Related Party Transactions
- Disclosure of Accounting Treatment
- Remuneration of Directors
- Management
- Shareholders
- Resignation of Directors
- Formal letters of appointment
- Annual Report
- Proceeds from public issues, Rights issues, preferential issues etc.

CEO/CFO CERTIFICATION

Clause 49(IX) deals with the CEO/CFO certification

The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and Companies Act 2013 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that:

- (a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :
 - (i) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
 - (ii) these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.
- (b) There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.
- (c) They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of the internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.

- (d) They have indicated to the auditors and the Audit committee –
- (i) significant changes in internal control over financial reporting during the year;
 - (ii) significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
 - (iii) instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting.

REPORT ON CORPORATE GOVERNANCE

Clause 49(X) narrates the details with respect to Corporate Governance.

The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format prescribed in this clause. The report is required to be signed either by the Compliance Officer or the Chief Executive Officer of the company. In annual report there should be a separate section on corporate governance and should contain the details as given in listing agreement.

COMPLIANCE CERTIFICATE

Clause 49(XI) deals with compliance certificate on Corporate Governance.

The practising Company Secretaries have also been recognised to issue Certificate of Compliance of Conditions of Corporate Governance. The clause provides that the company shall obtain a certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.

NON MANDATORY REQUIREMENTS

The following non-mandatory requirements have additionally been provided:

(1) The Board

A non-executive Chairman may be entitled to maintain a Chairman's office at the company's expense and also allowed reimbursement of expenses incurred in performance of his duties.

(2) Shareholder Rights

A half-yearly declaration of financial performance including summary of the significant events in last six-months, may be sent to each household of share-holders.

(3) Audit qualifications

Company may move towards a regime of unqualified financial statements.

(4) Separate posts of Chairman and CEO

The Company may appoint separate persons to the post of chairman and Managing Director/CEO.

(5) Reporting of Internal Auditor

The internal auditor may report directly to the Audit Committee.

COMPARISON BETWEEN REVISED CLAUSE 49 AND COMPANIES ACT, 2013

Sl. No.	Particulars	Clause 49	Companies Act, 2013 & Rules, 2014
1.	Partition of Nominee Director and IDs	Clause 49(II)(B): Nominee director is excluded from the definition of 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	Clause 49(II)(B): SEBI has amended the definition of Independent Director in alignment with the provisions of Companies Act, 2013.	Section 149(6) of the Companies Act 2013 defines the term Independent Director.
3.	Qualification of IDs	The qualifications of IDs are not specified in the amended clause 49 of the listing agreement	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	Clause 49(II)(F): The company shall establish a vigil mechanism for directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism should also provide for adequate safeguards against victimization of director(s)/ employee(s) who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases. The details of establishment of such mechanism shall be disclosed by	Section 177(9): Every listed company and other classes of companies to establish a Vigil mechanism for directors and employees to report genuine concern. It provide adequate safeguards against victimization of employees and directors who avail of the Vigil mechanism and also provide for direct access to the chairperson of the Audit committee or the director nominated to play the role of audit committee, as the case may be, in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization. The details of establishment of Vigil mechanism

		the company on its website and in the Board's report.	shall be disclosed by the company in the website, if any, and in the Board's Report.
5.	Prohibited Stock options for IDs	Clause 49(II)(C) : IDs shall not be entitled to any stock options.	Section 197(7): IDs shall not entitled to any stock option.
6.	Separate meeting of IDs	Clause 49(II)(B)(6) : The 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.	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	Clause 49(II)(B): The company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc. The details of such training imparted shall be disclosed in the Annual Report.	The Companies Act 2013 did not specify any training of IDs and Board of Directors.
8.	Liability of IDs	Clause 49(II)(E) : An independent director shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the Listing Agreement.	Section 149(12) : An independent director; a NED not being promoter or KMP, shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.
9.	Stakeholders Relationship Committee	Clause 49(VIII)(E): A committee under the Chairmanship of a non-executive director and such other members as	Section- 178(5): The Board of Directors of a company which consists of more than one thousand shareholders,

		<p>may be decided by the Board of the company shall be formed to specifically look into the redressal of grievances of shareholders, debenture holders and other security holders. This Committee shall be designated as 'Stakeholders Relationship Committee' and shall consider and resolve the grievances of the security holders of the company including complaints related to transfer of shares, non- receipt of balance sheet, non-receipt of declared dividends.</p>	<p>debenture-holders, deposit holders and any other security 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.</p>
10.	Disclosure Policy for Remuneration	<p>Clause 49(VIII)(C):</p> <ol style="list-style-type: none"> 1. All pecuniary relationship or transactions of the non-executive directors vis-a-vis the company shall be disclosed in the Annual Report. 2. In addition to the disclosures required under the Companies Act, 2013, the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report: <ol style="list-style-type: none"> (a) All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc. (b) Details of fixed component and performance linked incentives, along with the performance criteria. (c) Service contracts, notice period, severance fees. (d) Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable. 3. The company shall publish its 	<p>Section 197 (2) and Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014:</p> <ol style="list-style-type: none"> (1) Every listed company shall disclose in the Board's report: <ol style="list-style-type: none"> (i) the ratio of the remuneration of each director to the median remuneration of the 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;

		<p>criteria of making payments to non-executive directors in its annual report. Alternatively, this may be put up on the company's website and reference drawn thereto in the annual report.</p> <p>4. The company shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report.</p> <p>5. Non-executive directors shall be required to disclose their shareholding (both own or held by/for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment.</p> <p>These details should be disclosed in the notice to the general meeting called for appointment of such director.</p>	<p>(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, and in 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;</p> <p>(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;</p> <p>(ix) the key parameters for any variable component of remuneration availed by the directors;</p> <p>(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 the highest paid director during the year; and</p> <p>(xi) affirmation that the remuneration is as per the remuneration policy of the company.</p>
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11.	Performance evaluation of IDs	<p>Clause 49(II)(B)(5):</p> <p>(a) The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors.</p> <p>(b) The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report.</p> <p>(c) The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated).</p> <p>(d) 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.</p>	<p>Section 178(2) read with Schedule IV:</p> <p>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.</p> <p>The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.</p> <p>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.</p>
12.	Related Party Transaction (RPT)	<p>Clause 49 (VII):</p> <p>A RPT is a transfer of services or obligations between a company and a related party, regardless of whether a price is charged.</p> <p>A 'related party' is a person or entity that is related to the company.</p> <p>Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions and includes the following :</p> <p>1. A person or a close member of that person's family is related to a company if that person:</p> <p>(a) is a related party under Section 2(76) of the Companies Act, 2013; or</p> <p>(b) has control or joint control or significant influence over the company; or</p>	<p>Section 2 (76) & 188</p> <p>"Related party", with reference to a company, means –</p> <p>(i) a director or his relative</p> <p>(ii) a KMP or his relative;</p> <p>(iii) a firm, in which a director, manager or his relative is a partner;</p> <p>(iv) a private company in which a director or manager is a member or director;</p> <p>(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;</p> <p>(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;</p>

		<p>(c) is a KMP of the company or of a parent of the company; or</p> <p>2. An entity is related to a company if any of the following conditions applies:</p> <p>(a) The entity is a related party under Section 2(76) of the Companies Act, 2013; or</p> <p>(b) The entity and the company are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others); or</p> <p>(c) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member); or</p> <p>(d) Both entities are joint ventures of the same third party; or</p> <p>(e) One entity is a joint venture of a third entity and the other entity is an associate of the third entity; or</p> <p>(f) The entity is a post employment benefit plan for the benefit of employees of either the company or an entity related to the company. If the company is itself such a plan, the sponsoring employers are also related to the company; or</p> <p>(g) The entity is controlled or jointly controlled by a person identified in (1).</p>	<p>(vii) any person on whose advice, directions or instructions a director or manager is accustomed to act;</p> <p>(viii) any company which is –</p> <p>(A) a holding, subsidiary or an associate company of such company; or</p> <p>(B) a subsidiary of a holding company to which it is also a subsidiary.</p> <p>“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.</p> <p>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.</p> <p>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.</p> <p>A company shall not enter into any contract or arrangement, except with the prior approval of the company by a special resolution.</p> <p>A company shall not enter into any contract or arrangement with related party subject to conditions;</p> <ul style="list-style-type: none"> • 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
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		<p>(h) A person identified in (1)(b) has significant influence over the entity (or of a parent of the entity); or</p> <p>The company shall formulate a policy on materiality of RPTs and also on dealing with RPTs. A transaction with a related party shall be considered material if the transaction/transactions to be entered into individually or taken together with previous transactions during a financial year;</p> <ul style="list-style-type: none"> • exceeds 5% of the annual turnover or • 20% of the net worth of the company as per the last audited financial statements of the company, whichever is higher. <p>All RPTs shall require prior approval of the Audit Committee. All material RPTs shall require approval of the shareholders through special resolution and the related parties shall abstain from voting on such resolutions.</p>	<p>Net Worth.</p> <ul style="list-style-type: none"> • 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. <p>Turnover or Net Worth shall be on the basis of the Audited Financial statements of the preceding Financial Year.</p> <p>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.</p> <p>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:</p> <p>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.</p> <p>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.</p>
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			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	<p>Clause 49(VIII)(A):</p> <p>Details of all material transactions with related parties shall be disclosed quarterly along with the compliance report on corporate governance. The company shall disclose the policy on dealing with RPTs on its website and also in the Annual Report.</p>	No such Provision.
14.	Disclosure of Different Accounting Standard	<p>Clause 49(VIII)(B):</p> <p>Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report.</p>	<p>Section-129(5):</p> <p>Where the financial statements of a company do not comply with the accounting standards, the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.</p>
15.	Constitution of Nomination & Remuneration Committee	<p>Clause 49(IV)-</p> <p>The company shall set up a nomination and remuneration committee which shall comprise</p>	<p>Section 178 and Companies (Meetings of Board and its Powers) Rules, 2014:</p> <p>The Nomination and Remuneration</p>

		<p>atleast 3 directors, all of whom shall be NEDs and at least ½ shall be independent.</p> <p>A. Chairman of the committee shall be an independent director.</p> <p>B. The role of the committee shall, inter-alia, include the following:</p> <ol style="list-style-type: none"> 1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration of the directors, KMP and other employees; 2. Formulation of criteria for evaluation of IDs and the Board; 3. Devising a policy on Board diversity; 4. Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal. The company shall disclose the remuneration policy and the evaluation criteria in its Annual Report. <p>C. The Chairman of the nomination and remuneration committee could be present at the AGM, to answer the shareholders' queries. However, it would be upto the Chairman to decide who should answer the queries.</p>	<p>Committee is applicable to the following classes of Companies:</p> <ol style="list-style-type: none"> (i) Every listed Company (ii) Every other Public Company <ol style="list-style-type: none"> (a) Having Paid up capital of Rs.10 crores or more; or (b) Having turnover of Rs.100 Crores: <ul style="list-style-type: none"> • 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. <p>The above mentioned companies shall constitute the Nomination and Remuneration Committee consisting of –</p> <ul style="list-style-type: none"> • 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. <p>The Nomination and Remuneration Committee shall-</p> <ul style="list-style-type: none"> • 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.
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			<p>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 –</p> <ul style="list-style-type: none"> (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: <p>The policy shall be disclosed in the Board's report.</p>
<p>16.</p>	<p>Appointment of one Woman Director</p>	<p>Clause 49 (II)(A): The Board of Directors of the company shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty percent of the Board of Directors comprising non executive Directors.</p>	<p>Section 149(1) and Companies (Appointment and Qualification of Directors) Rules, 2014:</p> <ul style="list-style-type: none"> (i) every listed company; (ii) every other public company having - <ul style="list-style-type: none"> (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. <p>A company shall comply with provisions within a period of six months from the date of its incorporation.</p>

			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.	<p>Clause 49 (II)(B)(3):</p> <p>A person shall not serve as an independent director in more than seven listed companies. Any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.</p>	<p>Section 165:</p> <p>A person shall hold not office as a director, including any alternate directorship in more than 20 companies. The max no. of public companies in which a person can be appointed as a director shall not exceed 10.</p>
18.	Maximum tenure of IDs	<p>Clause 49(II)(B):</p> <p>An independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the A person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only.</p> <p>An independent director, who completes his above mentioned term shall be eligible for appointment as independent director in the company only after the expiration of three years of ceasing to be an independent director in the company.</p>	<p>Section 149:</p> <p>An independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.</p> <p>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.</p>
19.	Risk management	<p>Clause 49 (VI): The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. The Board shall be responsible for framing, implementing and monitoring the risk management plan for the company. The company shall also constitute a Risk Management Committee. The Board shall define the roles and</p>	<p>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.</p>

		responsibilities 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.	
20.	Succession planning	Clause 49 (II)(D) (6): The Board of the company shall satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management	There is no such provision.
21.	Filing of Casual Vacancy of IDs	Clause 49 (II)(D): An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.	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 or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.
22.	Code of Conduct of Board of Directors & Senior Management	All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO. The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013.	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, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;

			<ul style="list-style-type: none"> (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
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			<p>of the company's code of conduct or ethics policy;</p> <p>(12) acting within his authority, assist in protecting the legitimate interests of the company, shareholders and its employees;</p> <p>(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.</p>
23.	Disclosure of Appointment of Director	<p>Clause 49(VIII)(G):</p> <p>The letter of appointment of the independent director along with the detailed profile shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.</p>	<p>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.</p>
24.	Disclosure of Resignation of Director	<p>Clause 49(VIII)(F):</p> <p>The company shall disclose the letter of resignation along with the detailed reasons of resignation provided by the director of the company on its website not later than one working day from the date of receipt of the letter of resignation. The company shall also forward a copy of the letter of resignation along with the detailed reasons of resignation to the stock exchanges not later than one working day from the date of receipt of resignation for dissemination through its website.</p>	<p>Section 169:</p> <p>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.</p>

* Reference: <http://taxguru.in/company-law/clause-49-companies-act-2013.html>

Non Compliance

If a company fails to comply with the listing agreement, as a consequence, the stock exchange may delist the securities of the company for non compliance under Section 21A of SCRA Act, 1956. A company can also delist its securities when they want to expand or restructure, or is acquired by others.

DELISTING

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

In its continuous endeavour, SEBI in the year 2002 constituted a committee on delisting of shares to inter-alia examine and review the conditions for delisting of securities of companies listed on recognized stock exchanges and suggest norms and procedures in connection therewith. The Report of the Committee was considered and accepted by SEBI. Pursuant to the same, SEBI issued the SEBI (Delisting of Securities) Guidelines, 2003.

The said Guidelines, although, to a great extent covered the issues involved in Delisting of Securities. However, there were certain areas over which hue and cry was made from various quarters. Various representations and views, from intermediaries, stock exchanges, shareholders’ associations, chambers of commerce, etc., were given to the Regulators on the operational issues and procedural complications in the guidelines. Based on such representations, it was proposed to look into and suggest changes in the guidelines. In the month of April 2004, the initial changes proposing more systemic clarity were put up for public comments. Comments were received from various quarters and opinions were received on crucial provisions. SEBI circulated Concept Paper on the proposed SEBI (Delisting of Securities) Regulations, 2006, asking for public comments on the proposed Regulations. SEBI received various comments, opinions and suggestions on the subject and finally, by its publication dated 10th June 2009 in the Official Gazette, SEBI notified the much awaited SEBI (Delisting of Equity Shares) Regulations, 2009.

DIFFERENCE BETWEEN COMPULSORY AND VOLUNTARY DELISTING

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

SEBI in exercise of the powers conferred by Section 31 read with Section 21A of the Securities Contracts (Regulation) Act, 1956, Section 30, sub-section (1) of Section 11 and sub-section (2) of Section 11A of SEBI Act, 1992 made the SEBI (Delisting of Equity Shares) Regulations, 2009.

SEBI (DELISTING OF EQUITY SHARES) REGULATIONS, 2009

APPLICABILITY

Delisting of equity shares of a company from all or any of the recognised stock exchanges where such shares are listed.

NON-APPLICABILITY

These regulation shall not be applicable in case of delisting

Under a scheme sanctioned by the Board for Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985 or by the Tribunal under section 262 of the Companies Act, 2013*, if

* Section 262 is yet notified by MCA

such scheme lays down any specific procedure to complete the delisting; or provides an exit option to the existing public shareholders at a specified rate.

IMPORTANT DEFINITIONS

Public Shareholder

Public Shareholders have been defined as the holders of equity shares, other than the following:

- (a) promoters;
- (b) holders of depository receipts issued overseas against equity shares held with a custodian and such custodian;

Person Acting in Concert (PAC)

The term PAC shall have the same meaning as assigned to it under the SEBI (SAST) Regulations, 2011. PACs are individual(s) /company(ies)/ any other legal entity(ies) who are acting together for a common objective or for a purpose of substantial acquisition of shares or voting rights or gaining control over the target company pursuant to an agreement or understanding whether formal or informal. Acting in concert would imply co-operation, co-ordination for acquisition of voting rights or control. This co-operation/ co-ordinated approach may either be direct or indirect.

Unless the contrary is established certain entities are deemed to be persons acting in concert like companies with its holding company or subsidiary company, mutual funds with its sponsor / trustee/ Asset management company, etc.

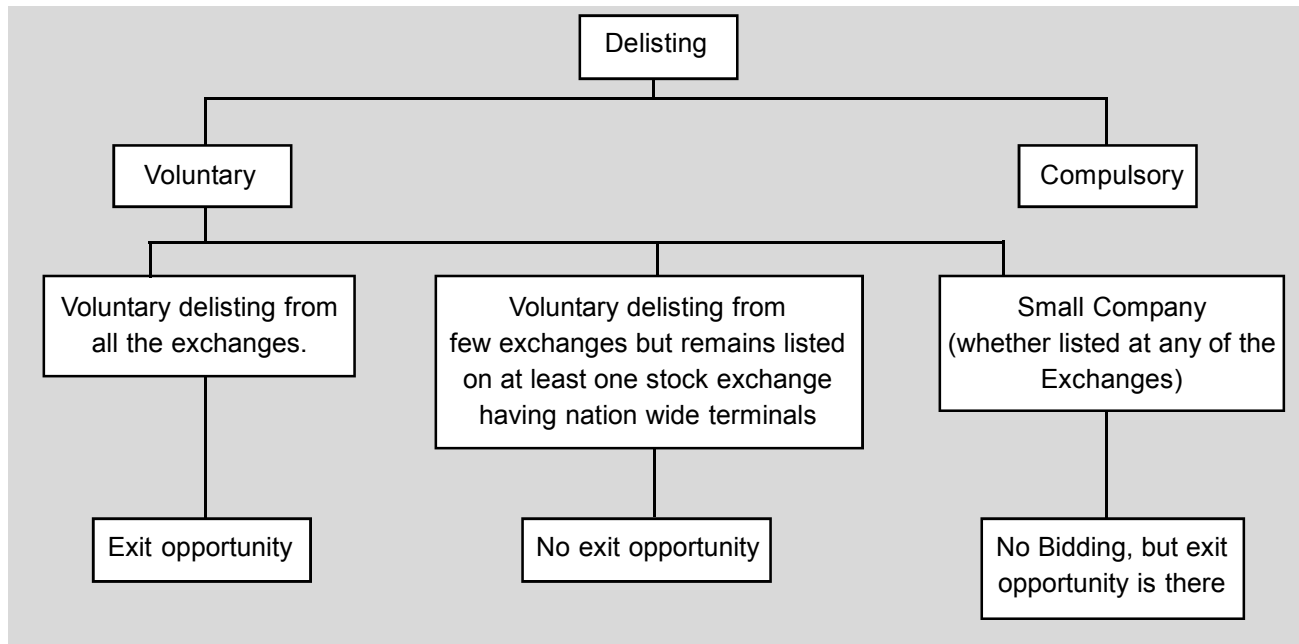
CIRCUMSTANCES WHERE DELISTING IS NOT PERMISSIBLE

- Buy back of equity shares by the company; or
- Preferential allotment made by the company; or
- Unless a period of three years has elapsed since the listing of that class of equity shares; or
- Instruments which are convertible into the same class of equity shares that are sought to be delisted are outstanding.
- Delisting of convertible securities. No promoter shall
- Directly or indirectly employ the funds of the company to finance an exit opportunity or an acquisition of shares made pursuant to provided under these regulation.
- Employ any device, scheme or artifice to defraud any shareholder or other person; or
- Engage in any transaction or practice that operates as a fraud or deceit upon any shareholder or other person; or
- Engage in any act or practice that is fraudulent, deceptive or manipulative in connection with such delisting.

VOLUNTARY DELISTING

DELISTING FROM ALL RECOGNISED STOCK EXCHANGES

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



PUBLIC ANNOUNCEMENT

- The promoters of the company shall upon receipt of in-principle approval for delisting from the recognised stock exchange, make a public announcement which contains all material information and shall not contain any false or misleading statement, in at least one English national daily with wide circulation, one Hindi national daily with wide circulation and one regional language newspaper of the region where the concerned recognised stock exchange is located.
- The public announcement shall also specify a date, being a day not later than thirty working days from the date of the public announcement, which shall be the 'specified date' for determining the names of shareholders to whom the letter of offer shall be sent.
- Before making the public announcement, the promoter shall appoint a merchant banker registered with SEBI and such other intermediaries as are considered necessary to ensure compliance with these regulations.
- No promoter shall appoint any person as a merchant banker if such a person is an associate of the promoter.

ESCROW ACCOUNT

- Before making the public announcement the promoter shall open an escrow account and deposit therein the total estimated amount of consideration calculated on the basis of floor price and number of equity shares outstanding with public shareholders.
- On determination of final price the promoter shall forthwith deposit in the escrow account such additional sum as may be sufficient to make up the entire sum due and payable as consideration in respect of equity shares outstanding with public shareholders.
- The escrow account shall consist of either cash deposited with a scheduled commercial bank, or a bank guarantee in favour of the merchant banker, or a combination of both.

LETTER OF OFFER

- The promoter shall despatch the letter of offer to the public shareholders of equity shares, not later than

forty five working days from the date of the public announcement, so as to reach them at least five working days before the opening of the bidding period.

- The letter of offer shall be sent to all public shareholders whose names appear on the register of the company or depository as on the date specified in the public announcement .
- The letter of offer shall contain all the disclosures made in the public announcement and such other disclosures as may be necessary for the shareholders to take an informed decision.
- The letter of offer shall be accompanied with a bidding form for use of public shareholders and a form to be used by them for tendering shares.

BIDDING PERIOD

- The date of opening of the offer shall not be later than fifty five working days from the date of the public announcement.
- The offer shall remain open for a minimum period of three working days and a maximum period of five working days.

RIGHT OF SHAREHOLDER

- All public shareholders of the equity shares which are sought to be delisted shall be entitled to participate in the book building process.
- A promoter or a person acting in concert with any of the promoters shall not make a bid in the offer.
- Any holder of depository receipts issued on the basis of underlying shares held by a custodian and any such custodian shall not be entitled to participate in the offer and this shall not affect if the holder of depository receipts exchanges such depository receipts with shares of the class that are proposed to be delisted.

OFFER PRICE

The offer price shall be determined through book building process after fixation of floor price and disclosure of the same in the public announcement and the letter of offer.

- (I) In case of frequently traded shares – The floor price shall not be less than the average of the weekly high and low of the closing prices of the equity shares of the company during the twenty six weeks or two weeks preceding the date on which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered, whichever is higher, as quoted on the recognised stock exchange where the equity shares of the company are most frequently traded;
- (II) In case of infrequently traded shares –

The floor price shall be determined by the promoter and the merchant banker taking into account the following factors:

 - (a) the highest price paid by the promoter for acquisitions, if any, of equity shares of the class sought to be delisted, including by way of allotment in a public or rights issue or preferential allotment, during the twenty six weeks period prior to the date on which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered and after that date upto the date of the public announcement; and,
 - (b) Other parameters including return on net worth, book value of the shares of the company, earning per share, price earning multiple vis-a-vis the industry average
- (III) Where the equity shares are frequently traded in some recognised stock exchanges and infrequently

traded in some other recognised stock exchanges where they are listed, the highest of the prices arrived at in accordance with clauses (I) and (II) above.

Equity shares shall be deemed to be infrequently traded, if on the recognised stock exchange, the annualised trading turnover in such shares during the preceding six calendar months prior to month in which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered, is less than five per cent (by number of equity shares) of the total listed equity shares of that class and the term 'frequently traded' shall be construed accordingly.

RIGHT OF PROMOTER NOT TO ACCEPT THE OFFER PRICE

The promoter is not bound to accept the equity shares at the offer price determined by the book building process. If the promoter decides not to accept the offer price so determined,—

- (a) the promoter shall not acquire any equity shares tendered pursuant to the offer and the equity shares deposited or pledged by a shareholder shall be returned or released to him within ten working days of closure of the bidding period;
- (b) the company shall not make the final application to the exchange for delisting of the equity shares;
- (c) the promoter may close the escrow account.
- (d) in a case where the public shareholding at the opening of the bidding period was less than the minimum level of public shareholding required under the listing agreement, the promoter shall ensure that the public shareholding shall be brought up to such minimum level within a period of six months from the date of closure of the bidding through any of following ways –
 - By issue of new shares by the company
 - By the promoter making an offer for sale of his or,
 - By the promoter making sale of his holdings through the secondary market in a transparent manner.

MINIMUM NUMBER OF EQUITY SHARES TO BE ACQUIRED

An offer shall be deemed to be successful if post offer the shareholding of the promoter (along with the persons acting in concert) taken together with the shares accepted through eligible bids at the final price determined, reaches the higher of –

- (a) ninety per cent of the total issued shares of that class excluding the shares which are held by a custodian and against which depository receipts have been issued overseas; or
- (b) the aggregate percentage of pre offer promoter shareholding (along with persons acting in concert with him) and fifty per cent of the offer size.

CLOSURE OF OFFER

Within eight working days of closure of the offer, the promoter and the merchant banker shall make a public announcement in the newspapers regarding:—

- (i) the success of the offer along with the final price accepted by the acquirer; or
- (ii) the failure of the offer; or
- (iii) rejection of the final price discovered under Schedule II, by the promoters.

FAILURE OF OFFER

(1) Where the offer is rejected or is not successful as, the offer shall be deemed to have failed and no equity shares shall be acquired pursuant to such offer.

(2) Where the offer fails –

- (a) the equity shares deposited or pledged by a shareholder shall be returned or released to him within ten working days from the end of the bidding period;
- (b) no final application shall be made to the exchange for delisting of the equity shares; and
- (c) the escrow account opened shall be closed.

PAYMENT OF CONSIDERATION

1. The promoter shall immediately on ascertaining success of the offer, open a special account with a banker to an issue registered with SEBI and transfer thereto, the entire amount due and payable as consideration in respect of equity shares tendered in the offer, from the escrow account.
2. All the shareholders whose equity shares are verified to be genuine shall be paid the final price stated in the public announcement within ten working days from the closure of the offer.

RETURN OF EQUITY SHARES

The equity shares deposited or pledged by a shareholder shall be returned or released to him, within ten working days from the closure of the offer, in cases where the bids pertaining thereto have not been accepted.

RIGHT OF REMAINING SHAREHOLDERS TO TENDER EQUITY SHARES

- (1) Where, pursuant to acceptance of equity shares tendered in terms of these regulations, the equity shares are delisted, any remaining public shareholder holding such equity shares may tender his shares to the promoter upto a period of at least one year from the date of delisting and, in such a case, the promoter shall accept the shares tendered at the same final price at which the earlier acceptance of shares was made.
- (2) The payment of consideration for shares accepted shall be made out of the balance amount lying in the escrow account.
- (3) The amount in the escrow account or the bank guarantee shall not be released to the promoter unless all payments are made in respect of shares tendered.

DELISTING FROM ONLY SOME OF THE RECOGNISED STOCK EXCHANGES

A company may delist its equity shares from one or more recognised stock exchanges where they are listed and continue their listing on one or more other recognised stock exchanges, if after the proposed delisting the equity shares would –

- remain listed on any recognised stock exchange which has nationwide trading terminals, no exit opportunity needs to be given to the public shareholders; and,
- not remain listed on any recognised stock exchange having nation wide trading terminals, exit opportunity shall be given to all the public shareholders holding the equity shares sought to be delisted.

‘Recognised stock exchange having nation wide trading terminals’ means the Bombay Stock Exchange Limited, the National Stock Exchange of India Limited or any other recognised stock exchange which may be specified by SEBI in this regard.’

PROCEDURE FOR DELISTING

In case of no exit opportunity

- (1) It shall be approved by a resolution of the board of directors of the company in its meeting;

- (2) The company shall give a public notice of the proposed delisting in at least one English national daily with wide circulation, one Hindi national daily with wide circulation and one regional language newspaper of the region where the concerned recognised stock exchanges are located.
- (3) The company shall make an application to the concerned recognised stock exchange regarding this.
- (4) The fact of delisting shall be disclosed in the first annual report of the company prepared after the delisting.
- (5) The public notice shall mention the names of the recognised stock exchanges from which the equity shares of the company are intended to be delisted, the reasons for such delisting and the fact of continuation of listing of equity shares on recognised stock exchange having nation wide trading terminals.
- (6) An application shall be disposed of by the recognised stock exchange within a period not exceeding thirty working days from the date of receipt of such application complete in all respects.

In case of exit opportunity

Except where the equity shares would remain listed on any recognised stock exchange which has nationwide trading terminals and no exit opportunity needs to be given to the public shareholders, any company desirous of delisting its equity shares –

- (1) Obtain the prior approval of the board of directors of the company in its meeting;
- (2) Obtain the prior approval of shareholders of the company by special resolution passed through postal ballot, after disclosure of all material facts in the explanatory statement sent to the shareholders in relation to such resolution; However, the special resolution shall be acted upon if and only if the votes cast by public shareholders in favour of the proposal amount to at least two times the number of votes cast by public shareholders against it.
- (3) Make an application to the concerned recognised stock exchange for in-principle approval of the proposed delisting and accompanied by an audit report as required under regulation 55A of SEBI (Depositories and Participants) Regulations, 1996 in respect of the equity shares sought to be delisted, covering a period of six months prior to the date of the application.
- (4) An application shall be disposed of by the recognised stock exchange within a period not exceeding thirty working days from the date of receipt of such application complete in all respects
- (5) The recognised stock exchange shall not unfairly withhold such application, but may require the company to satisfy it as to –
 - (a) Compliance with these regulations
 - (b) The resolution of investor grievances by the company;
 - (c) Payment of listing fees to that recognised stock exchange;
 - (d) The compliance with any condition of the listing agreement with that recognised stock exchange having a material bearing on the interests of its equity shareholders;
 - (e) Any litigation or action pending against the company pertaining to its activities in the securities market or any other matter having a material bearing on the interests of its equity shareholders;
 - (f) Any other relevant matter as the recognised stock exchange may deem fit to verify.
- (6) Within one year of passing the special resolution, make the final application to the concerned recognised stock exchange in the form specified by the recognised stock exchange and shall be accompanied with such proof of having given the exit opportunity in accordance with these regulations as the recognised stock exchange may require.

SPECIAL PROVISIONS FOR SMALL COMPANIES AND DELISTING BY OPERATION OF LAW

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

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

A delisting of equity shares may be made according to above mentioned provisions only if, in addition to the fulfillment of requirement where exit opportunity is required, the following conditions are fulfilled:-

- (a) the promoter appoints a merchant banker and decides an exit price in consultation with him;
- (b) the exit price offered to the public shareholders shall not be less than the price arrived at in consultation with the merchant banker;
- (c) the promoter writes individually to all public shareholders in the company informing them of his intention to get the equity shares delisted, indicating the exit price together with the justification there for and seeking their consent for the proposal for delisting;
- (d) at least ninety per cent of such public shareholders give their positive consent in writing to the proposal for delisting, and have consented either to sell their equity shares at the price offered by the promoter or to remain holders of the equity shares even if they are delisted;
- (e) the promoter completes the process of inviting the positive consent and finalisation of the proposal for delisting of equity shares within seventy five working days of the first communication made by the promoter individually to all public shareholders;
- (f) the promoter makes payment of consideration in cash within fifteen working days from the date of expiry of seventy five working days stipulated .

The communication made to the public shareholders shall contain justification for the offer price with particular reference to the applicable parameters for offer price, that consent for the proposal would include consent for dispensing with the exit price discovery through book building method.

The concerned recognised stock exchange may delist such equity shares upon satisfying itself of compliance with this regulation.

IN CASE OF WINDING UP, DERECOGNITION

In case of winding up proceedings of a company whose equity shares are listed on a recognised stock exchange, the rights, if any, of the shareholders of such company shall be in accordance with the laws applicable to those proceedings.

Where SEBI withdraws recognition granted to a stock exchange or refuses renewal of recognition to it, SEBI may, in the interest of investors pass appropriate order in respect of the status of equity shares of the companies listed on that exchange.

MONITORING COMPLIANCES

The respective recognised stock exchanges shall comply with and monitor compliance with the provisions of these regulations and shall report to SEBI any instance of non-compliance which comes to their notice.

LISTING OF DELISTED EQUITY SHARES

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

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

However, this shall not be applicable where a recommendation for listing has been made by SEBI for Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985.

While considering an application for listing of any equity shares which had been delisted the recognised stock exchange shall have due regard to facts and circumstances under which delisting was made.

An application for listing made in respect of delisted equity shares shall be deemed to be an application for fresh listing of such equity shares and shall be subject to provisions of law relating to listing of equity shares of unlisted companies.

COMPULSORY DELISTING

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

BY STOCK EXCHANGE

A recognised stock exchange may, by order, delist any equity shares of a company on any ground prescribed in the rules made under section 21A of the Securities Contracts (Regulation) Act, 1956.

However, no order shall be made under this sub-regulation unless the company concerned has been given a reasonable opportunity of being heard.

The decision on delisting shall be taken by a panel to be constituted by the recognised stock exchange consisting of –

- (a) two directors of the recognised stock exchange (one of whom shall be a public representative);
- (b) one representative of the investors;
- (c) one representative of the Ministry of Corporate Affairs or Registrar of Companies; and
- (d) the Executive Director or Secretary of the recognised stock exchange.

Before making an order the recognised stock exchange shall give a notice in one English national daily with wide circulation and one regional language newspaper of the region where the concerned recognised stock exchange is located, of the proposed delisting, giving a time period of not less than fifteen working days from the notice, within which representations may be made to the recognised stock exchange by any person who may be aggrieved by the proposed delisting and shall also display such notice on its trading systems and website.

The recognised stock exchange shall while passing any order consider the representations, if any, made by the company as also any representations received in response to the notice given and shall comply with the criteria specified in Schedule III which is given below –

SCHEDULE III

CRITERIA FOR COMPULSORY DELISTING

1. The recognised stock exchange shall take all reasonable steps to trace the promoters of a company

whose equity shares are proposed to be delisted, with a view to ensuring compliance with sub-regulation (3) of regulation 23.

2. The recognised stock exchange shall consider the nature and extent of the alleged non-compliance of the company and the number and percentage of shareholders who may be affected by such non-compliance.
3. The recognised stock exchange shall take reasonable efforts to verify the status of compliance of the company with the office of the concerned Registrar of Companies.
4. The names of the companies whose equity shares are proposed to be delisted and their promoters shall be displayed in a separate section on the website of the recognised stock exchange for a brief period of time. If delisted, the names shall be shifted to another separate section on the website.
5. The recognised stock exchange shall in appropriate cases file prosecutions under relevant provisions of the Securities Contracts (Regulation) Act, 1956 or any other law for the time being in force against identifiable promoters and directors of the company for the alleged non-compliances.
6. The recognised stock exchange shall in appropriate cases file a petition for winding up the company under section 271 of the Companies Act, 2013* or make a request to the Registrar of Companies to strike off the name of the company from the register under section 248 of the Companies Act, 2013*.

The provisions related to exit opportunity shall not be applicable to a compulsory delisting made by a recognised stock exchange under this Chapter.

Where the recognised stock exchange passes an order it shall, –

- (a) forthwith publish a notice in one English national daily with wide circulation and one regional language newspaper of the region where the concerned recognised stock exchange is located, of the fact of such delisting, disclosing therein the name and address of the company, the fair value of the delisted equity shares determined and the names and addresses of the promoters of the company who would be liable under these regulations and
- (b) inform all other stock exchanges where the equity shares of the company are listed, about such delisting and the surrounding circumstances.

RIGHTS OF PUBLIC SHAREHOLDERS

Where equity shares of a company are delisted by a recognised stock exchange the recognised stock exchange shall appoint an independent valuer or valuers who shall determine the fair value of the delisted equity shares which the promoter of the company pay to the shareholder from the delisted shares are acquired subject to their option of retaining their shares.

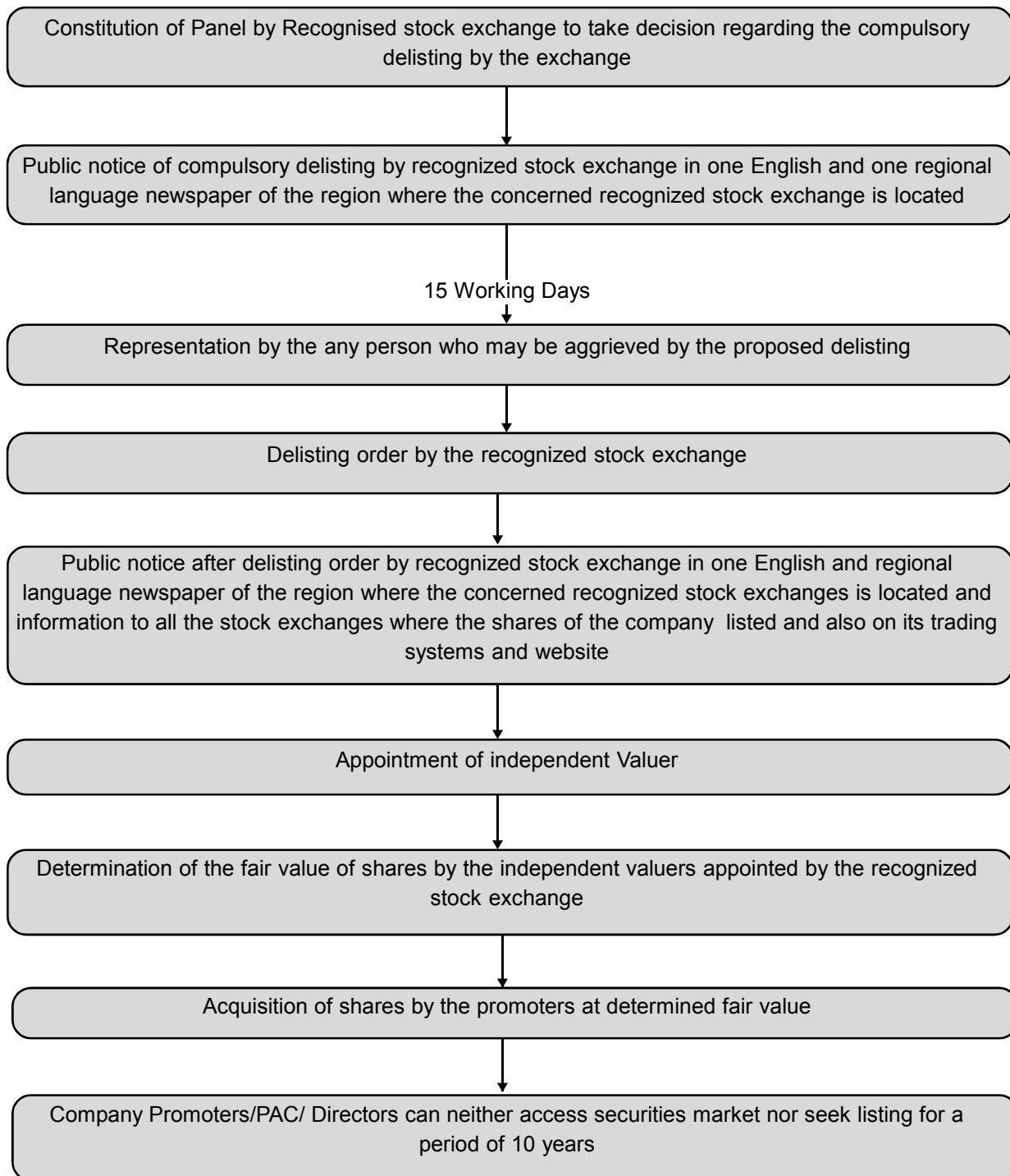
The recognised stock exchange shall form a panel of expert valuers from whom the valuer or valuers shall be appointed.

CONSEQUENCES

Where a company has been compulsorily delisted the company, its whole time directors, its promoters and the companies which are promoted by any of them shall not directly or indirectly access the securities market or seek listing for any equity shares for a period of ten years from the date of such delisting.

* Section 271 and Section 248 are not yet notified by MCA

PROCESS FLOW CHART FOR COMPULSORY DELISTING



LESSON ROUND UP

- Listing of securities with stock exchange is a matter of great importance for companies and investors, because this provides the liquidity to the securities in the market.
- Listing of Securities on Indian Stock Exchanges, thus, is essentially governed by the provisions in the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956, the Securities Contracts (Regulation) Rules, 1957, Rules, bye laws, regulations of concerned stock exchange, the listing agreement entered into by the issuer and stock exchange and circulars/guidelines issued by the Central Government and SEBI.
- The term delisting of securities means permanent removal of securities of a listed company from a stock exchange. As a consequence of delisting, the securities of that company would no longer be traded at that stock exchange.
- Delisting can be voluntary or compulsory.

GLOSSARY

Financial year	It means the period of twelve months commencing on the first day of April every year. However, a company may at its option have a financial year commencing on a date other than the first day of April.
Listing Agreement	An agreement which has to be entered into by companies when they such listing for their shares on a stock exchange, companies are called upon to keep the stock exchange fully informed of all corporate developments having a bearing on the market price of shares like dividend rights, bonus shares, etc.
Record Date	A date on which the records of a company are closed for the purpose of determining the stock-holders to whom dividends, proxies rights etc., are to be sent.
Material Non listed Indian subsidiary	Material non listed Indian company means an unlisted subsidiary, incorporated in India, whose turnover or net worth (i.e. paid up capital and free reserves) exceeds 20% of the consolidated turnover or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

SELF TEST QUESTIONS

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

1. Listing of securities with stock exchange is a matter of great importance for companies and investors'. Discuss.
2. What are the timelines for submission of disclosures relating to each class of equity shares/ security issued under Clause 35?
3. Enumerate the various requirements under clause 19 of listing agreement?
4. Briefly explain the provision related to composition of Board of Director under Clause 49 of the Listing Agreement?
5. What is the duty of Compliance officer under Clause 52 of the listing agreement?
6. Distinguish between voluntary delisting of securities and compulsory delisting of securities.
7. Briefly explain the procedure for voluntary delisting only from some of the stock exchange.

