PONDICHERRY UNIVERSITY

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DIRECTORATE OF DISTANCE EDUCATION

Security Market Operations

Paper Code: MBFM 4004

MBA - FINANCE

IV - Semester

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MBA (Finance) – IV Semester **Paper code: MBFM 4004**

Paper -XIX

Security Market Operations

Objectives

- To Familiarize the students about SEBI and its Rules
- To Understand the activities and procedures of Security Market and its mechanism and
- To acquaint the knowledge about funds mobilized through various sources and instruments of Financial Market.

Unit – I

Security Markets - Legal Environment: SEBI Act, 1992, Securities Contract Regulation Act 1956, Companies Act 1956 (various provisions relating to securities), RBI rules and guidelines for Fll's.

Unit – II

Security Markets - Primary market - its role and functions - Methods of selling securities in primary market – New financial instruments – New Issues – SEBI guidelines for public issues – pricing of issue, promoters' contribution – appointment and role of merchant bankers, underwriters, brokers, registrars and managers, bankers etc - Underwriting of issues – Allotment of shares – Procedures for new issues – e-trading.

Unit – III

Secondary Market – Role, importance, organization of stock exchanges – Listing of securities in stock exchanges – Trading mechanism – screen based system – Insider trading; Take-over's – Internet based trading.

Unit – IV

Depository: Role and need – The Depositories Act, 1996, SEBI (Depositories and Participants Regulation) 1996 – SEBI (Custodian of Securities) Regulation 1996 – National Securities Depository Ltd. (NSDL) – Depository participant.

Unit – V

Capital Market Instruments – Equity, Secured Premium Notes, Equity Shares with detachable warrants, Sweat Equity, Non-Voting Shares, Tracking stocks, Preference Shares, Debentures, Disaster Bonds, Option Bonds, Easy Exit Bonds, Split Coupon Debentures, Floating Rate Bonds and Notes, Clip and Strip Bonds, Dual Convertible Bonds, Debt Instruments with Debt warrants, Indexed Rate Notes, Stepped Coupon Bonds, Dual Option Warrants, Extendable Notes, Commodity Bonds, Mortgage Backed Securities, Carrot and Stick Bond, Capital Indexed Bonds, Debt for Equity Swap, Zero Coupon Convertible Notes, Global Depository Receipts, Foreign Currency Convertible Bonds – New instruments of Capital Market – Pure, Hybrid and Derivatives; Money Market Instruments – Treasury bills, Commercial Bills, Commercial Paper, Participatory Notes.

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1. **Dalton, John M,** HOW THE STOCK MARKET WORKS, *Prentice Hall, New Delhi.*
2. **Machi Raju, H.R,** MERCHANT BANKING; *Wiley Eastern Ltd.; New Delhi.*
3. **Chanratre, KR,** CAPITAL ISSUE, SEBI & LISTING; *Bharat Publishing House, New Delhi.*

UNIT – I

Security Market: Legal Environment

Learning Objectives

After Reading Unit you can be able to understand

- SEBI Act 1992
- Securities Contract Regulation Act 1956
- Companies Act 1956
- RBI rules and guidelines for FII's

Introduction

Many companies were set up as joint-stock enterprises with liability limited by shares. A vast number of businessmen in major cities purchased these shares and trading started in them early in the 19^{th} century. In those days, although many of these companies were financed by the issue of shares to the public, they mainly depended on the joint-stock British banks in India and borrowers from abroad. British enterprise and the British Government have thus helped the emergence of the securities markets in India. The corporate securities have come to have a market first. So far as the Government securities are concerned, the British India Government borrowed mostly in London by issue of Sterling consols. Only later in the 19^{th} century the Government issued treasury bills and Government securities in rupees. This led to the emergence of the Government securities market also in India.

What Is Securities Market?

According to Dr. V A Avadhani, Securities markets are markets in financial assets or instruments and these are represented as I.O.Us (I owe you) in financial form. These are issued by business organizations, corporate units and the Governments, Central or State. Public sector undertakings also issue these securities. These securities are used to finance their investment and current expenditure. These are thus sources of funds to the issuers. There are different types of business organizations in India, namely, partnership firms, cooperative societies, private and public limited companies and joint and public sector, organizations etc. the more frequently organized method is the company, registered under the Indian Companies Act 1956. Under this Act, there are three types of companies: (a) companies limited by guarantee; (b) companies which are private limited companies – limited by shares paid up; and (c) companies private limited companies can have 50 members and their shares are not transferable freely. These companies reserve the right to refuse any transfer of shares and as such trading in them is restricted. Due to these inhibitive features, private limited companies do not have easy access to the securities markets. Only public limited companies are largely popular as they can raise funds from the public through the issue of shares. The methods of raising funds used by the corporate sector are to issue securities, either ownership instruments or debt instruments.