Lesson 17

Issue of Securities

LESSON OUTLINE

- Introduction
- Issue of Equity Shares
- Meaning of Draft offer document, Letter of offer and Red Herring Prospectus
- Fast Track Issue
- Pricing
- Promoters' Contribution
- Lock-in Requirements
- Underwriting
- Introduction to ASBA
- Anchor Investor
- Reservation on competitive basis
- Allocation in net offer to public
- Book Building
- Green Shoe Option facility
- Procedure for Issue of Securities
- Rights issue
- Bonus Shares
- Preferential Issue by Existing Listed Companies
- Institutional Placement Programm
- Qualified Institutional Placement
- Issue of Securities by SME
- SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999
- Lesson Round-Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

The Indian stock market witnessed transformation after the opening up of the economy in the early nineties, especially after the establishment of SEBI. The companies are also raising funds through new avenues to fulfill its fund requirement for different purpose. SEBI regulates the issue of securities by listed public companies in India by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations), that regulates various types of issues relating to aspects such as eligibility, Promoters' Contribution, Pricing and other Procedural aspects.

This lesson will enable the students to learn the various provisions of ICDR Regulations in respect of various types of issues, such as IPO/ FPO, Rights Issue, Bonus Issue, Preferential Issue, Issue of Advertisements, Promoters' Contributions, Lock-in requirements, Green Shoe Option, Book Building Method, Issue of QIPs, Institutional Placement Program, ESOP Guidelines, etc.

INTRODUCTION

Management of a public issue involves coordination of activities and cooperation of a number of agencies such as managers to the issue, underwriters, brokers, registrar to the issue; solicitors/legal advisors, printers, publicity and advertising agents, financial institutions, auditors and other Government/Statutory agencies such as Registrar of Companies, Reserve Bank of India, SEBI etc. The whole process of issue of shares can be divided into two parts (i) pre-issue activities and (ii) post issue activities. All activities beginning with the planning of capital issue till the opening of the subscription list are pre-issue activities while all activities subsequent to the opening of the subscription list may be called post issue activities. Since only the demat shares are being admitted for dealings on the stock exchanges, hence the securities can be issued only with the purpose of allotting the shares in Dematerialised Form.

With the repeal of Capital Issues (Control) Act, 1947 all the guidelines, notifications, circulars etc. issued by the office of the Controller of Capital Issues have become defunct. Earlier, such companies were required to conform to the guidelines issued by SEBI vide its order dated 11.6.1992 called the Guidelines for Disclosure and Investor Protection, 1992.

SEBI had issued a compendium containing consolidated Guidelines, circulars, instructions relating to issue of capital effective from January 27, 2000. The compendium titled SEBI (Disclosure and Investor Protection) Guidelines, 2000 replaced the original Guidelines issued in June 1992 and clarifications thereof. On August 26, 2009 SEBI rescinded the SEBI (DIP) Guidelines, 2000 and notified SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 in order to bring more clarity to the provisions of the rescinded SEBI Guidelines by removing the redundant provision and modifying certain provisions on account of changes necessitated due to market design.

ISSUE OF EQUITY SHARES

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

APPLICABILITY OF THE REGULATIONS

These regulations shall apply to the following:

- (a) Public issue
- (b) Rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more
- (c) Preferential issue
- (d) Issue of bonus shares by a listed issuer
- (e) Qualified institutions placement by a listed issuer
- (f) Institutional Placement Programme (IPP)
- (g) Issue of Indian Depository Receipts.

ELIGIBILITY NORMS FOR PUBLIC ISSUE

Unlisted Company

An unlisted company can make an initial public offering (IPO) of equity shares or any other security which may be converted into or exchanged with equity shares at a later date, only if it meets all the following conditions:

- (a) The company has net tangible assets of at least ₹ 3 crores in each of the preceding 3 full years (of 12 months each), of which not more than 50% is held in monetary assets.

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

- (b) The company has a minimum average pre-tax operating profit of rupees fifteen crore, calculated on a restated and consolidated basis, during the three most profitable years out of the immediately preceding five years.
- (c) The company has a net worth of at least ₹ 1 crore in each of the preceding 3 full years (of 12 months each);
- (d) The aggregate of the proposed issue and all previous issues made in the same financial year in terms of size, does not exceed five (5) times its pre-issue net worth as per the audited balance sheet of the last financial year.
- (e) In case the company has changed its name within the last one year, at least 50% of the revenue for the preceding 1 full year is earned by the company from the activity suggested by the new name; and

Listed Company

A listed company shall be eligible to make a public issue of equity shares or any other security which may be converted into or exchanged with equity shares at a later date: the aggregate of the proposed issue and all previous issues made in the same financial year in terms of size, issue size does not exceed 5 times its pre-issue networth as per the audited balance sheet of the last financial year.

However, in case there is a change in the name of the issuer company within the last 1 year reckoned from the date of filing of the offer document, the revenue accounted for by the activity suggested by the new name is not less than 50% of its total revenue in the preceding 1 full-year period

ALTERNATIVE ELIGIBILITY NORMS FOR PUBLIC ISSUE

To provide sufficient flexibility and also to ensure that genuine companies do not suffer on account of rigidity of the parameters, SEBI has provided alternative route to company not satisfying any of the above conditions, for accessing the primary Market, if the issue is made through the book-building process and the issuer undertakes to allot, at least seventy five percent of the net offer to public, to qualified institutional buyers and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers in addition to satisfying the aforesaid eligibility norms, the company shall also satisfy the criteria of having at least 1000 prospective allottees in its issue.

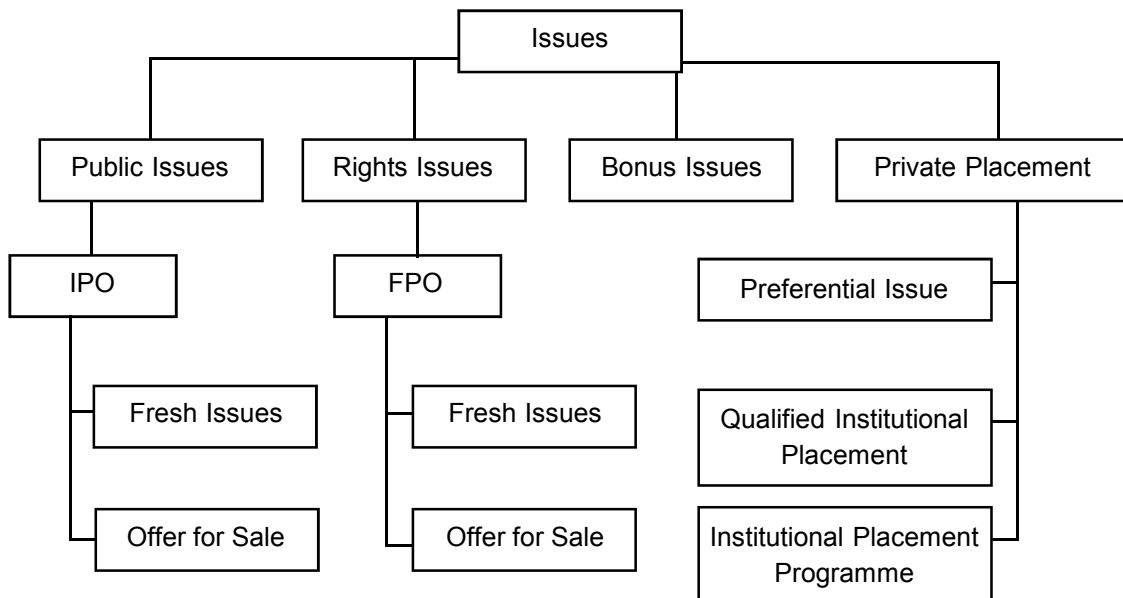
TYPES OF ISSUE

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, the Securities Contracts (Regulation) Act, 1956 including the Rules made thereunder and the guidelines and instructions issued by the concerned Government authorities, the Stock Exchanges and SEBI etc.

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

- (a) **Public issue:** When an issue/offer of securities is made to new investors for becoming part of shareholders' family of the issuer it is called a public issue. Public issue can be further classified into Initial public offer (IPO) and Further public offer (FPO). The significant features of each type of public issue are illustrated below:

- (i) **Initial public offer (IPO):** When an unlisted company makes either a fresh issue of securities or offers its existing securities for sale or both for the first time to the public, it is called an IPO. This paves way for listing and trading of the issuer's securities in the Stock Exchanges.
- (ii) **Further public offer (FPO) or Follow on offer:** When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, it is called a FPO.
- (b) **Right issue (RI):** When an issue of securities is made by an issuer to its shareholders existing as on a particular date fixed by the issuer (i.e. record date), it is called a rights issue. The rights are offered in a particular ratio to the number of securities held as on the record date.
- (c) **Bonus issue:** When an issuer makes an issue of securities to its existing shareholders as on a record date, without any consideration from them, it is called a bonus issue. The shares are issued out of the Company's free reserve or share premium account in a particular ratio to the number of securities held on a record date.
- (d) **Private placement:** When an issuer makes an issue of securities to a select group of persons not exceeding 49, and which is neither a rights issue nor a public issue, it is called a private placement. Private placement of shares or convertible securities by listed issuer can be of two types:
 - (i) **Preferential allotment:** When a listed issuer issues shares or convertible securities, to a select group of persons in terms of provisions of Chapter VII of SEBI (ICDR) Regulations, it is called a preferential allotment. The issuer is required to comply with various provisions which *inter alia* include pricing, disclosures in the notice, lock in etc., in addition to the requirements specified in the Companies Act, 2013.
 - (ii) **Qualified institutions placement (QIP):** When a listed issuer issues equity shares or securities convertible in to equity shares to Qualified Institutions Buyers (QIBs) only in terms of provisions of Chapter VIII of SEBI (ICDR) Regulations, it is called a QIP.
 - (iii) **Institutional placement programme (IPP):** When a listed issuer makes a further public offer of equity shares, or offer for sale of shares by promoter / promoter group of listed issuer in which, the offer allocation and allotment of such shares is made only to QIBs in terms of chapter VIIIA of SEBI (ICDR) Regulations, 2009 for the purpose of achieving minimum public shareholding it is called an IPP.



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

<i>Draft Offer Documents</i>	<i>Offer Document</i>	<i>RHP (Red Herring Prospectus)</i>
<p>“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.</p>	<p>“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.</p>	<p>“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.</p>

Debarment

An issuer can not make a public issue or rights issue of specified securities if the issuer, any of its promoters, promoter group or directors or persons in control of the issuer are debarred from accessing the capital market by SEBI. If any of the promoters, directors or person in control of the issuer was or also is a promoter, director or person in control of any other company which is debarred from accessing the capital market under any order or directions made by SEBI.

Filing of Offer Document

An issuer company can not make any public issue of securities, unless a draft offer document has been filed with SEBI through a Merchant Banker, at least 30 days prior to registering the prospectus with the Registrar of Companies (ROC) or filing the letter of offer with the designated stock exchange.

However, if SEBI specifies changes or issues observations on the draft Prospectus within 30 days from the date of receipt of the draft Prospectus by SEBI the issuer company or the Lead Manager to the Issue shall carry out such changes in the draft Prospectus or comply with the observations issued by SEBI before filing the Prospectus with ROC.

SEBI may specify changes or issue observations, if any, on the draft prospectus within 30 days from the later of the date of receipt of the draft offer document or the date of receipt of satisfactory reply from the lead merchant bankers. Where SEBI has sought any clarification or additional information from them or the date of receipt of clarification or information from any regulator or agency, where SEBI has sought any clarification or information from such regulator or agency or the date of receipt of a copy of in-principal approval letter issued by the recognized stock exchanges.

The lead merchant banker should while filing the offer document with SEBI, file a copy of such document with the recognized stock exchanges where the specified securities are proposed to be listed and a soft copy of the offer document should also be furnished to SEBI.

Issue of Securities in Dematerialised Form

A company can not make public or rights issue or an offer for sale of securities, unless the company enters into an agreement with a depository for dematerialisation of securities already issued or proposed to be issued to the public or existing shareholders; and the company gives an option to subscribers/ shareholders/ investors to receive the security certificates or hold securities in dematerialized form with a depository.

Partly Paid-up Shares

These Regulations also require that all the existing partly paid-up shares must be made fully paid or the subscription money be forfeited if the investor fails to pay call money within 12 months. A company can not make a public or rights issue of securities unless firm arrangements of finance through verifiable means towards 75% of the stated means of finance, excluding the amount to be raised through proposed Public/Rights issue, have been made.

FAST TRACK ISSUES

The fast-track route of fund raising is an alternative available for companies to access public funds by way of further capital offerings. Considering the need to enable well established and compliant listed companies to access Indian primary market in a time effective manner through follow-on public offerings and rights issues, SEBI decided to enable listed companies satisfying certain specified requirements to make Fast Track Issues (FTIs). Accordingly such listed companies are now able to proceed with follow-on public offering/rights issue by filing a copy of the Red Herring Prospectus (in case of book built issue)/Prospectus (in case of fixed price issue) registered with the Registrar of Companies or the letter of offer filed with Designated Stock Exchange, as the case may be, with SEBI and stock exchanges. Such companies are not required to file draft offer document with SEBI and stock exchanges.

Accordingly the provisions relating to filing of offer document are not applicable to public issue of securities by a listed issuer company or a rights issue of securities by a listed issuer company, if the following conditions are satisfied:

- (a) The shares of the company have been listed on any stock exchange having nationwide terminals for a period of at least three years immediately preceding the reference date;
- (b) The "average market capitalisation of public shareholding" of the company is at least ₹ 3000 crore
- (c) The annualized trading turnover of the shares of the company during six calendar months immediately preceding the month of the reference date has been at least two per cent of the weighted average number of shares listed during the said six months period;

However, for issuers whose public shareholding is less than 15% of its issued equity capital, the annualized trading turnover of its equity shares has been at least 2% of the weighted number of equity shares available as free float during such six months period.

- (d) The company has redressed at least 95% of the total shareholder/investor grievances or complaints received till the end of the quarter immediately preceding the month of the reference date;

- (e) The company has complied with the listing agreement for a period of at least three years immediately preceding the reference date;

However, if the issuer has not complied with the provision of the equity listing agreement relating to composition of board of directors, for any quarter during the last three years immediately preceding the reference date, but is compliant with such provisions at the time of filing of offer document with the Registrar of Companies or designated stock exchange, as the case may be, and adequate disclosures are made in the offer document about such non-compliances during the three years immediately preceding the reference date, it shall be deemed as compliance with the condition.

- (f) The impact of auditors' qualifications, if any, on the audited accounts of the company in respect of the financial years for which such accounts are disclosed in the offer document does not exceed 5% of the net profit/loss after tax of the company for the respective years.
- (g) No prosecution proceedings or show cause notices issued by SEBI are pending against the company or its promoters or whole time directors as on the reference date; and
- (h) The entire shareholding of the promoter group is held in dematerialised form as on the reference date.

A listed issuer company satisfying all the requirements specified in this clause and filing a red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with ROC or letter of offer with Designated Stock Exchange, as the case may be, shall simultaneously with such filing or as soon thereafter as reasonably practicable, but in any case not later than the opening of the issue, file a copy thereof with SEBI.

PRICING

An issuer can determine the price or determine the coupon rate and conversion price of convertible debt instruments of specified securities in consultation with the lead merchant banker or through the book building process.

Differential Pricing

An issuer can offer specified securities at different prices, subject to the following:

- (a) retail individual investors or retail individual shareholders or employees entitled for reservation making an application for a value of not more than two lakh rupees, can be offered specified securities at a price lower than the price at which net offer is made to other categories of applicants.

However, such difference shall not be more than 10% of the price at which specified securities are offered to other categories of applicants.

- (b) in case of a book built issue, the price of the specified securities offered to an anchor investor should not be lower than the price offered to other applicants;

If the issuer opts for alternate method of book building, the issuer can offer specified securities to its employees at a price, lower than floor price and the difference between such price and floor price shall not be more than 10%.

- (c) in case of a composite issue, the price of the specified securities offered in the public issue can be different from the price offered in rights issue and justification for such price difference should be given in the offer document.

Price and Price Band

- (1) The issuer can mention a price or price band in the draft prospectus (in case of a fixed price issue) and floor price or price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies.

However, the prospectus registered with the Registrar of Companies should contain only one price or the specific coupon rate, as the case may be.

- (2) If the floor price or price band is not mentioned in the red herring prospectus, the issuer should announce the floor price or price band at least 5 working days before the opening of the bid (in case of an initial public offer) and at least 1 working day before the opening of the bid (in case of a further public offer), in all the newspapers in which the pre issue advertisement was released.
- (3) The announcement should contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the prospectus.

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

- (4) The cap on the price band shall be less than or equal to one hundred and twenty per cent of the floor price.
- (5) The floor price or the final price should not be less than the face value of the specified securities. "Cap on the price band" includes cap on the coupon rate in case of convertible debt instruments.

Face Value of Equity Shares

An eligible company shall be free to make public or rights issue of equity shares in any denomination determined by it in accordance with the provisions of the Companies Act, 2013 and in compliance with the following and other norms as may be specified by SEBI from time to time.

- (i) In case of initial public offer by an unlisted company:
 - (a) if the issue price is ₹ 500/- or more, the issuer company shall have a discretion to fix the face value below ₹ 10/- per share subject to the condition that the face value shall in no case be less than Re. 1 per share.
 - (b) if issue price is less than ₹ 500 per share, the face value shall be ₹ 10/- per share.

It may be noted that this condition is not applicable to IPO made by Government company statutory authority, or corporation or any special purpose vehicle set up by any of them which is in intra-structure sector.

- (ii) The disclosure about the face value of shares (including the statement about the issue price being "X" times of the face value) shall be made in the advertisement, offer documents and in application forms in identical font size as that of issue price or price band.

PROMOTERS' CONTRIBUTION

Promoters' contribution in any issue shall be in accordance with the following provisions as on (i) the date of filing red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with ROC or letter of offer with Designated Stock Exchange, as the case may be, in case of a fast track issue; and (ii) the date of filing draft offer document with SEBI, in any other case.

Promoters' contribution

Unlisted Company	In case of Public Issue*	Not less than 20% of the post-issue capital
Listed Company	In case of Public Issue	To the extent of 20% of the proposed issue or 20% of the post-issue capital
Listed Company	Composite Issue**	20% of the proposed public issue or 20% of the post-issue capital.

** in case the post issue shareholding of the promoters is less than 20%, alternative investment funds may contribute for the purpose of meeting the shortfall in minimum contribution as specified for promoters, subject to a maximum of 10 % of the post issue capital.*

***Rights issue component of the composite issue shall be excluded while calculating the post-issue capital.*

Promoters' Contribution to be Brought in Before Public Issue Opens

Promoters shall bring in the full amount of the promoters' contribution including premium at least one day prior to the issue opening date which shall be kept in an escrow account with a Scheduled Commercial Bank and the said contribution/ amount shall be released to the company along with the public issue proceeds.

However, where the promoters' contribution has been brought prior to the public issue and has already been deployed by the company, the company shall give the cash flow statement in the offer document disclosing the use of such funds received as promoters' contribution.

If the promoters' minimum contribution exceeds ₹100 crores, the promoters shall bring in ₹100 crores before the opening of the issue and the remaining contribution shall be brought in by the promoters in advance on pro-rata basis before the calls are made on public.

Exemption from Requirement of Promoters' Contribution

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

- (a) an issuer which does not have any identifiable promoter
- (b) In case of a further public offer, where the equity shares of the issuer are not infrequently traded in a recognized stock exchange for a period of atleast 3 years and the issuer has a track record of dividend payment for atleast immediately preceding three years.
- (c) In case of rights issues.

However, in all the above cases the promoters shall disclose their existing shareholding and the extent to which they are participating in the proposed issue in the offer document.

LOCK-IN-REQUIREMENTS

For Securities Held by Promoters

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

- (a) The promoters contribution including contribution made by alternative investment fund is subject to lock-in-period of 3 years from the date of commencement of commercial production or date of allotment in the public issue whichever is later.
- (b) Any contribution made by promoters over and above the minimum contribution shall be subject to a lock-in-period of 1 year in case of all the companies.
- (c) In case of issue of securities by a company listed on a stock exchange for at least 3 years and having a track record of dividend payment for at least 3 immediately preceding years promoter's contribution shall not be subject to lock-in-period.

Securities Held by Persons other than Promoters

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

This is not applicable (i) in case of equity shares allotted to employees under employee stock option prior to initial public offer, if the issuer has made full disclosures with respect to such option and (ii) Equity shares held by a venture capital fund or alternative Investment fund of category I or a foreign venture capital investor and such equity shares shall be locked-in for a period of atleast one-year from the date of purchase by the venture capital or AIF or foreign venture capital investor.

Securities Lent to Stabilising Agent under Green Shoe Option

If the shares held by promoter(s) are lent to the Stabilizing Agent (SA) as prescribed, they should be exempted from the lock-in requirements specified above, for the period starting from the date of such lending and ending on the date on which they are returned to the same lender(s). However, the securities should be locked-in for the remaining period from the date on which they are returned to the lender.

TRANSFERABILITY OF SHARE UNDER LOCKED-IN

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

The securities held by persons other than promoters can be transferred to any other person holding the securities which are locked-in along with the securities proposed to be transferred, subject to the compliance of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. However, the lock-in on such securities shall continue for the remaining period with the transferee and such transferee shall not be eligible to transfer them till the lock-in-period stipulated has expired.

Pledging of Securities

The shares held by the promoters during lock-in-period are allowed to be pledged with any scheduled commercial bank or public financial Institutions as collateral security for loans granted by such scheduled commercial banks or financial Institutions provided that the pledge of shares is one of the terms of sanction of loan.

UNDERWRITING

Underwriting means an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them.

- (1) Where the issuer making a public issue (other than through the book building process) or rights issue, desires to have the issue underwritten, it shall appoint the underwriters in accordance with SEBI (Underwriters) Regulations, 1993.
- (2) Where the issuer makes a public issue through the book building process, such issue shall be underwritten by book runners or syndicate members.

However, atleast 75 % of the net offer to public proposed to be compulsorily allotted to qualified institutional buyers cannot be underwritten.

- (3) The issuer shall enter into underwriting agreement with the book runner, who in turn shall enter into underwriting agreement with syndicate members, indicating therein the number of specified securities which they shall subscribe to at the predetermined price in the event of under subscription in the issue.
- (4) If syndicate members fail to fulfill their underwriting obligations, the lead book runner shall fulfill the underwriting obligations.

- (5) The book runners and syndicate members shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.
- (6) In case of every underwritten issue, the lead merchant banker or the lead book runner shall undertake minimum underwriting obligations as specified in the SEBI (Merchant Bankers) Regulations, 1992.
- (7) Where 100% of the offer through offer document is underwritten, the underwriting obligations shall be for the entire 100% of the offer through offer document and shall not be restricted upto the minimum subscription level.

In respect of an underwritten issue, the lead merchant banker shall ensure that the relevant details of underwriters are included in the offer document as follows:

Underwriting of the issue:

- (a) Names and addresses of the underwriters and the amount underwritten by them
- (b) Declaration by board of directors of the issuer company that the underwriters have sufficient resources to discharge their respective obligations.”

In case of under subscription at an issue, the Lead Merchant Banker responsible for underwriting arrangements shall invoke underwriting obligations and ensure that the underwriters pay the amount of 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 Board.

Minimum Offer to Public [Rule 19(2)(B) Of SC(R) Rules, 1957]

In case of a public issue by an unlisted company, at least 10% or 25% of the post issue capital should be offered to the public and a listed company making public issue should make the net offer of at least 10% or 25% of the issue size to the public.

Manner of Call

The calls in which subscription is proposed to be called should be structured in such a manner that the entire subscription money is called within 12 months from the date of allotment and the subscription money shall be forfeited if the applicant fails to pay the call money within 12 months. Where the issue size exceeds ₹ 500 crores, it is not necessary to call the entire subscription money within 12 months. However the company should make arrangements for monitoring of the use of proceeds of the issue by one of the scheduled commercial banks or by a public financial institutions named in the offer document as bankers to the issuer and copy of the monitoring report must be filed with SEBI by such monitoring agency in the format specified on half yearly basis till the completion of the project for the purpose of record.

Despatch of Issue Material

The lead merchant banker must ensure that for public issues offer documents and other issue materials including forms for ASBA are dispatched to the designated stock exchanges, syndicate members, underwriters, bankers to the issue, investors associations, self certified syndicate banks, etc. in advance as agreed upon. In the case of rights issues also, lead merchant banker must ensure that the abridged letters of offer along with composite application form are dispatched through registered post or speed post to all shareholders at least 3 days before the date of opening of the issue. Where a specific request for letter of offer is received from any shareholder, the lead Merchant Banker shall ensure that the letter of offer is made available to such shareholder.

ISSUE OPENING DATE

Subject to the compliance with Section 26 of the Companies Act, 2013 a public issue may be open within 12 months from the date of issuance of the observation letter by SEBI, if any, or within 3 months of expiry from 31st

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day from the date of filing of draft offer document with SEBI, if no observation letter is issued. However, in case of a fast track issue, the issue must open within the period stipulated in Section 26(1)(a) of the Companies Act, 2013 and rules made thereunder.

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

SUBSCRIPTION LIST

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

MINIMUM NUMBER OF SHARE APPLICATIONS AND APPLICATION MONEY

The minimum application value shall be within the range of ₹ 10,000 to ₹ 15,000. The issuer company, in consultation with the merchant banker, shall stipulate the minimum application size (in terms of number of specified securities) falling within the aforesaid range of minimum application value and make upfront disclosures in this regard, in the offer document.

Thus, the minimum application value shall be with reference to the issue price of the specified securities and not with reference to the amount payable on application.

Assuming an issue is being made at a price of ₹ 900 per equity share. In this case, the issuer in consultation with the lead merchant banker can determine the minimum application lot within the range of 12 – 16 equity shares (in value terms between ₹10,000- ₹15,000), as explained hereunder:

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

Applications can be made in multiples of the minimum size /value so stipulated in the offer document by the issuer and merchant banker within the range of ₹ 5000-7000.

The minimum application moneys to be paid by an applicant along with the application money shall not be less than 25% of the issue price.

In case of an offer for sale, the issue price payable for each specified securities shall be brought in at the time of application.

ISSUE OF ADVERTISEMENTS

Advertisement includes notices, brochures, pamphlets, circulars show cards, catalogues, hoardings, placards, posters, insertion in newspapers, pictures, films, cover pages of offer documents or any other print medium radio, television programmes through any electronic medium.

Pre-issue advertisement

The issuer company shall soon after receiving final observations, if any, on the offer document from SEBI, make an advertisement in an English National daily with wide circulation, one Hindi National newspaper and a regional language newspaper with wide circulation at the place where the registered office of the issuer is situated, in the prescribed format, subject to section 30 of the Companies Act, 2013.

Post-issue Advertisements

The post-issue Lead Merchant Banker is required to ensure that in all issues, advertisement giving details relating to oversubscription, basis of allotment, number, value and percentage of applications, number, value and percentage of successful allottees for all application including ASBA, date of completion of despatch of refund orders or instructions to self certified Syndicate Banks by the Registrar, date of completion of despatch of refund orders or instructions to self certified syndicate banks by the registrar, date of despatch of certificates and date of filing of listing application is released within 10 days from the date of completion of the various activities at least in an English National Daily with wide circulation, one Hindi National Paper and a Regional language daily circulated at the place where registered office of the issuer company is situated. Post-issue Lead Merchant Banker is required to ensure that issuer company/advisors/brokers or any other entity connected with the issue do not publish any advertisement stating that the issue has been oversubscribed or indicating investors' response to the issue, during the period when the public issue is still open for subscription by the public.

Mandatory Collection Centres

The Regulations require a minimum number of collection centres for an issue of capital to be at the four metropolitan centre viz. Mumbai, Delhi, Kolkata and Chennai and at all such centres where the stock exchanges are located in the region in which the registered office of the company is situated. In addition, all designated branches of self certified syndicate banks, as displayed on the websites of such banks and of the Board, shall be deemed to be mandatory collection centres. However the issuer company is free to appoint as many collection centres as it may deem fit in addition to the above minimum requirement.

Minimum Subscription

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

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

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

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

For Non-underwritten issues

(a) If the issuing company does not receive the minimum subscription of ninety per cent. of the offer through offer document on the date of closure of the issue, or if the subscription level falls below ninety per cent. after the closure of issue on account of cheques having being returned unpaid or withdrawal of applications, the issuing company shall forthwith refund the entire subscription amount received.

(b) If the issuing company fails to refund the entire subscription amount within fifteen days from the date of the closure of the issue, it is liable to pay the amount with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay.

For underwritten issues

If the issuing company does not receive the minimum subscription of ninety per cent. of the offer through offer document including devolvement of underwriters within sixty days from the date of closure of the issue, the issuing company shall forthwith refund the entire subscription amount received with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay beyond sixty days.

RESTRICTIONS ON FURTHER ISSUE OF CAPITAL

These Regulations prohibit a company from making any further issue of capital by way of bonus shares, qualified institutions placement, preferential allotment, rights issue or public issue or otherwise, during the period commencing from submission of offer document to SEBI on behalf of the company for public or rights issue till the securities referred to in the said offer document have been listed or application moneys have been refunded on account of non-listing or under subscription etc. if any, unless full disclosures regarding the total capital to be raised from such further issues are made in the draft offer document. However, in case of a fast track issue, no such further issue of capital shall be made during the period between filing of the red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with ROC or the letter of offer with Designated Stock Exchange and listing of the specified securities offered in the issue or refund of application moneys, unless full disclosures regarding the total capital proposed to be so raised are made in the offer document.

PROPORTIONATE ALLOTMENT

The allotment to applicants other than retail individual investor and anchor investor shall be on a proportionate basis within the specified categories rounded off to the nearest integer subject to a minimum allotment being equal to the minimum application size as fixed and disclosed by the issuer.

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

Basis of Allotment

In a public issue of securities, the Executive Director/Managing Director of the Designated Stock Exchange along with the post issue Lead Merchant Banker and the Registrars to the Issue shall be responsible to ensure that the basis of allotment is finalised in a fair and proper manner in accordance with this regulations. However in case of book building portion of a book built public issue, SEBI (ICDR) Regulations, shall be applicable.

The listed company would ensure that all steps for completion of the necessary formalities for listing and commencement of trading at all stock exchanges where the securities are to be listed have been taken within 7 working days of finalisation of basis of allotment.

Coordination with Intermediaries

The Post-issue lead merchant banker shall maintain close co-ordination with the Registrars to the Issue and arrange to depute its officers to the offices of various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from collecting bank branches, and/or self certified syndicate banks processing of the applications including application form for applications supported by blocked amount and other matters till the basis of allotment is finalised, despatch of security certificates and refund orders are completed and securities are listed.

Any act of omission or commission on the part of any of the intermediaries noticed during such visits shall be duly reported to SEBI.

In case there is a development on underwriters, the merchant banker is required to ensure that the notice for development containing the obligation of the issuer is issued within a period of 10 days from the date of closure of the issue.

In case of undersubscribed issues, the merchant bank is required to furnish information in respect of underwriters who have failed to meet their underwriting development to SEBI in the format specified in these regulations.

The post-issue merchant banker is required to confirm to the bankers to the issue by way of copies of listing and trading approval that all formalities in connection with the issue have been completed and that the banker is free to release the money to the issuer or refund it in case of failure of the issue.

RESERVATION ON COMPETITIVE BASIS

Reservation on competitive basis means reservation wherein specified securities are allotted in portion of the number of specified securities applied for in respect of a particular reserved category to the number of specified securities reserved for that category.

According to SEBI (ICDR) Regulations, 2009, there are certain persons eligible for reservation on competitive basis.

(1) In case of an issue made through the book building process, the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of the following categories of persons:

- (a) employees, in case of new issuer, persons who are in the permanent and full time employment of the promoting companies excluding the promoters and an immediate relative of the promoter of such companies.
- (b) shareholders (other than promoters) of:
 - (i) listed promoting companies, in case of a new issuer; and
 - (ii) listed group companies, in case of an existing issuer:

However, if the promoting companies are designated financial institutions or state and central financial institutions, the shareholders of such promoting companies shall not be eligible for the reservation on competitive basis;

- (c) persons who, as on the date of filing the draft offer document with SEBI, are associated with the issuer as depositors, bondholders or subscribers to services of the issuer making an initial public offer. However, the issuer shall not make the reservation to the issue management team, syndicate members, their promoters, directors and employees and for the group or associate companies of the issue management team and syndicate members and their promoters, directors and employees.

(2) In case of an issue made other than through the book building process, the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of the following categories of persons:

- (a) employees and in case of new issuer, persons who are in the permanent and full time employment of the promoting companies excluding the promoters and an immediate relative of the promoter of such companies.
- (b) shareholders (other than promoters) of:
 - (i) listed promoting companies, in case of a new issuer; and
 - (ii) listed group companies, in case of an existing issuer:

However, if the promoting companies are designated financial institutions or state and central financial institutions, the shareholders of such promoting companies shall not be eligible for the reservation on competitive basis;

(3) In case of a further public offer (not being a composite issue), the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of retail individual shareholders of the issuer.

(4) The reservation on competitive basis shall be subject to following conditions:

- (a) the aggregate of reservations for employees shall not exceed 5% of the issue size;
- (b) reservation for shareholders shall not exceed 10% of the issue size;
- (c) reservation for persons who as on the date of filing the draft offer document with SEBI have business association as depositors, bondholders and subscribers to services with the issuer making an initial public offer shall not exceed 5% of the issue size;
- (d) no further application for subscription in the net offer to public category shall be entertained from any person (except an employee and retail individual shareholder) in favour of whom reservation on competitive basis is made;
- (e) any unsubscribed portion in any reserved category may be added to any other reserved category and the unsubscribed portion, if any, after such *inter-se* adjustments among the reserved categories shall be added to the net offer to the public category;
- (f) in case of under-subscription in the net offer to the public category, spill-over to the extent of under-subscription shall be permitted from the reserved category to the net public offer category;
- (g) value of allotment to any employee made shall not exceed two lakh rupees.

(5) In the case of reserved categories, a single applicant in the reserved category may make an application for a number of specified securities which exceeds the reservation.

ALLOCATION IN NET OFFER TO PUBLIC

A person should not make an application in the net offer to public category for that number of specified securities which exceeds the number of specified securities offered to public.

(1) In an issue made through the book building process satisfying the eligibility norms stipulated by SEBI, the allocation in the net offer to public category should be made as follows:

- (a) not less than 35% to retail individual investors;
- (b) not less than 15% to non-institutional investors;
- (c) not more than 50% to qualified institutional buyers, five per cent of which shall be allocated to mutual

funds. However, in addition to five per cent allocation available, mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

In an issue made through the book building process and following the alternative eligibility norms provided by SEBI for public issue, the allocation in the net offer to public category shall be as follows:

- (a) not more than 10 % to retail individual investors;
- (b) not more than 15 % to non-institutional investors;
- (c) not less than 75 % to qualified institutional buyers, 5 % of which shall be allocated to mutual funds. However, in addition to the 5 % allocation available, mutual funds shall also be eligible for allocation under the balance available for qualified institutional buyers.

The issuer may allocate upto 30% of the portion available for allocation to qualified institutional buyers to an anchor investor.

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

- (a) minimum 50% to retail individual investors; and
- (b) remaining to:
 - (i) individual applicants other than retail individual investors; and
 - (ii) other investors including corporate bodies or institutions, irrespective of the number of specified securities applied for;
- (c) the unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in the other category.

For the above purpose if the retail individual investor category is entitled to more than 50% on proportionate basis, the retail individual investors shall be allocated that higher percentage.

Offer Document to be Made Public

The draft offer document filed with SEBI shall be made public for comments, if any, for a period of 21 days from the date of filing the offer document with SEBI by hosting it on the websites of the SEBI, recognized stock exchanges where specified securities are proposed to be listed and merchant bankers associated with the issue.

After a period of 21 days from the date the draft offer document was made public, the Lead Merchant Bankers shall file with SEBI a statement giving information of the comments received by them or issuer during that period and the consequential changes, if any, to be made in the draft offer document.

Due Diligence

A merchant banker holding a valid certificate of registration is required to be appointed to manage the issue. A Memorandum of Understanding (MOU) is required to be entered into between lead merchant bankers and the issuer company specifying their mutual rights, liabilities and obligations relating to the issue.

MOUs should not contain any clauses contrary to the provision of the Companies Act, 1956 and SEBI (Merchant Bankers) Rules and Regulations, 1992 so as to diminish the liabilities and obligations of the lead merchant banker or the issuer company. Lead manager is required to exercise due diligence. The standard of due diligence shall be such that merchant banker shall satisfy himself about all aspects of offering, veracity and adequacy of disclosure in offer document. Lead manager who is responsible for preparation of the offer documents is required to submit to SEBI draft prospectus complete in all respects alongwith the Due Diligence Certificate, *Inter se*

allocation of Responsibilities Certificate and a copy of Memorandum of Understanding and the requisite fee in accordance with SEBI (Merchant Bankers) Rules and Regulations, 1992.

In addition to the due diligence certificate to be furnished alongwith the draft prospectus, lead managers are also required to –

- (i) Certify that all the amendments suggested/observations made by SEBI have been given effect to in the prospectus,
- (ii) Furnish a fresh due diligence certificate at the time of filing the prospectus with the Registrar of Companies,
- (iii) Furnish a fresh certificate immediately before the opening of the issue that no corrective action is needed, and
- (iv) Furnish a fresh and final compliance certificate before the issue is closed for subscription.

Allotment of Securities

The company agrees that as far as possible allotment of securities offered to the public shall be made within 15 days of the closure of public issue. The company further agrees that it shall pay interest @15% per annum if the allotment letters/ refund orders have not been despatched to the applicants or if, in a case where the refund or portion thereof is made in electronic manner, the refund instructions have not been given to the clearing system in the disclosed manner within 15 days from the date of the closure of the issue. In case of book-built issue the refund instruction have not been given to the clearing system in the disclosed manner within 15 days from the date of the closure of the issue. However, applications received after the closure of issue in fulfillment of underwriting obligations to meet the minimum subscription requirement, shall not be entitled for the said interest.

Despatch of Letter of Allotment and Share Certificates

The Company shall take such steps as are necessary to ensure the completion of allotment and despatch of letters of allotment and refund orders to the applicants including NRIs soon after the basis of allotment has been approved by the stock exchanges and in any case not later than the statutory time limit and in the event of failure to do so pay interest to the applicants as provided under the Companies Act, 2013 and the rules made thereunder.

Compliance Officer

Every company making a public issue is required to appoint a compliance officer and intimate the name of the compliance officer to SEBI. Compliance Officer shall directly liaise with SEBI with regard to compliance with various laws, rules regulations, and other directives issued by SEBI and investor complaints related matters. He is also required to co-ordinate with regulatory authorities in various matters and provide necessary guidance so as to ensure compliance internally and ensure that observations made/deficiency pointed out by SEBI do not recur. In terms of Clause 47 of the listing Agreement of Stock Exchanges, Compliance Officer shall be Company Secretary of the Company, who shall be responsible for ensuring the correctness, authenticity and comprehensiveness of the information, statements, reports etc. filled under corporate filing and dissemination system as specified in the listing agreement.

Redressal of Investors Grievances

These Regulations make it necessary for companies to assign high priority to investor grievances and ensure that all preventive steps have been taken to minimise the number of complaints. Proper grievance monitoring and redressal system should be set in consultation with the lead merchant banker and Registrar to an issue and necessary measures to resolve the grievances quickly and lead merchant banker should closely associate with the post issue refund and allotment activities and regularly monitor investor grievances arising therefrom.

The offer documents shall necessarily disclose the arrangements or any mechanism evolved by the company for redressal of investor grievances.

1. The company shall disclose the time normally taken by it for disposal of various types of investor grievances.
2. Similar disclosure shall be made in regard to the listed companies under the same management for the period of 3 years prior to the date of filing of the offer documents with ROC/Stock Exchange.

Powers of SEBI

Chapter XI of SEBI ICDR Regulations empowers SEBI to issue directions to the persons concerned, the stock exchanges and the intermediaries.

In case of the violation of these regulations, SEBI has been empowered to direct the persons concerned to refund any money collected under an issue to the investors with or without requisite interest as the case may be and not to access the capital market for a particular period. In respect of violations by stock exchanges, SEBI can direct the exchange concerned not to list or permit trading in the securities and to forfeit the security deposit by the issuer company. In case of violations by intermediaries, SEBI may suspend or cancel the certificate of registration of any intermediary who fails to exercise due diligence or fails to comply with the obligations entrusted under the guidelines or who is alleged to have updated any of these guidelines. SEBI is under an obligation to follow the specified procedures provided under the regulations dealing with such intermediaries.

Disclaimer Clause of SEBI

SEBI notified the format of issue advertisement in Schedule XIII of SEBI (ICDR) Regulations. This provide for inclusion of SEBI Disclaimer Clause which reads as under:

“Disclaimer Clause of SEBI – SEBI only gives its observations on the offer documents and this does not constitute approval of either the issue or the offer document.”

BOOK BUILDING

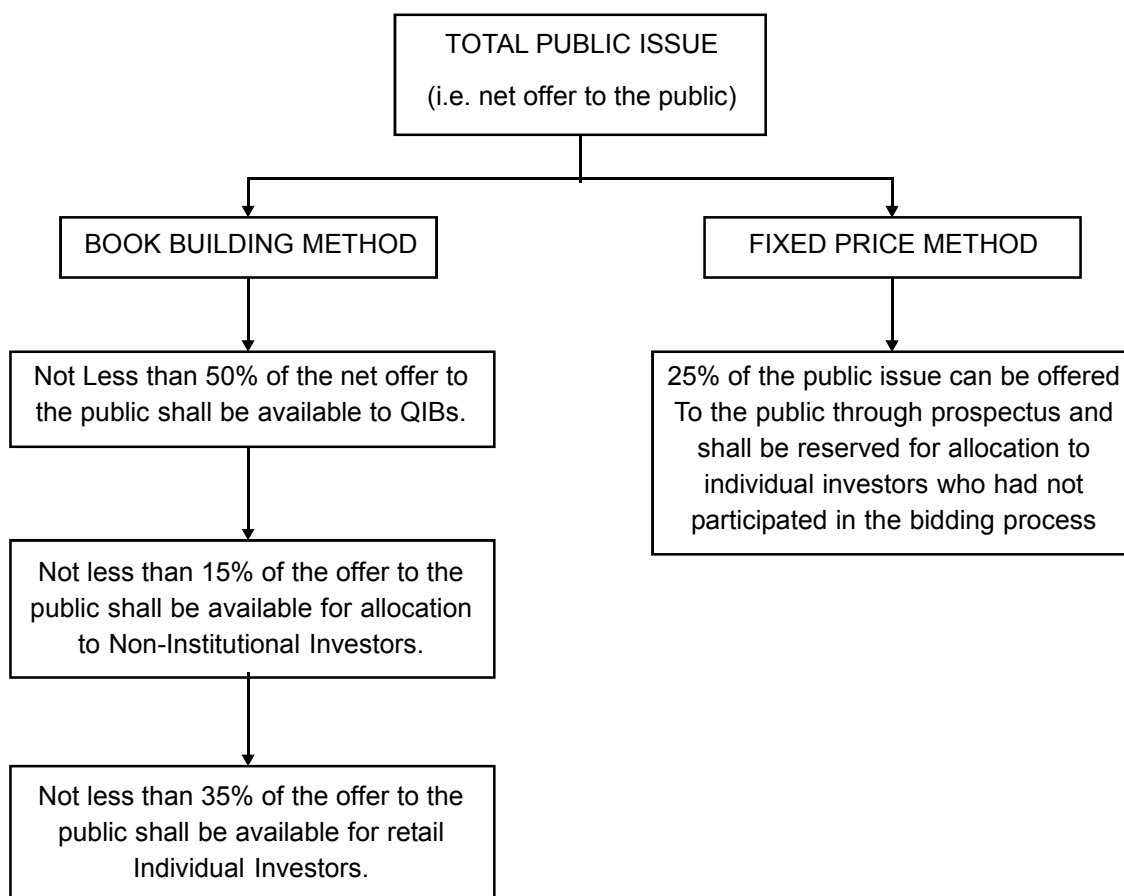
Book Building means a process undertaken to elicit demand and to assess the price for determination of the quantum or value of specified securities or Indian Depository Receipts, as the case may be.