What Are Securities?

Securities are claims on money and are like promissory notes or I.O.U. Securities are a source of funds for companies, Govt. etc. There are two types of sources of funds namely internal and external and securities emerge when funds are raised from external sources.

The external sources of funds of the companies are as follows:

(a) Long-Term Funds

(i) Ownership capital – equity and preference capital, and Non-voting Shares.

(ii) Debt Capital – debentures and long-term borrowings in the form of deposits from public or credit limits or advances from banks and financial institutions, etc.

(b) Short-term Funds

(i) Borrowings from banks, and other corporate

(ii) Trade credits and suppliers' credits, etc.

Of the above sources, the most popular are those which are tradable and transferable. They have a market and their liquidity is ensured, as in the case of equity shares, preference shares, debentures and bonds. Of these the ownership instruments, particularly the equity shares, are generally the most liquid as they are not only tradable in the securities markets but also enjoy the prospects of capital appreciation, in addition to dividends. The market for these has thus grown much faster than for others.

Characteristics of Securities

The major characteristics of securities are their transferability and marketability. These help the process of trading and investment in them. Under the Indian Companies Act, Sections 82 and 111 deal with the transfer of shares. In the case of public limited companies, the objective of the Companies Act as also of the Listing Agreement with the Stock Exchanges is to ensure free and unfettered transfer of shares. Under Section 82 of the Companies Act, shares are treated as any movable property.

As any right to property, these are freely transferable. By one amendment in 1985, Section 22(a) of the Securities Contracts (Regulation) Act has denied the right to refuse to transfer shares by a public limited company except on technical grounds. The other grounds on which the transfer can be refused are specifically laid down under the Act and the company has to specify the reasons for such refusal to transfer and reference has to be made to the Company Law Board whose decision to refuse or not to refuse the transfer of shares will be final. Thus the essential characteristic of transferability of shares is well preserved which gives them the market which in turn extends liquidity to these shares. This has led to the emergence of securities markets in India.

Primary Issues and Derivative Securities

Primary issues are those issued to the public by the companies, Governments and financial institutions. Derivative issues are those which are based on the original primary issues. There are a number of derivative instruments which are used to generate a market for the primary issues. Thus in many developed markets abroad, these are warrants, options, futures, index linked instruments etc. which have well-established markets and they are based on some primary instruments. In India, options are now permitted and some form of futures trading exists in Group A securities on the stock exchanges as they are permitted to be carried forward from settlement to settlement without taking delivery of shares. Since January 1995, options and futures have been permitted and futures market is now developing under strict control of SEBI.

More recently, new instruments have been developed in India, namely, warrants, Zero coupon bonds, conversion options, rights options etc. But in many cases these are not well developed and secondary markets for these instruments do not exist and trading does not take place as in the case of listed shares and particularly those on the specified group (Group A) of stock exchanges.

Reference is made in the subsequent chapters to many new instruments, which are introduced both in the capital market and the money market in India. Besides, the RBI has also recently permitted the securitisation of book debts of banks and financial institutions in the sense that the debit balances on companies' accounts can be transferred to other banks and financial institutions which are willing to discount them or purchase them at a price but the market in many new instruments is yet to be developed in India.

To understand the Security market operations fully it is always better to understand the relevant acts, and the guidelines of the SEBI, Institutional Investments, etc. so for the purpose of the students of MBA, the relevant materials have been collected from the different books written by the eminent authors, web sites and other journals etc., and presented and reproduced here as the study material. Students please note it is not book but it is only study material and so they are advised to go through the prescribed text books. The Securities and Exchange Board of India Act 1992 with its relevant Amendment Act 1995 is given in the Part I, The Securities Contracts (Regulation) Act, 1956 in Part II, Companies Act 1956 in Part – III, Foreign Institutional Investments In India (FII) in Part IV and the Guidelines in Part V.