The book building process in India is very transparent. All investors including small investors can see on an hourly basis where the book is being built before applying. According to this method, share prices are determines on the basis of real demand for the shares at various price levels in the market.

DIFFERENCE BETWEEN FIXED PRICE PROCESS AND BOOK BUILDING PROCESS

<i>Features</i>	<i>Fixed Price process</i>	<i>Book Building process</i>
Pricing	Price at which the securities are offered /allotted is known in advance to the investor.	Price at which securities will be offered/allotted is not known in advance to the investor. Only an indicative price range is known.
Demand	Demand for the securities offered is known only after the closure of the issue.	Demand for the securities offered can be known everyday as the book is built.
Payment	Payment if made at the time of subscription wherein refund is given after allocation.	Payment only after allocation

OFFER TO PUBLIC THROUGH BOOK BUILDING PROCESS



1. An issuer company may, subject to the requirements specified make an issue of securities to the public through a prospectus through 100% of the net offer to the public through book building process.
2. Reservation to the extent of percentage specified in these Regulations can be made only to the following categories
 - (a) 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 banks shall accept and upload the details of such application in electronic bidding system of the stock exchange.
7. The brokers, and self certified syndicate banks accepting applications and application monies, are considered as ‘bidding/collection centres’. The broker/s so appointed, shall collect the money from his/their client for every order placed by him/them and in case the client/investors fails to pay for shares allocated as per the Guidelines, the broker shall pay such amount.
8. In case of Applications Supported by Blocked Amount (ASBA), the Self Certified Syndicate Banks shall follow the procedure specified by SEBI in this regard. The company shall pay to the broker/s/Self Certified Syndicate Banks a commission/fee for the services rendered by him/them. The exchange shall ensure that the broker does not levy a service fee on his clients/investors in lieu of his services.

The draft prospectus containing all the disclosures except that of price and the number of securities to be offered to the public shall be filed by the Lead Merchant Banker with SEBI. The total size of the issue shall be mentioned in the draft prospectus.

9. The red herring prospectus shall disclose, either the floor price of the securities offered through it or a price band along with the range within which the price can move, if any.

However, the issuer may not disclose the floor price or price band in the red herring prospectus if the same is disclosed in case of an initial public offer, at least two working days before the opening of the bid and in case of a further public offer, at least one working day before the opening of the bid, by way of an announcement in all the newspapers in which the pre-issue advertisement was released by the issuer or the merchant banker;

Further, the announcement shall contain the relevant financial ratios, computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the offer document.

Where the issuer opts not to make the disclosure of the price band or floor price in the red-herring prospectus in terms of the foregoing proviso, the following shall be additionally disclosed in the red-herring prospectus:

- (a) a statement that the floor price or price band, as the case may be, shall be disclosed at least two working days (in case of an initial public offer) and at least one working day (in case of a further public offer) before the opening of the bid;
- (b) a statement that the investors may be guided in the meantime by the secondary market prices in case of public offer;
- (c) names and editions of the newspapers where the announcement of the floor price or price band would be made;
- (d) names of websites (with address), journals or other media in which the said announcement will be made.

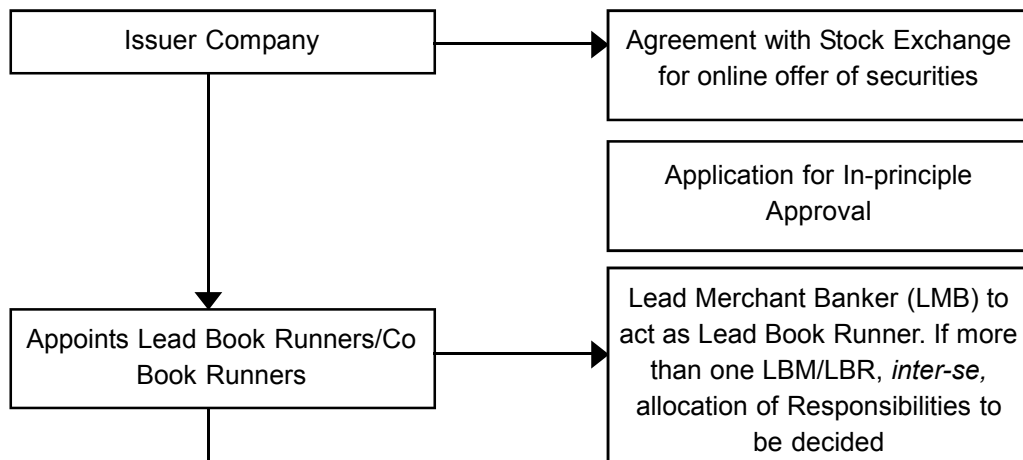
Where the issuer decides to opt for price band instead of floor price, the lead book runner shall ensure compliance with the following conditions:

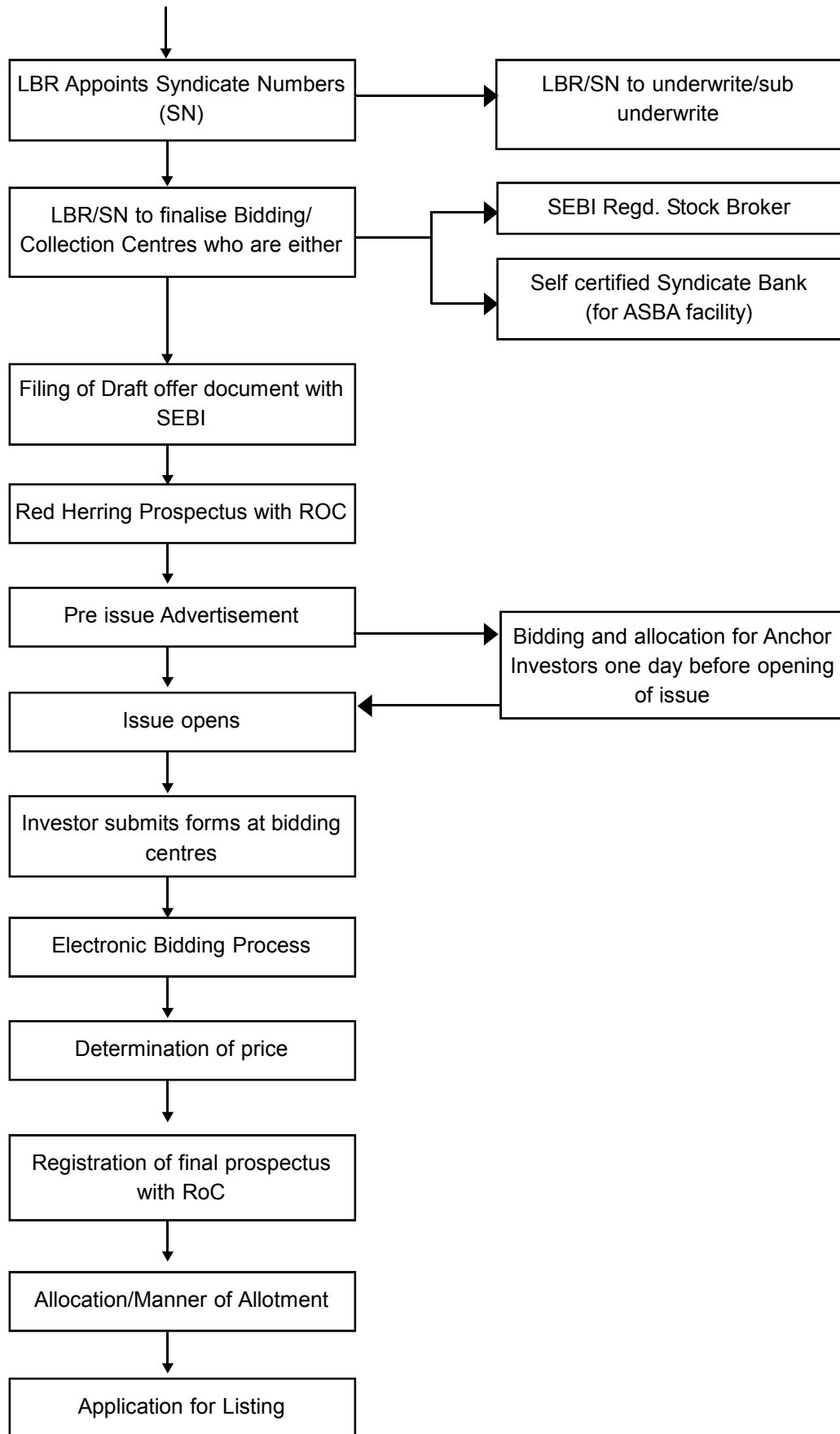
- (a) The cap of the price band should not be more than 20% of the floor of the band; i.e., cap of the price band shall be less than or equal to 120% of the floor of the price band.
- (b) The price band can be revised during the bidding period in which case the maximum revision on either side shall not exceed 20% i.e floor of price band can move up or down to the extent of 20% of floor of the price band disclosed in the red herring prospectus and the cap of the revised price band will be fixed in accordance with Clause (a) above;
- (c) Any revision in the price band shall be widely disseminated by informing the stock exchanges, by issuing press release and also indicating the change on the relevant website and the terminals of the syndicate members.
- (d) In case the price band is revised, the bidding period shall be extended for a further period of three days, subject to the total bidding period not exceeding ten working days.
- (e) The manner in which the shortfall, if any, in the project financing, arising on account of lowering of price band to the extent of 20% will be met shall be disclosed in the red herring prospectus. It shall also be disclosed that the allotment shall not be made unless the financing is tied up.

10. In case of appointment of more than one Lead Merchant Banker or Book Runner for book building, the rights, obligations and responsibilities of each should be delineated. In case of an under subscription in an issue, the shortfall shall have to be made good by the Book Runner(s) to the issue and the same shall be incorporated in the *inter se* allocation of responsibility as provided in the 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 these Guidelines 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.

BOOK BUILDING PROCESS THROUGH A FLOWCHART





ADDITIONAL DISCLOSURES IN CASE OF BOOK BUILDING

Apart from meeting the disclosure requirements as specified in these 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.

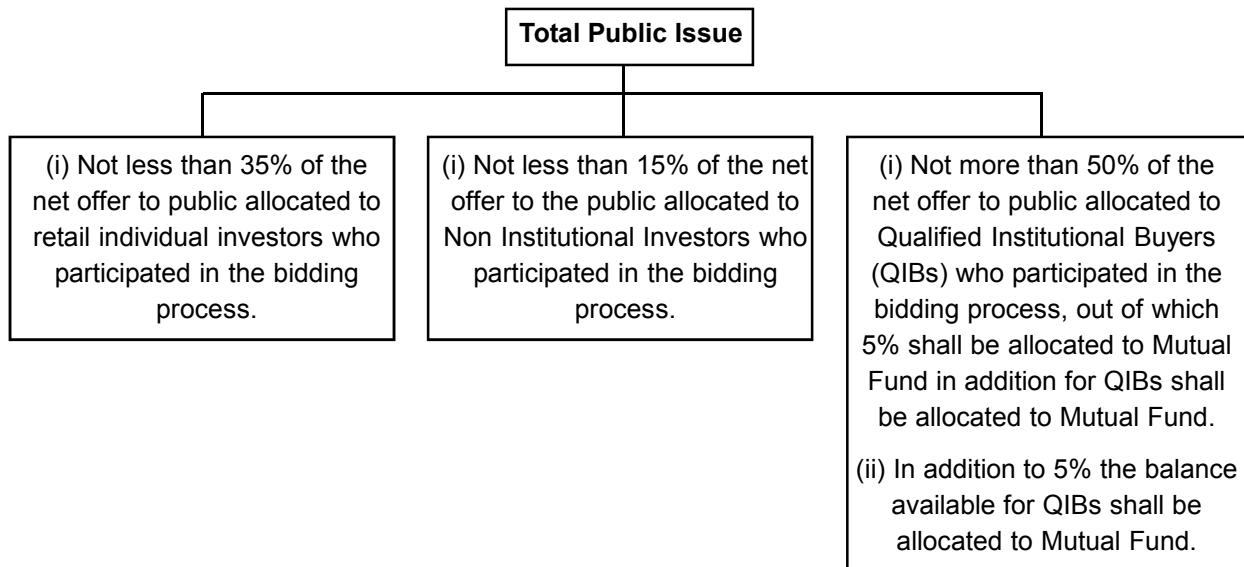
MAINTENANCE OF BOOKS AND RECORDS

A final book of demand showing the result of the allocation process shall be maintained by the book runner/s. The Book Runner/s and other intermediaries in the book building process associated shall maintain records of the book building prices. SEBI has the right to inspect the records, books and documents relating to the Book building process and such person shall extend full cooperation.

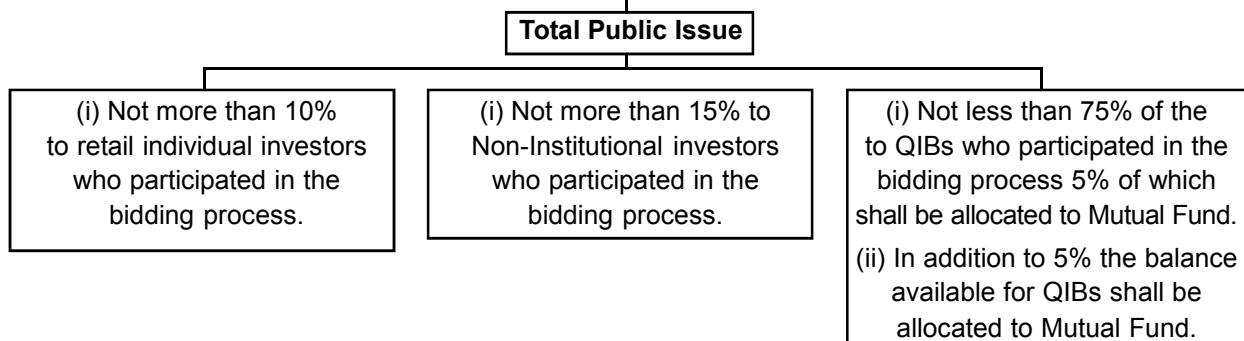
All references mentioned above with respect to draft prospectus shall be construed as having been made to 'red herring prospectus' in application to fast track issues.

ALLOCATION/ALLOTMENT PROCEDURE

100% of the Net offer to the public through 100% book building process



In case of Alternative Eligibility Norms



ANCHOR INVESTORS

“Anchor investor” means a qualified institutional buyer who makes an application for a value of ten crore rupees or more in a public issue made through the book building process in accordance with these regulations:

- (a) Allocation to Anchor Investors shall be on a discretionary basis and subject to the following:
 - (i) Maximum of 2 such investors shall be permitted for allocation upto ₹ 10 crore;
 - (ii) Minimum of 2 and maximum of 15 such investors shall be permitted for allocation above Rs, 10 crore and upto ₹ 250 crore, subject to minimum allotment of ₹ 5 crore per such investor;

- (iii) Minimum of 5 and maximum of 25 such investors shall be permitted for allocation above ₹ 250 crore, subject to minimum allotment of ₹ 5 crore per such investor.
- (b) Upto thirty per cent of the portion available for allocation to qualified institutional buyers shall be available to anchor investor(s) for allocation/ allotment.
- (c) One-third of the anchor investor portion shall be reserved for domestic mutual funds.
- (d) The bidding for Anchor Investors shall open one day before the issue opening date.
- (e) Anchor Investors shall pay on application the same margin which is payable by other categories of investors, the balance to be paid within two days of the date of closure of the issue.
- (f) Allocation to Anchor Investors shall be completed on the day of bidding by Anchor Investors.
- (g) If the price fixed as a result of book building is higher than the price at which the allocation is made to Anchor Investor, the Anchor Investor shall bring in the additional amount. However, if the price fixed as a result of book building is lower than the price at which the allocation is made to Anchor Investor, the excess amount shall not be refunded to the Anchor Investor and the Anchor Investor shall take allotment at the price at which allocation was made to it.
- (h) The number of shares allocated to Anchor Investors and the price at which the allocation is made, shall be made available in public domain by the merchant banker before opening of the issue.
- (i) There shall be a lock-in of 30 days on the shares allotted to the Anchor Investor from the date of allotment in the public issue.
- (j) Neither the merchant bankers nor any person related to the promoter/ promoter group/merchant bankers in the concerned public issue can apply under Anchor Investor category. The parameters for selection of Anchor Investor shall be clearly identified by the merchant banker and shall be available as part of records of the merchant banker for inspection by SEBI.
- (k) The applications made by qualified institutional buyers under the Anchor Investor category and under the Non Anchor Investor category may not be considered as multiple applications.

APPLICATION SUPPORTED BY BLOCK AMOUNT

In its continuing endeavour to make the existing public issue process more efficient, SEBI has introduced a supplementary process of applying in public issues, viz., the “Applications Supported by Blocked Amount (ASBA)” process.

The ASBA process is available in all public issues made through the book building route. It shall co-exist with the current process, wherein cheque is used as a mode of payment.

ASBA is an application for subscribing to an issue, containing an authorization to block the application money in a bank account. The main features of ASBA process are as follows:

Self Certified Syndicate Bank

Self Certified Syndicate Bank (SCSB) is a bank which offers the facility of applying through the ASBA process. A bank desirous of offering ASBA facility shall submit a certificate to SEBI as per the prescribed format for inclusion of its name in SEBI's list of SCSBs.

A SCSB shall identify its Designated Branches (DBs) at which an ASBA investor shall submit ASBA and shall also identify the Controlling Branch (CB) which shall act as a coordinating branch for the Registrar of the issue, Stock Exchanges and Merchant Bankers. The SCSB, its DBs and CB shall continue to act as such, for all issues to which ASBA process is applicable. The SCSB may identify new DBs for the purpose of ASBA process and intimate details of the same to SEBI, after which SEBI will add the DB to the list of SCSBs maintained by it. The

SCSB shall communicate the following details to Stock Exchanges for making it available on their respective websites; these details shall also be made available by the SCSB on its website:

- (i) Name and address of all the SCSB.
- (ii) Addresses of DBs and CB and other details such as telephone number, fax number and email ids.
- (iii) Name and contacts details of a nodal officer at a senior level from the CB.

Eligibility of Investors

An Investor is eligible to apply through ASBA process, if he/she:

- (i) is a “Resident Retail Individual Investor”;
- (ii) is bidding at cut-off, with single option as to the number of shares bid for;
- (iii) is applying through blocking of funds in a bank account with the SCSB;
- (iv) has agreed not to revise his/her bid;
- (v) is not bidding under any of the reserved categories.

ASBA Process

An ASBA investor submits an ASBA physically or electronically through the internet banking facility, to the SCSB with whom the bank account to be blocked, is maintained. The SCSB then blocks the application money in the bank account specified in the ASBA, on the basis of an authorization to this effect given by the account holder in the ASBA. The application money remains blocked in the bank account till finalisation of the basis of allotment in the issue or till withdrawal/failure of the issue or till withdrawal/rejection of the application, as the case may be. The application data shall thereafter be uploaded by the SCSB in the electronic bidding system through a web enabled interface provided by the Stock Exchanges. Once the basis of allotment is finalized, the Registrar to the Issue sends an appropriate request to the SCSB for unblocking the relevant bank accounts and for transferring the requisite amount to the issuer’s account. In case of withdrawal/failure of the issue, the amount shall be unblocked by the SCSB on receipt of information from the pre-issue merchant bankers.

Obligations of the Issuer

The issuer shall ensure that adequate arrangements are made by the Registrar to the Issue to obtain information about all ASBAs and to treat these applications similar to non-ASBA applications while finalizing the basis of allotment, as per the procedure specified in the Guidelines.

Applicability of ASBA process

ASBA process is applicable to all book-built public issues which provide for not more than one payment option to the retail individual investors.

GREEN SHOE OPTION FACILITY

“Green Shoe Option” means an option of allocating shares in excess of the shares included in the public issue and operating a post-listing price stabilizing mechanism in accordance with the provisions of Regulation 45 of SEBI (ICDR) Regulations, 2009.

GSO in the system of IPO using book-building method was recognised by SEBI in India through its new guidelines on 14th August 2003 (vide SEBI/ CFD/DIL/DIP/ Circular No. 11). ICICI bank has used Green Shoe Option first time 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.

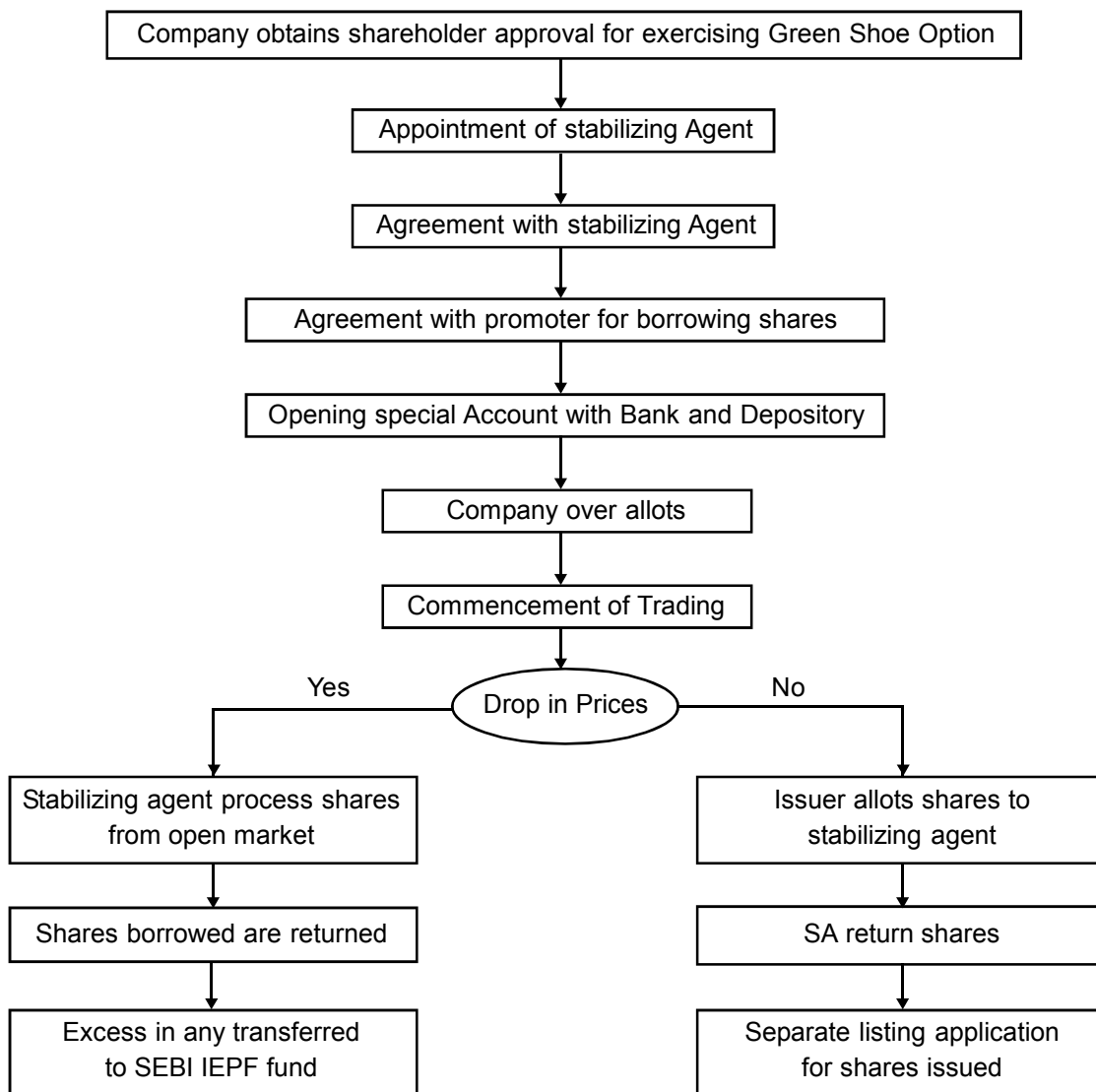
The shares bought from the market by the SA, if any during the stabilisation period, should be credited to the GSO Demat Account.

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.

GREEN SHOE OPTION PROCESS



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.

PROCEDURE FOR ISSUE OF SECURITIES

In the light of the provisions of the Companies Act and the guidelines issued by Government/SEBI under the Securities Contract (Regulations) Rules, 1956 and SEBI Act, 1992, the procedure for issue of securities to be followed by companies is given below. This procedure should be read along with the relevant SEBI regulations and provisions of the other Acts.

I. Issue of Shares to the Public

A company proposing to raise resources by a public issue should first select the type of securities i.e. shares and/or debentures to be issued by it. In case the company has applied for financial assistance to any of the financial/investment institutions, the requirement of the funds to be raised from the public is to be decided in consultation with the said institution while appraising the project of the company. The decision regarding the issue of shares to be made at par or premium should be taken. The various steps involved in public issue of shares are enumerated below:

1. Compliance with SEBI Regulations

Before making any issue of capital, it is to be ensured that the proposed issue complies with the eligibility norms and other provisions of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

2. Holding of general meeting

A general meeting of the shareholders (annual or extraordinary) is to be convened for obtaining their consent to

the proposed issue of shares if the articles so require. In case the proposed issue requires any increase in authorised share capital (Section 61, 62, 64), alteration in capital clause of the Memorandum of Association (Section 13), alteration of the articles of association (Section 14) etc. the approvals for the same should also be obtained at the General Meeting.

3. Intimation to Stock Exchange

A copy of the Memorandum and Articles of Association of the company is to be sent to the Stock Exchanges where the shares are to be enlisted, for approval.

4. Appointment of managers to the issue

Company issuing shares is to appoint one or more Merchant Bankers to act as managers to the public issue. The company should enter into a memorandum of understanding with the managers to the issue and decide the fees payable to them. Lead Managers are free to negotiate with the Managements their fee for handling the issue. If more than one Merchant Bankers are associated with the issue, the *inter-se* allocation of responsibility of each of them, shall be disclosed in the offer document.

5. Appointment of various other agencies

The company should in consultation with the Managers to the issue, decide upon the appointment of the following other agencies:

(a) Registrars to the Issue; (b) Collecting bankers to the Issue; (c) Advisors to the Issue; (d) Underwriters to the Issue; (e) Brokers to the Issue; (f) Printers; (g) Advertising Agents, Self Certified Syndicate Banks, etc.

These agencies should be registered with SEBI wherever Registration is a condition for handling work by any of these agencies.

Consent of the aforesaid persons should be obtained in writing for acting in their respective capacities for filing, with the Registrar of Companies alongwith the prospectus.

6. Drafting of prospectus

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

7. Approval of prospectus

The draft offer document alongwith the application form for issue of shares should be got approved by the solicitors/legal advisors of the company to ensure that it contains all disclosures and information as required by various statutes, rules, notifications, etc. The managers to the issue should also verify and approve the draft prospectus. The financial institutions providing loan facilities generally stipulate that the prospectus should be got approved by them. The company should in such a case, forward a copy of the draft prospectus for their verification and approval as well. The approval of underwriters should also be taken if they so require.

A copy of the draft offer document is also to be forwarded to the Registrar of Companies for its scrutiny and approval.

Merchant Bankers, acting as the Lead Manager to ensure that an offer document contain the disclosure requirements as specified by SEBI from time to time for the issue of securities. Also to ensure that an offer document provides a true, correct and fair view of the state of affairs of the company which are adequate for the investors to arrive at a well informed investment decision. The Merchant Bankers are required to submit the draft of the offer document along with Due Diligence Certificate to SEBI in the form specified within six weeks before the issue is scheduled to open for subscription. Further, they are held responsible for ensuring the compliance

with SEBI Rules, Regulations, Guidelines and requirements for other laws, for the time being in force. A check list containing aspects related to prospectus is given as under.

1. Check that a merchant banker holding a valid certificate of registration has been appointed to manage the issue and the lead merchant banker exercises the due diligence to satisfy himself about all the aspects of offering, veracity and adequacy of disclosures in the offer documents.
2. Check that a Memorandum of Understanding (MOU) has been entered into between lead merchant bankers and the issuer company specifying their mutual rights, liabilities and obligations relating to the issues.
3. Check that MOU does not contain any clause contrary to the provisions of the Companies Act, 2013 and SEBI (Merchant Bankers) Rules and Regulations, 1992 so as to diminish the liabilities and obligations of the lead merchant banker and issuer company.
4. Check that a draft offer document complete in all respects alongwith the Due Diligence Certificate, *inter-se* allocation of Responsibilities Certificate and a copy of Memorandum of Understanding and the requisite fee in accordance with SEBI (Merchant Bankers) Rules and Regulation, 1992 has been submitted to SEBI at least 30 days prior to the filing of prospectus with Registrar of Companies.
5. Check that the draft of offer document involving amount upto ₹ 50 crores has been referred to concerned regional offices of SEBI under the jurisdiction of which registered office of issuer company falls.
6. Check that a copy of the draft offer document has been filed simultaneously with all the Stock Exchanges where listing is sought for clearance and in principle approval of stock exchange for listing of securities has been obtained and furnished to SEBI within 30 days of filing of the draft offer document with the stock exchanges.
7. Check that the lead manager has handed over not less than 10 copies of the draft offer document to dealing offices of SEBI, 3 copies to Primary Market Department, SEBI Head Office and 25 copies to the Stock Exchange(s) where the issue is proposed to be listed.

Ensure that the lead merchant banker has also submitted the draft offer document on a computer floppy to the dealing officer of SEBI and Primary Market Department, SEBI Head Office. Also ensure that in case of issues made through book building process, the merchant banker has submitted a printed as well as soft copy of the offer document incorporating the Board's observations and also a bid cum application form to the Primary Market Department, SEBI head office atleast five days before opening of bidding.

8. Check that draft offer document filed with SEBI has been made public for a period of 21 days from the date of filing the offer document with SEBI. The lead managers/stock exchanges can charge an appropriate sum to the person requesting copy(ies) of draft prospects.
9. Check that after a period of 21 days from the date, draft offer document was made public, the lead manager has filed with SEBI a statement:
 - (a) giving a list of complaints received by it,
 - (b) a statement by it whether it is proposed to amend the draft prospectus or not, and
 - (c) highlighting the amendments.
10. Check that the lead merchant bankers have furnished to SEBI, a due diligence certificate alongwith draft offer document and has –
 - (a) Issued a certificate to SEBI that all the amendments suggested/ observations made by SEBI have been given effect to in the offer documents.

- (b) Furnished a 'fresh due diligence' certificate to SEBI at the time of filing of prospectus with the Registrar of Companies as per format specified.
 - (c) Furnished a fresh certificate immediately before the opening of the issue that no corrective action is needed.
 - (d) Furnished a fresh certificate after the issue has opened but before the issue is closed for subscription.
11. Check that the particulars as per audited statements contained in the offer document are not more than six months old from the issue opening date.
 12. However, in case of a Government company auditors' report in the offer document shall not be more than six months from the date of filing the offer document with the ROC or stock exchanges as the case may be.
 13. SEBI may within 30 days from the date of submission of draft offer document specify changes. Check that the changes specified by SEBI are duly considered by the merchant bankers before filing of the offer document with ROC.
 14. Check that the offer document or letter of offer has been filed with ROC or stock exchanges.
 15. Check that the two copies of final printed copy of the final offer document have been sent to dealing offices of SEBI at least within three days of filing offer document with Registrar of Companies/Stock Exchange as the case may be.
 16. Check that lead merchant banker has also submitted one final printed copy of the final offer document alongwith the computer floppy containing the final prospectus/letter of offer to SEBI.
 17. Check that the public issue offer documents and other issue material has been despatched to the various stock exchanges, brokers, underwriters, bankers/self certified syndicate banks to the issue etc. in advance as agreed upon.
 18. Check that 20 copies of the prospectus and application form has been despatched in advance of the issue opening date to various Investor Associations.
 19. Check that the following details about themselves certified as correct have been included by the lead merchant bankers in all the forwarding letters of offer document filed with any Department/office of SEBI.
 - (i) Registration number
 - (ii) Date of Registration/Renewal of Registration
 - (iii) Date of expiry of registration
 - (iv) If applied for renewal, date of application
 - (v) Any communication from the Board prohibiting from acting as a merchant banker
 - (vi) Any inquiry/investigation being conducted SEBI.
 20. Also ensure that in the forwarding letters, the following details about the issuer company have been included while filing offer documents for public/ rights issue/buy-back/takeovers:
 - (i) Whether any promoter/director/group/associate company/entity of the issuer company and/or any company/entity with which any of the above is associated as promoter/director/partner/proprietor, is/was engaged in securities related business and registered with SEBI.
 - (ii) If any one or more of these persons/entities are/were registered with SEBI, their respective registration numbers.

- (iii) If registration has expired, reasons for non-renewal.
- (iv) Details of any enquiry/investigation conducted by SEBI at any time.
- (v) Penalties imposed by SEBI which includes deficiency/warning letter, adjudication proceedings, suspension/cancellation/prohibitory order.
- (vi) Outstanding fees payable to SEBI by these entities, if any.

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

After the concerned parties/agencies have approved the draft prospectus and the application form, the board of directors of the company should approve the final draft before filing with the Registrar of Companies. The company should, therefore, hold the meeting of the board of directors to transact the following business:

- (a) to approve and accept consent letters received from various parties agencies to act in their respective capacities;
- (b) to approve and accept appointment of underwriters, brokers bankers to the issue registrar to the issue, solicitors and advocates to the issue, etc.
- (c) to accept the Auditors' Report for inclusion in the prospectus;
- (d) to approve the date of opening of subscription list as also earliest and latest dates for closing of subscription list with the authority in favour of any director for earlier closing if necessary.
- (e) to approve draft prospectus/draft abridged prospectus and the draft share application form.
- (f) to authorise filing of the prospectus signed by all the directors or their constituted attorneys with the Registrar of Companies.
- (g) to authorise any officer of the company to deliver the prospectus for registration with the Registrar of Companies and to carry out the corrections, if any, at the office of the Registrar of Companies.
- (h) to approve the format of the statutory announcement.

9. Making application to Stock Exchange(s) for permission to listing

Before filing prospectus with the Registrar of Companies the company should submit an application(s) to the Stock Exchange(s) for enlistment of securities offered to the public by the said issue [Section 40(1) of the Companies Act, 2013]. The fact that an application(s) has/have been made to the Stock Exchange(s) must be stated in the prospectus.

10. Printing and distribution of prospectus and application forms

After receipt of the intimation from Registrar of Companies regarding registration of prospectus, the company should take steps to issue the prospectus within 90 days of its registration with ROC. For the purpose, the first step is to get adequate number of prospectuses and application forms printed. The provisions of Section 33 of the Companies Act, 2013 should be kept in view in this regard which provide that no one shall issue any form of application for shares in or debenture of a company unless the form is accompanied by a memorandum containing such salient features of a prospectus as may be prescribed.

At least 2 weeks before the announcement is made in any newspaper, journal etc. requisite number of copies of the prospectus and application forms accompanied by the abridged prospectus should be distributed to the brokers, underwriters, merchant bankers, lead managers, bankers etc. to the issue.

11. Pricing**12. Promoters contribution and lock-in-period****13. Underwriting****14. Mandatory Collection Centres****15. Certificate relating to promoters' contribution**

SEBI Regulations require that atleast one day prior to the date of opening of the issue, a certificate from the Chartered Accountant to the effect that the promoters' contribution in its entirety has been brought in advance before the public issue opens should be forwarded to it. The certificate should be accompanied by a list of names and addresses of friends, relatives and associates who have contributed to the promoters' quota, along with the amount of subscription made by each of them.

16. Coordination with the bankers to the issue

The date of opening and closing of the subscription list should be intimated to all the collecting and controlling branches of the bank with whom the company has entered into an agreement for the collection of application forms. Further, the company should ensure that a separate bank account is opened for the purpose of collecting the proceeds of the issues as required by Section 40(3) of the Companies Act, 2013 and furnish to the controlling branches the resolution passed by the Board of directors for opening bank account.

17. Minimum subscription**18. Allotment of shares**

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

19. Refund orders

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

RIGHTS ISSUE

Rights issue as identified in the SEBI 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 the Board, through a Merchant Banker, at least 30 days prior to the filing of the letter of offer with the Designated Stock Exchange (DSE).

However, in case of the rights issue where the aggregate value of the securities offered is less than ₹ 50 Lakhs, the company shall prepare the letter of offer in accordance with the disclosure requirements specified in these regulation 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 can not make an issue of security through a public or rights issue unless a Memorandum of Understanding has been entered into between a lead merchant banker and the issuer company specifying their mutual rights, liabilities and obligations relating to the issue.
- In case a rights issue is managed by more than one Merchant Banker the rights, obligations and responsibilities of each merchant banker shall be demarcated as specified in Chapter VI.
- In the case of rights issues, lead merchant banker shall ensure that the abridged letters of offer are dispatched to all shareholders at least three days before the date of opening of the issue.

However, if a specific request for letter of offer is received from any shareholder, the Lead Merchant Banker shall ensure that the letter of offer is made available to such shareholder.

- A disclosure to the effect that the securities offered through this rights issue shall be made fully paid up or may be forfeited within 12 months from the date of allotment of securities in the manner specified in these Regulations.
- A company can not make any further issue of capital during the period commencing from the submission of offer document to SEBI on behalf of the company for rights issues, till the securities referred to in the said offer document have been listed or application moneys refunded on account of non-listing or under subscription etc. unless full disclosures regarding the total capital to be raised from such further issues are made in the draft offer document.
- A Company can not 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 subscribers 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 SHARES

A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares. The issue of bonus shares by a company is a common feature. When a company is prosperous and accumulates large distributable profits, it converts these accumulated profits into capital and divides the capital among the existing members in proportion to their entitlements. Members do not have to pay any amount for such shares. They are given free. The bonus shares allotted to the members do not represent taxable income in their hands. [*Commissioner of Income Tax, Madras v. A.A.V. Ramchandra Chettiar* (1964) 1 Mad CJ 281]. Issue of bonus shares is a bare machinery for capitalizing undistributed profits. The vesting of the rights in the bonus shares takes place when the shares are actually allotted and not from any earlier date.

ADVANTAGES OF ISSUING BONUS SHARES

- 1. Fund flow is not affected adversely.
- 2. Market value of the Company's shares comes down to their nominal value by issue of bonus shares.
- 3. Market value of the members' shareholdings increases with the increase in number of shares in the company.
- 4. Bonus shares is not an income. Hence it is not a taxable income.
- 5. Paid-up share capital increases with the issue of bonus shares.

Pursuant to the provisions of Section 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, 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. Schedule I 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 IN ISSUE OF BONUS SHARES

A company issuing bonus shares should ensure that the issue is in conformity with the Regulations for bonus issue laid down by SEBI (ICDR) Regulations, 2009.

The procedure for issue of bonus shares by a listed company is enumerated below:

1. Ensure that if conversion of FCDs/PCDs is pending, similar benefit has been extended to the holders of such FCDs/PCDs, through reservation of shares in proportion of such convertible part of FCDs/PCDs. The shares so reserved may be issued at the time of conversion(s) of such debentures on the same terms on which the bonus issue was made.
2. Ensure that bonus issue has been made out of free reserves built out of the genuine profits or securities premium collected in cash only.
3. Ensure that reserves created by revaluation of fixed assets are not capitalised.
4. Ensure that the company has not defaulted in payment of interest or principal in respect of fixed deposits

or debt securities issued by it or in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.

5. Ensure that the bonus issue is not made in lieu of dividend.
6. There should be a provision in the articles of association of the company permitting issue of bonus shares; if not, steps should be taken to alter the articles suitably.
7. The share capital as increased by the proposed bonus issue should be well within the authorised capital of the company; if not, necessary steps have to be taken to increase the authorised capital.
8. Finalise the proposal and fix the date for the Board Meeting for considering the proposal and for authorising the taking up of incidental and attendant matters.
9. If there are any partly paid-up shares, ensure that these are made fully paid-up before the bonus issue is recommended by the Board of directors.
10. The date of the Board Meeting at which the proposal for bonus issue is proposed to be considered should be notified to the Stock Exchange(s) where the company's shares are listed.
11. Hold the Board Meeting and get the proposal approved by the Board.
12. The resolution to be passed at the General Meeting should also be approved by the Board in its meeting. The intention of the Board regarding the rate of dividend to be declared in the year after the bonus issue should be indicated in the resolution for bonus issue to be passed by members in general meeting.
13. Immediately after the Board meeting intimate the Stock Exchange(s) regarding the outcome of the Meeting.
14. Ensure that the company has announced bonus issue after the approval of Board of Directors and did not require shareholders' approval for capitalization of profits or reserves for making bonus issue as per the Article of Association, had implemented bonus issue within fifteen days from the date of approval of the issue by the board of directors of the company and must not have the option of changing the decision.

However, where the company was required to seek shareholders' approval for capitalization of profits or reserves for making bonus issue as per the Article of Association, the bonus issue has implemented within two months from the date of the meeting of the Board of Directors where in the decision to announce bonus was taken subject to shareholders' approval.

15. Arrangements for convening the general meeting should then be made keeping in view the requirements of the Companies Act, with regard to length of notice, explanatory statement etc. Also three copies of the notice should be sent to the Stock Exchange(s) concerned.
16. Hold the general meeting and get the resolution for issue of bonus shares passed by the members. A copy of the proceedings of the meeting is to be forwarded to the concerned Stock Exchange(s).
17. In consultation with the Regional Stock Exchange fix the date for closure of register of members or record date and get the same approved by the Board of directors. Issue a general notice under Section 154 of Companies Act in respect of the fixation of the record date in two newspapers one in English language and other in the language of the region in which the Registered Office of the company is situated.
18. Give 7 days notice to the Stock Exchange(s) concerned before the date of book closure/record date.
19. After the record date process the transfers received and prepare a list of members entitled to bonus shares on the basis of the register of members as updated. This list of allottees is to be approved by the

Board or any Committee thereof. The list usually serves as allotment list and on this basis the allotment is to be made to the eligible members.

20. File return of allotment with the Registrar of Companies within 30 days of allotment (Section 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 BY EXISTING LISTED COMPANIES

Preferential issue means issuance of equity shares to promoter group or selected investors. It covers allotment of fully convertible debentures, partly convertible debentures or any other financial instruments that could be converted into equity shares at a later date. The investors could be institutional investors, private equity investors, high net-worth individuals, or companies.

Preferential issue is one of the key sources of funding for companies. It has its own advantages and disadvantages. One of the biggest advantages of a preferential issue is that the company can raise money quickly and cheaply compared with other means of raising money, say IPO or issue of shares on a rights basis.

On the other hand, preferential issues and private placement is only for selected class of investors and not for the retail investors. It is like a wholesale market, where institutions with financial clout are allowed to participate. This deprives investment opportunity to the retail investors.

SEBI (ICDR) REGULATIONS, 2009 REGARDING PREFERENTIAL ISSUE

1. *Applicability*

The preferential issue of equity shares/Fully Convertible Debentures (FCDs)/ Partly Convertible Debentures (PCDs) or any other financial instruments which would be converted into or exchanged with equity shares at a later date, by listed companies whose equity share capital is listed on any stock exchange, to any select group of persons under Section 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) 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 of 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 the Board 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 the Board 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

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.

- (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.

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

In 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

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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 application 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 this Chapter.

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 the Board 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 the Board and with the stock exchange(s) through the lead merchant banker.
- The issuer shall file the soft copy of the offer document with the Board, 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 the Board 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.

ISSUE OF SECURITIES BY SMALL AND MEDIUM ENTERPRISES

The necessary provisions for the listing of specified securities under the SME Platform have been made in accordance with the Chapter XB of Issue of Capital and Disclosure Requirements (ICDR).

APPLICABILITY

A company can issue specified securities if :

- The post-issue face value capital does not exceed 10 crore rupees.
- The post issue face value capital is more than 10 crore rupees and upto 25 crore rupees.

FILING OF OFFER DOCUMENT

A company is not required to file the draft offer document with SEBI as in case of public issue. But the company has to file a copy of the offer document with SEBI through a merchant banker, simultaneously with the filing of the prospectus with the SME exchange and the Registrar of Companies or letter of offer with the SME Exchange. SEBI should not issue any observation on the offer document.

The offer document shall be displayed from the date of filing on the websites of SEBI, the issuer, the merchant banker and the SME exchange where the specified securities offered through the offer document are proposed to be listed.

MINIMUM APPLICATION VALUE AND NUMBER OF ALLOTTEES

- The minimum application size in terms of number of specified securities shall not be less than one lakh rupees per application.
- The minimum number of prospective allottees should be less than fifty.

LISTING OF SPECIFIED SECURITIES

- The specified securities issue in accordance with the provision of SEBI ICDR regulations will be listed on SME exchange.
- A listed company can migrate the specified securities already listed on any recognized stock exchange/s to the SME exchange.

MIGRATION TO SME EXCHANGE

A listed company whose post-issue face value capital is less than 25 crore rupees can migrate its specified securities to SME exchange –

- if its shareholders approve such migration by passing a special resolution through postal ballot to this effect and
- if such issuer fulfils the eligibility criteria for listing laid down by the SME exchange.

However, the special resolution shall be acted upon if and only if the votes cast by shareholders other than promoters in favour of the proposal amount to at least two times the number of votes cast by shareholders other than promoter shareholders against the proposal.

MIGRATION TO MAIN BOARD

- An company, whose specified securities are listed on a SME Exchange and whose post issue face value capital is more than 10 crore rupees and upto 25 crore rupees, can migrate its specified securities to Main Board –
 - if its shareholders approve such migration by passing a special resolution through postal ballot to this effect and
 - if such issuer fulfils the eligibility criteria for listing laid down by the Main Board.

However, the special resolution shall be acted upon if and only if the votes cast by shareholders other than promoters in favour of the proposal amount to at least two times the number of votes cast by shareholders other than promoter shareholders against the proposal.

- Where the post issue face value capital of an issuer listed on SME exchange is likely to increase beyond 25 crore rupees by virtue of any further issue of capital by the issuer by way of rights issue, preferential issue, bonus issue, etc. the issuer shall migrate its specified securities listed on SME exchange to Main Board and seek listing of specified securities proposed to be issued on the Main Board subject to the fulfilment of the eligibility criteria for listing of specified securities laid down by the Main Board.

However, no further issue of capital by the issuer shall be made unless –

- (a) the shareholders of the issuer have approved the migration by passing a special resolution through postal ballot wherein the votes cast by shareholders other than promoters in favour of the proposal amount to at least two times the number of votes cast by shareholders other than promoter shareholders against the proposal.
- (b) the issuer has obtained in- principle approval from the Main Board for listing of its entire specified securities on it.

UNDERWRITING OBLIGATION

- The issue shall be 100 % underwritten.

- The merchant banker/s shall underwrite at least fifteen per cent of the issue size on his/ their own account/s.
- The issuer in consultation with merchant banker may appoint underwriters and the merchant banker may enter into an agreement with nominated investor indicating therein the number of specified securities which they agree to subscribe at issue price in case of under-subscription.
- If other underwriters fail to fulfill their underwriting obligations or other nominated investors fail to subscribe to unsubscribed portion, the merchant banker shall fulfill the underwriting obligations.
- The underwriters other than the merchant banker and the nominated investors, who have entered into an agreement for subscribing to the issue in case of under-subscription, shall not subscribe to the issue in any manner except for fulfilling their obligations under their respective agreements with the merchant banker in this regard.
- All the underwriting and subscription arrangements made by the merchant banker shall be disclosed in the offer document.
- The merchant banker shall file an undertaking to SEBI that the issue has been 100 % underwritten along with the list of underwriters and nominated investors indicating the extent of underwriting or subscription commitment made by them, one day before the opening of issue.

MARKET MAKING

- The merchant banker ensure that there shall be compulsory market making through the stock brokers of SME exchange for a minimum period of three years from the date of listing of specified securities.
- The merchant banker may enter into agreement with nominated investors for receiving or delivering the specified securities in the market making subject to the prior approval by the SME exchange where the specified securities are proposed to be listed.
- The company shall disclose the details of arrangement of market making in the offer document.
- The specified securities being bought or sold in the process of market making may be transferred to or from the nominated investor with whom the merchant banker has entered into an agreement for the market making. However, the inventory of the market maker, as on the date of allotment of the specified securities, shall be at least 5 % of the specified securities proposed to be listed on SME exchange.
- The market maker shall buy the entire shareholding of a shareholder of the issuer in one lot, where value of such shareholding is less than the minimum contract size allowed for trading on the SME exchange. However, the market maker shall not sell in lots less than the minimum contract size allowed for trading on the SME exchange.
- Market maker shall not buy the shares from the promoters or persons belonging to promoter group of the issuer or any person who has acquired shares from such promoter or person belonging to promoter group, during the compulsory market making period.
- The promoters' holding shall not be eligible for offering to the market maker. However, the promoters' holding which is not locked-in as per these regulations can be traded with prior permission of the SME exchange.
- Subject to the agreement between the issuer and the merchant banker/s, the merchant banker/s who have the responsibility of market making may be represented on the board of the issuer.

Term one should Know**Main Board**

It means a recognized stock exchange having nationwide trading terminals, other than SME exchange.

Nominated investor

It means a qualified institutional buyer or private equity fund, who enters into an agreement with the merchant banker to subscribe to the issue in case of under-subscription or to receive or deliver the specified securities in the market making process.

SEBI (LISTING OF SPECIFIED SECURITIES ON INSTITUTIONAL TRADING PLATFORM) REGULATIONS, 2013

SEBI notified a new set of regulations called the SEBI (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013 (ITP Regulations) and amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 to insert a new "Chapter XC "Listing and Issue of Capital by Small and Medium Enterprises on Institutional Trading Platform without Initial Public Offering". The provisions relating to ITP Regulations are covered under Regulations 106W to 106ZE.

Key highlights of the Regulations

Under these Regulations, a separate institutional trading platform is available in an SME exchange for listing and trading of specified securities of SMEs for informed investors. Such listing may be availed of without going through a public offering process. In other words, this provides exit options to investors even where the company or the promoters do not require additional capital to be raised from the public. Chapter XB of the ICDR Regulations provides for issuance of specified securities by SMEs on SME exchange. Broadly, an SME was required to make an IPO without having to file the draft offer document with SEBI. Here, SME is defined to mean a public company, including Start-up Company that complies with all the eligibility conditions specified in these Regulations. The main highlights of the regulation are as under:

(i) Eligibility criteria

For SME to be eligible to list its specified securities on the ITP, the following requirements should be satisfied:

- (a) The name of promoter, Group Company or director should not appear on the wilful defaulters list of Reserve Bank of India maintained by CIBIL.
- (b) There should be no winding up petition against the company admitted by a competent court.
- (c) The company, group companies or subsidiaries have not been referred to BIFR within a period of 5 years prior to the date of application for listing;
- (d) No regulatory action has been taken against the company, its promoter or directors, by the SEBI, RBI, IRDA, MCA within a period of 5 years prior to the date of application for listing;
- (e) The incorporation of the company should be atleast one year old and not more than 10 years.
- (f) The revenues of the company have not exceeded one hundred crore rupees in any of the previous financial years.
- (g) The paid up capital of the company has not exceeded twenty five crore rupees in any of the previous financial years.
- (h) The company has atleast one full year's audited financial statements, for the immediately preceding financial year at the time of making the listing application.

- (i) In addition to above, the company should have received minimum prescribed investment in terms of the specified regulation from any one of the following entities such as Alternative Investment Fund/ Venture Capital Fund/ other category of investors approved by SEBI (ii) Angel Investor, (iii) Registered Merchant Banker, (iv) a QIB, (v) a specialized International Multilateral Agency or domestic agency or a Public Financial Institution, (vi) receipt of finance from a scheduled bank for its project financing or working capital and a period of three years has been elapsed from the date of such financing and the funds so received have been fully utilized.

(ii) Restriction on further issue of securities

Listing of specified securities on the ITP cannot be accompanied by any issue of securities to the public in any manner. Further, the SME cannot undertake an IPO while its specified securities are listed on the ITP.

(iii) Procedure for Listing

1. Submission of Information Memorandum (IM) as per the prescribed format.
2. The IM should be on the Recognised Stock Exchange website 21 days from date of filing.
3. Recognised Stock Exchange shall grant In-Principle approval.
4. The Principle approval from Recognised Stock Exchange shall be the deemed waiver by SEBI for Section 19(2)(b) (7) of Securities Contract Regulations Act i.e. listing without public offering.

(iv) Post Issue Conditions for Fund Raising

1. No other securities of the company shall be listed other than the Specified Securities.
2. No IPO shall be made by the company for listing on ITP.
3. The company may raise capital through private placement or rights issue without an option for renunciation of rights subject to the guidelines mentioned in the notification.

(v) Minimum Promoter Shareholding and Lock-In

At least 20 % of the post listed capital shall be held by the promoters at the time of listing which shall be locked-in for a period of three years from date of listing.

(vi) Exit from Institutional Trading Platform

1. A company whose specified securities are listed on institutional trading platform may exit from that platform, if:
 - (a) Its 90 % of total votes and the majority of non-promoter votes have been cast in favour of such proposal.
 - (b) The recognised stock exchange approves such exit.
2. A company whose securities are listed on institutional trading platform shall exit the platform within a period of 18 months upon happening of following event of:
 - (a) Its specified securities have been listed on this platform for a period of ten years;
 - (b) The company has paid up capital of more than twenty five crore rupees;
 - (c) The company has revenue of more than three hundred crore rupees as per the last audited financial statement; and
 - (d) The company has market capitalization of more than five hundred crore rupees.
3. A company be delisted and permanently removed from the trading platform on account of non-compliances with various clauses as below:

- (a) failure to file periodic filing with stock exchange for more than one year; or
- (b) failure to comply with corporate governance norms for more than one year; or
- (c) Non-compliance of the condition of listing as may be specified by the recognised stock exchange.

4. In case of a company delisted and permanently removed under the above mentioned non-compliances, no company promoted by the promoters and directors of such delisted company shall be permitted to be listed on ITP for a period of five years from the date of such delisting. Further this provision shall not apply to a company promoted by the independent directors of such delisted company.

EMPLOYEE STOCK OPTIONS

The term 'Employee Stock Option' (ESOP) has been defined under Sub-section (37) of Section (2) of the Companies Act, 2013, according to which 'employee stock option' means the option given to the whole-time directors, officers or employees of a company, which gives such directors, officers or employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a pre-determined price.

SEBI has issued SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 according to which Employee Stock Option Scheme means a scheme under which the company grants option to its employees and option means a right but not an obligation granted to an employee in pursuance of ESOS to apply for shares of the company at a pre-determined price.

The issue of ESOPs would be subject to approval by shareholders through a special resolution. In cases of employee being offered more than 1% shares, a specific disclosure and approval would be necessary in the annual general meeting.

A minimum period of one year between grant of options and its vesting has been prescribed. After one year, the period during which the option can be exercised would be determined by the company.

The operation of the ESOP Scheme would have to be under the superintendence and direction of a Compensation Committee of the Board of directors in which there would be a majority of independent directors. With the specific approval of the shareholders, the scheme would be allowed to cover the employees of a subsidiary or a holding company.

Directors' report shall contain the following disclosures:

- (i) the total number of shares covered by the ESOP as approved by the shareholders;
- (ii) the pricing formula;
- (iii) options granted, options vested, options exercised, options forfeited, extinguishment or modification of options, money realised by exercise of options, total number of options in force, employee-wise details of options granted to senior managerial personnel and to any other employee who receive a grant in any one year of options amounting to 5% or more of options granted during that year.
- (iv) Fully diluted earning per share (EPS) computed in accordance with International Accounting Standards.

SEBI (EMPLOYEE STOCK OPTION SCHEME AND EMPLOYEE STOCK PURCHASE SCHEME) GUIDELINES, 1999

In November 1997, SEBI constituted a Group to review the existing regulations relating to Employee Stock Options Plans (ESOP) and recommend changes thereto.

The Group submitted its report in June 1999 and has recommended Guidelines to be called SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. The Guiding Principles for the Group in recommending the guidelines is the important role that Employee Stock Options play in rewarding and motivating employees, in attracting and retaining the best talent, and in ensuring employee commitment and

performance. In several knowledge based industries. India's competitive strength is derived from the skills and talent of its people and Employee Stock Options are critical of the success of Indian companies in the global market place.

The Group also took note of the fact that the typical employee in India is not a hard-nosed investor. To bring a significant number of employees on board a stock option scheme, has to be sufficiently attractive to convince the average skeptical employee. While a liberal stock option scheme would lead to earning dilution for existing shareholders, it could be beneficial.

The Guidelines as made effective by SEBI since 19th June, 1999 as amended, are reproduced hereunder:

EMPLOYEE STOCK OPTION

ELIGIBILITY TO PARTICIPATE

- (i) An employee is eligible to participate in Employee Stock Option Scheme (ESOS) of the company.

Explanation: Where such employee is a director nominated by an institution as its representative on the Board of Directors of the company –

- (i) the contract/agreement entered into between the institution nominating its employee as the director of a company and the director so appointed shall, *inter-alia*, specify the following:
- (a) whether options granted by the company under its ESOS can be accepted by the said employee in his capacity as director of the company;
 - (b) that options, if granted to the director, shall not be renounced in favour of the nominating institution; and
 - (c) the conditions subject to which fees, commissions, ESOSs, other incentives, etc. can be accepted by the director from the company.
- (ii) The employee should not be a promoter or belongs to the promoter group.
- (iii) A director who either himself or through his relative or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company can not participate as he is not eligible to participate in the scheme.

COMPENSATION COMMITTEE

- (i) The disclosures, as specified in Schedule IV are required to be made by the company to the prospective option guaranters.
- (ii) The company is required to constitute a Compensation Committee for administration and superintendence of the scheme.
- (iii) The Compensation Committee must be a Committee of the Board of Directors consisting of a majority of independent directors.
- (iv) The Compensation Committee should formulate the detailed terms and conditions of the scheme including:
 - (a) The quantum of option to be granted under the scheme per employee and in aggregate;
 - (b) The conditions under which option vested in employees may lapse in case of termination of employment for misconduct;
 - (c) The exercise period within which the employee should exercise the option and that option would lapse on failure to exercise the option within the exercise period;

- (d) The specified time period within which the employee shall exercise the vested options in the event of termination or resignation of an employee;
- (e) The right of an employee to exercise all the options vested in him at one time or at various points of time within the exercise period;
- (f) The procedure for making a fair and reasonable adjustment to the number of options and to the exercise price in case of corporate actions such as rights issues, bonus issues, merger, sale of division and others. In this regard, the following actions should be taken into consideration by the compensation Committee:
 - (i) The number and the price of ESOS shall be adjusted in a manner such that total value of ESOS remains the same after the corporate action.
 - (ii) For this purpose global best practices in this area including the procedures followed by the derivatives markets in India and abroad shall be considered
 - (iii) The vesting period and the life of the options shall be left unaltered as far as possible to protect the rights of option holders
- (g) The grant, vest and exercise of option in case of employees who are on long leave; and
- (h) The procedure for cashless exercise of options.
- (v) Suitable policies and systems are required to be framed by the compensation committee to ensure that there is no violation of the following by any employee —
 - (a) Securities and Exchange Board of India (Insider Trading) Regulations, 1992; and
 - (b) Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations.

SHAREHOLDERS' APPROVAL

- (i) the approval of shareholders of the company is required to be obtained by passing a special resolution in general meeting.
- (ii) explanatory statement to the notice and the resolution proposed to be passed in general meeting for scheme containing the following information is required to be sent:
 - (a) the total number of options to be granted;
 - (b) identification of classes of employees entitled to participate in the scheme;
 - (c) requirements of vesting and period of vesting;
 - (d) maximum period within which the option shall be vested;
 - (e) exercise price or pricing formula;
 - (f) exercise period and process of exercise;
 - (g) the appraisal process for determining the eligibility of employees to the scheme;
 - (h) maximum number of options to be issued per employee and in aggregate;
 - (i) a statement to the effect that the company shall conform to the accounting policies specified by SEBI in regard to ESOS;
 - (j) the method which the company uses to value its options, i.e., whether fair value or intrinsic value;
 - (k) in case the company calculates the employees compensation cost using the intrinsic value of the

stock options, the difference between the employees compensation cost so computed and employee compensation cost that shall have been recognized, if it had used the fair value of the options, shall be disclosed in the directors report and also the impact of this difference on profits and on EPS of the company shall be disclosed in directors report.

- (iii) approval of shareholders by way of a separate resolution in the general meeting is to be obtained by company in case of –
 - (a) grant of option to employees of subsidiary or holding company and,
 - (b) grant of option to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option.

VARIATION OF TERMS OF ESOS

- (i) the company should not vary the terms of the Scheme in any manner which may be detrimental to the interests of the employees.
- (ii) However, if such variation is not prejudicial to the interests of the option holders, the company is required to pass a special resolution in a general meeting to vary the terms of scheme.
- (iii) The provisions of clause 3(iii) as above shall apply to such variation of terms as they apply to the original grant of option.
- (iv) the notice for passing special resolution for variation of terms of ESOS is required to be sent.
- (v) the notice should disclose full details of the variation, the rationale therefor and the details of the employees who are beneficiary of such variation.
- (vi) The companies should be given an option to reprice the options which are not exercised if ESOSs were rendered unattractive due to fall in the price of shares in the market. The Company must ensure that such re-pricing should not be detrimental to the interest of employees and approval of shareholders in General Meeting has been obtained for such pricing.

PRICING

The companies granting option to its employees pursuant to the scheme have the freedom to determine the exercise price subject to adherence to the accounting policies. In case the company calculates the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that shall have been recognised if it had used the fair value of the options, is required to be disclosed in the Director's Report and also the impact of this difference on profits and on Earnings per Share of the company shall also be disclosed in the Director's Report.

LOCK-IN-PERIOD AND RIGHTS OF THE OPTION-HOLDER

- (i) There should be a minimum period of one year between the grant of options and vesting of option.

However, where options are granted by a company under an ESOS in lieu of options held by the same person under an ESOS in another company which has merged or amalgamated with the first mentioned company, the period during which the options granted by the transferor company were held by him shall be adjusted against the minimum vesting period required under this clause.
- (ii) The company has the freedom to specify the lock-in-period for the shares issued pursuant to exercise of option.
- (iii) The employee does not have the right to receive any dividend or to vote or in any manner enjoys the benefits of a shareholder in respect of option granted to him, till shares are issued on exercise of option.

CONSEQUENCE OF FAILURE TO EXERCISE OPTION

- (i) Amount payable by the employee, if any, at the time of grant of option can be forfeited by the company if the option is not exercised by the employee within the exercise period; or
- (ii) The amount is required to be refunded to the employee if the option is not vested due to non-fulfilment of condition relating to vesting of option as per the Scheme.

NON-TRANSFERABILITY OF OPTION

- (i) Option granted to an employee is not transferable to any person.
- (ii) (a) No person other than the employee to whom the option is granted is entitled to exercise the option.
(b) Under the cashless system of exercise, the company may itself fund or permit the empaneled stock brokers to fund the payment of exercise price which shall be adjusted against the sale proceeds of some or all the shares, subject to the provisions of the Companies Act, 1956.
- (iii) The option granted to the employee can not pledged, hypothecated, mortgaged or otherwise alienated in any other manner.
- (iv) In the event of the death of employee while in employment, all the options granted to him till such date are vested in the legal heirs or nominees of the deceased employee.
- (v) In case the employee suffers a permanent incapacity while in employment, all the option granted to him as on the date of permanent incapacitation, shall vest in him on that day.
- (vi) If an employee resigns or is terminated, all options not vested as on that day expire. However, the employee subject to the terms and conditions formulated by compensation committee, is entitled to retain all the vested options.
- (vii) The options granted to a director, who is an employee of an institution and has been nominated by the said institution, shall not be renounced in favour of the institution nominating him.

DISCLOSURE IN THE DIRECTORS' REPORT

The Board of Directors are required to disclose either in the Directors Report or in the Annexure to the Director's Report, the following details of the Scheme:

- (a) options granted;
- (b) the pricing formula;
- (c) options vested;
- (d) options exercised;
- (e) the total number of shares arising as a result of exercise of option;
- (f) options lapsed;
- (g) variation of terms of options;
- (h) money realised by exercise of options;
- (i) total number of options in force;
- (j) employee-wise details of options granted to –
 - (i) senior managerial personnel;
 - (ii) any other employee who receives a grant in any one year of option amounting to 5% or more of option granted during that year;

- (iii) identified employees who were granted option, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;
- (k) diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of option calculated in accordance with Accounting Standard (AS) 20 'Earning Per Share'.
- (l) Where the company has calculated the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that shall have been recognised if it had used the fair value of the options, shall be disclosed. The impact of this difference on profits and on EPS of the company shall also be disclosed.
- (m) Weighted-average exercise prices and weighted-average fair values of options shall be disclosed separately for options whose exercise price either equals or exceeds or is less than the market price of the stock.
- (n) A description of the method and significant assumptions used during the year to estimate the fair values of options, including the following weighted average information:
 - (1) risk-free interest rate,
 - (2) expected life,
 - (3) expected volatility,
 - (4) expected dividends, and
 - (5) the price of the underlying share in market at the time of option grant.

Until all options granted in the three years prior to the IPO have been exercised or have lapsed, disclosures shall be made either in the Directors' Report or in an Annexure thereto of the information specified above in respect of such options also and of the impact on the profits and on the EPS of the company if the company had followed the accounting policies specified in these guidelines in respect of such options.

ACCOUNTING POLICIES

The company is required to pass a resolution for the scheme complies with the accounting policies specified by SEBI in regard to the Scheme under Schedule I of SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.

CERTIFICATE FROM AUDITORS

Board of Directors of the company are required to present before the shareholders at each AGM, a certificate from the auditors of the company that the Scheme has been implemented in conformity with these guidelines and in accordance with the resolution of the company in the general meeting.

EMPLOYEES STOCK PURCHASE SCHEME (ESPS)

ELIGIBILITY TO PARTICIPATE IN THE SCHEME

- (i) An employee eligible to participate in the scheme should be:
 - (a) a permanent employee of the company working in India or out of India; or
 - (b) a director of the company, whether a whole time director or not;
 - (c) an employee as defined in sub-clauses (a) or (b) of a subsidiary, in India or out of India, or of a holding company of the company.

- (ii) The employee should neither be a promoter nor belongs to the promoter group.
- (iii) A director who either by himself or through his relatives or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company can not participate, as he is not eligible to participate in the scheme.

SHAREHOLDER APPROVAL

- (i) The Scheme should be approved by the shareholders by passing a special resolution in the meeting of the general body of shareholders.
- (ii) The explanatory statement to the notice is required to be sent to the shareholders and it should specify the following –
 - (a) the price of the shares and also the number of shares to be offered to each employee;
 - (b) the appraisal for determining the eligibility of employee for the scheme;
 - (c) total number of shares to be granted.
- (iii) The number of shares offered may be different for different categories of employees.
- (iv) The special resolution must state that the company should conform to the accounting policies as specified in schedule II of SEBI (Employee Stock Option Scheme and Stock Purchase Scheme) Guidelines, 1999.
- (v) Approval of shareholders must be obtained by way of separate resolution in the general meeting in case of –
 - (a) allotment of shares to employees of subsidiary or holding company and;
 - (b) allotment of shares to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of allotment of shares.

PRICING AND LOCK-IN-PERIOD

- (i) The company has the freedom to determine price of shares to be issued under an ESPS, provided they comply with the accounting policies specified.
- (ii) The shares issued under an ESPS are subject to lock-in for a minimum period of one year from the date of allotment.
- (iii) If the scheme is part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employees under the scheme are not subject to any lock-in-period.

DISCLOSURE AND ACCOUNTING POLICIES

- (i) The Director's Report or Annexure thereto should contain, *inter alia*, the following disclosures:
 - (a) the details of the number of shares issued in the scheme;
 - (b) the price at which such shares are issued;
 - (c) employee-wise details of the shares issued to:
 - (i) senior managerial personnel;
 - (ii) any other employee who is issued shares in any one year amounting to 5% or more shares issued during that year;

- (iii) identified employees who were issued shares during any one year equal to or exceeding 1% of the issued capital of the company at the time of issuance;
 - (d) diluted Earning Per Share (EPS) pursuant to issuance of shares under the scheme; and
 - (e) consideration received against the issuance of shares.
- (ii) Every company passing a resolution for the scheme must comply with the accounting policies as specified in Schedule II to SEBI (Employee Stock Option Scheme and Employee Stock Purchase) Guidelines, 1999.

PREFERENTIAL ALLOTMENT

Nothing in these guidelines applies to shares issued to employees in compliance with the Securities and Exchange Board of India Guidelines on Preferential Allotment.

LISTING

- (i) The shares arising pursuant to an ESOS and shares issued under an ESOS are required to be listed immediately upon exercise in any recognized stock exchange where the securities of the company are listed subject to compliance of the following:
 - (a) The ESOS/ESOS is in accordance with these Guidelines.
 - (b) In case of an ESOS the company has also filed with the concerned stock exchanges, before the exercise of option, a statement as per Schedule V and has obtained in-principle approval from such Stock Exchanges.
 - (c) As and when ESOS/ESOS are exercised the company has notified the concerned Stock Exchanges as per the statement as per Schedule VI.
- (ii) The shares arising after the IPO, out of options granted under any ESOS framed prior to its IPO shall be listed immediately upon exercise in all the recognised stock exchanges where the equity shares of the company are listed subject to compliance with SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 wherever applicable.
- (iii) No listed company shall make any fresh grant of options under any ESOS framed prior to its IPO and prior to the listing of its equity shares unless:
 - (a) such pre-IPO scheme is in conformity with these guidelines; and,
 - (b) such pre-IPO scheme is ratified by its shareholders in general meeting subsequent to the IPO.

However, the ratification under item (b) may be done any time prior to grant of new options under such pre-IPO scheme.
- (iv) No change shall be made in the terms of options issued under such pre-IPO schemes, whether by repricing, change in vesting period or maturity or otherwise, unless prior approval of the shareholders is taken for such change.

However, this shall not apply to any adjustments for corporate actions made in accordance with these guidelines.
- (v) For listing of shares issued pursuant to ESOS or ESOS the company is required to obtain the in-principle approval from Stock Exchanges where it proposes to list the said shares.
- (vi) The listed companies is required to file the ESOS or ESOS Schemes through EDIFAR filing.
- (vii) When holding company issues ESOS/ESOS to the employee of its subsidiary, the cost incurred by the holding company for issuing such options/shares is required to be disclosed in the 'notes to accounts' of

the financial statements of the subsidiary company. If the subsidiary reimburses the cost incurred by the holding company in granting options to the employees of the subsidiary, both the subsidiary as well as the holding company shall disclose the payment or receipt, as the case may be, in the 'notes to accounts' to their financial statements.

- (x) The company is required to appoint a registered Merchant Banker for the implementation of ESOS and ESPS as per these guidelines till the stage of framing the ESOS/ESPS and obtaining in-principal approval from the stock exchanges.

ESOS/ESPS THROUGH TRUST ROUTE

In case ESOS/ESPS are administered through a Trust Route, the accounts of the company shall be prepared as if the company itself is administering the ESOS/ ESPS.

PROHIBITION OF ACQUISITION OF SECURITIES FROM SECONDARY MARKET

No ESOS/ESPS shall involve in acquisition of securities from the secondary market.

LESSON ROUND UP

- Public Issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus.
- Public Issue of shares are regulated by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.
- All listed companies whose equity shares are listed on a stock exchange and unlisted companies eligible to make a public issue and desirous of getting its securities listed on a recognised stock exchange pursuant to a public issue, may freely price its equity shares or any securities convertible at a later date into equity shares.
- The promoters should contribute not less than 20% of post-issue capital, in case of a public issue by an unlisted company.
- Underwriting means an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them.
- In case of a public issue by an unlisted company, at least 10% or 25% of the post issue capital should be offered to the public and a listed company making public issue should make the net offer of at least 10% or 25% of the issue size to the public.
- A merchant banker holding a valid certificate of registration is required to be appointed to manage the issue.
- Every company making a public issue is required to appoint a compliance officer and intimate the name of the compliance officer to SEBI.
- Book Building means a process undertaken by which a demand for the securities proposed to be issued by a body corporate is build up and a 'Fair Price' and 'Quantum' of securities to be issued is finally determined.
- An issuer company making a public offer of equity shares can avail of the Green Shoe Option (GSO) for stabilizing the post listing price of its shares.
- A SME can issue specified securities in accordance with chapter XB of ICDR Regulations, 2009.
- SEBI has inserted a new chapter XC by amending the SEBI (ICDR) Regulations, 2009 on 8.10.2013.
- Issue of Employee Stock option is regulated by SEBI ESOP Guidelines, 1999.

GLOSSARY

Average market capitalisation of public shareholding	It means the sum of daily market capitalization of “public shareholding” for a period of one year up to the end of the quarter preceding the month in which the proposed issue was approved by the Board/shareholders, as the case may be, divided by the number of trading days.
General Corporate Purpose	It include such identified purposes for which no specific amount is allocated or any amount so specified towards General Corporate Purpose or any such purpose by whatever name called, in the draft offer document filed with SEBI.
Key Management Personnel	It means the officers vested with executive powers and the officers at the level immediately below the board of directors of the issuer and includes any other person whom the issuer may declare as a key management personnel.
Retail individual investor	It means an investor who applies or bids for specified securities for a value of not more than two lakhs rupees.
Retail individual shareholder	It means a shareholder of a listed issuer, who applies or bids for specified securities for a value of not more than two lakhs. Rupees.

SELF TEST QUESTIONS

1. What is a prospectus? Discuss broadly the disclosures to be made in prospectus.
2. Explain the various legal provisions to be complied with for further issue of capital.
3. Write a note on the work involved in making an issue of share open to the public.
4. State the Regulations relating to Issue of Bonus Shares.
5. What do you understand by Book Building? Explain briefly SEBI’s Regulations for 100% book building.
6. Explain briefly about the ASBA process. Who are the eligible investors? State.
7. What are the criteria for issue specified securities by a SME?
8. Write short notes on –
 - (a) Minimum subscription
 - (b) Anchor Investor
 - (c) Minimum promoters’ contribution and lock-in-period
 - (d) Preferential allotment
 - (e) Green Shoe Option
 - (f) Employee Stock Option Scheme
 - (g) Self Certified Syndicate Bank.
9. What are the conditions for making Qualified Institutions placement under SEBI ICDR Regulations?
10. What is Institutional Placement Programme (IPP)? Briefly explain the restrictions on making IPP.

Lesson 18

Regulatory Framework relating to Securities Market Intermediaries

LESSON OUTLINE

- Introduction
- Primary Market Intermediaries
- 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
- Secondary Market Intermediaries
- SEBI (Stock Brokers & Sub Brokers) Regulations, 1992
- SEBI (Portfolio Managers) Regulations, 1993
- Internal Audit of Portfolio Manager
- SEBI (Custodian of Securities) Regulations, 1996
- SEBI (Investment Advisers) Regulations, 2013
- Guidelines on Anti Money Laundering Measures
- SEBI (Intermediaries) Regulations, 2008
- SEBI {KYC (Know Your Client) Registration Agency (KRA)}, Regulations, 2011
- In-person Verifications (IPV)
- SEBI (Self Regulatory Organisations) Regulations, 2004
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

Intermediaries are service providers and are an integral part of any financial system. The Market Regulator, i.e., SEBI regulates various intermediaries in the primary and secondary markets through its Regulations for these respective intermediaries. SEBI has defined the role of each of the intermediary, the eligibility criteria for granting registration, their functions and responsibilities and the code of conduct to which they are bound. These Regulations also empower SEBI to inspect the functioning of these intermediaries and to collect fees from them and to impose penalties on erring entities.

This lesson, will enable the students to know about the regulatory framework of the intermediaries operating in the Primary and the Secondary markets, Know your client norms prescribed by SEBI, SEBI (Intermediaries) Regulations and Self Regulatory Organisation etc.

INTRODUCTION

The market Regulator, SEBI regulates various intermediaries in the primary and secondary markets through its Regulations 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. These Regulations also empower SEBI to inspect the functioning of these intermediaries and to collect fees from them and to impose penalties on erring entities. As per Section 11 of SEBI Act, it is the duty of SEBI to register and regulate the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities market in any manner.

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 which is discussed below.

PRIMARY MARKET INTERMEDIARIES

The following market intermediaries are involved in the primary market:

- Merchant Bankers/Lead Managers
- Registrars and Share Transfer Agents
- Underwriters
- Bankers to issue
- Debenture Trustees

MERCHANT BANKERS

'Merchant Banker' means any person engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser 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 (Form A) seeking grant of a certificate of initial registration alongwith a non-refundable application fee as specified in Schedule II of these 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 to grant the certificate of registration.

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

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 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.)

Regulation 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 fees.

GENERAL OBLIGATIONS AND RESPONSIBILITIES OF MERCHANT BANKER

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

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

Code of Conduct for Merchant Bankers

1. A merchant banker shall make all efforts to protect the interests of investors.
2. A merchant banker shall maintain high standards of integrity, dignity and fairness in the conduct of its business.
3. A merchant banker shall fulfil its obligations in a prompt, ethical, and professional manner.
4. A merchant banker shall at all times exercise due diligence, ensure proper care and exercise independent professional judgement.
5. A merchant banker shall endeavour to ensure that –
 - (a) inquiries from investors are adequately dealt with;
 - (b) grievances of investors are redressed in a timely and appropriate manner;
 - (c) where a complaint is not remedied promptly, the investor is advised of any further steps which may be available to the investor under the regulatory system.
6. A merchant banker shall ensure that adequate disclosures are made to the investors in a timely manner in accordance with the applicable regulations and guidelines so as to enable them to make a balanced and informed decision.
7. A merchant banker shall endeavour to ensure that the investors are provided with true and adequate information without making any misleading or exaggerated claims or any misrepresentation and are made aware of the attendant risks before taking any investment decision.
8. A merchant banker shall endeavour to ensure that copies of the prospectus, offer document, letter of offer or any other related literature is made available to the investors at the time of issue or the offer.
9. A merchant banker shall not discriminate amongst its clients, save and except on ethical and commercial considerations.
10. A merchant banker shall not make any statement, either oral or written, which would misrepresent the services that the merchant banker is capable of performing for any client or has rendered to any client.
11. A merchant banker shall avoid conflict of interest and make adequate disclosure of its interest.
12. A merchant banker shall put in place a mechanism to resolve any conflict of interest situation that may arise in the conduct of its business or where any conflict of interest arises, shall take reasonable steps to resolve the same in an equitable manner.
13. A merchant banker shall make appropriate disclosure to the client of its possible source or potential areas of conflict of duties and interest while acting as merchant banker which would impair its ability to render fair, objective and unbiased services.
14. A merchant banker shall always endeavour to render the best possible advice to the clients having regard to their needs.
15. A merchant banker shall not divulge to anybody either orally or in writing, directly or indirectly, any confidential information about its clients which has come to its knowledge, without taking prior permission of its clients, except where such disclosures are required to be made in compliance with any law for the time being in force.
16. A merchant banker shall ensure that any change in registration status/any penal action taken by the

SEBI or any material change in the merchant banker's financial status, which may adversely affect the interests of clients/ investors is promptly informed to the clients and any business remaining outstanding is transferred to another registered intermediary in accordance with any instructions of the affected clients.

17. A merchant banker shall not indulge in any unfair competition, such as weaning away the clients on assurance of higher premium or advantageous offer price or which is likely to harm the interests of other merchant bankers or investors or is likely to place such other merchant bankers in a disadvantageous position while competing for or executing any assignment.
18. A merchant banker shall maintain arms length relationship between its merchant banking activity and any other activity.
19. A merchant banker shall have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients, investors and other registered entities from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.
20. A merchant banker shall not make untrue statement or suppress any material fact in any documents, reports or information furnished to 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 SEBI 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 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 interests, if any, of himself, his dependent family members and the employer merchant banker, including their long or short position in the said security, while rendering such advice.
24. A merchant banker shall demarcate the responsibilities of the various intermediaries appointed by it clearly so as to avoid any conflict or confusion in their job description.
25. A merchant banker shall provide adequate freedom and powers to its compliance officer for the effective discharge of the compliance officer's duties.
26. A merchant banker shall develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in carrying out their duties. Such a code may extend to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance or resolution of conflict of interests, disclosure of shareholdings and interests, etc.
27. A merchant banker shall ensure that good corporate policies and corporate governance are in place.
28. A merchant banker shall ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed (including having relevant professional training or experience).

29. A merchant banker shall ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it in the conduct of its business, in respect of dealings in securities market.
30. A merchant banker shall be responsible for the Acts or omissions of its employees and agents in respect of the conduct of its business.
31. A merchant banker shall ensure that the senior management, particularly decision makers have access to all relevant information about the business on a timely basis.
32. A merchant banker shall not be a party to or instrument for—
 - (a) creation of false market;
 - (b) price rigging or manipulation; or
 - (c) passing of unpublished price sensitive information in respect of securities which are listed and proposed to be listed in any stock exchange to any person or intermediary in the securities market.

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

RESPONSIBILITIES OF LEAD MANAGERS

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

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 bankers offices and records by SEBI.

Regulation 29 empowers SEBI to appoint one or more persons as inspecting authority to undertake inspection of books of accounts, records etc. of the merchant banker, to ensure that such books and records are maintained in the prescribed manner, the provisions of SEBI Act and the rules and regulations thereunder are complied with to investigate into complaints from investors, other merchant bankers or other persons on any matter having a bearing on the activities of the merchant banker and to investigate suo-motu in the interest of the securities business or investors interest into the working of the merchant banker.

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

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

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

PROCEDURE FOR ACTION AGAINST MERCHANT BANKER IN CASE OF DEFAULT

Chapter V containing Regulation 35 deals with the procedure for taking action against the merchant banker in case of default.

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

REGISTRARS AND SHARE TRANSFER AGENTS

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

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

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 RTA and STA or Category-II to carry on the activity either as Registrar to an Issue or as a Share Transfer Agent. The application should be complete and conform to the requirements otherwise it will be rejected. But an opportunity will be given to remove the objections as may be indicated by SEBI. In case of failure the application may be rejected.

CRITERIA FOR REGISTRATION

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

- (a) has the necessary infrastructure like adequate office space, equipments and manpower to effectively discharge his activities;
- (b) has any past experience in the activities;

- (c) any person directly or indirectly connected with him has been granted registration by SEBI under the Act;
- (d) fulfills the capital adequacy requirement;
- (e) has been subjected to any disciplinary proceedings under the Act;
- (f) any of its director, partner or principal officer is or has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence;
- (g) is a fit and proper person.

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

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

Regulation 11 says that in case of refusal to grant or renew a certificate of registration, the concerned person shall cease to carry on any activity as registrar or share transfer agent.

Regulation 12 prescribes payment of fees and indicates the consequences of failure to pay fees. In the latter case SEBI may suspend the certificate with the consequence that the RTA shall cease to carry on his activity from the date of suspension of the certificate.

GENERAL OBLIGATIONS AND RESPONSIBILITIES

Chapter III consisting of Regulations 13 to 15 lays down the general obligations and responsibilities of RTAs. Specified in Schedule III of these regulations.

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

- (i) he or it controls directly or indirectly not less than 10% of the voting power of the body corporate or of Registrar to an issue, as the case may be or
- (ii) he or any of his relative is a director or promoter of the body corporate or of the Registrar to an Issue, as the case may be. The term 'relative' shall have the same meaning as assigned to it under Section 2(77) of the Companies Act, 2013.

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

PROCEDURE FOR INSPECTION

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

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

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

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

LIABILITY FOR ACTION IN CASE OF DEFAULT

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

- (i) fails to comply with any conditions subject to which registration has been granted.
- (ii) Contravenes any of the provisions of the Act, rules or regulations.
- (iii) Contravenes the provisions of the SCRA and the rules made thereunder, provisions of the Depositories Act, 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. 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 one month in order to enable the applicant to comply with the requirements of SEBI.

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

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

SEBI shall take into account whether a previous application for a certificate of any person directly or

indirectly connected with the applicant has been rejected by SEBI or any disciplinary action has been taken against such person under the Act or any rules/regulations.

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

Regulation 7 prescribes for the following capital adequacy requirement:

1. The networth should not be less than ₹ 20 lakhs.
2. The stock broker who acts 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.

Regulations 10 and 11 deal with the procedure where registration is not granted and the effect of refusal to grant certificate of permanent registration. Regulation 12 prescribes fees payable and consequences of failure to pay fees.

OBLIGATIONS AND RESPONSIBILITIES OF UNDERWRITERS

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

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

The contents of the agreement shall include the period of agreement, the 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 arrangement 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 network.
3. Every underwriter, in the event of being called upon to subscribe for securities of a body corporate pursuant to an agreement shall subscribe to such securities within 45 days of the receipt of such intimation from such body corporate.

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

APPOINTMENT OF COMPLIANCE OFFICER

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

INSPECTION AND DISCIPLINARY PROCEEDINGS

Chapter IV containing Regulations 19 to 24 makes provisions on this subject. SEBI is empowered to appoint inspectors to ensure that books of accounts, records etc. are maintained properly and the Act along with the rules and regulations are duly complied with. SEBI is also empowered to investigate into complaints received

from investors, other underwriters etc. as well as under their own power to investigate *suo motu* in the interest of securities business and the investors.

Regulations 20 and 21 lay down the procedure for inspection and obligations of underwriter during such inspections.

Regulations 22 relate to submission of inspection report to SEBI.

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

Regulation 24 authorises 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.