Part I

Securities and Exchange Board of India Act, 1992

[15 of 1992]

[As Amended by Securities Laws (Amendment) Act, 1995]

An Act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto.

BE it enacted by Parliament in the Forty-third Year of the Republic of India as follows:-

Preliminary

Short title, extent and commencement

1. (1) This Act may be called the Securities and Exchange Board of India Act, 1992.

   (2) It extends to the whole of India.

   (3) It shall be deemed to have come into force on the 30^{th} day of January, 1992.

Definitions

2. (1) In this Act, unless the context otherwise requires-

(a) "Board" means the Securities and Exchange Board of India established under section 3.

(b) "Chairman" means the Chairman of the Board.

(c) "existing Securities and Exchange Board" means the Securities and Exchange Board of India constituted under the Resolution of the Government of India in the Department of Economic Affairs No. 1(44)SE/86, dated the 12th day of April, 1988;

(d) "Fund" means the Fund constituted under section 14.

(e) "member" means a member of the Board and includes the Chairman;

(f) "notification" means a notification published in the Official Gazette;

(g) "prescribed" means prescribed by rules made under this Act;

(h) "regulations" means the regulations made by the Board under this Act;

(i) "securities" has the meaning assigned to it in section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956).

Establishment of the Securities and Exchange Board of India (SEBI)

With effect from such date as the Central Government may, be notification, appoint, there shall be established, for the purposes of this Act, a Board by the name of the Securities and Exchange Board of India. The Board shall be a body corporate by the name aforesaid, having perpetual succession and a common seal, with power subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract, and shall, by the said name, sue or be sued. The head office of the Board shall be at Bombay. The Board may establish offices at other places in India.

Management of the Board

The Board shall consist of the following members, namely:-

(a) A Chairman;

(b) Two members from amongst the officials of the Ministries of the Central Government dealing with Finance and Law;

(c) One member from amongst the officials of the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934 (2 of 1934);

(d) Two other members, to be appointed by the Central Government.

The general superintendence, direction and management of the affairs of the Board shall vest in a Board of members, which may exercise all powers and do all acts and things which may be exercised or done by the Board. Save as otherwise determined by regulations, the Chairman shall also have powers of general superintendence and direction of the affairs of the Board and may also exercise all powers and do all acts and things which may be exercised or done by that Board. The Chairman and members referred to in clauses (a) and (d) of subsection (1) shall be appointed by the Central Government and the members referred to in clauses (b) and (c) of that sub-section shall be nominated by the Central Government and the Reserve Bank of India respectively.

The Chairman and the other members referred to in clauses (a) and (d) of sub-section (1) 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 the Board.

Term of office and conditions of service of Chairman and members of the Board

The term of office and other conditions of service of the Chairman and the members referred to in clause (d) of sub-section (1) of section 4 shall be such as may be prescribed. Notwithstanding anything contained in sub-section (1), the Central Government shall have the right to terminate the services of the Chairman or a member appointed under clause (d) of sub-section (1) of section 4, at any time before the expiry of the period prescribed under sub-section (1), by giving him notice of not less than three months in writing or three months' salary and allowances in lieu thereof, and the Chairman or a member, as the case may be, shall also have the right to relinquish his office, at any time before the expiry of the period prescribed under sub-section (1), by giving to the Central Government notice of not less than three months in writing.

Removal of member from office

The Central Government shall remove a member from office if he-

(a) Is, or at any time has been, adjudicated as insolvent:-
(b) Is of unsound mind and stands so declared by a competent court;

(c) Has been convicted of an offence which, in the opinion of the Central Government, involves a moral turpitude;

(d) Has, in the opinion of the Central Government, so abused his position as to render his continuation in office detrimental to the public interest; Provided that no member shall be removed under this clause unless he has given a reasonable opportunity of being heard in the matter.

Meetings

The Board shall meet at such times and places, and shall observe such rules of procedure in regard to the transaction of business at its meetings (including quorum at such meetings) as may be provided by regulations. The Chairman or, if for any reason, he is unable to attend a meeting of the Board, any other member chosen by the members present from amongst themselves at the meeting shall preside at the meeting. All questions which come up before any meeting of the Board shall be decided by a majority votes of the members present and voting, and, in the event of an equality of votes, the Chairman, or in his absence, the person presiding, shall have a second or casting vote.