BANKERS TO AN ISSUE

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

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

SEBI (BANKERS TO AN ISSUE) REGULATIONS, 1994

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

Chapter I deals with preliminary matters and definitions.

Chapter II containing Regulations 3 to 11 deals with 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, it shall be rejected after giving due opportunity to remove such defects within specified time. SEBI may call for and obtain further information or clarification from the applicant.

CONSIDERATION OF APPLICATION

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

- (a) the applicant has the necessary infrastructure, communication and data processing facilities and manpower to effectively discharge his activities;
- (b) the applicant or any of its directors is not involved in any litigation connected with the securities market and which has an adverse bearing on the business of the applicant or has not been convicted of any economic offence;
- (c) the applicant is a scheduled bank;

- (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, and 8A deal with the grant of certificate of initial registration and permanent registration, 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 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 enter into an agreement with the body corporate for whom he is the banker to an issue with regard to the following matters:

- (a) the number of centres at which the application and the application monies of an issue of a body corporate will be collected from the investors;
- (b) the time within which the statements regarding the applications and the application monies received from the investors investing in an issue of a body corporate will be forwarded to the registrar to an issue of the body corporate, as the case may be;
- (c) the daily statement will be sent by the designated controlling branch of the bankers to the issue to the registrar to an issue indicating the number of body corporate and the amount of application money received.

Regulation 15 requires the banker to 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 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 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 the request from SEBI take appropriate steps to undertake inspection of Bankers to an Issue for such purposes as may be required by SEBI.

Regulation 20 requires that the banker shall offer all assistance and 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

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

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

- (1) has the necessary infrastructure like adequate office space, equipments, and manpower to effectively discharge his activities;
- (2) has any past experience as a debenture trustee or has in his employment minimum two persons who had the experience in matters which are relevant to a debenture trustee; or
- (3) any person, directly or indirectly connected with the applicant has not been granted registration by SEBI under the Act;
- (4) has in his employment at least one person who possesses the professional qualification in law from an institution recognised by the Government; or
- (5) any of its director or principal officer is or has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence and is a fit and proper person;
- (6) is a fit and proper person;
- (7) fulfills the capital adequacy requirements specified in Regulation 7A of 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 fulfill the requirements of Regulation 6 above, it may be rejected after giving reasonable opportunity to the applicant for being heard. The rejection shall be conveyed in writing by SEBI and the applicant may again apply for reconsideration of SEBI. After due reconsideration SEBI shall communicate its bindings in writing to the applicant.

Regulations 11 and 12 deal with effect of refusal to grant 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 topic. Regulation 13 lays down that no debenture trustee who has been granted a certificate by SEBI shall act as debenture trustee unless he enters into a written agreement with the body corporate before the opening of the subscription list for issue of debentures and the agreement *inter alia* contains that debenture trustee has agreed to act as such under the trust deed for securing an issue of debentures for the body corporate and the time limit within which the security for the debentures shall be created.

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

- (a) it is an associate of the body corporate; or
- (b) it has lent and the loan is not yet fully repaid or is proposing to lend money to the body corporate.

However, the requirement shall not be applicable in respect of debentures issued prior to the commencement of Companies (Amendment) Act, 2000 where – (i) recovery proceedings in respect of the assets charged against security has been initiated or the body corporate has been referred to Board for Industrial and Financial Reconstruction under Sick Industrial Companies (Special Provisions) Act, 1985 prior to commencement of SEBI (Debenture Trustee) Regulations, 2003.

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

DUTIES OF DEBENTURE TRUSTEES

Regulation 15 casts the following duties on the debenture trustees:

- (1) call for periodical reports from the body corporate;
- (2) take possession of trust property in accordance with the provisions of the trust deed;
- (3) enforce security in the interest of the debenture holders;
- (4) do such acts as necessary in the event the security becomes enforceable;
- (5) carry out such acts as are necessary for the protection of the debenture holders and to do all things necessary in order to resolve the grievances of the debenture holders;
- (6) ascertain and specify that:
 - (a) in case where the allotment letter has been issued and debenture certificate is to be issued after registration of charge, the debenture certificates have been despatched by the body corporate to the debenture holders within 30 days of the registration of the charge with ROC;
 - (b) debenture certificates have been despatched to the debenture holders in accordance with the provisions of the Companies Act;
 - (c) interest warrants for interest due on the debentures have been despatched to the debenture holders on or before the due dates;
 - (d) debentureholders have been paid the monies due to them on the date of redemption of the debentures;
- (7) ensure on a continuous basis that the property charged to the debenture is available and adequate at all time to discharge the interest and principal amounts payable in respect of the debentures and that such property is free from any other encumbrances save and except those which are specifically agreed to by the debenture trustee.

- (8) exercise due diligence to ensure compliance by the body corporate, with the provisions of the Companies Act, the listing agreement of the stock exchange or the trust deed;
- (9) to take appropriate measures for protecting the interest of the debenture holders as soon as any breach of the trust deed or law comes to his notice;
- (10) to ascertain that the debentures have been converted or redeemed in accordance with the provisions and conditions under which they are offered to the debentureholders;
- (11) inform SEBI immediately of any breach of trust deed or provision of any law;
- (12) appoint a nominee director on the Board of the body corporate in the event of:
 - (i) two consecutive defaults in payment of interest to the debentures; or
 - (ii) default in creation of security for debentures; or
 - (iii) default in redemption of debentures.
- (13) communicate to the debenture holders on half yearly basis the compliance of the terms of the issue by the body corporate, defaults, if any, in payment of interest or redemption of debentures and action taken therefor;
- (14) The debenture trustee shall –
 - (a) obtain reports from the leading bank regarding the project.
 - (b) monitor utilization of funds raised in the issue.
 - (c) obtain a certificate from the issuer's auditors.
 - (i) in respect of utilization of funds during the implementation period of the project; and
 - (ii) in the case of debentures issued for financing working capital at the end of accounting year.
- (15) A debenture trustee may call or cause to be called by the body corporate a meeting of all the debenture holders on –
 - (a) a requisition in writing signed by at least one-tenth of the debentureholders in value for the time being outstanding.
 - (b) the happening of any event, which constitutes a default or which in the opinion of the debenture trustees affects the interest of the debentureholders.
- (16) No debenture trustee can relinquish its assignment in respect of the debenture issue of any body corporate, unless and until another debenture trustee is appointed in its place by the body corporate.
- (17) A debenture trustee is required to maintain the 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 Board or chairman, may after consideration of inspection or investigation report take such action as the Board or chairman may deem fit and appropriate including action under Chapter V of SEBI (Intermediaries) Regulations, 2008.

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 BROKER & SUB BROKERS

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 AND SUB-BROKERS) REGULATIONS, 1992

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

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

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

- (a) whether the applicant is eligible to be admitted as a member of a stock exchange;
- (b) whether he has the necessary infrastructure like adequate office space, equipment and manpower to effectively discharge his activities;
- (c) whether he has any past experience in the business of buying, selling or dealing in securities;
- (d) whether he was subjected to disciplinary proceedings under the rules, regulations and bye-laws of a stock exchange with respect to his business as a stock broker involving either himself or any of his partners, directors or employees; and
- (e) whether he is a fit and proper person.

SEBI, on being satisfied that the stock broker is eligible, shall grant a certificate of registration to him and send an intimation to that 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, may apply within a period of 30 days from the date of receipt of such intimation, to SEBI for reconsideration of its decision. SEBI shall reconsider an application made and communicate its decision as soon as possible in writing to the applicant and to the concerned stock exchange. The stock broker whose application for grant of a certificate has been refused by SEBI shall not, on and from the date of the receipt of SEBI's communication, buy, sell or deal in securities as a stock broker.

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

REGISTRATION OF SUB-BROKERS

Chapter III 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 fresh certificate. Again there is no need of obtaining fresh certificate where a registered stock broker is affiliated to stock broker who is eligible to trade on SME platform.

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

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

- (1) In the case of an individual:
 - (a) the applicant is not less than 21 years of age;
 - (b) the applicant has not been convicted of any offence involving fraud or dishonesty;
 - (c) the applicant has at least passed 12th standard equivalent examination from an Institution recognised by the Government. However, SEBI may relax this criterion on merits having regard to the applicant's experience;
 - (d) the applicant is a fit and proper person.
- (2) In the case of partnership firm or a body corporate, the partners or directors as the case may be shall comply with the requirements stated above. It is also to be assessed whether the applicant has necessary infrastructure like adequate office space, equipment and manpower to effectively discharge his activities. The applicant should be person recognised by the stock exchange as a sub-broker affiliated to a member broker of the stock exchange.

The stock exchange shall forward the application form of such applicants, alongwith recommendation letter issued by the stock broker with whom he affiliated alongwith a recognition letter issued by the stock exchange to SEBI within 30 days from the date of its receipt.

SEBI on being satisfied that the sub-broker is eligible, shall grant a certificate in Form-E to the sub-broker and send an intimation to that 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 of registration. Any registration granted by SEBI shall be subject to the following conditions: –

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

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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 have a net worth as may be specified from time to time and the approved user and sales personnel of the trading member shall have passed a certification programme approved by SEBI. An applicant who desires to act as a clearing member shall also have a minimum net worth of ₹ 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 complying 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 161 lays down 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 application does not fulfil the requirements, SEBI may reject the application after giving a reasonable opportunity to the applicant of being heard. The refusal to grant such certificate shall be communicated by SEBI within 30 days of such refusal to the concerned segment of stock exchange or clearing corporation or clearing house and to the applicant stating therein the grounds on which the application has been rejected. If aggrieved by the decision of SEBI as referred to above, the applicant may apply within a period of 30 days from the date of receipt of such information to SEBI for reconsideration of its decision. SEBI shall reconsider the application and communicate its decision as soon as possible in writing to the applicant and to the concerned segment of stock exchange or clearing house or corporation.

If certificate of registration is refused to an applicant he shall not from the date of receipt of SEBI's letter of rejection, deal in or settle the derivatives contracts as a member of the derivatives exchange as a member of derivatives exchange, segment, clearing corporation or clearing house. Every applicant eligible for

grant of certificate as a trading or clearing member or self clearing member, shall pay such fee as may be specified. If the fee is not paid, SEBI may suspend or cancel the registration after giving an opportunity of being heard where upon the trading 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 SEBI as early as possible but not later than thirty days from the date of its receipt.

Regulation 16K provided 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, whether 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 man-power 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 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 fulfill the requirements SEBI may reject the application of the applicant after giving a reasonable opportunity of being heard. The refusal to grant the certificate of

registration shall be communicated by SEBI within 30 days of such refusal to the currency derivatives segment of the stock exchange, or clearing house or corporation and to the applicant stating therein the grounds on which the application has been rejected. An applicant may, if aggrieved by the decision of SEBI as referred to above, the applicant may apply within a period of thirty days from the date of receipt of such information to SEBI for reconsideration of its decision. SEBI shall reconsider an application made and communicate its decision as soon as possible in writing to the applicant and to the currency derivatives segment of the stock exchange or clearing house or corporation.

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 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 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, 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, 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 SEBI (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 Jhunjunwala v. SEBI

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

CERTIFICATION BY PRACTISING COMPANY SECRETARY

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

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

- (i) to ensure that the books of account, records (including telephone records and electronic records) and documents are being maintained in the manner required under SEBI Act, 1992, SCR Act, 1956 and SEBI (Stock brokers and Sub-brokers) Regulations, 1992.
- (ii) to ascertain as to whether adequate internal control systems, procedures and safeguards have been

established and are being followed by the intermediary to fulfill its obligations within the scope of the audit.

- (iii) to ascertain as to whether any circumstances exist which would render the intermediary unfit or ineligible.
- (iv) to ascertain whether the provisions of the securities laws and the directions or circulars issued thereunder are being complied with.
- (v) to ascertain whether the provision of stock exchange bye-laws, notices, circulars, instructions or orders issued by stock exchanges are being complied with.
- (vi) to inquire into the complaints received from investors, clients, other market participants or any other person on any matter having a bearing on the activities of the stock broker.

PORTFOLIO MANAGERS

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

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

SEBI (PORTFOLIO MANAGERS) REGULATIONS, 1993

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

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

Regulation 3 provides that a person shall not act as 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 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 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 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.

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 at least 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 character of a mutual fund, whereas the non discretionary portfolio manager shall manage the funds in accordance with the directions of the client. The portfolio manager shall not accept from the client, funds or securities worth less than twenty five lacs rupees. The portfolio manager shall act in a fiduciary capacity with regard to the clients funds. The portfolio manager shall keep the funds of all clients in a separate account to be maintained by it in a Scheduled Commercial Bank. He shall transact in securities within the limitation placed by the client for dealing in securities under the provisions of RBI Act, 1934. He shall not derive any direct or indirect benefit out of the clients funds or securities. The portfolio manager shall not borrow funds or securities for behalf of the client. The portfolio manager shall not lend securities held on behalf of clients to a third person except as provided under these regulation.

INVESTMENT OF CLIENTS MONEY

Regulation 16 provides that the money or securities accepted by the portfolio manager shall not be invested or managed by the portfolio manager except in terms of the agreement between the portfolio manager and the client. Any renewal of portfolio fund on maturity of the initial period shall be deemed as a fresh placement. The

funds or securities can be withdrawn or taken back by the client before the maturity of the contract under the following circumstances, namely –

- (a) voluntary or compulsory termination of portfolio management services by the portfolio manager or the client.
- (b) suspension or cancellation of the certificate of registration of the portfolio manager by SEBI.
- (c) bankruptcy or liquidation of the portfolio manager.

The portfolio manager shall invest funds of his clients in money market instruments or derivatives or as specified in the contract:

However, leveraging of portfolio shall not be permitted in respect of investment in derivatives. Further the portfolio manager shall not deploy the clients' funds in bill discounting, badla financing or for the purpose of lending or placement with corporate or non-corporate bodies. "Money market instruments" includes commercial paper, trade bill, treasury bills, certificate of deposit and usance bills.

The portfolio manager shall not while dealing with clients' funds indulge in speculative transactions that is, he shall not enter into any transaction for purchase or sale of any security which is periodically or ultimately settled otherwise than by actual delivery or transfer of security except the transactions in derivatives.

The portfolio manager shall, ordinarily purchase or sell securities separately for each client. However, in the event of aggregation of purchases or sales for economy of scale, *inter se* allocation shall be done on a *pro rata* basis and at weighted average price of the day's transactions. The portfolio manager shall not keep any open position in respect of allocation of sales or purchases effected in a day.

Any transaction of purchase or sale including that between the portfolio manager's own accounts and client's accounts or between two clients' accounts shall be at the prevailing market price.

The portfolio manager shall segregate each clients' funds and portfolio of securities and keep them separately from his own funds and securities and be responsible for safekeeping of clients' funds and securities.

The portfolio manager shall not hold the listed securities 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.

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 under these regulations for any other preceeding five accounting years. Regulation 18 provides that portfolio manager shall furnish to SEBI half-yearly unaudited financial results when required by SEBI with a view to assist in monitoring the capital adequacy of the portfolio manager.

The portfolio manager shall preserve the books of account and other records and documents mentioned in any of the regulations mentioned under 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 shall furnish periodically a report to the client as agreed to in the contract but not exceeding a period of 6 months add as and when required by the client 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 the 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 proceeding by SEBI.

Regulation 24 empowers SEBI to appoint one or more persons as inspecting authority to under take the inspection of the books of accounts, records and documents of the portfolio manager to ensure that they are being maintained in the manner required, that the provisions of the Act, Rules and Regulations are being complied with. The inspecting authority shall investigate into the complaints received from the investors, other portfolio managers or any other person on any matter having a bearing on the activities of the portfolio manager and investigate *suo motu* in the interest of securities business or investors interest into the affairs of the portfolio manager.

SEBI shall give a reasonable notice to the portfolio manager before undertaking an inspection. However, where SEBI is satisfied that in the interest of the investors, no such notice should be given it may by an order in writing direct that the inspection of the affairs of the portfolio manager be taken up without such notice. During the course of the inspection the portfolio manager against whom an inspection is being carried out shall be bound to discharge his obligations as stated below:

OBLIGATIONS OF PORTFOLIO MANAGER

It shall be the duty of every director, proprietor, partner, officer and employee of the portfolio manager who is being inspected, to produce to the inspecting authority such books of accounts and documents in his custody or control and furnish him with the statements and information relating to these activities within such time as the inspecting authority may require. The portfolio manager shall allow the inspecting authority to have reasonable access to the premises occupied by the former or by any other person on his behalf and also extend reasonable facility for examining any books, records, documents and computer data in his possession or in the possession of any other person and also provide copies of documents or other material which in the opinion of the inspecting authority are relevant for the purposes of the inspection. In the course of inspection, the inspecting authority shall be entitled to examine or record statements of any principal officer, director, partner, proprietor and employee of the portfolio manager. It shall be the duty of each such person to give to the inspecting authority all assistance in connection with the inspection which the portfolio manager may reasonably be expected to give.

The inspecting authority shall submit an inspection report to SEBI as soon as it is possible. SEBI or 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 deed 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 of 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 SEBI notified the SEBI (Custodian of Securities) Regulations, 1996 on May 16, 1996.

Chapter I contains preliminary matter and definitions. Chapter II consisting Regulation 3 to 11 relating to procedure for registration 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 custodian 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 regulation;
- (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 fulfill all duties to the clients relating to the gold so kept with the other person, except for its physical safekeeping.”

SEPARATE CUSTODY ACCOUNT

Every custodian of securities is required to open a separate custody account for each client, in the name of the client whose securities are in its custody and ensure that the assets of one client would not be mixed with those of another client.

AGREEMENT WITH THE CLIENT

Every custodian of securities is required to enter into an agreement with each client on whose behalf it is acting as custodian of securities and every such agreement shall provide for the following matters, namely:

- (a) the circumstances under which the custodian of securities will accept or release securities, assets or documents from the custody account;
- (b) the circumstances under which the custodian of securities will accept or release monies from the custody account.

- (c) the circumstances under which the custodian of securities will receive rights or entitlements on the securities of the client;
- (d) the circumstances and the manner of registration of securities in respect of each client;
- (e) details of the insurance, if any, to be provided for by the custodian of securities.

INTERNAL CONTROLS

Every custodian of securities is required to have adequate internal controls to prevent any manipulation of records and documents, including audits for securities and rights or entitlements arising from the securities held by it on behalf of its client. Every custodian of securities would take appropriate safekeeping measures to ensure that such securities, assets or documents are protected from theft and natural hazard.

MAINTENANCE OF RECORDS AND DOCUMENTS

Regulation 19(1) provides that every custodian of securities is required to maintain the following records and documents, containing details of:

- (a) securities, assets or documents received and released on behalf of each client;
- (b) monies received and released on behalf of each client;
- (c) rights or entitlements of each client arising from the securities held on behalf of the client;
- (d) registration of securities in respect of each client;
- (e) ledger for each client;
- (f) instructions received from and sent to clients; and records of all reports submitted to SEBI.

The Custodian of securities would intimate to SEBI the place where the records and documents are maintained and custodian of securities shall preserve the records and documents maintained for a minimum period of five years.

APPOINTMENT OF COMPLIANCE OFFICER

Regulation 19A(1) provides that every custodian of securities would appoint a compliance officer responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by SEBI or the Central Government. He is under an obligation for redressal of investors' grievances.

The compliance officer is required to immediately and independently report to SEBI any non-compliance observed by him.

INFORMATION TO SEBI

SEBI may, at any time, call for any information from a custodian of securities with respect to any matter relating to its activity as custodian of securities. Where any information is called for by SEBI, it shall be the duty of the custodian of securities to furnish such information, within such reasonable period as SEBI may specify.

INSPECTION AND AUDIT

SEBI may appoint one or more persons as inspecting officer to undertake inspection of the books of accounts, records and documents of the custodian of securities for any of the following purposes, namely:-

- (a) to ensure that the books of account, records and documents are being maintained by the custodian of securities in the manner specified in these regulations;
- (b) to investigate into complaints received from investors, clients or any other person, on any matter having a bearing on the activities of the custodian of securities;

- (c) to ascertain whether the provisions of the Act and these regulations are being complied with by the custodian of securities; and
- (d) to investigate *suo motu* into the affairs of the custodian of securities, in the interest of the securities market or in the interest of investors.

The custodian of securities against whom the inspection is being carried out is under an obligation to discharge his obligations.

OBLIGATIONS OF CUSTODIAN

It is the duty of the custodian of securities whose affairs are being inspected, and of every director, officer and employee thereof, to produce to the inspecting officer such books, securities, accounts, records and other documents in its custody or control and furnish him with such statements and information relating to his activities of the custodian of securities, as the inspecting officer may require, within such reasonable period as the inspecting officer may specify.

The custodian of securities is required to allow the inspecting officer to have reasonable access to the premises occupied by such custodian or by any other person on his behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the custodian of securities or such other person and also provide copies of documents or other materials which, in the opinion of the inspecting officer are relevant for the purposes of the inspection.

The inspecting officer, in the course of inspection, is entitled to examine or to record the statements of any director, officer or employee of the custodian of securities. It is the duty of every director, officer or employee of the custodian of securities to give to the inspecting officer all assistance in connection with the inspection, which the inspecting officer may reasonably require.

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 made 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 Prescribed Form and shall be accompanied by 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 fulfillment of the conditions stipulated therefor, –

- (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 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 recognized by the Central Government or any State Government or a recognized foreign university or institution or association. Alternatively, advisers having a graduate in any discipline with experience of at least five years in activities relating to advice in financial products or securities or fund or asset or portfolio management are also qualified.
- 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 these 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 possess 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 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 follows :

- (1) An investment adviser shall act in a fiduciary capacity towards its clients and shall disclose all conflicts of interests as and when they arise.
- (2) 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.
- (3) An investment adviser shall maintain an arms-length relationship between its activities as an investment adviser and other activities.
- (4) 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.
- (5) 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.

(6) 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.

(7) 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.

(8) An investment adviser shall follow Know Your Client procedure as specified by SEBI from time to time.

(9) An investment adviser shall abide by Code of Conduct as specified in Third Schedule.

(10) 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.

(11) In case of change in control of the investment adviser, prior approval from SEBI shall be taken.

(12) Investment advisers shall furnish to SEBI information and reports as may be specified by SEBI from time to time.

(13) 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

Regulation 19 provides that 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 Accountants of India or Institute of Company Secretaries of India.

GUIDELINES ON ANTI MONEY LAUNDERING MEASURES

The Prevention of Money Laundering Act, 2002 (PMLA) has been brought into force with effect from 1st July 2005. Necessary Notifications / Rules under the said Act have been published in the Gazette of India on 1st July 2005 by the Department of Revenue, Ministry of Finance, Government of India. SEBI has laid down obligations of securities market intermediaries under PMLA, 2002 and rules framed thereunder.

As per the provisions of PML the Act, every banking company, financial institution (which includes chit fund company, a co-operative bank, a housing finance institution and a non-banking financial company) and intermediary (which includes a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and any other intermediary associated with securities market and registered under section 12 of the Securities and Exchange Board of India Act, 1992) shall have to maintain a record of all the transactions; the nature and value of which has been prescribed in the Rules notified under the PMLA. Such transactions include:

- All cash transactions of the value of more than Rs 10 lakhs or its equivalent in foreign currency.
- All series of cash transactions integrally connected to each other which have been valued below Rs 10 lakhs or its equivalent in foreign currency where such series of transactions take place within one calendar month.
- All suspicious transactions whether or not made in cash and including *inter alia*, credits or debits into from any non-monetary account such as demat account, security account maintained by the registered intermediary.

It may, however, be clarified that for the purpose of suspicious transactions, reporting apart from 'transactions integrally connected', 'transactions remotely connected or related should also be considered.

SEBI has laid down the minimum requirements / disclosures to be made in respect of clients. The intermediaries are required to specify additional disclosures to be made by clients to address concerns of Money Laundering and suspicious transactions undertaken by clients, according to their requirements.

The intermediaries are also required to designate an officer as 'Principal Officer' who would be responsible for ensuring compliance of the provisions of the PMLA. And also designate a person as a 'Designated Director' on whom the director, FIU-IND can take appropriate action including levying monetary penalty on the designated director for failure of the intermediary to comply with any of its AML/CFT obligation.

Each registered intermediary should adopt written procedures to implement the anti money laundering provisions as envisaged under the Anti Money Laundering Act, 2002. Such procedures should include *inter alia*, the following three specific parameters which are related to the overall 'Client Due Diligence Process':

- (a) Policy for acceptance of clients
- (b) Procedure for identifying the clients
- (c) Transaction monitoring and reporting especially Suspicious Transactions Reporting (STR)

OBLIGATIONS OF INTERMEDIARIES UNDER PREVENTION OF MONEY LAUNDERING ACT, 2002

Section 12 of the Prevention of Money Laundering Act, 2002 lays down following obligations on an intermediary:

Every banking company, financial institution and intermediary shall –

- (A) maintain a record of all transactions, the nature and value of which may be prescribed, whether such transactions comprise of a single transaction or a series of transactions integrally connected to each other, and where such series of transactions take place within a month;
- (B) furnish information of transactions referred to in clause (a) to the Director within such time as may be prescribed;
- (C) verify and maintain the records of the identity of all its clients, in such a manner as may be prescribed.

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

The records shall be maintained for a period of ten years from the date of cessation of the transactions between the clients of the banking company or financial institution or intermediary, as the case may be.

CASH TRANSACTION REPORT

The Prevention of Money Laundering Act, 2002 and the Rules thereunder require every intermediary to furnish details of the following cash transactions:

- (A) All cash transactions of the value of more than rupees ten lakhs or its equivalent in foreign currency.
- (B) All series of cash transactions integrally connected to each other which have been valued below rupees ten lakhs or its equivalent in foreign currency where such series of transactions have taken place within a month.

SUSPICIOUS TRANSACTION REPORT

The Prevention of Money Laundering Act, 2002 and the Rules notified thereunder require every intermediary to furnish details of suspicious transactions whether or not made in cash. Suspicious transaction means a transaction whether or not made in cash which, to a person acting in good faith –

- (a) gives rise to a reasonable ground of suspicion that it may involve the proceeds of crime; or
- (b) appears to be made in circumstances of unusual or unjustified complexity; or
- (c) appears to have no economic rationale or bonafide purpose.

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

Identity of Client

- False identification documents
- Identification documents which could not be verified within reasonable time
- Non-face to face client

- Doubt over the real beneficiary of the account
- Accounts opened with names very close to other established business entities

Suspicious Background

- Suspicious background or links with known criminals

Multiple Accounts

- Large number of accounts having a common account holder, introducer or authorized signatory with no rationale
- Unexplained transfers between multiple accounts with no rationale

Activity in Accounts

- Unusual activity compared to past transactions
- Use of different accounts by client alternatively
- Sudden activity in dormant accounts
- Activity inconsistent with what would be expected from declared business
- Account used for circular trading

Nature of Transactions

- Unusual or unjustified complexity
- No economic rationale or bonafide purpose
- Source of funds are doubtful
- Appears to be case of insider trading
- Investment proceeds transferred to a third party
- Transactions reflect likely market manipulations
- Suspicious off market transactions

Value of Transactions

- Value just under the reporting threshold amount in an apparent attempt to avoid reporting
- Large sums being transferred from overseas for making payments
- Inconsistent with the clients apparent financial standing
- Inconsistency in the payment pattern by client
- Block deal which is not at market price or prices appear to be artificially inflated/deflated

CLIENT IDENTIFICATION PROCEDURE

The 'Know your Client' (KYC) policy should clearly spell out the client identification procedure to be carried out at different stages i.e. while establishing the intermediary – client relationship, while carrying out transactions for the client or when the intermediary has doubts regarding the veracity or the adequacy of previously obtained client identification data. SEBI has prescribed the minimum requirements relating to KYC for certain class of the registered intermediaries from time to time. Taking into account the basic principles enshrined in the KYC norms which have already been prescribed or which may be prescribed by SEBI from time to time, all registered intermediaries should frame their own internal guidelines based on their experience in dealing with their clients

and legal requirements as per the established practices. Further, the intermediary should also maintain continuous familiarity and follow-up where it notices inconsistencies in the information provided. The underlying principle should be to follow the principles enshrined in the PML Act, 2002 as well as the SEBI Act, 1992 so that the intermediary is aware of the clients on whose behalf it is dealing.

INFORMATION TO BE MAINTAINED

Intermediaries are required to maintain and preserve the following information in respect of transactions mentioned above.

- (i) the nature of the transactions;
- (ii) the amount of the transaction and the currency in which it was denominated;
- (iii) the date on which the transaction was conducted; and
- (iv) the parties to the transaction.

MAINTENANCE AND PRESERVATION OF RECORDS

Intermediaries are required to take appropriate steps to evolve an internal mechanism for proper maintenance and preservation of such records and information in a manner that allows easy and quick retrieval of data as and when requested by the competent authorities. Further, the records have to be maintained and preserved for a period of ten years from the date of cessation of the transactions between the client and intermediary.

Records evidencing the identity of its clients and beneficial owners as well account files and business correspondence shall be maintained and preserved for a period of five years after the business relationship between a client and intermediary has ended or the account has been closed, whichever is later.

REPORTING TO FINANCIAL INTELLIGENCE UNIT-INDIA

In terms of the PMLA rules, intermediaries are required to report information relating to cash and suspicious transactions to the Director, Financial Intelligence Unit-India (FIU-IND) at the following address:

Director, FIU-IND,
Financial Intelligence Unit-India,
6th Floor, Hotel Samrat, Chanakyapuri,
New Delhi-110021.
Website: <http://fiuindia.gov.in>

The Intermediaries are required to adhere to the following:

- (a) The cash transaction report (CTR) (wherever applicable) for each month should be submitted to FIU-IND by 15th of the succeeding month.
- (b) The Suspicious Transaction Report (STR) should be submitted within 7 days of arriving at a conclusion that any transaction, whether cash or non-cash, or a series of transactions integrally connected are of suspicious nature. The Principal Officer should record his reasons for treating any transaction or a series of transactions as suspicious. It should be ensured that there is no undue delay in arriving at such a conclusion.
- (c) The Principal Officer is responsible for timely submission of CTR and STR to FIU-IND;
- (d) Utmost confidentiality is to be maintained in filing of CTR and STR to FIU-IND. The reports may be transmitted by speed/registered post/fax at the notified address.

The Trading Member should not put any restrictions on operations in the accounts where an STR has been made. Further, it should be ensured that there is no tipping off to the client at any level.

It is clarified that the registered intermediaries, irrespective of the amount of transaction and/or the threshold

limit envisaged for predicate offences specified in Part B of Schedule of PMLA, 2002, should file STR if they have reasonable grounds to believe that the transactions involve proceeds of crime.

SEBI (INTERMEDIARIES) REGULATIONS, 2008

In the present regime a dozen regulations govern different categories of intermediaries. The broad framework of such regulations is similar to one another. SEBI in exercise of the powers conferred by section 30 of the Securities and Exchange Board of India Act, 1992 issued the SEBI (Intermediaries) Regulations, 2008 which seek to consolidate the common requirements and put in place a comprehensive framework which will apply to the intermediaries and prescribe the obligations, procedure, limitations etc. in so far as the common requirements are concerned. The new regulations seek to simplify procedures to make the registration/ regulation process of intermediaries less burdensome and cost effective without diluting the regulatory oversight. The regulation is primarily principle based and some significant changes in the framework are given below :

1. Permanent Registration

Subject to compliance with the SEBI Act, regulations, updation of relevant disclosures and payment of fees registration shall be permanent.

2. Registration for multiple activities

The process for registration for undertaking multiple activities by the same intermediary has been simplified.

3. Registration Form- information divided into two parts

Part 1 of the form will be disclosed and available to the public and Part II will contain such information which will be retained with the Board as regulatory filing.

4. Fit and Proper person requirements

The criteria to determine whether the intermediary is a Fit and Proper person have been revised and are now principle based.

5. Suspension/Cancellation of certificate of registration

The manner of suspension/cancellation of any certificate granted to any person has been provided in the regulations. Consequently the SEBI (Procedure for holding enquiry by enquiry officer and imposing penalty) Regulations, 2002 has been repealed and SEBI (Intermediaries) Regulations, 2008 has taken place.

APPLICATION FOR GRANT OF CERTIFICATE

(1) Regulation 3 provides that an application for grant of a certificate to act as an intermediary, shall be made to the SEBI in Form A of Schedule I with such additional information as required and the application fee, as specified.

However, the applicant seeking registration to act as a stock broker or sub-broker or a trading member or a clearing member or a depository participant shall make the application along with such additional information through the stock exchange or through the clearing corporation of which the applicant is a member or trading member or through the depository in which the applicant proposes to act as a participant, as the case may be.

(2) The stock exchange, the clearing corporation, the depository or the specified self regulatory organization, as the case may be, shall examine the eligibility of the applicant in terms of these regulations, relevant regulations and the rules, regulations or bye-laws of the concerned stock exchange, clearing corporation, depository or the self regulatory organization and forward the application with the application fees to SEBI along with its recommendation as early as possible but not later than thirty days of receipt of the complete application with the specified application fees.

(3) An intermediary, who was granted a certificate under the relevant regulations prior to the commencement of these regulations in relation to such intermediary, may continue to act as such, subject to the following –

- (a) where the certificate was granted for a specified period, an application for grant of certificate under sub-regulation (1) shall be made by the intermediary at least three months prior to the expiry of such period or three months prior to expiry of two years from the commencement of these regulations in relation to such intermediary, whichever is earlier and if the intermediary fails to do so, it shall cease to act as an intermediary on and from the expiry of the aforementioned period;
- (b) where a certificate has been granted to an intermediary on a permanent basis, the certificate may continue to be valid under these regulations subject to the condition that the intermediary shall, within two years of commencement of these regulations in relation to such intermediary, furnish the information in Form A to SEBI and upload the information in Part I thereof on the website specified by SEBI:

However, the time may be extended by SEBI up to a period of six months on sufficient reasons being shown by the intermediary.

(4) An intermediary who has complied with the provisions of these regulations shall be deemed to have been granted certificate under these regulations, subject to the payment of fees specified under the relevant regulations.

(5) An applicant or an intermediary as the case may be may carry on the activities of one or more intermediaries only if it obtains a separate certificate to carry on each such activity.

DISCLOSURE OF INFORMATION

Regulation 4 stipulates that the information contained in Part I of Form A shall be disclosed to the public by uploading such information on the website as specified by SEBI.

However, the other relevant information furnished by the intermediary in Part II of Form A which relates to commercial confidence and private information of the intermediary, may be treated as confidential by SEBI.

Any material change in the information furnished or uploaded under these regulations shall be updated by the intermediary promptly but not later than fifteen days of the occurrence of such change.

FURNISHING OF INFORMATION AND CLARIFICATION

Regulation 5 lays down that SEBI may require the applicant to furnish further information or clarifications, regarding matters relevant to the activity of such an intermediary and the applicant shall furnish such information and clarification to the satisfaction of SEBI, within the time specified.

VERIFICATION OF INFORMATION

Regulation 6 deals with the verification part. While considering the application, SEBI may, if it so desires, verify the information by physical verification of documents, office space, and inspect the availability of office space, infrastructure, and technological support which the applicant is required to have. For the purpose under sub-regulation (1), SEBI may appoint any person including an auditor.

CONSIDERATION OF APPLICATION

As per regulation 7 while considering an applicant, SEBI shall take into account all matters which it deems relevant to the activities in the securities market, including but not limited to the following–

- (a) whether the applicant or any of its associates have in the past been refused certificate by SEBI and if so, the ground for such refusal;
- (b) whether the applicant, its directors or partners, or trustees, as the case may be or its principal officer is involved in any pending litigation connected with the securities market which has an adverse bearing on the business of the applicant or on development or functioning of the securities markets;
- (c) whether the applicant satisfies the eligibility criteria and other requirements;

- (d) whether the grant of a certificate to the applicant is in the interest of the investors and the development of the securities market.

Any application for grant of certificate:

- (a) which is not complete in all respects and does not conform to the requirements in Form A and the requirements specified in the relevant regulation;
- (b) which does not contain such additional information as required;
- (c) which is incorrect, false or misleading in nature;
- (d) where the applicant is not in compliance with the eligibility requirements;
- (e) where the applicant is not a 'fit and proper person' as stated in Schedule II;
- (f) where the principal officer does not have the requisite qualification or experience as required under the relevant regulations;

shall be rejected by SEBI for reasons to be recorded by SEBI in writing. Before rejecting an application, the applicant shall be given an opportunity in writing to make good the deficiencies within the time specified by SEBI, for the purpose. Where an application is rejected for the reason that it contains false or misleading information, no such opportunity may be given and the applicant shall not make any application for grant of certificate under these regulations or any other regulations for a period of one year from the date of such rejection.

PROCEDURE FOR GRANT OF CERTIFICATE

Regulation 8 stipulates that SEBI on being satisfied that the applicant is eligible, shall grant a certificate in the form specified in the relevant regulations and send an intimation to the applicant in this regard:

Provided that where a pending proceeding before SEBI or any court or tribunal may result in the suspension or cancellation of the certificate, SEBI may give a conditional registration.

When an intermediary, who has been granted a certificate and who has filed Form A under these regulations, wishes to commence a new activity which requires a separate certificate under the relevant regulations, it shall, while seeking such certificate, not be required to file Form A, and shall furnish to SEBI only such additional information as is required under the relevant regulations.

CONDITIONS OF CERTIFICATE

Regulation 9 provides that any certificate granted by SEBI to an intermediary shall be subject to the following conditions, namely : –

- (a) where the intermediary proposes to change its status or constitution, it shall obtain prior approval of SEBI for continuing to act as an intermediary after such change in status or constitution. A request in this regard shall be disposed off by SEBI within a period of sixty days from the date of receipt of such request and where the decision of SEBI has not been communicated to the intermediary within the said period of sixty days, the prior approval shall be deemed to have been granted and it shall contain the information in Form A;
- (b) it shall pay the applicable fees in accordance with the relevant regulations;
- (c) it shall abide by the provisions of the securities laws and the directions, guidelines and circulars as may be issued thereunder;
- (d) it shall continuously comply with the requirements of disclosure norms;
- (e) it shall meet the eligibility criteria and other requirements specified.

However, SEBI may impose other conditions as it may deem fit.

EFFECT OF REFUSAL TO GRANT CERTIFICATE OR EXPIRY OF CERTIFICATE

Regulation 10 provides that where an intermediary has failed to make an application or where an existing intermediary has been refused grant of certificate under these regulations, the intermediary shall:

- (a) forthwith cease to act as such intermediary;
- (b) transfer its activities to another intermediary which has been granted a certificate for carrying on such activity and allow its clients or investors to withdraw or transfer their securities or funds held in its custody without any additional cost to such client or investor;
- (c) make provisions as regards liability incurred or assumed by the intermediary;
- (d) take such other action, within the time period and in the manner, as may be required.

While refusing grant of certificate under these regulations to an intermediary, SEBI may impose such conditions upon the intermediary as it deems fit for protection of investors or clients of the intermediary or the securities market and such conditions shall be complied with.

PERIOD OF VALIDITY OF CERTIFICATE

The certificate granted to an intermediary shall be permanent unless surrendered by the intermediary or suspended or cancelled in accordance with these regulations.

GENERAL OBLIGATIONS

Regulation 12 lays down the general obligation of the intermediary. An intermediary shall provide SEBI with a certificate of its compliance officer on the 1st April of each year certifying;

- (a) the compliance by the intermediary on a continuous basis under these regulations and the relevant regulations;
- (b) disclosures made in Form A true and complete.

Each intermediary shall prominently display a photocopy of the certificate at all its offices including branch offices and also the name and contact details of the compliance officer to whom complaint may be made in the event of any investor grievance.

REDRESSAL OF INVESTOR GRIEVANCES

Regulation 13 provides that the intermediary shall make endeavours to redress investor grievances promptly but not later than forty-five days of receipt thereof and when called upon by SEBI to do so it shall redress the grievances of investors within the time specified by SEBI.

The intermediary shall at the end of each quarter of a Financial Year ending on 31st March upload information about the number of investor grievances received, redressed and those remaining unresolved beyond three months of the receipt thereof by the intermediary on the website specified by SEBI.

APPOINTMENT OF COMPLIANCE OFFICER

Regulation 14 of these regulations provides that an intermediary shall appoint a compliance officer for monitoring the compliance by it of the requirements where applicable. The intermediary may not appoint compliance officer if it is not carrying on the activity of the intermediary.

The compliance officer shall report to the intermediary or its board of directors, in writing, of any material non-compliance by the intermediary.

INVESTMENT ADVICE

Regulation 15 provides that an intermediary, its directors, officers, employees or key management personnel shall

not render, directly or indirectly, any investment advice about any security in the publicly accessible media, whether real-time or non-real-time, unless a disclosure of its interest, direct or indirect, including its long or short position in the said security has been made, while rendering such advice and also discloses the interest of his dependent family members and that of the employer including employer's long or short position in the said security.

An intermediary shall not make a recommendation to any client or investor who may be expected to rely thereon to acquire, dispose of or retain any securities unless he has reasonable grounds to believe that the recommendation is suitable.

Code of conduct

Regulation 16 stipulates that an intermediary and its directors, officers, employees and key management personnel shall continuously abide by the code of conduct specified in Schedule III.

INSPECTION OF BOOKS, ACCOUNTS AND RECORDS

The intermediary shall maintain such books, accounts and records as specified in the relevant regulations. Regulation 17 provides that without prejudice to the provisions of section 11 and section 11C of the Act, SEBI may appoint one or more persons as inspecting authority to undertake the inspection of the books, accounts, records including telephone records and electronic records and documents of an intermediary for any purpose.

The purposes may include:

- (a) to ensure that the books of account, records including telephone records and electronic records and documents are being maintained in the manner required under the relevant regulations;
- (b) to ascertain whether adequate internal control systems, procedures and safeguards have been established and are being followed by the intermediary to fulfill its obligations under the relevant regulations;
- (c) to ascertain whether any circumstances exist which would render the intermediary unfit or ineligible;
- (d) to ascertain whether the provisions of the securities laws and the directions or circulars issued thereunder are being complied with;
- (e) to inquire into the complaints received from investors, clients, other market participants or any other person on any matter having a bearing on the activities of the intermediary;
- (f) to inquire *suo motu* into such matters as may be deemed fit in the interest of investors or the securities market.

NOTICE BEFORE INSPECTION

Regulation 18 stipulates that before undertaking an inspection, the inspecting authority shall give a notice to the concerned intermediary. If the inspecting authority is satisfied that in the interest of the investors no such notice should be given, it may, for reasons to be recorded in writing, dispense with such notice.

OBLIGATIONS OF INTERMEDIARY ON INSPECTION

Regulation 19 provides that –

- (1) It shall be the duty of every director, proprietor, partner, trustee, officer, employee and any agent of an intermediary which is being inspected, to produce to the inspecting authority such books, accounts, records including telephone records and electronic records and documents in his custody or control and furnish to the inspecting authority with such statements and information relating to its activities within such time as the inspecting authority may require.
- (2) The intermediary shall allow the inspecting authority to have reasonable access to the premises occupied by such intermediary or by any other person on its behalf and also extend reasonable facility for examining such documents.
- (3) The inspecting authority shall, in the course of inspection, be entitled to examine or record statements of any principal officer, director, trustee, partner, proprietor or employee of such intermediary.

- (4) It shall be the duty of every director, proprietor, trustee, partner, officer and employee of such intermediary to give to the inspecting authority all assistance which the inspecting authority may reasonably require in connection with the inspection.

APPOINTMENT OF AUDITOR OR VALUER

Regulation 20 provides that SEBI may appoint a qualified auditor to inspect the books of account or the affairs of an intermediary. The auditor so appointed shall have the same powers of the inspecting authority.

SUBMISSION OF REPORT TO SEBI

As per regulation 21 the inspecting authority shall submit an inspection report including interim reports to SEBI. On submission of the inspection report, SEBI may take such action thereon as it may deem fit and appropriate.

CANCELLATION OR SUSPENSION OF REGISTRATION AND OTHER ACTIONS

Regulation 23 provides that where any person who has been granted a certificate of registration under the Act or regulations made thereunder –

- (a) fails to comply with any conditions subject to which a certificate of registration has been granted to him;
- (b) contravenes any of the provisions of the securities laws or directions, instructions or circulars issued thereunder.

SEBI may, without prejudice to any action under the securities laws or directions, instructions or circulars issued thereunder, by order take such action in the manner provided under these regulations.

APPOINTMENT OF DESIGNATED AUTHORITY

Regulation 24 provides that where it appears to the designated member, that any person who has been granted certificate of registration under the Act, regulations made thereunder has committed any default of the nature specified in regulation 23, he may appoint an officer not below the rank of a Division Chief, as a designated authority.

However, the designated member may, at his discretion, appoint a bench of three officers, each of whom shall not be below the rank of a Division Chief and such bench shall be presided by the senior most amongst them and all the decisions or recommendations of such bench shall be by way of majority.

No officer who has conducted investigation or inspection in respect of the alleged violation shall be appointed as a designated authority.

ISSUANCE OF NOTICE

As per regulation 25 the designated authority shall, if it finds reasonable grounds to do so, issue a notice to the concerned person requiring him to show cause as to why the certificate of registration granted to it, should not be suspended or cancelled or why any other action provided herein should not be taken.

Every notice shall specify the contravention alleged to have been committed by the noticee copies of documents containing the findings arrived at in an investigation or inspection, if any, carried out.

The noticee shall be called upon to submit within a period to be specified in the notice, not exceeding twenty-one days from the date of service thereof, a written representation along with documentary evidence, if any, in support of the representation to the designated authority.

REPLY BY THE NOTICEE

Regulation 26 provides that the noticee shall submit to the designated authority its written representation within the period specified in the notice along with documentary evidence, if any, in support thereof. The designated authority may extend the time specified in the notice for sufficient grounds shown by the noticee and after recording reasons in writing.

EX-PARTE PROCEEDINGS

The noticee does not reply to the show cause notice, the designated authority may proceed with the matter ex-parte recording the reasons for doing so and make recommendation as the case may be on the basis of material facts available before it.

ACTION IN CASE OF DEFAULT

Regulation 27 provides for the following in case of default –

- (i) suspension of certificate of registration for a specified period;
- (ii) cancellation of certificate of registration;
- (iii) prohibiting the noticee to take up any new assignment or contract or launch a new scheme for the period specified in the order;
- (iv) debarring a principal officer of the noticee from being employed or associated with any registered intermediary or other registered person for the period specified in the order;
- (v) debarring a branch or an office of the noticee from carrying out activities for the specified period;
- (vi) warning the noticee.

PROCEDURE FOR ACTION ON RECEIPT OF THE RECOMMENDATION

Regulation 28 provides that on receipt of the report recommending the measures from the designated authority, the designated member shall consider the same and issue a show cause notice to the noticee enclosing a copy of the report submitted by the designated authority calling upon the noticee to submit its written representation as to why the action, including passing of appropriate direction, as the designated member considers appropriate, should not be taken.

The noticee may, within twenty one days of receipt of the notice send a reply to the designated member who may pass appropriate order after considering the reply, if any received from the noticee and providing the person with an opportunity of being heard, as expeditiously as possible and endeavour shall be made to pass the order within one hundred and twenty days from the date of receipt of reply of the notice or hearing.

INTIMATION OF THE ORDER

As per Regulation 29 and 30 deals with the order pass by the designated member. The designated member may pass a common order in respect of a number of notices where the subject matter in question is substantially the same or similar in nature. Every report made by a designated authority and every order passed by the designated member under this Chapter shall be dated and signed and sent to the noticee and also uploaded on the website of SEBI. If the noticee is a member of a stock exchange, clearing corporation, a depository or a self-regulatory organization, a copy of the order shall also be sent to the concerned stock exchange, clearing corporation, depository or self regulatory organization.

SURRENDER OF ANY CERTIFICATE OF REGISTRATION

Regulation 31 provides that any person, who has been granted a certificate of registration under the Act or the regulations made thereunder, desirous of giving up its activity and surrender the certificate, may make a request for such surrender to SEBI and while disposing such request, SEBI shall not be bound by the procedure specified in the foregoing provisions of this Chapter.

- (a) the arrangements made by the person for maintenance and preservation of records and other documents required to be maintained under the relevant regulations;
- (b) redressal of investor grievances;

- (c) transfer of records, funds or securities of its clients;
- (d) the arrangements made by it for ensuring continuity of service to the clients;
- (e) defaults or pending action, if any.

While accepting surrender, SEBI may impose such conditions as it deems fit.

EFFECT OF DEBARMENT, SUSPENSION, CANCELLATION OR SURRENDER

Regulation 32 provides that on and from the date of debarment or suspension of the certificate, the concerned person shall –

- (a) not undertake any new assignment or contract or launch any new scheme and during the period of such debarment or suspension;
- (b) allow its clients or investors to withdraw or transfer their securities or funds without any additional cost to such client or investor;
- (c) make provisions as regards liability incurred or assumed by it;
- (d) take such other action including the action relating to any records or documents and securities or money of the investors.

On and from the date of surrender or cancellation of the certificate, the concerned person shall—

- (a) return the certificate of registration so cancelled to SEBI and shall not represent itself to be a holder of certificate for carrying out the activity for which such certificate had been granted;
- (b) cease to carry on any activity in respect of which the certificate had been granted;
- (c) transfer its activities to another person holding a valid certificate of registration to carry on such activity and allow its clients or investors to withdraw or transfer their securities or funds held in its custody or to withdraw any assignment given to it, without any additional cost to such client or investor;
- (d) make provisions as regards liability incurred or assumed by it;
- (e) take such other action including the action relating to any records or documents and securities or money of the investors.

APPEAL TO SECURITIES APPELLATE TRIBUNAL

Regulation 33 provides that the person aggrieved by an order under these regulations may prefer an appeal to the Securities Appellate Tribunal against such order in accordance with the provisions of section 15T of the Act and Rules prescribed in this regards.

DIRECTIONS

As per regulation 35, SEBI can issue, necessary direction including but not limited to any or all of the following –

- (a) directing the intermediary or other persons associated with securities market to refund any money or securities collected from the investors under any scheme or otherwise, with or without interest;
- (b) directing the intermediary or other persons associated with securities market not to access the capital market or not to deal in securities for a particular period or not to associate with any intermediary or with any capital market related activity;
- (c) directing the recognised stock exchange concerned not to permit trading in the securities or units issued by a mutual fund or collective investment scheme;
- (d) directing the recognised stock exchange concerned to suspend trading in the securities or units issued by a mutual fund or collective investment scheme;

(e) any other direction which SEBI may deem fit and proper.

Before issuing any directions SEBI shall give a reasonable opportunity of being heard to the persons concerned. Further that if the circumstances warrant any interim direction is required to be passed immediately, SEBI shall give a reasonable opportunity of hearing to the persons concerned after passing the direction, without any undue delay.

SEBI {KYC (KNOW YOUR CLIENT) REGISTRATION AGENCY (KRA)}, REGULATIONS, 2011

With a view to bring uniformity in the KYC requirements for the securities markets, SEBI has initiated usage of uniform KYC by all SEBI registered intermediaries. In this regard SEBI has issued the SEBI {KYC (Know Your Client) Registration Agency (KRA)}, Regulations, 2011.

KRA provides for centralization of the KYC records in the securities market. The client who is desirous of opening an account/trade/deal with the SEBI registered Intermediary shall submit the KYC details through the KYC Registration form and supporting documents. The Intermediary shall perform the initial KYC and upload the details on the system of the KYC Registration Agency (KRA). This KYC information can be accessed by all the SEBI Registered Intermediaries while dealing with the same client. As a result, once the client has done KYC with a SEBI registered intermediary, he need not undergo the same process again with another intermediary.

The key highlights of the regulation are as follows:

- An intermediary shall perform the initial KYC of its clients and upload the details on the system of the KRA.
- When the client approaches another intermediary, the intermediary can verify and download the client's details from the system of the KRA (KYC Registration Agency).
- As a result, once the client has done KYC with a SEBI registered intermediary, he need not undergo the same process again with another intermediary.
- SEBI shall not consider an application, unless the applicant is a fit and proper person to the satisfaction of the SEBI and is a wholly-owned subsidiary of a recognised stock exchange, having nationwide network of trading terminals
- Besides, wholly-owned subsidiaries of depositories, other market intermediaries and Self Regulatory Organisations would also be able to secure certificate for initial registration as KRA..
- The KRA shall obtain the KYC documents of the client from the intermediary as prescribed by SEBI and in terms of the rules, regulations, guidelines and circulars issued by the Board or any other authority for Prevention of Money Laundering, from time to time.
- The KRAs can, in coordination with each other, prepare operating instructions for implementing requirements under this regulation and share data on KYC documents.
- KRA shall be responsible for storing, safeguarding and retrieving the KYC documents and submit to SEBI or any other statutory authority as and when required.

LIST OF SEBI REGISTERED INTERMEDIARIES

List of SEBI registered intermediaries as per the new KYC Regulations

1. KYC Registration Agencies (KRAs),
2. Stock Brokers through Stock Exchanges,
3. Depository Participants (DPs) through Depositories,
4. Mutual Funds (MFs)
5. Portfolio Managers (PMs)

6. Venture Capital Funds (VCFs)
7. Collective Investment Schemes (CIS)

GRANT OF CERTIFICATE OF INITIAL REGISTRATION

SEBI on being satisfied that the applicant is eligible, shall send intimation to that effect to the applicant, for the grant of certificate of initial registration, and grant a certificate in the Form as specified by SEBI.

(2) The certificate of initial registration granted shall be valid for a period of five years from the date of its issue to the applicant.

(3) The grant of certificate of initial registration shall be subject to the payment of such fees and in such manner as specified in these regulations.

GRANT OF CERTIFICATE OF PERMANENT REGISTRATION

The KRA which has been granted a certificate of initial registration may, three months before the expiry of the period of certificate of initial registration, make an application for grant of certificate of permanent registration in the Prescribed Form.

An application shall be accompanied by such fees and in such manner as specified in these regulations.

The application for grant of a certificate of permanent registration shall be accompanied by details of the changes that have taken place in the information that was submitted to SEBI while seeking initial registration, as the case may be, and a declaration stating that no changes other than those as mentioned in such details have taken place.

The application for permanent registration shall be dealt with in the same manner as if, it were a fresh application for grant of a certificate of initial registration.

SEBI, on being satisfied that the applicant is eligible, shall send intimation to that effect, to the applicant and shall grant a certificate of permanent registration in the prescribed format.

CRITERIA FOR FIT AND PROPER PERSON

For the purpose of determining whether an applicant is a fit and proper person, SEBI may take into account the criteria specified in SEBI Intermediaries Regulations.

CODE OF CONDUCT

The KRA holding a certificate of registration shall at all times abide by the Code of Conduct as specified in Schedule III of these regulations.

DOCUMENTS TO BE OBTAINED BY THE KRA FOR THE PURPOSE OF KYC

The KRA shall obtain the KYC documents of the client from the intermediary; as prescribed by SEBI and in terms of the rules, regulations, guidelines and circulars issued by SEBI or any other authority for Prevention of Money Laundering, from time to time.

FUNCTIONS AND OBLIGATIONS OF THE KRA

The KRA has the following functions and obligations –

- (a) KRA may prepare the Operating Instructions in co-ordination with other KRA(s) and issue the same to implement the requirements of these regulations.
- (b) KRA(s) shall have electronic connectivity and with other KRA(s) in order to establish inter-operability among KRAs.

- (c) KRA shall have a secure data transmission link with other KRA(s) and with each intermediary that uploads the KYC documents on its system and relies upon its data.
- (d) KRA shall be responsible for storing, safeguarding and retrieving the KYC documents and submit to SEBI or any other statutory authority as and when required.
- (e) KRA shall retain the KYC documents of the client, in electronic form for the period specified by Rules, as well as ensuring that retrieval of KYC information is facilitated within stipulated time period.
- (f) Any information updated about a client shall be disseminated by KRA to all intermediaries that avail of the services of the KRA in respect of that client.
- (g) KRA shall ensure that the integrity of the automatic data processing systems for electronic records is maintained at all times.
- (h) KRA shall take all precautions necessary to ensure that the KYC documents/records are not lost, destroyed or tampered with and that sufficient back up of electronic records is available at all times at a different place.
- (i) KRA shall have adequate mechanisms for the purposes of reviewing, monitoring and evaluating its controls, systems, procedures and safeguards.
- (j) KRA shall cause an audit of its controls, systems, procedures and safeguards to be carried out periodically and take corrective actions for deficiencies, if any and report to SEBI.
- (k) KRA shall take all reasonable measures to prevent unauthorized access to its database and have audit of its systems and procedures at regular intervals as prescribed by SEBI.
- (l) KRA shall have checks built in its system so that an intermediary can access the information only for the clients who approach him.
- (m) KRA 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 the Central Government and for redressal of client's grievances. The compliance officer shall immediately and independently report to SEBI any non-compliance observed by him.
- (n) KRA shall send a letter to each client after receipt of the KYC documents from the intermediary, confirming the client's details thereof.
- (o) KRA shall take adequate steps for redressal of the grievances of the clients within one month of the date of receipt of the complaint and keep the Board informed about the number, nature and other particulars of the complaints from such investors.

FUNCTIONS AND OBLIGATIONS OF AN INTERMEDIARY

The Intermediary has the following functions and obligations –

- (a) The intermediary shall perform the initial KYC/due diligence of the client, upload the KYC information with proper authentication on the system of the KRA, furnish the scanned images of the KYC documents to the KRA, and retain the physical KYC documents.

However, in case of clients of a mutual fund, the Registrar to an Issue and Share Transfer Agent appointed by the mutual fund may perform the initial KYC/due diligence of the client, upload the KYC information with proper authentication on the system of the KRA, and furnish the scanned images of KYC documents to the KRA.

- (b) The intermediary or the mutual fund, as the case may be, shall furnish the physical KYC documents or authenticated copies thereof to the KRA, whenever so desired by the KRA.

- (c) When the client approaches another intermediary subsequently, the intermediary shall verify and download the client's details from the system of KRA.

Provided that upon receipt of information on change in KYC details and status of the clients by the intermediary or when it comes to the knowledge of the intermediary, at any stage, the intermediary shall be responsible for uploading the updated information on the system of KRA and retaining the physical documents.

- (d) An intermediary shall not use the KYC data of a client obtained from the KRA for purposes other than it is meant for; nor shall it make any commercial gain by sharing the same with any third party including its affiliates or associates.
- (e) The intermediary shall have the ultimate responsibility for the KYC of its clients, by undertaking enhanced KYC measures commensurate with the risk profile of its clients.

LIABILITY FOR ACTION IN CASE OF DEFAULT

A KRA shall be liable for action if it –

- (a) contravenes any of the provisions of the Act, and these regulations;
- (b) fails to furnish any information relating to its activity as a KRA as required under these regulations;
- (c) does not co-operate in any inspection or investigation or enquiry conducted by SEBI;
- (d) fails to comply with any direction of SEBI;
- (e) fails to pay the requisite fees to SEBI;

and shall be dealt with in the manner provided under the SEBI Intermediaries Regulations.

IN-PERSON VERIFICATION (IPV)

SEBI has made it compulsory for all the intermediaries to carry out IPV of their clients.

The intermediary shall ensure that the details like name of the person doing IPV, his designation, organization with his signatures and date are recorded on the KYC form at the time of IPV.

The IPV carried out by one SEBI registered intermediary can be relied upon by another intermediary.

In case of Stock brokers, their sub-brokers or Authorised Persons (appointed by the stock brokers after getting approval from the concerned Stock Exchanges) can perform the IPV.

In case of Mutual Funds, their Asset Management Companies (AMCs) and the distributors who comply with the certification process of National Institute of Securities Market (NISM) or Association of Mutual Funds (AMFI) and have undergone the process of 'Know Your Distributor (KYD)', can perform the IPV.

However, in case of applications received by the mutual funds directly from the clients i.e. not through any distributor), they may also rely upon the IPV performed by the scheduled commercial banks.

SEBI (SELF REGULATORY ORGANISATIONS) REGULATIONS, 2004

SEBI (Self Regulatory Organizations) Regulations, 2004 came into effect on 19th February, 2004.

RECOGNITION OF SELF REGULATORY ORGANIZATION

Regulation 3 provides that any group or association of intermediaries, which is desirous of being recognized as a Self Regulatory Organization, may form a company under section 8 of the Companies Act, 2013 and such company may make an application to the SEBI for grant of certificate of recognition as a Self Regulatory Organization. However, a distributors shall be deemed to be any intermediary for the purpose of this regulation.

Further, SEBI may, in case of distributors engaged by asset management companies of mutual funds, grant certificate of recognition to only one group of association making in application under this regulation.

Every application made by such company must contain such particulars as may be specified and is to be accompanied by a copy of the governing norms of Self Regulatory Organization and also a copy of the memorandum and articles of association relating in general to the constitution of the Self Regulatory Organization and in particular, to –

- (a) Board of Directors of Self Regulatory Organization, its constitution and powers of management and the manner in which its business would be transacted;
- (b) the powers and duties of the office bearers of Self Regulatory Organization;
- (c) the admission into the Self Regulatory Organization of members, agents, their qualifications for membership, and the exclusion, suspension, expulsion and readmission of members therefrom or there into;

The application is to be signed on behalf of the applicant under authority of its Board of Directors by its Chairman, Managing Director, Chief Executive Officer or whole time director. The application is to be made in Form A of the first schedule and is to be accompanied by a non-refundable application fee, as specified in Part A of the second schedule, to be paid in the manner specified in Part B thereof.

ELIGIBILITY CRITERIA

Regulation 4 provides the following criteria to be fulfilled by an association seeking registration under these regulations:-

- (a) the applicant should have been granted license under section 8 of Companies Act, 2013;
- (b) the memorandum of association, should specify admission of members and discharging the functions of Self Regulatory Organization as one of its main objects;
- (c) the applicant should have a minimum networth of one crore rupees;
- (d) the applicant is to have adequate infrastructure, to enable it to discharge its functions as a Self Regulatory Organization in accordance with the provisions of the Act and these regulations;
- (e) the directors have the professional competence, financial soundness and general reputation of fairness and integrity to the satisfaction of SEBI;
- (f) neither the applicant, nor any director of the applicant is involved in any legal proceeding connected with the securities market, which may have an adverse impact on the interests of the investors;
- (g) neither the applicant, nor any director has at any time in the past been convicted of any offence involving moral turpitude or any economic offence;
- (h) the applicant has, in its employment, persons having adequate professional and other relevant experience to the satisfaction of SEBI;
- (i) the applicant, is a fit and proper person based on the internal specified in Schedule II of SEBI (Intermediaries) Regulations, 2008;
- (j) grant of certificate to the applicant is in the interest of investors and the securities market.

Grant of in-principle approval

Regulation 4A stipulates that where the applicant is not in compliance with the provisions of clauses (c), (d) or (h) of regulation 4, on the date of submission of the application under regulation 3, SEBI may grant an in-principle approval to the applicant, which shall be valid for a period of one hundred and eighty days, within which the applicant shall ensure compliance with all provisions of regulation 4.

Provided that SEBI may, upon sufficient cause shown by the applicant, extend the validity of the in-principle approval for a further period not exceeding ninety days.

Grant of recognition as a Self Regulatory Organization

If SEBI is satisfied, after making such inquiry as may be necessary in this behalf and after obtaining such further information, if any, as it may require, –

- (a) that the articles and governing norms of the applicant applying for recognition are in conformity with such conditions as may be specified by SEBI;
- (b) that the applicant is willing to comply with any other conditions which SEBI may impose for the purpose of carrying out the objects of these Regulations; and,
- (c) that it would be in the interest of the trade and also in the public interest to grant recognition to the applicant as a Self Regulatory Organization;

SEBI may grant certificate of recognition to the applicant as a Self Regulatory Organization in Form B1 of the First Schedule subject to such terms and conditions as it may deem fit and appropriate.

Regulation 5(2) empowers SEBI to specify any conditions for the grant of recognition to the applicant as a Self Regulatory Organization. Such conditions may relate to –

- (i) the qualification for membership of the Self Regulatory Organization;
- (ii) the representation of SEBI in the Board of Directors of the Self Regulatory Organization by such number of directors not exceeding four as SEBI may nominate in this behalf; and
- (iii) the maintenance of accounts of members and their audit by chartered accountants whenever such audit is required by SEBI.

The Self Regulatory Organization cannot amend its articles without the prior written approval of the SEBI.

APPLICATION TO CONFORM TO THE REQUIREMENTS

Regulation 6 provides that subject to provisions of regulation 4A, any application for a certificate, which is not complete in all respects or does not conform to the requirements of these regulations and particularly regulations 3, 4 and 5 or instructions specified in Form A shall be rejected by SEBI. However, before rejecting any such application, SEBI shall give an opportunity to the applicant to remove such objections as may be indicated by SEBI, within 30 days of the date of receipt of relevant communication, from SEBI. On sufficient cause being shown, SEBI may extend the time for removal of objections by such further time, not exceeding 30 days as it may consider fit, to enable the applicant to remove such objections.

FURNISHING OF INFORMATION, CLARIFICATION AND PERSONAL REPRESENTATION

SEBI may under Regulation 7 require the applicant to furnish such further information or clarification as it may consider necessary for the purpose of processing of the application. It may also require the applicant to appear before it through an authorized representative for personal representation in connection with the grant of a certificate of recognition.

CONDITIONS OF CERTIFICATE AND VALIDITY PERIOD

As provided under Regulation 8 the certificate granted under regulation 5 is valid for a period of five years, and subject to the following conditions, namely: -

- (a) the applicant shall comply with the provisions of the Act, applicable regulations and guidelines, directions or circulars issued by the SEBI from time to time;
- (b) any information or particulars furnished to the SEBI by the applicant shall not be false or misleading in any material respect;

- (c) where any material information or particulars furnished to SEBI by the applicant, in or in connection with the application for recognition, has undergone change subsequent to its furnishing, the applicant shall forthwith inform the fact to SEBI in writing.

RENEWAL OF CERTIFICATE

Regulation 9 provides that an application for renewal of Certificate of Recognition shall make an application to SEBI in Form A of the First Schedule. Such application shall be made not less than three months before expiry of the period of validity of the certificate. The application shall be accompanied by a renewal fee as specified in the second schedule and, as far as may be, shall be dealt with in the same manner as if it were an application for the grant of a fresh certificate under regulation 3.

SEBI, if satisfied may renew the certificate in Form B2 of the First Schedule subject to such terms and conditions as it may deem fit and appropriate.

PROCEDURE WHERE CERTIFICATE IS NOT GRANTED

Regulation 10 provides that if, after considering an application SEBI is of the opinion that a certificate should not be granted or renewed, it may, after giving the applicant a reasonable opportunity of being heard, reject the application within a period of thirty days of receipt of such application complete in all respects or within thirty days of receipt of further information or clarification sought. The fact of the rejection of the application shall be communicated to the applicant forthwith stating the grounds for such rejection.

EFFECT OF REFUSAL TO GRANT CERTIFICATE

Regulation 11 provides that an applicant whose application for the grant of a certificate has been rejected shall not undertake any activity as Self Regulatory Organization. Similarly, a Self Regulatory Organization whose application for the renewal of certificate has been rejected by SEBI shall on and from the date of the receipt of the communication of rejection from SEBI cease to carry on any activity as Self Regulatory Organization.

If SEBI is satisfied that it is in the interests of investors to do so, it may permit Self Regulatory Organization to complete the functions or obligations already initiated or undertaken by it during the pendency of the application or during the period of validity of the certificate. In order to protect the interests of investors, SEBI may issue directions with regard to the transfer of records, documents or reports relating to the functions of the Self Regulatory Organization, whose application for the grant or renewal of a certificate has been rejected. Further, SEBI may, appoint any person to take charge of the records, documents or reports relating to the organization and also determine the terms and conditions of such appointment.

COMPOSITION OF BOARD OF DIRECTORS

Regulation 12 of Chapter III of the Regulations provides that the Articles of Association of a Self Regulatory Organization shall provide for the following: –

- (a) There shall be a Board of Directors of the Self Regulatory Organization and majority of directors shall be independent directors.
- (b) The independent directors shall not be required to hold any qualification shares.
- (c) The Board of Directors shall consist of nine directors out of which five directors shall be nominated by SEBI and the remaining four shall be elected by the members of the Self Regulatory Organization.
- (d) The General Superintendence, direction and management of the affairs of the Self Regulatory Organization shall vest in its Board of Directors, which may exercise all powers and do all acts and things which may be exercised or done by the Self Regulatory Organization.

- (e) There shall be a Chairman, who shall be an independent professional, appointed by Board of Directors, with the prior approval of SEBI.
- (f) The Chairman shall be responsible for day-to-day administration of Self Regulatory Organization and implementing the decisions of Board of Directors.
- (g) The Board of Directors may establish committees including disciplinary committee, screening committee, arbitration committee or remuneration committee in order to carry out the purposes of these regulations. It has been provided that the committees constituted under this regulation may consist wholly of other persons or partly of directors and partly of other persons. The majority of members of each such committee shall be independent.
- (h) The office bearers of Board of Directors shall relinquish their office, when SEBI passes an order under clause (c) of sub-section (4) of section 11 of the SEBI Act.
- (i) The Board of Directors of the Self Regulatory Organization shall be reconstituted as and when required by SEBI.

MEMBERSHIP OF SELF REGULATORY ORGANIZATION

As per Regulation 13, any application for registration or renewal of registration as an intermediary with SEBI under the respective regulations applicable to such intermediaries, shall in case of any applicant who is a member of a Self Regulatory Organization or who ought to be a member of a Self Regulatory Organization, be made only through the Self Regulatory Organization of which he is a member, in the specified manner. The application is to be forwarded by the Self Regulatory Organization to SEBI along with its recommendation for grant or refusal of certificate of registration not later than 30 days from the date of its receipt. The Self Regulatory Organization is also required to give the reasons for its recommendation either for granting certificate of recognition or for refusal of certificate of registration by SEBI.

FUNCTIONS AND OBLIGATIONS OF SELF REGULATORY ORGANIZATION

As per Regulation 14, a Self Regulatory Organization shall always abide by the directions of SEBI. It shall be responsible for investor protection and education of investors or its members and shall ensure observance of Securities Laws by its members. It is required to specify standard of conduct for its members and also shall be responsible for the implementation of the same by its members. The SRO is required to conduct inspection and audit of its members, on regular basis, through independent auditors. The Annual Report of the SRO is to be submitted to SEBI. The SRO shall treat all its members and the applications for membership in a fair and transparent manner. The SRO may collect admission and membership fees from its members for carrying out the purposes of these regulations. SEBI is to be promptly informed of violations of the provisions of the Act, the rules, the regulations, the directions, the circulars or the guidelines by any of its members. The SRO is required to conduct screening and certification tests for its members, agents and such other persons as it may determine. The SRO is to conduct training programmes for its members or agents and also conduct awareness programmes for securities market investors. The SRO is required to make endeavors for introduction of best business practices amongst its members. It must act in utmost good faith and must avoid conflict of interest in the conduct of its functions. The SRO must comply with the norms of corporate governance as applicable to listed companies. It may discharge such other functions and obligations as may be specified by SEBI, from time to time.

GOVERNING NORMS OF SELF REGULATORY ORGANIZATION

Regulation 15 provides that a Self Regulatory Organization may, subject to the previous approval of SEBI, make governing norms and articles consistent with the provisions of the Act and these regulations. In particular, and without prejudice to the generality of the foregoing power, the governing norms or articles may provide for:

- (i) eligibility criteria for admission and removal of members from Self Regulatory Organization;

- (ii) manner and the periodicity of furnishing information to SEBI and to its members;
- (iii) arbitration mechanism for resolving disputes between members and/or between members and their constituents;
- (iv) procedure for proceeding against the member committing breach of the governing norms or articles including provisions for suspension or expulsion of members from the Self Regulatory Organization;
- (v) internal control standards including procedure for inspection, auditing, reviewing, monitoring and surveillance of its members by Self Regulatory Organization;
- (vi) code of conduct specifying standards for its members in the conduct of business;
- (vii) procedure for conduct of election of the office bearers and members of the committees;
- (viii) obligation of members to supply such information or explanation and to produce such documents relating to the business as Board of Directors may require;
- (ix) manner of disciplinary action against its members by Self Regulatory Organization;
- (x) contents and format of the annual report;
- (xi) procedure for conduct of the meetings, quorum etc. of Board of Directors;
- (xii) manner of maintaining accounts or records of the Self Regulatory Organization; and,
- (xiii) reporting requirements to SEBI on monthly basis about various aspects of its functioning including policy initiatives, progress in certification, number of members admitted and disciplinary action taken against members, if any.

The governing norms or articles must provide that the contravention of any of the governing norms shall render the member of Self Regulatory Organization concerned liable to one or more of the following punishments, namely:-

- (i) forfeiture of shares;
- (ii) expulsion from membership;
- (iii) suspension from membership for a specified period;
- (iv) any other penalty of a like nature not involving the payment of money.

If SEBI considers it expedient so to do, it may, by order in writing, direct a Self Regulatory Organization to make any governing norms or to amend or revoke any of them within such period as it may specify in this behalf. If a Self Regulatory Organization fails or neglects to comply with such order within the specified period, SEBI can make, amend or revoke the governing norms either in the form specified in the order or with such modifications as it may think fit.

SEBI'S RIGHT TO INSPECT

Regulation 16 of Chapter IV provides that where it appears to SEBI so to do, it may appoint one or more persons as inspecting authority to undertake inspection of the books of accounts, other records and documents of the Self Regulatory Organization.

OBLIGATIONS OF SELF REGULATORY ORGANIZATION

As provided under Regulation 18, it shall be the duty of the Chairman, every Director, officer and employee of the Self Regulatory Organization, who is being inspected to produce to the inspecting authority or to any person authorized by him, such books, accounts and other documents in their custody or control and furnish to the Board the statements and information relating to the activities of Self Regulatory Organization in securities market within such time as the Board may require. The SRO shall allow the inspecting authority or any person authorized by him to have reasonable access to the premises occupied by the SRO or by any other person on

its behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the SRO or any other person and also provide copies of documents or other materials which, in the opinion of the inspecting authority are relevant.

The inspecting authority in the course of inspection shall be entitled to examine or record statements of the Chairman, Director, any member and employee of the Self Regulatory Organization. It is the duty of the Chairman, every Director, officer and employee of the SRO to give to the inspecting authority all assistance in connection with the inspection, which the SRO may reasonably be expected to give.

SUBMISSION OF REPORT AND APPOINTMENT OF AUDITOR

Regulation 19 provides that the inspecting authority shall, as soon as possible, submit an inspection report to SEBI. Under Regulation 20 SEBI can appoint a qualified auditor to inspect the books of account or the affairs of the Self Regulatory Organization.

OBLIGATION OF BOARD OF DIRECTORS

Regulation 22 of Chapter V provides that after receiving the report of an enquiry made under regulation 21, SEBI may take such action as it deems proper and, in particular, may direct Board of Directors of the Self Regulatory Organization to take such disciplinary action against the delinquent member, including expulsion, suspension or any other penalty of a like nature not involving the levy of monetary penalty, as may be specified by it and thereupon, notwithstanding anything to the contrary contained in the articles or governing norms of the Self Regulatory Organization concerned, the Board of Directors of the Self Regulatory Organization shall give effect to the directions of SEBI and shall not in any manner commute, revoke or modify the action taken in pursuance of such directions, without the prior written approval of SEBI.

SEBI may either on its own motion or on representation of the member concerned, modify or withdraw any of its directions issued under sub-regulation (1), if it is satisfied that there are sufficient grounds for doing so.

WITHDRAWAL OF RECOGNITION

Regulation 23 provides that if SEBI is of the opinion that the recognition granted to a Self Regulatory Organization under the provisions of these Regulations should, in the interest of the trade or in the public interest, be withdrawn, it may serve a written notice in Form "C" on Board of Directors of the Self Regulatory Organization calling upon it to show cause as to why the recognition should not be withdrawn for the reasons stated in the notice. Where such notice is issued, SEBI may, after giving an opportunity to Board of Directors of the Self Regulatory Organization to be heard in the matter, withdraw, by passing an order, the recognition granted to the Self Regulatory Organization and thereupon the provisions of regulation 11 would apply as if the application of the Self Regulatory Organization for renewal of recognition has been rejected.

SEBI shall promptly communicate such order to the concerned Self Regulatory Organization. On receipt of the order, the Self Regulatory Organization shall cease to carry on any activity as a Self Regulatory Organization and shall comply with such directions as may be issued by SEBI.

ACTION IN CASE OF VIOLATION

It has been provided under Regulation 24 that if any Self Regulatory Organization, any office bearer or member thereof violates any provisions of the SEBI Act or these regulations, it may be liable for –

- (a) action under Chapter VIA of the Act;
- (b) action under subsection (3) of section 12 of the Act;
- (c) action under subsection (4) of section 11 and section 11B of the Act;
- (d) action under section 24 of the Act;
- (e) such other action permissible under the Act which may be deemed appropriate in the facts and circumstances of the case.

LESSON ROUND UP

- The market Regulator, SEBI regulates various intermediaries in the primary and secondary markets through its Regulations for these intermediaries.
- 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.
- The activities of the merchant bankers in the Indian capital market are regulated by SEBI (Merchant Bankers) Regulations, 1992.
- The Registrars to an Issue and Share Transfer Agents 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.
- '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.
- SEBI (Banker to an Issue) Regulation, 1994, requires that the application by a scheduled bank for grant of certificate as a banker to an issue should be made to SEBI in Form A conforming to the instructions therein failing which, it shall be rejected after giving due opportunity to remove such defects within specified time.
- 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.
- Debenture Trustee means a trustee of a trust deed for securing any issue of debentures of a body corporate.
- A portfolio manager with professional experience and expertise in the field, studies the market and adjusts the investment mix for his client on a continuing basis to ensure safety of investment and reasonable returns therefrom.
- Every Portfolio manager is required to appoint a Practising Company Secretary or a Practising Chartered Accountant for conducting the internal audit.
- Custodian of securities means any person who carries on or proposes to carry on the business of providing custodial services.
- Investment adviser means any person, who for consideration is engaged in the business of providing investment advice to clients or other group of persons and includes any person who holds out himself as an investment adviser, by whatever name called.
- Section 12 of the Prevention of Money Laundering Act, 2002 lays down certain obligations on an intermediary to be fulfilled.
- All intermediaries are required to appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications guidelines, instructions etc. issued by SEBI or Central Government and for redressal of investor grievances. Compliance officer is required to immediately and independently report to SEBI, any non-compliance observed by *him*.
- With a view to bring uniformity in the KYC requirements for the securities markets, SEBI has initiated usage of uniform KYC by all SEBI registered intermediaries.

- SEBI has made it compulsory for all the intermediaries to carry out In Person Verification of their clients.

GLOSSARY

Financial Planning	It includes analysis of client's current financial situation, identification of their financial goals, and developing and recommending financial strategies to realize such goals.
Inter-operability	Inter-operability means the ability of the KRA to determine whether the KYC documents of the client are in the custody of another KRA.
KYC	KYC means the procedure prescribed by the Board for identifying and verifying the Proof of Address, Proof of Identity and compliance with rules, regulations, guidelines and circulars issued by SEBI or any other authority for Prevention of Money Laundering from time to time;
Offshore derivative Instruments (ODIs)	These are investment vehicles used by overseas investors for an exposure in Indian equities or equity derivatives. These investors are not register with SEBI.
Self Regulatory Organization	It means an organization of intermediaries which is representing a particular segment of the securities market and which is duly recognised by SEBI under these regulations, but excludes a stock exchange.

SELF TEST QUESTIONS

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

1. Explain general obligations and responsibilities of merchant banker and due diligence certificate issued by the merchant banker.
2. Discuss the role and obligation of portfolio manager.
3. Discuss the obligation of intermediaries under Prevention Money Laundering Act, 2002
4. Explain the inspection and disciplinary proceedings which can be initiated by against SEBI registered intermediaries.
5. What are actions taken by SEBI, if a Self-Regulatory Organization violates any provisions of SEBI Act or the regulation make there under.

Lesson 19

Insider Trading – An Overview

LESSON OUTLINE

- Introduction
- Provisions of Companies Act, 2013 relating to Insider Trading
- SEBI (Prohibition of Insider Trading) Regulation, 1992
- Prohibition on Dealing Communication or Counselling on Matters Relating to Insider Trading
- Code of Internal Procedures and Conduct for Listed Companies and other Entities
- Disclosure of interest or holding by certain persons
- Model Code of Conduct For Prevention of Insider Trading for Listed Companies
- Code of Corporate Disclosure Practices for Prevention of Insider Trading
- Investigation by SEBI
- Penalty Provisions for violations of the Regulations
- Appeal to Securities Appellate Tribunal
- Role of Company Secretary in Compliance Requirements
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

In simple terms 'insider trading' is buying or selling a security, in breach of a fiduciary duty or other relationship of trust, and confidence, while in possession of material, nonpublic information about the security. Therefore, preventing such transactions is an important obligation for any capital market regulatory system, because insider trading undermines investor confidence in the fairness and integrity of the securities markets.

A Company Secretary being a professional play an important role in a company to prevent Insider Trading by establishment of policies and procedures in this regard. This lesson will enable the students to have the basic understanding of the Insider trading regulations in India, the disclosures required to be made under the regulations by the company, employee directors, promoters, etc., the duty of compliance officer, Model Code of Conduct, Code of Corporate Disclosure Practices, the Penal provisions for Insider Trading by SEBI and the new provisions of the Insider Trading in the Companies Act, 2013, etc.

INTRODUCTION

The practice of Insider Trading came into existence ever since the very concept of trading of securities of a company became prevalent among the investors worldwide and has now become a formidable challenge for investors all over the world.

The United State of America was the first country to formally enact a legislation to regulate insider trading. Over the years, most of the jurisdictions around the world have recognized the requirement to restrict insider trading in one form or other and accordingly put in place legal restrictions to this effect.

India was not late in recognizing the detrimental impact of insider trading. The history of Insider Trading in India relates back to the 1940's with the formulation of government committees such as the Thomas Committee under the chairmanship of Mr. P.J.Thomas to evaluate restrictions that can be imposed on short swing profit of 1948, which evaluated inter alia, the regulations in the US on short swing profits under Section 16 of the Securities Exchange Act, 1934. Thereafter in India provisions relating to Insider Trading were incorporated in the Companies Act, 1956 under Sections 307 and 308, which required shareholding disclosures by the directors and managers of a company. Due to inadequate provisions of enforcement in the companies Act, 1956, the Sachar Committee in 1979, the Patel Committee in 1986 and the Abid Hussain Committee in 1989 proposed recommendations for a separate statute regulating Insider Trading.

The Patel committee in 1986 in India defined Insider Trading as,

“ Insider trading generally means trading in the shares of a company by the persons who are in the management of the company or are close to them on the basis of undisclosed price sensitive information regarding the working of the company, which they possess but which is not available to others.”

The concept of Insider Trading in India started fermenting in the 80's and 90's and came to be known and observed extensively in the Indian Securities market. As mentioned earlier due to inadequate provisions in the Companies Act, 1956 and rapidly advancing Indian Securities market needed a more comprehensive legislation to regulate the practice of Insider Trading, thus resulting in the formulation of the SEBI (Insider Trading) Regulations in the year 1992, which were amended in the year 2002 after the discrepancies observed in the 1992 regulations in the cases like Hindustan Levers Ltd. vs. SEBI, Rakesh Agarwal vs. SEBI, etc. to remove the lacunae existing in the Regulations of 1992. The amendment in 2002 came to be known as the SEBI ([Prohibition of] Insider Trading) Regulations, 1992.

The regulations of 1992 seemed to be more punitive in nature. The 2002 amendment 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. 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). Earlier these provisions were contained in regulations framed by SEBI, as the capital market regulator. Now, it has also been informed that SEBI is expected to discuss changes in certain norms for listed firms so as to make them in line with the rules in the new Act.

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.

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.

SEBI (PROHIBITION OF INSIDER TRADING) REGULATION, 1992

The SEBI (Prohibition of Insider Trading) Regulation 1992, comprise of four chapters and three schedules encompassing the various regulations related to insider trading. Chapter I deal mainly with the definitions used in regulation. Chapter II provides for prohibitions on dealing, communicating or counselling by insider. It also contains the defences available to a company in proceeding against it on allegation of Insider trading. Chapter III narrates the investigating powers of SEBI under the regulation and also enumerates the prohibitory orders or directions that it can issue against the guilty in the interest of the capital market regulation. Chapter IV deals with the code of internal procedure and conduct to be followed by listed companies and other entities, disclosure requirements be followed by company. It also contains appeal provisions which an aggrieved person may like to follow against the orders of SEBI.

IMPORTANT DEFINITIONS

Connected Person

“Connected Person” means any person who –

- (i) is a director, as defined in clause (34) of section 2 of the Companies Act, 2013 of a company, or is deemed to be a director of that company, or
- (ii) occupies the position as an officer or an employee of the company or holds a position involving a professional or business relationship between himself whether temporary or permanent and the company

and who may reasonably be expected to have an access to unpublished price sensitive information in relation to that company;

It may be noted that “connected person” means any person who is a connected person six months prior to an act of insider trading.

Insider

“Insider” means any person who, is or was connected with the company or is deemed to have been connected with the company, and who is reasonably expected to have access, to unpublished price sensitive information in respect of securities of company, or who has received or has had access to such unpublished price sensitive information.

Person deemed to be connected person

“Person is deemed to be a connected person”, if such person –

- (i) is a company under the same management or group, or any subsidiary company thereof within the meaning of sub-clause (g) of section 2 of the Monopolies and Restrictive Trade Practices Act, 1969 as the case may be; or
- (ii) is an intermediary as specified in section 12 of the Act, Investment company, Trustee Company, Asset Management Company or an employee or director thereof or an official of a stock exchange or of clearing house or corporation;
- (iii) is a merchant banker, share transfer agent, registrar to an issue, debenture trustee, broker, portfolio manager, Investment Advisor, sub-broker, Investment Company or an employee thereof, or is member of the 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 who have a fiduciary relationship with the company;
- (iv) is 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
- (v) is an official or an employee of a Self-regulatory Organisation recognised or authorised by the Board of a regulatory body; or
- (vi) is a relative of any of the aforementioned persons;
- (vii) is a banker of the company.
- (viii) relatives of the connected person; or
- (ix) is a concern, firm, trust, Hindu undivided family, company or association of persons wherein any of the connected persons mentioned in sub-clause (i) of clause (c), of this regulation or any of the persons mentioned in sub-clause (vi), (vii) or (viii) of this clause have more than 10 per cent of the holding or interest;

Price sensitive Information

“Price sensitive information” means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company;

The following shall be deemed to be price sensitive information:-

- periodical financial results of the company;
- intended declaration of dividends (both interim and final);
- issue of securities or buy-back of securities;
- any major expansion plans or execution of new projects;

- amalgamation, mergers or takeovers;
- disposal of the whole or substantial part of the undertaking;
- any significant changes in policies, plans or operations of the company.