Vacancies, etc., not to invalidate proceedings of Board

No act or proceeding of the Board shall be invalid merely by reason of —

(a) Any vacancy in, or any defect in the constitution of, the Board; or

(b) Any defect in the appointment of a person acting as a member of the Board; or

(c) Any irregularity in the procedure of the Board not affecting the merits of the case.

Officers and Employees of the Board

The Board may appoint such other officers and employees as it considers necessary for the efficient discharge of its functions under this Act. The term and other conditions of service of officers and employees of the Board appointed under sub-section (1) shall be such as may be determined by regulations.

Powers and Functions

Functions of Board

Subject to the provisions of this Act, it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit.

(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.

(c) Registering and regulating the working of venture capital funds and collective investment schemes including mutual funds;

(d) Promoting and regulating self-regulatory organisations;

(t) Prohibiting fraudulent and unfair trade practices relating to securities markets;

(/) Promoting investors' education and training of intermediaries of securities markets;

(g) Prohibiting insider trading in securities;

(h) Regulating substantial acquisition of shares and take-over 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;

(j) Performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956 (42 of 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;

(m) Performing such other functions as may be prescribed.

[Matters to be Disclosed by the Companies]

Without prejudice to the provisions of the Companies Act, 1956 (1 of 1956), the Board may, for the protection of investors, specify, by regulations,-

(a) The matters relating to issue of capital, transfer of securities and other matters incidental thereto; and

(b) The manner in which such matters, shall be disclosed by the companies.

Power to Issue Directions

Save as otherwise provided in section 11, if after making or causing to be made an enquiry, the Board is satisfied that it is necessary—

(i) In the interest of investors, or orderly development of securities market; or

(ii) To prevent the affairs of any intermediary or other persons referred to in section 12 being conducted in a manner detrimental to the interests of investors or securities market; or

(iii) To secure the proper management of any such intermediary or person, it may issue such directions,—

(a) To any person or class of persons referred to in section 12, or associated with the securities market; or

(b) To any company in respect of matters specified in section 11 A, as may be appropriate in the interests of investors in securities and the securities market.]

Registration Certificate

Registration of stock-brokers, sub-brokers, share transfer agents, etc.

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 the Board in accordance with the regulations made under this Act:

Provided that 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 the Board 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:

Provided that any person sponsoring or causing to be sponsored, carrying or causing to be carried on any venture capital funds or collective investment scheme operating in the securities market immediately before the commencement of the Securities Laws (Amendment) Act, 1995 for which no certificate of registration was required prior to such commencement, may continue to operate till such time regulations are made under clause (d) of sub-section (2) of section 30.]. Every application for registration shall be in such manner and on payment of such fees as may be determined by regulations. The Board may, by order, suspend or cancel a certificate of registration in such manner as may be determined by regulations:

Provided that no order under this sub-section shall be made unless the person concerned has been given a reasonable opportunity of being heard.

Finance, Accounts and Audit

Grants by the Central Government

The- Central Government may, after due appropriation made by Parliament by law in this behalf, make to the Board grants of such sums of money as that Government may think fit for being utilised for the purposes of this Act.

Fund

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 the Board under this Act; all sums realised by way of penalties under this Act; and, all sums received by the Board from such other sources as may be decided upon by the Central Government. The Fund shall be applied for meeting— (a) the salaries, allowances and other remuneration of the members, officers and other employees of the Board; the expenses of the Board in the discharge of its functions under section 11; the expenses on objects and for purposes authorised by this Act.

Accounts and Audit

The Board 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 the Board 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 the Board 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 the Board. The accounts of the Board 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 and Adjudication

Penalty for failure to furnish information, return, etc.

If any person, who is required under this Act or any rules or regulations made there under,—

(a) To furnish any document, return or report to the Board, fails to furnish the same, he shall be liable to a penalty not exceeding one lakh and fifty thousand rupees for each such failure;

(b) To file any return or furnish any information, books or other documents within the time specified therefore in the regulations, fails to file return or furnish the same within the time specified therefore in the regulations, he shall be liable to a penalty not exceeding five thousand rupees for every day during which such failure continues ;

(c) To maintain books of account or records, fails to maintain the same, he shall be liable to a penalty not exceeding ten thousand rupees for every day during which the failure continues.

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

If any person, who is registered as an intermediary and is required under this Act or any rules or regulations made there under to enter into an agreement with his client, fails to enter into such agreement, he shall be liable to a penalty not exceeding five lakh rupees for every such failure.

Penalty for Failure to Redress Investors' Grievances

If any person, who is registered as an intermediary, after having been called upon by the Board in writing to redress the grievances of investors, fails to redress such grievances, he shall be liable to a penalty not exceeding ten thousand rupees for each such failure.

Penalty for certain defaults in case of mutual funds.

If any person, who is—

(a) Required under this Act or any rules or regulations made there under to obtain a certificate of registration from the Board 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 not exceeding ten thousand rupees for each day during which he carries on any such collective investment scheme, including mutual funds, or ten lakh rupees, whichever is higher;

(b) Registered with the Board 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 not exceeding ten thousand rupees for each day during which such failure continues or ten lakh rupees, whichever is higher;

(c) Registered with the Board 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 a penalty not exceeding five thousand rupees for each day during which such failure continues or five lakh rupees, whichever is higher;

(d) Registered as a collective investment scheme, including mutual funds, fails to despatch unit certificates of any scheme in the manner provided in the regulation governing such despatch, he shall be liable to a penalty and exceeding one thousand rupees for each day during which such failure continues;

(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 and exceeding one thousand rupees for each day during which such failure continues;

(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 not exceeding five lakh rupees for each such failure.

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

Where any asset management company of a mutual fund registered under this Act fails to comply with any of the regulations providing for restrictions on the activities of the asset management companies, such asset management company shall be liable to a penalty not exceeding five lakh rupees for each such failure.

Penalty for default in case of stock-brokers

If any person, who is registered as a stock-broker under this Act,—

(a) Fails to issue contract notes in the form and 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 not exceeding five thousand rupees for each day during which such failure continues;

(c) Charges an amount of brokerage which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty not exceeding five thousand rupees or five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

Penalty for Insider Trading

If any insider who,—

(i) Either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price sensitive information; or

(ii) Communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or

(iii) Counsels, or procures for any other person to deal in any securities of anybody corporate on the basis of unpublished price sensitive information, shall be liable to a penalty not exceeding five lakh rupees.

Penalty for non-disclosure of acquisition of shares and take-overs

If any person, who is required under this Act or any rules or regulations made there under, fails to—

(i) Disclose the aggregate of a share holding in the body corporate before he acquires any shares of that body corporate; or

(ii) Make a public announcement to acquire shares at a minimum price, he shall be liable to a penalty not exceeding five lakh rupees.

Power to adjudicate

1. For the purpose of adjudging under sections 15A, 15B, 15C, 15D, 15E, 15F, 15G and 15H, the Board shall appoint any officer not below the rank of a 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 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 sub-section (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.

Factors to be taken into account by the adjudicating officer.

While adjudging the quantum of penalty under section 15-1, 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.

Establishment of Securities Appellate Tribunals

The Central Government shall by notification, establish one or more Appellate Tribunals to be known as the Securities Appellate Tribunal to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under this Act.. The Central Government shall also specify in the notification referred to in sub-section (1) the matters and places in relation to which the Securities Appellate Tribunal may exercise jurisdiction.

Composition of Securities Appellate Tribunal

A Securities Appellate Tribunal shall consist of one person only (hereinafter referred to as the Presiding Officer of the Securities Appellate Tribunal) to be appointed, by notification, by the Central Government.

Qualifications for appointment as Presiding Officer of the Securities Appellate Tribunal

A person shall not be qualified for appointment as the Presiding Officer of a Securities Appellate Tribunal unless he—

(a) Is, or has been, or is qualified to be, a Judge of a High Court; or

(b) Has been a member of the Indian Legal Service and has held a post in Grade I of that Service for at least three years; or

(c) Has held off ice as the Presiding Officer of a Tribunal for at least three years:

Term of Office

The Presiding Officer of a Securities Appellate Tribunal shall hold off ice for a term of five years from the date on which he enters upon his off ice or until he attains the age of sixty-five years, whichever is earlier.

Salary and allowances and other terms and conditions of service of Presiding Officers

The salary and allowances payable to and the other terms and conditions of service including pension, gratuity and other retirement benefits of, the Presiding Officer of a Securities Appellate Tribunal shall be such as may be prescribed:

Provided that neither the salary and allowances nor the other terms and conditions of service of the said Presiding. Officers shall be varied to their disadvantage after appointment.