Unpublished

“Unpublished” means information which is not published by the company or its agents and is not specific in nature.

PROHIBITION ON DEALING COMMUNICATING OR COUNSELLING ON MATTERS RELATING TO INSIDER TRADING

Regulation 3 provides that insider shall not either on his own behalf or on behalf of any other person, deal in securities of a company listed on any stock exchange when in possession of any unpublished price sensitive information; or communicate, counsel or procure, directly or indirectly, any unpublished price sensitive information to any person who while in possession of such unpublished price sensitive information shall not deal in securities.

However, above provisions shall not applicable to any communication required in the ordinary course of business or profession or employment or under any law.

Under Regulation 3A no company shall deal in the securities of another company or associate of that other company while in possession of any unpublished price sensitive information. Any insider, who deals in securities in contravention of the provisions of regulation 3 or 3A shall be guilty of Insider trading.

Non-applicability of Regulation 3A in certain cases.

Regulation 3B provides that in a proceeding against a company in respect of regulation 3A, it shall be a defence to prove that it entered in to a transaction in the securities of a listed company when the published price sensitive information was in the possession of an officer or employee of the Company, if :

- (a) the decision to enter into the transaction or agreement was taken on its behalf by a person or person other than that officer or employee; and
- (b) such company has put in place such systems and procedures which demarcate the activities of the company in such a way that the person who enters into transaction in securities on behalf of the company cannot have access to information which is in possession of other officer or employee of the company; and
- (c) it is in operation at that time, arrangement that could reasonably be expected to ensure that the information was not communicated to the person or persons who made the decision and that no advice with respect to the transaction or agreement was given to that person or any of those persons by that officer or employee; and
- (d) the information was not so communicated and no such advice was so given.

(2) In a proceeding against a company in respect of regulation 3A which is in possession of unpublished price sensitive information, it shall be defense to prove that acquisition of shares of a listed company was as per the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

CODE OF INTERNAL PROCEDURES AND CONDUCT FOR LISTED COMPANIES AND OTHER ENTITIES

Regulation 12 (1) provides that all listed companies and organisations associated with securities markets including

- (a) the intermediaries as mentioned in section 12 of the Act, asset management company and trustees of mutual funds;

- (b) the self regulatory organisations recognised or authorised by the SEBI;
- (c) the recognised stock exchanges and clearing house or corporations;
- (d) the public financial institutions as defined in Section 2(72) of the Companies Act, 2013; and
- (e) the professional firms such as auditors, accountancy firms, law firms, analysts, consultants, etc., assisting or advising listed companies, shall frame a code of internal procedures and conduct as near there to the Model Code specified in Schedule I of these Regulations.

Sub-regulation (2) provides that the entities mentioned in sub regulation (1) shall abide by the code of corporate disclosure Practices as specified in Schedule II of these Regulations.

Sub-regulation (3) lays down that all entities mentioned in sub-regulations (1) shall adopt appropriate mechanisms and procedures to enforce the codes specified under sub-regulations (1) and (2).

Sub-regulation (4) stipulates action taken by the entities mentioned in sub-regulation (1) against any person for violation of the code under sub-regulation (3) shall not preclude the SEBI from initiating proceeding for violation of these regulations.

DISCLOSURE OF INTEREST OR HOLDING IN A LISTED COMPANIES BY CERTAIN PERSONS

INITIAL DISCLOSURE

As per regulation 13(1), any person who holds more than 5% shares or voting rights in any listed company shall disclose to the company, in the prescribed form the number of shares or voting rights held by such person, on becoming such holder, within 2 working days of the receipt of intimation of allotment of shares or the acquisition of shares or voting rights, as the case may be.

As per regulation 13(1), any person who is a director or officer of a listed company, shall disclose to the company, in the prescribed Form the number of shares or voting rights held by such person, within 2 working days of becoming a director or officer of the company. Any person who is a promoter or part of promoter group of a listed company shall disclose to the company in prescribed Form the number of shares or voting rights held by such person, within two working days of becoming such promoter or person belonging to promoter group.

CONTINUAL DISCLOSURE

As per regulation 13(3), any person who holds more than 5% shares or voting rights in any listed company shall disclose to the company in prescribed Form the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below 5%, if there has been change in such holdings from the last disclosure made under sub-regulation (1) or under this sub-regulation; and such change exceeds 2% of total shareholding or voting rights in the company.

As per regulation 13(4), any person who is a director or officer of a listed company, shall disclose to the company and the stock exchange where the securities are listed , in prescribed Form the total number of shares or voting rights held and change in shareholding or voting rights, if there has been a change in such holdings of such person and his dependents (as defined by the company) from the last disclosure and the change exceeds ₹ 5 lac in value or 25,000 shares or 1% of total shareholding or voting rights, whichever is lower.

As per regulation 13(5), the disclosure shall be made within 2 working days of the receipt of intimation of allotment of shares, or the acquisition or sale of shares or voting rights, as the case may be.

Any person who is a promoter or part of promoter group of a listed company, shall disclose to the company and the stock exchange where the securities are listed in prescribed Form , the total number of shares or voting rights held and change in shareholding or voting rights, if there has been a change in such holdings of such person from the last disclosure made under Listing Agreement or under this regulation, and the change exceeds ₹ 5 lakh in value or 25,000 shares or 1% of total shareholding or voting rights, whichever is lower.

DISCLOSURE BY COMPANY TO STOCK EXCHANGES

As per regulation 13(6), every listed company, within 2 working days of receipt of the information mentioned above is required to disclose to all stock exchanges on which the company is listed.

DISCLOSURE THROUGH E-FILING

As per regulation 13(7), the disclosures required under this regulation may also be made through electronic filing in accordance with the system devised by the stock exchange.

MODEL CODE OF CONDUCT FOR PREVENTION OF INSIDER TRADING FOR LISTED COMPANIES

Compliance Officer

- The listed company has appointed a compliance officer (senior level employee) who shall report to the Managing Director/Chief Executive Officer.
- The compliance officer shall be responsible for setting forth policies, procedures, monitoring adherence to the rules for the preservation of “Price Sensitive Information”, pre-clearing of designated employees’ and their dependents’ trades (directly or through respective department heads as decided by the company), monitoring of trades and the implementation of the code of conduct under the overall supervision of the Board of the listed company.
- The compliance officer shall maintain a record of the designated employees and any changes made in the list of designated employees.

The compliance officer shall assist all the employees in addressing any clarifications regarding the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 and the company’s code of conduct.

Preservation of “Price Sensitive Information”

Employees/ directors shall maintain the confidentiality of all Price Sensitive Information. Employees/ directors shall not pass on such information to any person directly or indirectly by way of making a recommendation for the purchase or sale of securities.

Need to Know

Price Sensitive Information is to be handled on a “need to know” basis, i.e., Price Sensitive Information should be disclosed only to those within the company who need the information to discharge their duty.

Limited access to confidential information

Files containing confidential information shall be kept secure. Computer files must have adequate security of login and pass word etc.

Prevention of misuse of “Price Sensitive Information”

All directors/ officers and designated employees of the company shall be subject to trading restrictions.

Trading window

- The company shall specify a trading period, to be called “Trading Window”, for trading in the company’s securities. The time for commencement of closing of trading window shall be decided by the company. The trading window shall be opened 24 hours after the following information is made public.
- The trading window shall be closed during the time of:-

- Declaration of Financial results (quarterly, half-yearly and annual)
 - Declaration of dividends (interim and final)
 - Issue of securities by way of public/ rights/bonus etc.
 - Any major expansion plans or execution of new projects
 - Amalgamation, mergers, takeovers and buy-back
 - Disposal of whole or substantially whole of the undertaking
 - Any changes in policies, plans or operations of the company.
- When the trading window is closed, the employees / directors shall not trade in the company's securities in such period. The time for commencement of closing of trading window shall be decided by the company.
 - All directors/ officers/designated employees of the company shall conduct all their dealings in the securities of the Company only in a valid trading window and shall not deal in any transaction involving the purchase or sale of the company's securities during the periods when trading window is closed or during any other period as may be specified by the Company from time to time.
 - In case of ESOPs, exercise of option may be allowed in the period when the trading window is closed. However, sale of shares allotted on exercise of ESOPs shall not be allowed when trading window is closed.

Pre-clearance of trades

- All directors/officers/designated employees of the company and their dependents as defined by the company who intend to deal in the securities of the company (above a minimum threshold limit to be decided by the company) should pre-clear the transaction as per the pre-dealing procedure as described hereunder.
- An application can be made in such form as the company may notify in this regard, to the Compliance Officer indicating the estimated number of securities that the designated employee/officer/director intends to deal in, the details as to the depository with which he has a security account, the details as to the securities in such depository mode and such other details as may be required by any rule made by the company in this behalf.
- An undertaking shall be executed in favour of the company by such designated employee/director/officer incorporating, *inter alia*, the following clauses, as may be applicable :
 - (a) That the employee/director/officer does not have any access or has not received "Price Sensitive Information" upto the time of signing the undertaking.
 - (b) That in case the employee/director/officer has access to or receives "Price Sensitive Information" after the signing of the undertaking but before the execution of the transaction he/she shall inform the Compliance Officer of the change in his position and that he/she would completely refrain from dealing in the securities of the company till the time such information becomes public.
 - (c) That he/she has not contravened the code of conduct for prevention of insider trading as notified by the company from time to time.
 - (d) That he/she has made a full and true disclosure in the matter.

Other restrictions

- All directors/officers/designated employees and their dependents (as defined by the company) shall execute their order in respect of securities of the company within one week after the approval of

pre-clearance is given. If the order is not executed within one week after the approval is given, the employee/ director must pre-clear the transaction again.

- All directors/ officers/ designated employees who buy or sell any number of shares of the company shall not enter into an opposite transaction i.e. sell or buy any number of shares during the next six months following the prior transaction. All directors/ officers/ designated employees shall also not take positions in derivative transactions in the shares of the company at any time.
- 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/her reasons in this regard.

Reporting Requirements for transactions in securities

All directors/officers/designated employees of the listed company shall be required to forward following details of their securities transactions including the statement of dependent family members (as defined by the company) to the Compliance Officer:

- (a) all holdings in securities of that company by directors/officers/designated employees at the time of joining the company;
- (b) periodic statement of any transactions in securities (the periodicity of reporting may be defined by the company. The company may also be free to decide whether reporting is required for trades where pre-clearance is also required); and
- (c) annual statement of all holdings in securities.

The Compliance Officer shall maintain records of all the declarations in the appropriate form given by the directors/officers/designated employees for a minimum period of three 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 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.

Penalty for contravention of code of conduct

- Any employee/officer/director who trades in securities or communicates any information for trading in securities in contravention of the code of conduct may be penalised and appropriate action may be taken by the company.
- Employees/officers/directors of the company who violate the code of conduct shall also be subject to disciplinary action by the company, which may include wage freeze, suspension, ineligible for future participation in employee stock option plans, etc.
- The action by the company shall not preclude SEBI from taking any action in case of violation of SEBI (Prohibition of Insider Trading) Regulations, 1992.

Information to SEBI in case of violation of SEBI (Prohibition of Insider Trading) Regulations, 1992

In case it is observed by the company/Compliance Officer that there has been a violation of SEBI (Prohibition of Insider Trading) Regulations, 1992. SEBI shall be informed by the company.

CODE OF CORPORATE DISCLOSURE PRACTICES FOR PREVENTION OF INSIDER TRADING

CORPORATE DISCLOSURE POLICY

To ensure timely and adequate disclosure of price sensitive information, the following norms shall be followed by listed companies: –

– **Prompt disclosure of price sensitive information**

Price sensitive information shall be given by listed companies to stock exchanges and disseminated on a continuous and immediate basis. Listed companies may also consider ways of supplementing information released to stock exchanges by improving Investor access to their public announcements.

– **Overseeing and co-ordinating disclosure**

Listed companies shall designate a senior official (such as compliance officer) to oversee corporate disclosure. This official shall be responsible for ensuring that the company complies with continuous disclosure requirements. Overseeing and co-ordinating disclosure of price sensitive information to stock exchanges, analysts, shareholders and media and educating staff on disclosure policies and procedure.

Information disclosure/dissemination may normally be approved in advance by the official designated for the purpose. If information is accidentally disclosed without prior approval, the person responsible may inform the designated officer immediately, even if the information is not considered price sensitive.

– **Responding to market rumours**

Listed companies shall have clearly laid down procedures for responding to any queries or requests for verification of market rumours by exchanges. The official designated for corporate disclosure shall be responsible for deciding whether a public announcement is necessary for verifying or denying rumours and then making the disclosure.

– **Timely Reporting of shareholdings/ownership and changes in ownership**

Disclosure of shareholdings/ownership by major shareholders and disclosure of changes in ownership as provided under any Regulations made under the Act and the listing agreement shall be made in a timely and adequate manner.

– **Disclosure/dissemination of Price Sensitive Information with special reference to Analysts, Institutional Investors**

Listed companies should follow the guidelines given hereunder while dealing with analysts and institutional investors : –

- (i) *Only Public information to be provided* -Listed companies shall provide only public information to the analyst/research persons/large investors like institutions . Alternatively, the information given to the analyst should be simultaneously made public at the earliest.
- (ii) *Recording of discussion* -In order to avoid misquoting or misrepresentation, it is desirable that at least two company representative be present at meetings with Analysts, Brokers or Institutional Investors and discussion should preferably be recorded.
- (iii) *Handling of unanticipated questions* -A listed company should be careful when dealing with analysts' questions that raise issues outside the intended scope of discussion. Unanticipated questions may be taken on notice and a considered response given later. If the answer includes price sensitive information, a public announcement should be made before responding.
- (iv) *Simultaneous release of Information* -When a company organises meetings with analysts, the company shall make a press release or post relevant information on its website after every such meet. The company may also consider live webcasting of analyst meets.

– **Medium of disclosure/dissemination**

- (i) Disclosure/dissemination of information may be done through various media so as to achieve maximum reach and quick dissemination.
- (ii) Corporates shall ensure that disclosure to stock exchanges is made promptly.
- (iii) Corporates may also facilitate disclosure through the use of their dedicated Internet website.
- (iv) Company websites may provide a means of giving investors a direct access to analyst briefing material, significant background information and questions and answers.
- (v) The information filed by corporates with exchanges under continuous disclosure requirement may be made available on the company website.

– **Dissemination by stock exchanges**

- (i) The disclosures made to stock exchanges may be disseminated by the exchanges to investors in a quick and efficient manner through the stock exchange network as well as through stock exchange websites.
- (ii) Information furnished by the companies under continuous disclosure requirements, should be published on the website of the exchange instantly.
- (iii) Stock exchanges should make immediate arrangement for display of the information furnished by the companies instantly on the stock exchange website.

INVESTIGATION BY SEBI

Power to make inquiries and inspection

Regulation 4A provides that if SEBI suspects that any person has violated any provision of these regulations, it may make inquiries with such persons or any other person as deemed fit, to form a prima facie opinion as to whether there is any violation of these regulations.

SEBI's right to investigate

Regulation 5 empowers SEBI to investigate into the complaints received from investors, intermediaries or any other person on any matter having a bearing on the allegations of insider trading; and to investigate suo-moto upon its own knowledge or information in its possession to protect the interest of investors in securities against breach of these regulations.

Regulation 6 provides procedure for investigation : Before undertaking an investigation under regulation 5 SEBI shall give a reasonable notice to insider for that purpose. However, where SEBI is satisfied that in the interest of investors or in public interest no such notice should be given, it may by an order in writing direct that the investigation be taken up without such notice.

Obligations of Insider on Investigation by SEBI

- It shall be the duty of every insider who is being investigated or any other person mentioned in clause (i) of sub-section (1) of section 11 of the Act, to produce to the investigating authority such books, accounts and other documents in his custody or control and furnish the authority with the statements and information relating to the transactions in securities market within such time as the said authority may require.
- The insider or any other person in clause (i) of sub-section (2) of section 11 of the Act] shall allow the investigating authority to have reasonable access to the premises occupied by such insider 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 investigating authority are relevant.

- The investigating authority, in the course of investigation, shall be entitled to examine or record statements of any member, director, partner, proprietor and employee of the insider or any other person mentioned in clause (i) of sub-section (2) of section 11 of the Act.
- It shall be the duty of every director, proprietor, partner, officer and employee of the insider to give to the investigating authority all assistance in connection with the investigation, which the insider or any other person mentioned in clause (i) of sub-section (2) of section 11 of the Act may be reasonably expected to give.

Directions by SEBI

SEBI may without prejudice to its right to initiate criminal prosecution under the Act, to protect the interests of investors and in the interests of the securities market and for due compliance with the provisions of the Act, Regulations made thereunder issue any or all of the following order, namely:-

- directing the insider or such person not to deal in securities in any particular manner;
- prohibiting the insider or such person from disposing of any of the securities acquired in violation of these Regulations;
- restraining the insider to communicate or counsel any person to deal in securities;
- declaring the transaction(s) in securities as null and void;
- directing the person who acquired the securities in violation of these regulations to deliver the securities back to the seller;

However, in case the buyer is not in a position to deliver such securities, the market price prevailing at the time of issuing of such directions or at the time of transactions whichever is higher, shall be paid to the seller;

- directing the person who has dealt in securities in violation of these regulations to transfer an amount or proceeds equivalent to the cost price or market price of securities, whichever is higher to the investor protection fund of a Recognised Stock Exchange.

PENALTY PROVISIONS FOR VIOLATIONS OF THE REGULATIONS

Without prejudice to the directions under regulation 11, if any person violates provisions of these regulations, he shall be liable for appropriate action under Sections 11, 11 B, 11D, Chapter VIA and Section 24 of the SEBI Act.

Regulation 11 & 14 of the Insider regulations empowers the SEBI to issue following directions to the violators without prejudice to its right to initiate criminal prosecution under section 24 or any action under Chapter VIA of the SEBI Act, to protect the interests of investor and in the interests of the securities market and for due compliance with the provisions of the Act, regulation made there under issue any or all of the following order, namely:

- (a) directing the insider or such person as mentioned in clause (i) of sub-section (2) of section 11 of the Act not to deal in securities in any particular manner;
- (b) prohibiting the insider or such person as mentioned in clause (i) of sub-section (2) of section 11 of the Act from disposing of any of the securities acquired in violation of these regulations;
- (c) restraining the insider to communicate or counsel any person to deal in securities;
- (d) declaring the transaction(s) in securities as null and void;
- (e) directing the person who acquired the securities in violation of these regulations to deliver the securities back to the seller:

However, in case the buyer is not in a position to deliver such securities, the market price prevailing at the time of issuing of such directions or at the time of transactions whichever is higher, shall be paid to the seller;

- (f) directing the person who has dealt in securities in violation of these regulations to transfer an amount or proceeds equivalent to the cost price or market price of securities, whichever is higher to the investor protection fund of a recognised stock exchange.

Section 24 of the SEBI Act, 1992 provides as under:

- (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 there under, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine which may extend to twenty-five crore rupees or with both.
- (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.

Penalty for insider trading under Section 15G of SEBI Act:

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 any body corporate on the basis of unpublished price-sensitive information.

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

Thus violation of the provisions of the regulations attract huge monetary penalty and may lead to criminal prosecution. However those aggrieved by an order of SEBI, may prefer an appeal to the Securities Appellate Tribunal within a period of forty-five days of the order. The persons aggrieved can also apply to SEBI for consent order under the scheme announced by it in which case the case is considered by a High Power Committee constituted under the SEBI Act, 1992.

APPEAL TO SECURITIES APPELLATE TRIBUNAL

Any person aggrieved by an order of SEBI under these regulations can prefer an appeal to the Securities Appellate Tribunal.

ROLE OF COMPANY SECRETARY IN COMPLIANCE REQUIREMENTS

The obligations cast upon the Company Secretary in relation to the insider trading regulations can be summarized as under:

1. To frame a code of internal procedures and conduct in line with the Model Code specified in the Schedule I of the regulations and get the same approved from the Board of Directors of the Company.
2. To place before the Board the “Code of Corporate Disclosure Practices for Prevention of Insider Trading” as enumerated in the Schedule II of the regulations.

3. The Company Secretary has to place before the Board for their consideration and approval the following:
 - (i) closing period for trading window.
 - (ii) minimum threshold limit beyond which it would be mandatory for the directors/officers/designated employees to obtain pre-clearance from the compliance officer before they trade in the company's securities.
 - (iii) format of application form for pre-clearance.
 - (iv) format of undertaking to be attached with pre-clearance application.
 - (v) internal guidelines as to the circumstances when the holding period may be waived by the compliance officer.
 - (vi) periodicity at which the directors/officers/designated employees are required to submit periodic statement of transaction in securities of the company to comply with the Code of Corporate Disclosure Practices.
 - (vii) To identify and declare the designated employees for the purpose of the regulations.
4. In case of unlisted company the company secretary is required
 - (i) To prepare the Chinese wall policy for adoption in the company.
 - (ii) To prepare Restricted/ Grey List of securities from time to time.
5. To frame and then to monitor adherences to the rules for the preservation of "Price Sensitive information".
6. To monitor and confirm whether transactions for which pre-clearance has been granted were executed within one week.
7. To suggest any improvements required in the policies, procedures, etc to ensure effective implementation of the code.
8. To maintain a record of all directors, officers and persons covered within the ambit of the term 'designated employee' and any changes in the same.
9. To assist in addressing any clarifications regarding the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 and the company's code of conduct.
10. To maintain a list of all information termed as 'price sensitive information'.
11. To maintain a record of names of files containing confidential information deemed to be price sensitive information and persons in charge of the same.
12. To ensure that computer data is adequately secured.
13. To keep records of periods specified as 'close period' and the 'Trading Window'.
14. To ensure that the 'Trading Window' is closed at the time of:
 - (i) Declaration of Financial results (quarterly, half-yearly and annual).
 - (ii) Declaration of dividends (interim and final)
 - (iii) Issue of securities by way of public /right/ bonus etc.
 - (iv) Any major expansion plans or execution of new projects.
 - (v) Amalgamation, mergers, takeovers and buy-back.
 - (vi) Disposal of whole or substantially whole 'of the undertaking.

- (vii) Any change in policies, plans or operations of the company.
 - (viii) Considering any other matter which could be construed as price-sensitive information.
 - (ix) All other events as specified under clause 36 of the Listing Agreement.
15. To ensure that the trading window is opened 24 hours after the information mentioned in para 14 is made public.
 16. To ensure that the trading restrictions are strictly observed and that all directors/officers/designated employees conduct all their dealings in the securities of the company only in a valid trading window and do not deal in the company's securities during the period when the trading window is closed.
 17. To ensure that no sale of shares allotted on exercise of ESOPs is made during a close period.
 18. To receive initial disclosure from any person holding more than 5% shares or voting rights in the company in the prescribed form within two working days of:
 - (i) the receipt of information of allotment of shares; or
 - (ii) the acquisition of shares or voting rights, as the case may be.
 19. To procure initial disclosure of the number of shares or voting rights held by any person who is a director or officer or is a promoter or part of promoter group of the listed company in the prescribed form within two working days of becoming a director or officer of the company.
 20. To receive from any person continual disclosures of the number of shares or voting rights held in the company and changes (purchase or sales or otherwise) therein, even if the shareholding falls below 5% since the last disclosure made under para 18 or this para, and such change exceeds 2% of the total shareholding or voting rights in the prescribed form within 2 working days of:
 - the receipt of intimation of allotment of shares; or
 - the acquisition or sale of shares or voting rights, as the case may be.
 21. To procure from any person who is a director or officer or is a promoter or part of promoter group of the listed company, continual disclosures of the total number of shares or voting rights held and change in shareholding or voting rights, if there has been a change in such holdings from the last disclosure made under para 19 above or this para, and the change exceeds ₹ 5 lac in value or 25000 shares or 1% of total shareholding or voting rights, whichever is lower, in the prescribed form within 2 working days of:
 - the receipt of intimation of allotment of shares; or
 - the acquisition or sale of shares or voting rights, as the case may be.
 22. To inform all stock exchanges on which the company's securities are listed, the information received under para 18, 19, 20 and 21 within five days of receipt.
 23. To process the applications received for pre-clearance of transactions from the directors/officers/designated employees
 24. To confirm whether the directors/ officers/ designated employees executed their order in respect of securities of the company within one week after the approval of pre-clearance is given.
 25. To ensure that a minimum holding period as specified by the company, which is not less than 30 days is observed by all directors/officers/ designated employees.
 26. To waive the requirement of holding period under certain circumstances.
 27. To receive and maintain records of periodic and annual statement of holdings from directors/officers/designated employees and their dependant family members.

28. To maintain records of all disclosures made by directors/officers/designated employees for a minimum period of three years.
29. To place before the Managing Director or Chief Executive Officer or Committee of directors, as may be specified for the purpose, on a monthly basis all the details of the dealings in the securities by directors/officers of the company and the accompanying documents that such persons had executed under the pre-clearance procedure.
30. To implement the punitive measures or disciplinary action prescribed for any violation or contravention of the code of conduct.

External Reporting by the Company Secretary as Compliance Officer

1. To disclose within two working days of receipt, to all stock exchanges on which the company is listed, the information received under regulation 13.
2. To inform the SEBI the violation of the SEBI (Prohibition of Insider Trading) Regulations, 1992 if any committed by any person. But before bringing it to the notice of SEBI, the compliance officer has to inform the Managing Director/ Chief Operating Officer and the Board of the Company.
3. In addition to the above he is also required to liaison with other authorities and the shareholders of the Company.

Chinese Wall

To prevent the misuse of confidential information the organization/firm shall adopt a "Chinese Wall" policy which separates those areas of organization/firm which routinely have access to confidential information, from those areas which deal with sale/marketing/investment advice or other departments providing support services. The employees in the respective areas shall not communicate any price sensitive information to the other areas.

Restricted/Grey List

In order to monitor Chinese Wall procedure and trading in client securities based on price sensitive information, the organization/firm shall restrict trading in certain securities and designate such list a restricted/ grey list. Securities of a listed company shall be out on the restricted/ grey list if the organization/firm is handling any assignment for the listed company and is privy to price sensitive information.

LESSON ROUND UP

- To curb insider trading SEBI formulated SEBI (Prohibition of Insider Trading) Regulations, 1992 and which prescribes code of conduct and corporate disclosure practices to be followed by listed companies and entities connected with them.
- The Insider Trading Regulations Comprises of four chapter and three schedules encompassing the various regulations relating to Insider Trading.
- Insider means and includes deemed to be a connected person. The definition of deemed to be a connected person is very elaborate.
- The regulations not only seeks to curb dealing in securities, they also seek to curb communicating or counseling about securities by the insiders.
- The regulations provide for initial as well as continual disclosures by members of the company after a threshold limit of holding and by the directors/ employees/ designated employees/promoter/promoter group at regular interval.

GLOSSARY

Book Closure	The periodic closure of the Register of Members and Transfer Books of the company, to take a record of the shareholders to determine their entitlement to dividends or to bonus or right shares or any other rights pertaining to shares.
Chinese Walls	Artificial barriers to the flow of information set up in large firms to prevent the movement of sensitive information between departments.
Continuous Disclosure	Procedure where certain companies are required to make disclosures on a continuing basis of their business activities by filing documents.
Interim Dividend	A dividend payment made during the course of a company's financial year. Interim dividend, unlike the final dividend, does not have to be agreed in a general meeting.
Punitive	It implies involving or inflicting punishment..

SELF TEST QUESTIONS

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

1. What are the compliances to be made by a company under SEBI (Prohibition of Insider Trading) Regulations, 1992?
2. Describe the obligations cast upon the company under SEBI (Prohibition of Insider Trading) Regulations, 1992.
3. What are the Initial Disclosure Required to be made by a person under SEBI (insider Trading) regulations, 1992?
4. What are the Penalty for insider trading under Section 15G of SEBI Act?
5. Briefly explain the duty of Compliance Officer under these regulations.

Lesson 20

Takeover Code – An Overview

LESSON OUTLINE

- Introduction
- Important Definitions
- Trigger Point for making an open offer by an acquirer
- Open Offer
- Public Announcement
- Offer Price
- Submission of Draft letter of Offer
- Dispatch of Letter of Offer
- Opening of the Offer
- Completion of Requirements
- Restriction on Acquisition
- Provision of Escrow
- Mode of Payment
- Disclosures
- Exemptions
- Lesson Round Up
- Glossary
- Self Test Questions

LEARNING OBJECTIVES

A lot has changed in the corporate world since 1997, the year in which the (SAST) Regulations, 1997 was enacted. In line with the ever changing global scenario this old takeover code was replaced with new SEBI, [Substantial Acquisition of Shares and Takeovers (SAST)] Regulations, 2011. The main purpose for the new takeover code is to prevent hostile takeovers and at the same time, provide some more opportunities of exit to innocent Shareholders who do not wish to be associated with a particular acquirer. The new code will also balance the conflicting objectives and interests of various stakeholders in the context of substantial acquisition of shares in, and takeovers of, listed companies and also regulate and provide for fair and effective competition among acquirers desirous of taking over the same target company.

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

INTRODUCTION

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

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

The earliest attempts at regulating takeovers in India can be traced back to the 1990s with the incorporation of Clause 40 in the Listing Agreement. While, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994 which were notified in November 1994 made way for regulation of hostile takeovers and competitive offers for the first time; the subsequent regulatory experience from such offers brought out certain inadequacies existing in those Regulations. As a result, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 were introduced and notified on February 20, 1997, pursuant to repeal of the 1994 Regulations.

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

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

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

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulation 2011, comprises of Six chapters and one schedules encompassing the various regulations related to Substantial Acquisition of Shares and Takeovers. Chapter I (Regulation 1 – 2) deals mainly with the definitions used in regulation. Chapter II (Regulation 3-11) provides for substantial acquisition of shares, Voting Rights or Control, threshold limit for open offer. It also contains the exemption available to the Company. Chapter III (regulation 12-23) narrates the open offer process and deals with concept related to open offer. Chapter IV (regulation 24-27) deals with the other obligations of Acquirer, Merchant Banker etc., Chapter V (regulation 28-31) deals with disclosure requirements of Shareholding and control and limit for making disclosures. Chapter VI (regulation 32-35) deals with miscellaneous provisions relating to power of SEBI and its right to issue directions. A further amendment to these regulation came on 26th March, 2013 with modification in these regulations. SAST code of internal procedure and conduct to be followed by listed companies, disclosure requirements followed by companies. The Takeover Regulations are applicable on the acquisition of voting rights or control over the listed company.

What is Takeover?

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 to first go through some of the definitions :

Acquirer

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

Acquisition

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

Control

"control" includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

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.

Enterprise value

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

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

Frequently traded shares

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

Offer period

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

Persons Acting in Concert

"Persons acting in concert" means, –

- (1) persons who, with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly co-operate for acquisition of shares or voting rights in, or exercise of control over the target company.
- (2) Without prejudice to the generality of the foregoing, the persons falling within the following categories shall be deemed to be persons acting in concert with other persons within the same category, unless the contrary is established, –
 - (i) a company, its holding company, subsidiary company and any company under the same management or control;
 - (ii) a company, its directors, and any person entrusted with the management of the company;
 - (iii) directors of companies referred to in item (i) and (ii) of this sub-clause and associates of such directors;
 - (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;
 - (viiiia) an alternate investment fund and its sponsor, trustees, trustee company and manager;
 - (ix) a foreign institutional investor and its sub-accounts;
 - (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.

Target company

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

Tendering period

Tendering period means the period within which shareholders may tender their shares in acceptance of an open

offer to acquire shares made under these regulations.

"Volume weighted average market price"

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

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

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

"Weighted average number of total shares"

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

"Volume weighted average price"

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

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

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

TRIGGER POINT FOR MAKING AN OPEN OFFER BY AN ACQUIRER

25% shares or voting rights

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

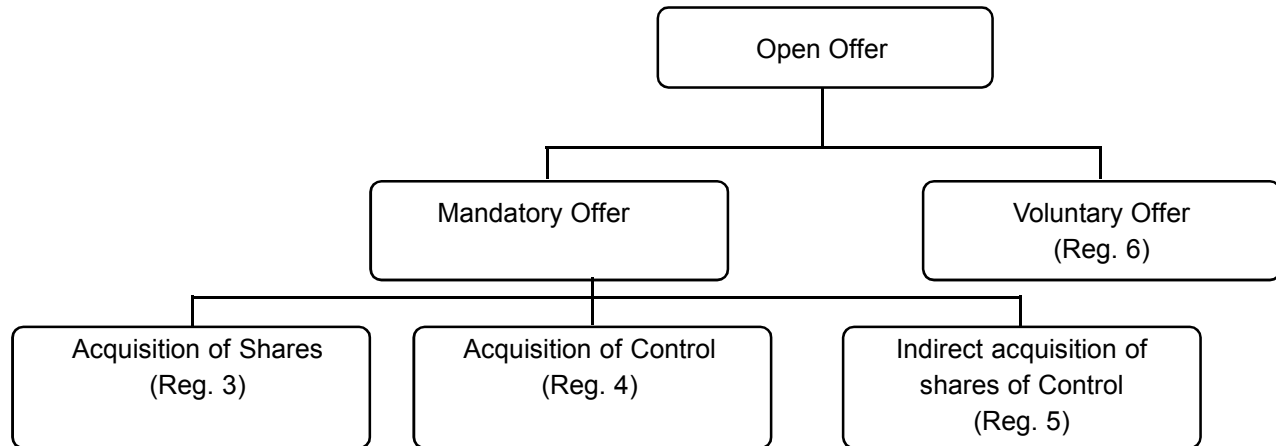
Creeping acquisition limit

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

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

OPEN OFFER

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



I. MANDATORY OPEN OFFER

SEBI Takeover Regulations, 2011 provides a threshold for mandatory Open Offer. The regulations 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 now 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-Prior holding of atleast 25% shares**

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

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

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

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

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

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

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

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

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

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

- **Offer size**

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

CONDITIONAL OFFER

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

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

PUBLIC ANNOUNCEMENT

I. Short Public Announcement

A short public announcement shall be made on the same day or as prescribed under Regulation 13(1), (2) and (3) of the Regulations as the date of transaction which triggered the Open Offer to all the stock exchanges where the shares of the Target Company are listed for the purpose of dissemination of the information to the public. Further, a copy of the public announcement shall be sent to SEBI and to the Target Company at its registered office within one working day of the date of short public announcement. [Regulation 13 read with Regulation 14(1) and 14(2)]

II. Detailed Public Announcement-[Regulation 14(3) & (4)]

After the short Public Announcement, a detailed Public Announcement shall be made by the Acquirer within 5 working days from the date of short Public Announcement. Such public announcement 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)].

Simultaneously, a copy of the publication shall be sent to SEBI, Stock Exchanges where the shares of the Target Company are listed and to the Target Company at its registered office.[Regulation 14(4)]

Offer price

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

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

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

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

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

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

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

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

SUBMISSION OF DRAFT LETTER OF OFFER

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

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

DISPATCH OF LETTER OF OFFER-[REGULATION 18(2)]

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

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

OPENING OF THE OFFER -[REGULATION 18(8)]

The tendering period shall start within maximum 12 working days from date of receipt of comments from the Board and shall remain open for 10 working days.

COMPLETION OF REQUIREMENTS-[REGULATION 18(10)]

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.

RESTRICTION ON ACQUISITION-[REGULATION 8(10)]

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

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

However, where an open offer is made conditional upon minimum level of acceptance, hundred per cent 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 the Board;
- (d) by issue, exchange or transfer of convertible debt securities entitling the holder thereof to acquire listed shares in the equity share capital of the acquirer or of any person acting in concert; or
- (e) a combination of the mode of payment of consideration stated in clause (a), clause (b), clause (c) and clause (d):

Where any shares have been acquired or agreed to be acquired by the acquirer and persons acting in concert with him during the fifty-two weeks immediately preceding the date of public announcement constitute more than ten per cent of the voting rights in the target company and has been paid for in cash, the open offer shall entail an option to the shareholders to require payment of the offer price in cash, and a shareholder who has not exercised an option in his acceptance shall be deemed to have opted for receiving the offer price in cash. In case of revision in offer price the mode of payment of consideration may be altered subject to the condition that the component of the offer price to be paid in cash prior to such revision is not reduced.

WITHDRAWAL OF OPEN OFFER

1. An open offer for acquiring shares once made shall not be withdrawn except under any of the following circumstances, –
 - (a) statutory approvals required for the open offer or for effecting the acquisitions attracting the obligation to make an open offer under these regulations having been finally refused, subject to such requirements for approval having been specifically disclosed in the detailed public statement and the letter of offer;

- (b) the acquirer, being a natural person, has died;
 - (c) any condition stipulated in the agreement for acquisition attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, and such agreement is rescinded, subject to such conditions having been specifically disclosed in the detailed public statement and the letter of offer; or

“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.”
 - (d) such circumstances as in the opinion of the SEBI, merit withdrawal.
2. In the event of withdrawal of the open offer, the acquirer shall through the manager to the open offer, within two working days, –
- (a) make an announcement in the same newspapers in which the public announcement of the open offer was published, providing the grounds and reasons for withdrawal of the open offer; and
 - (b) simultaneously with the announcement, inform in writing to,–
 - (i) 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.

OBLIGATIONS OF THE ACQUIRER

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

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

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

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

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

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

DISCLOSURES

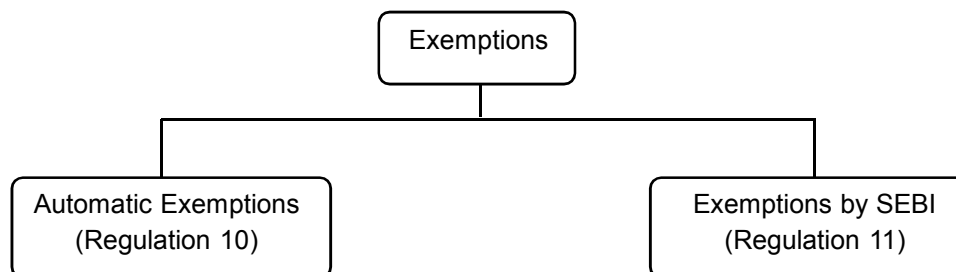
In SEBI Takeover Regulations, 2011, the obligation to give the disclosures on the acquisition of certain limits is only on the acquirer and not on the Target Company. Further as against the Open Offer obligations where the individual shareholding is also to be considered, the disclosure shall be of the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

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

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

EXEMPTIONS

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



Regulation 10 - Automatic Exemptions

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

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

Some of the important exemptions provided therein regulation 10 along with their conditions for exemption 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 by the target company shall be exempt from the obligation to make an open offer provided such shareholder reduces his shareholding such that his voting rights fall to below the threshold referred to in sub-regulation (1) of regulation 3 within ninety days from the date of the closure of the said buy back offer.

(4) The following acquisitions shall be exempt from the obligation to make an open offer 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 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
 - (iv) the increase in voting rights does not result in an acquisition of control by such shareholder over the

target company. However, where the aforesaid conditions are not met, in the event such shareholder reduces his shareholding such that his voting rights fall below the level at which the obligation to make an open offer would be attracted under sub-regulation (2) of regulation 3, within ninety days from the date of closure of the buyback 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 category I Alternative Investment Fund or foreign venture capital investor and such promoters.

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

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

(7) In respect of any acquisition of or increase in voting rights pursuant to exemption provided for in clause (a) of sub-regulation (1), sub-clause (iii) of clause (d) of sub-regulation (1), clause (h) of sub-regulation (1), sub-regulation (2), sub-regulation (3) and clause (c) of sub-regulation (4), clauses (a), (b) and (f) of sub-regulation (4), the acquirer shall, within twenty-one working days of the date of acquisition, submit a report in such form as may be specified along with supporting documents to SEBI giving all details in respect of acquisitions, along with a non-refundable fee of rupees 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 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.

LESSON ROUND UP

- SAST aims at protecting interest of the investors in securities of a listed company providing amongst others, an opportunity for the public shareholders to exit where there is a substantial acquisition of shares or voting rights or control over a listed company, consolidation of holdings by existing shareholders and related disclosures and penalties for non-compliance etc.
- The Takeover Regulations, 1997 stand repealed from October 22, 2011, i.e. the date on which SAST Regulations, 2011 come into force.
- SEBI Takeover Regulations, 2011 provides certain trigger events wherein the Acquirer is required to give Open Offer to the shareholders of the Target Company to provide them exit opportunity.
- Regulation 6 of the Takeover Regulations provides the threshold and conditions for making the Voluntary Open Offer.
- An offer in which the acquirer has stipulated a minimum level of acceptance is known as a conditional offer.
- Regulation 10 & 11 provides for automatic exemptions and exemptions by SEBI.
- The public announcement shall be sent to all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public.
- In SEBI Takeover Regulations, 2011, the obligation to give the disclosures on the acquisition of certain limits is only on the acquirer and not on the Target Company.

GLOSSARY

Competitive Bid	An offer made by a person other than the acquirer who has made the first public announcement.
Control of management	The right to appoint directly or indirectly or by virtue of agreements or in any other manner majority of directors on the Board of the target company or to control management or policy decisions affecting the target company.
Corporate restructuring	Involves making radical changes in the composition of the businesses in the company's portfolio.
Disinvestment	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;
Encumbrance	It shall include a pledge, lien or any such transaction, by whatever name called.
Public Announcement	A public announcement is an announcement made in the newspapers by the acquirer primarily disclosing his intention to acquire shares of the target company from existing shareholders by means of an open offer.
Takeover	Takeover is a corporate device whereby one company acquires control over another company, usually by purchasing all or majority of its shares.
Weighted average number of total shares	Weighted average number of total shares means the number of shares at the beginning of a period, adjusted for shares cancelled, bought back or issued during the aforesaid period, multiplied by a time-weighting factor;

Lesson 21

Investor Protection

LESSON OUTLINE

- Introduction
- Legal Framework for Investor Protection In India
- Investor Education and Protection Fund
- SEBI (Investor Protection and Education Fund) Regulation, 2009
- Financial Education
- Investors' rights and responsibilities.
- Types of Grievances and Dealing Authorities
- Initiatives taken so far on Financial Literacy in India
- SCORES
- SEBI (Informal Guidance)Scheme, 2003
- Lesson Round Up
- Glossary
- Self-Test Questions

LEARNING OBJECTIVES

Investor protection is one of the most important elements of a thriving securities market or other financial investment institution. Investor protection focuses on making sure that investors are fully informed about their purchases, transactions and the affairs of the company that they have invested in.