Filling up of Vacancies

If, for reason other than temporary absence, any vacancy occurs in the office of the Presiding Officer of a Securities Appellate Tribunal, then the Central Government shall appoint another person in accordance with the provisions of this Act to fill the vacancy and the proceedings may be continued before the Securities Appellate Tribunal from the stage at which the vacancy is filled.

Resignation and Removal

(1) The Presiding Officer of a Securities Appellate Tribunal may, by notice in writing under his hand addressed to the Central Government, resign his office:

Provided that the said Presiding Officer shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of his term of office, whichever is the earliest.

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

(3) The Central Government may, by rules, regulate the procedure for the investigation of misbehaviour or incapacity of the aforesaid Presiding Officer.

Orders constituting Appellate Tribunal to be final and not to invalidate its proceedings

No order of the Central Government appointing any person as the Presiding Officer of a Securities Appellate Tribunal shall be called in question in any manner, and no act or proceeding before a Securities Appellate Tribunal shall be called in question in any manner on the ground merely of any defect in the constitution of a Securities Appellate Tribunal

Staff of the Securities Appellate Tribunal

The Central Government shall provide the Securities Appellate Tribunal with such officers and employees as that Government may think fit. The officers and employees of the

Securities Appellate Tribunal shall discharge their functions under general superintendence of the Presiding Officer. The salaries and allowances and other conditions of service of the officers and employees of the Securities Appellate Tribunal shall be such as may be prescribed.

Appeal to the Securities Appellate Tribunal

Any person aggrieved 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.

No appeal shall lie to the Securities Appellate Tribunal from an order made by an Adjudicating Officer with the consent of the parties. Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date, on which a copy of the order made, by the Adjudicating Officer is received by him 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 under sub-section (I), 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 the parties to the appeal and to the concerned Adjudicating Officer. 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 the Securities Appellate Tribunal

The Securities Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 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 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 (5 of 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 pane;

(g) Setting aside any order of dismissal of any application for default orany order passed by it ex parte;

(h) Any other matter which may be prescribed.

Every proceedings 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 (45 of 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 (2 of 1974).

Miscellaneous

Power of Central Government to Issue Directions

Without prejudice to the foregoing provisions of this Act, the Board shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy as the Central Government may give in writing to it from time to time:

Provided that the Board shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section. (2) The decision of the Central Government whether a question is one of polio or not shall be final.

Power of Central Government to supersede the Board

If at any time the Central Government is of opinion—

(a) That on account of grave emergency, the Board is unable to discharge the functions and duties imposed on it by or under the provisions of this Act; or

(b) That the Board 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 provisions of this Act and as a result of such default the financial position of the Board or the administration of the Board has deteriorated; or

(c) That circumstances exist which render it necessary in the public interest so to do, the Central Government may, by notification, supersede the Board for such period, not exceeding six months, as may be specified in the notification.

(2) Upon the publication of a notification under sub-section (1) superseding the Board,—

(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 the Board, shall until the Board 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 the Board shall, until the Board is reconstituted under sub-section (3), vest in the Central Government.

(3) On the expiration of the period of supersession specified in the notification issued under sub-section (1), the Central Government may reconstitute the Board by a fresh appointment and in such case any person or persons who vacated their offices under clause

(a) Of sub-section (2), shall not be deemed disqualified for appointment:

Provided that the Central Government may, at any time, before the expiration of the period of supersession, take action under this sub-section.

(4) The Central Government shall cause a notification issued under subsection (1) and a full report of any action taken under this section and the circumstances leading to such action to be laid before each House of Parliament at the earliest.

Returns and Reports

The Board shall 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.

(2) Without prejudice to the provisions of sub-section (1), the Board 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.

(3) A copy of the report received under sub-section (2) shall be laid, as soon as may be after it is received, before each House of Parliament.

Powers of Recognised Stock Exchange

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:—

(1) The restriction of voting right of members only in respect of any matter placed before the stock exchange at any meeting;

(2) The regulation of voting right 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;

(3) 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;

(4) Such incidental, consequential and supplementary matters as may be necessary to give effect to any of the matters specified above in clauses (1), (2), and (3).

Notice that, the rules so made or amended must be approved by the Central Government. The Central Government must then publish them in its Official Gazette.