Investors protections is a very popular phrase with all these concerned with regulation of the capital market these days, be the stock exchanges. SEBI, MCA, RBI, Investors Association, or for that matter of fact the companies themselves – Various Procedures, Guidelines, Rules and Regulations have been issued in the Legislations to protect the 'Investors' right and repose the confidence.

Keeping the above in view, this lesson will enable the students to understand the concept and need for Investor Protection and Education, Rights and responsibilities of investors, legal framework for investor protection in India, measures taken for financial literacy in India and SEBI initiatives, etc.

INTRODUCTION

The securities market operations promote the economic growth of the country. More efficient is the securities market, the greater is the promotion effect on economic growth. It is, therefore, necessary to ensure that securities market operations are more efficient, transparent and safe. In this context, the investors need protection from the various malpractices and unfair practices made by the corporate and intermediaries. As the individual investors' community and the investment avenues are on the rise, it is interesting to know how the investors shall be protected through various legislations. Securities market in general are to be regulated to improve the market operations in fair dealings and easy to access the market by corporate and investors. The present positive attitude of investors is heartening though investor sentiments have been shaken by the various scandals. Even though, there are various opportunities available for investment, investors are scared of investing. In this situation, the individual investors' protection becomes necessary to sustain the economic development of the country.

The desired level of economic growth of a country is dependent upon availability of protection to its investors'. Globally, there is increased evidence to suggest that investor protection has assumed an important role in the economic development of a country. Integrity of the financial markets and economic well being of the country depend on corporate accountability and investors confidence. The global concern to make capital markets safer and transparent can be achieved by strengthening financial system and managing the crisis efficiently. The revival of investors' protection in the corporate securities market is necessary to make market more efficient by means of converting savings to investment. If the investors are not protected properly by way of providing fair rate of return and safeguarding their capital, the corporate will not be able to mobilize funds from the market at reasonable rate in times to come. In view of the foregoing with a view to gain the confidence of investors in the securities market it is necessary to provide adequate rate of return on investors' capital by corporates through their operational efficiency. This will enable us to lure back investors to the capital market. This can be done by a series of systematic measures which would build their confidence in the systems and processes and protect the interest of investors.

INVESTORS' RIGHTS AND RESPONSIBILITIES

Equity shareholders are the real owner of the company and with the growth of the company equity shareholders also get capital appreciation, vice versa is also true. Investment in equity shares cannot be guaranteed with any income and/or growth. Following are the rights and responsibilities of a shareholder of a company :

The Rights of Investor as a shareholder

- To receive the share certificates, on allotment or transfer (if opted for transaction in physical mode) as the case may be, in due time. Now in IPO investors will be allotted shares in dematerialized mode only and subsequently they can rematerialized the allotted shares.
- To receive copies of the Annual Report containing the Balance Sheet, the Profit & Loss account and the Auditor's Report.
- To participate and vote in general meetings either personally or through proxy.
- To receive dividends in due time once approved in general meetings.
- To receive corporate benefits like rights, bonus, etc. once approved.
- To apply to Company Law Board (CLB) to call or direct the calling of an Annual General Meeting.
- To inspect the minute books of the general meetings and to receive copies thereof.
- To proceed against the company by way of civil or criminal proceedings.
- To apply for the winding up of the company.

- To receive the residual proceeds in case of winding up.
- To receive offer to subscribe to right share in case of further issue of shares.
- To receive offer in case of Takeover or Buy-back under SEBI Regulations.
- Besides the above rights, which investors enjoy as an individual shareholder, investors also enjoy the following rights as a group:
 - To give requisition for an Extra-ordinary General meeting.
 - To demand a poll on any resolution.
 - To apply to CLB to investigate into the affairs of the company.
 - To apply to CLB for relief in cases of oppression and/or mismanagement.

Rights of Investors as a debenture holder

- To receive interest on redemption of debentures in due time.
- To receive a copy of the trust deed on request.
- To apply for winding up of the company if the company fails to pay its debt.
- To approach the Debenture Trustee with your grievance.
- You may note that the above mentioned rights may not necessarily be absolute. For example, the right to transfer securities (in physical mode) is subject to the company's right to refuse transfer as per statutory provisions.

Responsibilities of an Investor as a security holder

- To be specific
- To remain informed
- To be vigilant
- To participate and vote in general meetings
- To exercise your rights on your own or as a group.

WHOM TO APPROACH FOR COMPLAINT AGAINST STOCK BROKERS/DEPOSITORY PARTICIPANTS

Investors who are not satisfied with the response to their grievances received from the brokers/Depository Participants/listed companies, can lodge their grievances with the Stock Exchanges or Depositories. The grievance can be lodged at any of the offices of the BSE/NSE located at Chennai, Mumbai, Kolkata and New Delhi. In case of unsatisfactory redressal, BSE/NSE has designated Investor Grievance Redressal Committees (IGRCs), or Regional Investor Complaints Resolution Committees (RICRC), this forum acts as a mediator to resolve the claims, disputes and differences between entities and complainants. 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. For any detailed information, please visit the website of the respective stock exchange. If the grievance is still not resolved, an investor can file arbitration under the Rules, Bye laws and Regulations of the respective Stock Exchange/Depository.

TYPES OF GRIEVANCES AND DEALING AUTHORITY

Grievances pertaining to	Regulator
Banks deposits and banking Fixed Deposits with Non Banking Financial Companies (NBFCs) and other matters pertaining to NBFCs Primary Dealers	Reserve Bank of India (RBI) http://www.rbi.org.in/
Fixed Deposits with manufacturing companies Unlisted companies Mismanagement of companies, financial performance of the company, Annual General Meeting, Annual Report, minority shareholders interest, non-receipt of preferential allotment shares, etc. and corporate actions as per the court order such as mergers, amalgamation, reduction of share capital/par value, etc. Nidhi Companies	Ministry of Corporate Affairs (MCA) http://www.mca.gov.in/
Insurance Companies/Brokers /Agents/products of and Service	Insurance Regulatory and Development Authority India (IRDA) http://www.irdaindia.org/
Commodities	Forward Markets Commission (FMC) http://www.fmc.gov.in/
Pension fund	Pension Fund Regulatory and Development Authority (PFRDA) http://www.pfrda.org.in/
Monopoly and anti competitive practices	Competition Commission of India (CCI) http://www.cci.gov.in/
Chit Funds	Registrars of Chit Funds of the concerned State.
Housing Finance Companies	National Housing Bank (NHB) www.nhb.org.in

LEGAL FRAMEWORK FOR INVESTOR PROTECTION IN INDIA

In order to afford adequate protection to the investors, provisions have been incorporated in different legislations such as the Companies Act, Securities Contracts (Regulation) Act, Consumer Protection Act, Depositories Act, and Listing Agreement of the Stock Exchanges supplemented by many guidelines, circulars and press notes issued by the Ministry of Finance, Ministry of Company Affairs and SEBI from time to time. The legislations as well as the rules and regulations notified thereunder specify disclosure requirements to be complied with by the companies and also punishments and remedies for failure of compliance.

1. COMPANIES ACT, 2013**Acceptance of Deposits**

Section 73 - This section provides that no Company shall accept or review deposit under this Act from the public

except in a manner provided under Chapter V (Acceptance of Deposits by Companies) of Companies Act, 2013 and Companies (Acceptance of Deposits) Rules, 2014 made thereunder.

Sub-section 3 of section 74 lays down that if a company fails to repay the deposit or part thereof or any interest thereon within the time specified under section 74 or such further times as may be allowed by the Tribunal, the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.

In terms of sub-section 4, where a Company fails to repay the deposit or part thereof, or any interest thereon the deposit for concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.

Rule 21 of Companies (Acceptance of Deposits) Rules, 2014 stipulates that if any company referred to in sub-section (2) of section 73 or any eligible company inviting deposits or any other person contravenes any provisions of these rules for which no punishment is provided in the act, the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five thousand rupees for every day after the first day during which the contraventions continue.

Mis-statements in Prospectus

Section 34 deals with criminal liability for mis-statement in prospectus issued by a company.

Section 34: Where a prospectus, issued, circulated or distributed, includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to be mislead, every person who authorises the issue of such prospectus shall be liable for action under section 447.

Section 447: Any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. Provided that where the fraud in question involves public interest the terms of the imprisonment shall not be less than three years.

Fraudulently inducing persons to invest money

Section 36: Any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into-

- (a) any agreement for, or with a view to, acquiring, disposing of, subscribing for or underwriting, securities; or
- (b) any agreement the purpose or the pretended purpose of which is to secure a profit or any of the parties form the yield of securities or by reference to fluctuations in the value of securities; or
- (c) any agreement, for, or with a view to, obtaining credit facilities from any bank or financial institution,

shall be liable for action under section 447.

Personation for acquisitions, etc. of securities

Section 38: Any person who –

- (a) makes or abets making an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or
- (b) makes or abets making of multiple applications to the company in different names or in different combinations of his name or surname for acquiring or subscribing for its securities; or
- (c) otherwise induces directly or indirectly a company to allot, or register any transfer thereof, securities to him, or to any other person in a fictitious name,

shall be liable for action under section 447.

Non-payment of Dividend

Section 123: This section, inter alia, requires a company who has declared a dividend for any financial year to deposit the amount of such dividend (including interim dividend) in a scheduled bank in a separate account within 5 days from the date of declaration of such dividend.

Section 124: This section provides that where a dividend has been declared by a company which has not been paid or claimed within 30 days from the date of such declaration, the company shall within 7 days of expiry of the said period of 30 days transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by a company in this behalf in any scheduled bank to be called the unpaid dividend account.

This section also provide for penalty for non complying with the above requirement and the same by way of interest @ 12% per annum and the interest accruing on the amount of unpaid/unclaimed dividend not transferred to the unpaid dividend account.

Section 125: This section provides for establishment of Investors' Education and Protection Fund by the Central Government. Various types of unpaid/unclaimed amounts of application money/matured deposits/matured debenture etc. are to be credited to the said fund. The said accumulation in this fund are to be utilized for promotion of investors' awareness and protection of investors' interests.

Further, if a company fails to comply with any of the requirements of Section 124, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty- five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Transfers and Transmission of Securities

Regarding transfers and transmissions of securities necessary provisions are available in Section 56, 58, 59 of the Companies Act, 2013. As regards listed companies, the clauses in the listing agreement contain provisions for prompt issue of certificates after effecting transfers.

Failure to comply with the provisions of Companies Act, 2013 can be brought before the Tribunal through an appeal under Section 58 and 59. After hearing the parties the Tribunal may by order direct the company to register the transfer.

Failure to Send Financial Statements

Section 136: This section provides for the right of a member to obtain copies of Balance-sheet and auditors Report.

Sub-section 3 provides that in case of default complying with this requirement, the company shall be liable for a penalty of twenty-five thousand rupees and every officer who is in default shall be liable to a penalty of five thousand rupees.

Besides, Section 436 permits the shareholder to proceed against the company and its officers in a court of law generally for offences committed under the Companies Act including prospectus, abridged prospectus, allotment,

listing, transfer of shares, dividend payment etc. committed by the company as well as its officers under various provisions in the Act.

Protection to Debentureholders

Section 71 of the Companies Act, 2013 protects the debenture holders and contains stringent penalties for default and also empowers the debenture trustee to make an appeal to the Tribunal.

2. SEBI ACT, 1992

In the preamble to the SEBI Act, 1992 two objectives are mentioned. The first objective is protecting the interest of the investors in securities and the second is to promote the development of and to regulate the securities market and for matters connected therewith or incidental thereto. Thus priority is accorded to investor protection in the SEBI Act.

Section 11 in Chapter IV of the SEBI Act lists out the functions of the SEBI. Section 11(2)(e) stipulates prohibition of fraudulent and unfair practices relating to securities markets as one of these functions and Section 11(2)(g) provides for prohibition of insider trading in securities. In pursuance of this provision the Board had notified the SEBI (Prohibition of fraudulent and unfair practices relating to securities markets) Regulations, 1995 on 25th October, 1995 which have now been replaced with SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 w.e.f. 17.7.2003.

Section 15A to Section 15HA provide for penalty in respect of failure to furnish information, return, etc., failure by any person to enter into agreement with clients, failure to redress investors' grievances, certain defaults in case of mutual funds, failure to observe rules and regulations by an asset management company, default in case of stock brokers, insider trading, non-disclosure of acquisition of shares and takeovers, fraudulent and unfair trade practices.

Section 24 provides for punishment with imprisonment upto 10 years or with fine which may extend to ₹ 25 crores or with both. If any person contravenes or attempts to contravene or abets the contravention of the provision of SEBI Act or any rules or regulation.

As regards violation of provisions in the listing agreement, investors can forward their complaints to the stock exchanges with whom the company is listed to initiate action. The Investors are also at liberty to file complaints before the District Forum, State Commission or National Commission established under Section 9 of the Consumer Protection Act.

In the case of listed companies investors are entitled to forward their complaints to the company and SEBI and the latter takes up the matter with the companies. SEBI has the power to take action including criminal proceeding where necessary against persons responsible for delay.

3. SECURITIES CONTRACTS (REGULATION) ACT, 1956

Section 23 provides for penalties which may extend to 10 years or with fine which may extend to ₹ 25 crores or with both for contravention of the provisions of the Act.

Section 23A to Section 23H provide for penalty in respect of failure to furnish information, return etc., failure by any person to enter into an agreement with clients, failure to redress investor grievances, failure to segregate securities or moneys of client or clients, failure to comply with provisions of listing conditions or delisting conditions or grounds, excess dematerialization or delivery of unlisted securities, failure to furnish periodical returns, contravention with any provision of the act where no separate penalty is provided.

Section 23M provides for penalty for imprisonment for a term which may extend to 10 years or with fine which may extend to ₹ 25 crore or both for contravention or attempts to contravene or abates the contravention of the provisions of the Act or any rules or regulations or bylaws.

4. RESERVE BANK OF INDIA ACT, 1938

Section 45 QA of the Reserve Bank of India Act gives a depositor similar rights as are provided under Companies Act to approach CLB for payment of matured deposits in the case of NBFCs

5. INDIAN PENAL CODE

Economic Offence Wings of the Police Departments have powers under IPC to take up the cases of cheating, forgery and misappropriation etc. relating to investments.

Stock exchanges can also take up the issues pertaining to securities in terms of the conditions of listing agreement, rules and regulations

INVESTORS EDUCATION AND PROTECTION FUND

Investor Education and Protection Fund (IEPF) has been established under Section 125 of the Companies Act, 2013, for promotion of investors' awareness and protection of the interests of investors. Affairs has laid down the Ministry of Corporate for administration of IEPF. MCA has laid down draft rules on Investor Education and Protection Fund Authority Rules, 2014* (IEPF Rules).

SEBI (INVESTOR PROTECTION AND EDUCATION FUND) REGULATIONS, 2009

SEBI in exercise of the powers conferred by section 30 of SEBI Act, 1992, SEBI made the SEBI (Investor Protection and Education Fund) Regulations, 2009.

Regulation 3 of the Act lays down the establishment of the fund which shall be called the Investor Protection and Education Fund.

Regulation 4 provides for the amounts to be credited to the Fund. The following amounts shall be credited to the Fund:

- (a) contribution as may be made by SEBI to the Fund;
- (b) grants and donations given to the Fund by the Central Government, State Government or any other entity approved by SEBI for this purpose;
- (c) proceeds in accordance with the sub-clause (ii) of clause(e) of sub-regulation (10) of regulation 17 and the sub- regulation (3) of regulation 21 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
- (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) amounts forfeited for non-fulfilment of obligations specified in regulation 15B of the SEBI (Buy-back of Securities) Regulations, 1998;
- (g) monies transferred in accordance with sub-regulation (9) of regulation 45 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009;
- (h) amounts disgorged under section 11B of the Act or section 12A of the Securities Contracts (Regulation) Act, 1956 or section 19 of the Depositories Act, 1996
- (i) interest or other income received out of any investments made from the Fund;
- (j) such other amount as SEBI may specify in the interest of investors.

* The Sections and Rules have not yet notified by MCA till date. This is the draft rules.

Utilisation of Fund

The fund shall be utilised for the purpose of protection of investors and promotion of investor education and awareness in accordance with these regulations. The fund may be used for the following purposes, namely:-

- (a) Educational activities including seminars, training, research and publications, aimed at investors;
- (b) Awareness programmes including through media - print, electronic, aimed at investors;
- (c) Funding investor education and awareness activities of Investors' Associations recognized by SEBI
- (d) Aiding investors' associations recognized by SEBI to undertake legal proceedings in the interest of investors in securities that are listed or proposed to be listed;
- (e) Refund of the security deposits which are held by stock exchanges and transferred to the Fund consequent on de-recognition of the stock exchange, in case the concerned companies apply to SEBI and fulfill the conditions for release of the deposit;
- (f) Expenses on travel of members of the Committee, who are not officials of the Board, and special invitees to the meetings of the Committee, in connection with the work of the Committee;
- (g) Salary, allowances and other expenses of office of Ombudsman; and
- (h) Such other purposes as may be specified by SEBI.

The amount disgorged and **credited** to the fund in accordance with clause (h) of regulation 4 and the interest accrued thereon shall, in cases when SEBI deems fit to make restitution to eligible and identifiable investors who have suffered losses resulting from violation of securities Law, be utilised for the purposes of such restitution. However, the money left in the fund after earmarking the amount for the process of restitution to eligible and identifiable investors may be utilised for the purposes of the fund specified in the regulation. Further, no claim for restitution from the disgorged amounts in specified case shall be adjustable after a period of seven years from the date of invitation of claim for disgorgement in the said case by SEBI.

Conditions for Aid

The aid shall be given by SEBI to investors' associations, in accordance with the guidelines made by it and subject to the following conditions:

- (a) that the aid shall not exceed seventy five per cent. of the total expenditure on legal proceedings;
- (b) such aid shall not be considered for more than one legal proceeding in a particular matter;
- (c) if more than one investors' association applies for seeking legal aid, the investors' association whose application is received first, shall be considered for such aid.

Constitution of The Committee

SEBI shall constitute an advisory committee for recommending investor education and protection activities that may be undertaken directly by the Board or through any other agency, for utilisation of the Fund for the purposes referred in these regulations. The Committee shall consist of the following members, namely:-

- (a) The Executive Director of SEBI in charge of Office of Investor Assistance and Education who shall be the convener of the Committee;
- (b) Two other officials of SEBI;
- (c) Five other members who have expertise about the securities market and experience in matters of investor grievance redressal or investor education.

The term of office of members shall be two years, which may be extended for a further period of two years. Any vacancy arising out of resignation, retirement or death of a member or for any other reason shall be filled by the Board for the remaining period of the term of such member. SEBI may dissolve and reconstitute the Committee if, at any time, SEBI is of the opinion that the Committee is unable to discharge the functions and duties imposed on it by or under these regulations.

FINANCIAL EDUCATION

An increased need for financial education is felt in both developed and developing countries. In developed countries, the increasing number of financial products, its complexity, importance of retirement savings, increased growth of secondary market has made the imparting of financial education imperative for all age groups, including students so that individuals are educated about financial matters as early as possible in their lives. In the developing countries, the growing number of investors, technically advanced financial markets, liberalised economy etc. necessitates imparting of financial education for better operation of markets and economy and in the interest of investor. Further imparting of financial education is international concern due to growth of international transactions, international financial instruments like ADR, GDR, IDR etc., mobility of individuals from one country to another etc.

INITIATIVES TAKEN SO FAR ON FINANCIAL LITERACY IN INDIA

RBI's initiatives

Reserve Bank of India has undertaken a project titled "Project Financial Literacy". The objective of this project is to disseminate information regarding the central bank and general banking concepts to various target groups, including school and college students, women, rural and urban poor, defense personnel and senior citizens. The project envisages a multi pronged approach. The project has been designed to be implemented in two modules, one module focusing on the economy, RBI and its activities, and the other module on general banking. The material is created in English and other vernacular languages. It is disseminated to the target audience with the help of banks, local government machinery, schools and colleges through presentations, pamphlets, brochures, films and also through RBI's website.

SEBI Initiatives

Securities Exchange Board of India has embarked financial education on a nationwide campaign. To undertake financial education to various target segments viz. school students, college students, working executives, middle income group, home makers, retired personnel, self help groups etc., SEBI has empanelled Resource Persons throughout India. The Resource Persons are given training on various aspects of finance and equipped with the knowledge about the financial markets. These SEBI Certified Resource Persons organise workshops to these target segments on various aspects viz. savings, investment, financial planning, banking, insurance, retirement planning etc.

Investor education programs are conducted by SEBI through investor associations all over the country. Regional seminars are conducted by SEBI through various stakeholders viz. Stock Exchanges, Depositories, Mutual Funds Association, Association of Merchant Bankers etc. SEBI has a dedicated website for investor education wherein study materials are available for dissemination. SEBI also publishes study materials in English and vernacular languages. Under "Visit SEBI" programme, School and college students are encouraged to visit SEBI and understand its functioning. SEBI has recently set up SEBI Helpline in 14 languages wherein through a toll free number, investors across the country can access and seek information for redressal of their grievances and guidance on various issues.

Ministry of Corporate Affairs (MCA) Initiatives

Financial literacy allows to fully appreciate opportunities and associated risks, take informed decisions and participate actively in the economic growth story of the country by converting saving into investments. Ministry of

Corporate Affairs (MCA) has a dedicated approach for empowering investors through education and awareness building.

MCA on 27th September, 2007 launched a website www.iepf.gov.in. It provides information about IEPF and the various activities that have been undertaken/ funded by it. This website provides information on various aspects such as role of capital market, IPO investing, Mutual Fund Investing, Stock Investing, Stock Trading, Depository Account, Debt Market, Derivatives, Indices, Indices (comic strip), Index Fund, Investor Grievances & Arbitration (Stock Exchanges), Investor Rights & Obligations, Do's and Don'ts etc.

Ministry of Corporate Affairs has taken various initiatives to educate investors, particularly, since 2001, the Investor Education and Protection Fund (IEPF) has been working for educating the investors and for creating greater awareness about investments in the corporate sector.

IRDA'S Initiatives on Financial Education

Insurance Regulatory and Development Authority has taken various initiatives in the area of financial literacy. Awareness programmes have been conducted on television and radio and simple messages about the rights and duties of policyholders, channels available for dispute redressal etc. have been disseminated through television and radio as well as the print media through sustained campaigns in English, Hindi and 11 other Indian languages. IRDA conducts an annual seminar on policy holder protection and welfare and also partially sponsors seminars on insurance by consumer bodies. IRDA has got a pan India survey on awareness levels about insurance carried out through the NCAER in a bid to improve on its strategy of crating insurance awareness. IRDA has also brought out publications of 'Policyholder Handbooks' as well as a comic book series on insurance. A dedicated website for consumer education in insurance is on the verge of launch

IRDA's Integrated Grievance Management System (IGMS) creates a central repository of grievances across the country and provides for various analyses of data indicative of areas of concern to the insurance policyholder.

PFRDA Initiatives on Financial Education

The Pension Fund Regulatory and Development Authority, India's youngest regulator has been engaged in spreading social security messages to the public. PFRDA has developed FAQ on pension related topics on its web, and has been associated with various non government organizations in India in taking the pension services to the disadvantaged community.

PFRDA's initiatives have become more broad-based with direct mass publicity on NPS - both as individual model through POPs and group models through Aggregators. PFRDA has issued advertisements in print media and electronic media through radio and television. PFRDA appointed intermediaries are called Aggregators who are directly responsible for pension awareness mostly in vernacular languages and in line with socio-economic sensibilities.

Market players Initiatives on Financial Education

Commercial banks are increasingly realizing that they are missing out on large segment of financially illiterate and excluded segment of prospective customers. Also, in view of the national emphasis on electronic benefit transfer the commercial banks have initiated various measures for creating awareness through Financial Literacy and Counseling Centers and Rural Self Employment Training Institutes on financial literacy. The objective of these centers is to advise people on gaining access to the financial system including banks, creating awareness among the public about financial management, counseling people who are struggling to meet their repayment obligations and help them resolve their problems of indebtedness, helping in rehabilitation of borrowers in distress etc. Some of these credit counseling centers even train farmers/women groups to enable them to start their own income generating activities to earn a reasonable livelihood. Even top management of commercial banks is undertaking Outreach visits to villages with a view to spread financial literacy.

Similarly, many Stock Exchanges, Broking Houses and Mutual Funds have initiatives in the field of financial

education that spawns conducting of seminars, issuance of do's and don'ts, and newspaper campaigns. Insurance companies too, carry out campaigns and other educational activities for generic education in insurance.

INVESTOR GRIEVANCE REDRESSAL MECHANISM AT SEBI

INVESTOR GRIEVANCES

There will be occasions when an investor has a complaint against, a listed company or an intermediary registered with SEBI. In the event of such complaint, the investor should first approach the concerned company/ intermediary against whom there is a complaint. Sometimes the response received may not be satisfactory. Therefore, investors should know as to which authority they should approach, to get their complaints redressed.

SCORES (SEBI COMPLAINTS REDRESS SYSTEM)

SCORES is a web based centralized grievance redress system of SEBI (<http://scores.gov.in>). SCORES enables investors to lodge and follow up their complaints and track the status of redressal of such complaints online from the above website from anywhere. This enables the market intermediaries and listed companies to receive the complaints online from investors, redress such complaints and report redressal online. All the activities starting from lodging of a complaint till its closure by SEBI would be online in an automated environment and the complainant can view the status of his complaint online. An investor, who is not familiar with SCORES or does not have access to SCORES, can lodge complaints in physical form at any of the offices of SEBI. Such complaints would be scanned and also uploaded in SCORES for processing.

The salient features of SCORES are:

- SCORES is web enabled and provides online access 24 x 7;
- Complaints and reminders thereon can be lodged online at the above website at anytime from anywhere;
- An email is generated instantaneously acknowledging the receipt of complaint and allotting a unique complaint registration number to the complainant for future reference and tracking;
- The complaint forwarded online to the entity concerned for its redressal;
- The entity concerned uploads an Action Taken Report (ATR) on the complaint;
- SEBI peruses the ATR and closes the complaint if it is satisfied that the complaint has been redressed adequately;
- The concerned investor can view the status of the complaint online from the above website by logging in the unique complaint registration number;
- The entity concerned and the concerned investor can seek and provide clarification on his complaint online to each other;
- Every complaint has an audit trail; and
- All the complaints are saved in a central database which generates relevant MIS reports to enable SEBI to take appropriate policy decisions and or remedial actions, if any.

How to lodge complaint in SCORES?

To register a complaint online on SCORES portal, (<http://scores.gov.in>) click on “Complaint Registration” under “Investor Corner”. The complaint registration form contains personal details and complaint details. There are certain mandatory fields in the Form. These fields include Name, Address for correspondence, State, Email Address of Investor. After filling the personal details, select the complaint category, entity name, nature of complaint related to, complaint details in brief (up to 1000 characters). A PDF document (up to 1MB of size for each nature of complaint) can also be attached along with the complaint as the supporting document. On successful submission

of complaint, system generated unique registration number will be displayed on the screen which may be noted for future correspondence. An email acknowledging the complaint with complaint registration number will also be sent to the complainant's email id entered in the complaint registration form.

What are the limitations in dealing with complaints?

Sometimes a complaint is successfully resolved and the entity is advised to send reply to complainant. But in certain cases, the entity or company denies wrongdoing, and it remains unclear as to who is wrong or whether any wrongdoing occurred at all. If this happens, SEBI cannot act as a judge or an arbitrator and force the entity or company to resolve the complaint. Further, SEBI cannot act as personal representative or attorney of the complainant. Securities laws and other laws provide important legal rights and remedies if an investor has suffered wrongdoing. On their own, investors can also seek to resolve their complaint through the courts, consumer courts, or arbitration.

When can a case be referred for arbitration?

If the grievance is not resolved by the Stock Exchange/Depository due to disputes, an investor can file arbitration subject to the Bye-laws, Rules and Regulations of the exchange / Depository. All claims, differences or disputes between the investors and stock brokers/depository participants can be filed for arbitration. To obtain information about when and how to file an arbitration claim, please visit:

Bombay Stock Exchange

<http://www.bseindia.com/invdesk/Arbitrage.asp>

National Stock Exchange

http://www.nseindia.com/content/assist/asst_investser.htm

Central Depository Services Limited

<http://www.cdslindia.com/downloads/Operating%20Instruction/Chapters-as-of-June-2011.pdf>

National Securities Depository Limited

<https://nsdl.co.in>

Simplified arbitration can be a less costly alternative to legal recourse before the courts of law. If the investor has an account with the broker or a depository participant (DP), he/she can choose arbitration to settle disputes. The investor generally cannot pursue an issue through arbitration if it is barred by limitation prescribed. When deciding whether to arbitrate, the investor has to bear in mind that if the broker or DP goes out of business or declares bankruptcy, he/she might not be able to recover money even if the arbitrator or court rules in his/her favor. However, with certain restriction to the nature of transactions, Stock Exchanges may settle on case to case basis the claim of an investor up to a limit prescribed in the "Investor protection fund" guidelines of the respective Stock Exchange.

The claimant is required to carefully review the rules governing simplified arbitration before filing a claim and should also weigh the costs of arbitrating against the likelihood of being able to collect any award in favor. An investor, who has a claim / counter claim upto ₹10 lakh and files arbitration reference for the same within six months, need not make any deposit for filing arbitration.

When can SEBI take action for non resolution of the complaint?

While the entity is directly responsible for redressal of the complaint, SEBI initiates action against recalcitrant entities on the grounds of their unsatisfactory redressal of large number of investor complaints as a whole.

Which are the matters that are not considered as complaints by SEBI?

- Complaints that are incomplete or not specific
- Allegations without supporting documents
- Offering suggestions or seeking guidance/explanation
- Seeking explanation for non-trading of shares or illiquidity of shares
- Not satisfied with trading price of the shares of the companies
- Non-listing of shares of private offer
- Disputes arise out of private agreement with companies/intermediaries.

SEBI (INFORMAL GUIDANCE) SCHEME, 2003

In the interests of better regulation of and orderly development of the Securities market, SEBI has issued SEBI (Informal Guidance) Scheme 2003. The following persons may make a request for informal Guidance under the scheme:

- (a) any intermediary registered with the SEBI.
- (b) any listed company.
- (c) any company which intends to get any of its securities listed and which has filed either a listing application with any stock exchange or a draft offer document with the Board or the Central Listing authority.
- (d) any mutual fund trustee company or asset management company.
- (e) any acquirer or prospective acquirer under the SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 2011.

The Guidance Scheme, further deals with various aspects such as the nature of request, fees to be accompanied alongwith request letter, disposal of requests, SEBI's discretion not to respond certain types of requests and confidentiality of requests etc.

The informal guidance may be sought for and given in two forms:

- **No-action letters:** SEBI indicates that the Department would or would not recommend any action under any Act, Rules, Regulations, Guidelines, Circulars or other legal provisions administered by SEBI to the Board if the proposed transaction described in a request made under para 6 is consummated.
- **Interpretive letters:** SEBI provides an interpretation of a specific provision of any Act, Rules, Regulations, Guidelines, Circulars or other legal provision being administered by SEBI in the context of a proposed transaction in securities or a specific factual situation.

The request seeking informal guidance should state that it is being made under this scheme and also state whether it is a request for a no-action letter or an interpretive letter and should be accompanied with a fee of ₹ 25,000/- and addressed to the concerned Department of SEBI. It should also describe the request, disclose and analyse all material facts and circumstances involved and mention all applicable legal provisions. SEBI may dispose off the request as early as possible and in any case not later than 60 days after the receipt of the request. The Department may give a hearing or conduct an interview if it feels necessary to do so. The requestor shall be entitled only to the reply. The internal records or views of SEBI shall be confidential.

SEBI may not respond to the following types of requests:

- (a) those which are general and those which do not completely and sufficiently describe the factual situation;
- (b) those which involve hypothetical situations;

- (c) those requests in which the requestor has no direct or proximate interest;
- (d) where the applicable legal provisions are not cited;
- (e) where a no-action or interpretive letter has already been issued by that or any other Department on a substantially similar question involving substantially similar facts, as that to which the request relates;
- (f) those cases in which investigation, enquiry or other enforcement action has already been initiated;
- (g) those cases where connected issues are pending before any Tribunal or Court and on issues which are subjudice; and,
- (h) those cases where policy concerns require that the Department does not respond.

Where a request is rejected for non-compliance, the fee if any paid by the requestor shall be refunded to him after deducting therefrom a sum of ₹ 5,000/- towards processing charges. However SEBI is not be under any obligation to respond to a request for guidance made under this scheme, and shall not be liable to disclose the reasons for declining to reply the request.

Confidentiality of Request

Any person submitting a letter or written communication under this scheme may request that it receive confidential treatment for a specified period of time not exceeding 90 days from the date of the Department's response. The request shall include a statement of the basis for confidential treatment. If the Department determines to grant the request, the letter or written communication will not be available to the public until the expiration of the specified period. If it appears to the Department that the request for confidential treatment should be denied, the requestor will be so advised and such person may withdraw the letter or written communication within 30 days of receipt of the advise, in which case the fee, if any, paid by him would be refunded to him. In case a request has been withdrawn under clause (c), no response will be given and the letter or written communication will remain with the SEBI but will not be made available to the public. If the letter or written communication is not withdrawn, it shall be available to the public together with any written staff response.

A no-action letter or an interpretive letter issued by a Department constitutes the view of the Department but will not be binding on SEBI, though the SEBI may generally act in accordance with such a letter. The letter issued by a Department under this scheme should not be construed as a conclusive decision or determination of any question of law or fact by SEBI. Such a letter cannot be construed as an order of SEBI under Section 15T of the Act and shall not be appealable. Where a no action letter is issued by a Department affirmatively, it means that the Department will not recommend enforcement action to the Board, subject to other provisions of this scheme.

LESSON ROUND UP

- In order to afford adequate protection to the investors, provisions have been incorporated in different legislations such as the Companies Act, 2013, Securities Contracts (Regulation) Act, 1956, Depositories Act, 1996, and Listing Agreement of the Stock Exchanges supplemented by many guidelines, circulars and press notes issued by the Ministry of Finance, Ministry of Company Affairs and SEBI from time to time.
- Investor Education and Protection Fund (IEPF) has been established under Section 125 of the Companies Act, 2013, for promotion of investors' awareness and protection of the interests of investors.
- Investor Education and Protection Fund Authority Rules, 2014 (IEPF Rules) stipulate the activities related to investors' education, awareness and protection for which the financial sanction can be provided under IEPF.
- SEBI issued SEBI (Investor Protection and Education Fund) Regulations, 2009 to protect the interest of investors and provide for the utilization of the fund established under these regulations.

- In the developing countries, the growing number of investors, technically advanced financial markets, liberalised economy etc. necessitates imparting of financial education for better operation of markets and economy and in the interest of investor.
- Ministry of Corporate Affairs has taken various initiatives to educate investors, particularly, since 2001, the Investor Education and Protection Fund (IEPF) has been working for educating the investors and for creating greater awareness about investments in the corporate sector.
- www.iepf.gov.in provide information about IEPF, various activities that have been undertaken/ funded by it. It also fulfils the need for an information resource for small investors on all aspects of the financial markets and would attempt to do it in the small investors' language.
- SEBI has also launched a comprehensive securities market awareness campaign for educating investors through workshops, audio-visual clippings, distribution of educative investor materials/booklets, dedicated investor website etc.
- SCORES is a web based centralized grievance redress system of SEBI which enables investors to lodge and follow up their complaints and track the status of redressal of such complaints online from the above website from anywhere.
- In the interest of and orderly development of Securities Market, SEBI has issued SEBI (Informal Guidance) Scheme, 2003

GLOSSARY

Forward Markets Commission	The Forward Markets Commission (FMC) is a regulatory authority that is overseen by the Ministry of Consumer Affairs, Food and Public Distribution, Government of India. It is a statutory body set up in 1953 under the Forward Contracts (Regulation) Act, 1952.
IPF	Investor Protection Fund is the 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.
Indian Penal Code (IPC)	It is the main criminal code of India. It is a comprehensive code, intended to cover all substantive aspects of criminal law.
Nidhi company	It is a company registered under Companies Act and notified as a nidhi company by Central Government under Section 406 of Companies Act, 2013. It is a non-banking finance company doing the business of lending and borrowing with its members or shareholders.

SELF TEST QUESTIONS

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

1. Explain the investors rights and responsibilities as an individual shareholder and as a group.
2. Outline the various statutory measures initiated by MCA for investor protection.
3. What is SCORES? Briefly discuss the salient features of SCORES.
4. Explain the utilisations of Investor Protection and Education Fund established under the SEBI (Investor Protection and Education Fund) Regulations, 2009.
5. Who are eligible to make a request under the SEBI (Informal Guidances) Scheme, 2003?

EXECUTIVE PROGRAMME

CAPITAL MARKETS AND SECURITIES LAWS

EP-CM&SL

TEST PAPERS

A Guide to CS Students

To enable the students in achieving their goal to become successful professionals, Institute has prepared a booklet 'A Guide to CS Students' providing the subject specific guidance on different papers and subjects contained in the ICSI curriculum. The booklet is available on ICSI website and students may download from <http://www.icsi.edu/Portals/0/AGUIDETOCSSSTUDENTS.pdf>

WARNING

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

"27. Suspension and cancellation of examination results or registration

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

Explanation - Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute".

EXECUTIVE PROGRAMME

CAPITAL MARKETS AND SECURITIES LAWS

TEST PAPER 1

(This Test Paper is for recapitulate and practice for the students. Students need not to submit responses/answers to this test paper to the Institute.)

Time Allowed : 3 Hours

Maximum Marks : 100

PART A (60 marks)

(Capital Markets)

1. (a) What do you mean by Investment Advisers? Discuss the role of an Investment Adviser. (5 marks)
- (b) Briefly explain the working mechanism of Foreign Currency Exchangeable Bonds (FCEBs) with the help of an example? (5 marks)
- (c) Enumerate the regulatory framework governing Indian Depository Receipts (IDRs) in India. (5 marks)

Attempt either Question No. 2 or 2A

2. Briefly explain the advertisement code prescribed for Mutual Funds under the SEBI (Mutual Fund) Regulations, 1996. (15 marks)

OR

- 2A. Discuss the provisions relating to winding up of an Alternative Investment Fund, prescribed under the SEBI (Alternative Investment Funds) Regulations, 2012. (15 marks)

3. Distinguish between the following:

- (a) FCEB and FCCB
- (b) Long position and short position
- (c) Listed cleared securities and permitted securities
- (d) Future and Option
- (e) French auction and Dutch auction (3 marks each)

4. (a) What do you understand by IOSCO? Briefly discuss the different membership categories of IOSCO. (5 marks)
- (b) Briefly discuss the conditions required to be fulfilled by an India Company for issuing Global Depository Receipts (GDR) under the Companies (Issue of Global Depository Receipts) Rules, 2014. (5 marks)
- (c) A co-operative bank wishes to buy 91 days Treasury Bill on October 12, 2013 which is maturing on December 6, 2013. The rate quoted by seller is ₹ 99.1489 per ₹ 100 face values bill. Calculate the yield to maturity. (5 marks)

PART B (40 marks)

(Securities Laws)

5. (a) State the grounds on which a stock exchange can delist the securities of a company under the Securities Contracts (Regulation) Rules, 1957. (5 marks)

- (b) Enumerate the various powers of Securities Appellate Tribunal (SAT). (5 marks)
- (c) What is an Institutional Placement Programme (IPP)? What are the conditions required to be fulfilled by a company for making an IPP under the SEBI (ICDR) Regulations, 2009. (5 marks)
- (d) State the provisions relating to whistle blower policy under Clause 49 of Listing Agreement. (5 marks)

Attempt all parts of either Question No. 6 or Question No. 6A

- 6. (a) The shares of XYZ Ltd. were listed in Delhi Stock Exchange. The stock exchange delists the shares of the company. The aggrieved company approaches you as the Company Secretary of XYZ Ltd. to know the remedy available to the company. Give your suggestion to the company keeping in view the provision of the Securities Contracts (Regulation) Act, 1956. (10 marks)
- (b) What are the obligations of intermediaries under Prevention of Money Laundering Act, 2002? Explain. (10 marks)

OR

- 6A. (a) What do you understand by SCORES (SEBI Complaints Redress System)? Briefly discuss the salient features of SCORES. (10 marks)
- (b) Briefly discuss the provisions relating to the migration of a listed company from Main Board to SME Exchange under SEBI (ICDR) Regulations, 2009. (10 marks)

TEST PAPER 2

(This Test Paper is for recapitulate and practice for the students. Students need not to submit responses/answers to this test paper to the Institute.)

Time Allowed : 3 Hours

Maximum Marks : 100

PART-A (60 marks)

(Capital Markets)

1. (a) Explain the salient features of Real Estate Mutual Funds (REMFs) under the SEBI (Mutual Fund) Regulations, 1996. *(5 marks)*
(b) With reference to the capital market, explain the term "Straight Through Processing" (STP)? *(5 marks)*
(c) Discuss the various categories of Alternative Investment Funds explained under the SEBI (Alternative Investment Funds) Regulations, 2012. *(5 marks)*

Attempt either Question No. 2 or 2A

2. What do you understand by External Commercial Borrowings (ECB)? Who are eligible borrowers under the Automatic Route for accessing ECB? *(15 marks)*

OR

- 2A. What do you understand by Algorithmic Trading? Discuss briefly the guidelines formulated by SEBI for stock exchanges and stock brokers relating to Algorithmic Trading. *(15 marks)*

3. Write short notes on the following:

- (a) Commodity pool
- (b) IPO Grading
- (c) No delivery period
- (d) Primary Dealers
- (e) Dematerialization *(3 marks each)*

4. (a) Briefly discuss the role of a Company Secretary as compliance officer in listing of Debt securities. *(5 marks)*
(b) What is an infrastructure debt fund scheme? Discuss the eligibility criteria need to be fulfilled by a mutual fund company for launching such scheme. *(5 marks)*
(c) What are the advantages of Indian Depository Receipts, both to the issuing company as well as to an investor? *(5 marks)*

PART B (40 marks)

(Securities Laws)

5. (a) Enumerate the provisions relating to continual disclosures required to be made by a person under SEBI (Prohibition of Insider Trading) Regulations, 1992. *(5 marks)*
(b) What are the timelines for submission of disclosures relating to each class of equity shares/ security issued by a company under Clause 35 of Listing Agreement? *(5 marks)*

(c) Briefly explain the In-Person Verification (IPV) carried out by intermediaries. (4 marks)

(d) What are the provisions relating to public announcement under the SEBI Takeover Regulations, 2011?

(6 marks)

Attempt all parts of either Question No. 6 or Question No. 6A

6. (a) Discuss briefly the functions and obligations of KYC Registration Agencies (KRAs) under SEBI {KYC (Know Your Client) Registration Agency (KRA)} Regulations, 2011. (10 marks)

(b) Enumerate briefly the disclosures required to be made by a company in the Directors' Report under the SEBI (Employee Stock Option Scheme and Employee Stock Purchase scheme) Guidelines, 1999.

(10 marks)

OR

6A. (a) What is compulsory delisting? Explain with the help of a flow chart, the process of compulsory delisting.

(10 marks)

(b) Briefly explain the various defaults which cannot be considered for settlement of proceedings under the SEBI (Settlement of Administrative & Civil Proceedings) Regulations, 2014. (10 marks)