(b) **Power to make Bye-Laws**

Any recognised stock exchange may, subject to the previous approval of the Central Government, make bye-Jaws 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 number and classes of contracts in respect of which settlements shall be made or differences paid through the clearing house;

(d) The regulation or prohibition of blank transfers;

(e) The regulation or prohibition of budlas or carry-over facilities;

(f) The method and procedure for the settlement of claims or disputes, including settlement by arbitration;

(g) The levy and recovery of fee, fines and penalties;

(h) The fixing of a scale of brokerage and other charges;

(i) The regulation of dealings by members for their own account;

(j) The limitations on the volume of trade done by any individual member in exceptional circumstances;

(k) The making, comparing, settling and closing of bargains;

(l) 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.

(m) 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.

Options in Securities

The Act prohibits options in securities. Section 20 declares “Notwithstanding anything contained in this Act or in any other law for the time being in force, all options in securities entered into after the commencement of this Act shall be illegal.”

Listing of Securities by Public Companies

‘Listing of securities’ means the inclusion of the securities in the official list of stock exchange for the purpose of trading. A stock exchange does not deal in the securities of all-companies. It has to, therefore, select the companies - whose securities may be allowed to be bought and sold. The companies selected for this purpose are included in the official trade list of the stock exchange. In technical terms, it means that securities of these companies have been listed by the exchange concerned.

Right of Appeal against Refusal to List Securities

Where a recognised stock exchange refuses to list the securities of any public company, the company shall be entitled to demand the reasons for such refusal. On receipt of the reasons for refusal, the company may, within 15 days, appeal to the Central Government against such refusal. The Central Government may thereupon (after giving the stock exchange an opportunity of being heard) vary or set aside, the decision of the stock exchange. On decision being varied or set aside, the recognised stock exchange shall act in conformity with the order of the Central Government.

Procedure for Listing of Securities

As per the Securities Contracts (Regulation) Rules, 1957, a public company desirous of getting its securities listed on a recognised stock exchange has to apply for the purpose to the stock exchange and forward 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 advertisement offering any securities for subscription or sale during the last 5 years ;

(d) Copies of balance-sheets and audited accounts for the last 5 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 10 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 promoter,

  (ii) Underwriters and sub-underwriter,

  iii) Brokers and sub-brokers ;

(g) Certified copies of agreements with:—

  (i) Selling agents,

  (ii) Managing and technical directors,

  (iii) Manager, general manager, sales manager 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 5 years ;

(i) A statement containing particulars of the dates of, and parties to all material contracts, concessions and similar other documents 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 reorganisation, reconstruction or amalgamation, change in its capital structure (authorised, issued and subscribed) and debenture borrowings, if any ;

(k) Particulars of share 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 terms including an option for issue of any kind of the securities granted to any person; (m)certified copies of—

  (i) Letter of consent of the Controller of Capital Issue,

  (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 debenture held by and the address of each such holder ;

(p) Particulars of shares or debentures for which permission to deal is applied for.

However, a recognised stock exchange may either generally by its bye-laws or in any particular case call for such further particulars or documents as it deems proper. The stock exchange shall be bound to carry out such order of the Central Government.

Waiver or Relaxation of Listing Rules..

The Central Government 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 under Securities Contracts (Regulation) Rules.

Part II

The Securities Contracts (Regulation) Act, 1956 (Act No.42 Of 1956)

The main purpose of the Act is to prevent the undesirable transactions in securities by regulating the business of dealing in securities. This is discussed in 6 sub heads.

1. Preliminary
2. Recognised Stock Exchanges
3. Contracts And Options In Securities
4. Listing Of Securities Of Public Companies
5. Penalties And Procedures
6. Miscellaneous

Preliminary

This Act may be called the Securities Contracts (Regulation) Act, 1956. It extends to the whole of India. It shall come into force on such date as the Central Government may, by notification in the Official Gazette appoint.

Definitions

In this Act, unless the context otherwise requires,-

(a) "contract" means a contract for or relating to the purchase or sale of securities;

(aa) "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;

B. A contract which derives its value from the prices, or index or prices, of underlying securities;

(b) "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 (18 of 1944);

(c) «member» means a member of a recognised stock exchange;

(d) «option in securities» means a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a teji, a mandi, a teji mandi, a galli, a put, a call or a put and call in securities;

(e) «prescribed» means prescribed by rules made under this Act;

(f) «recognised stock exchange» means a stock exchange which is for the time being recognised by the Central Government under section 4;

(g) «rules», with reference to the rules relating in general to the constitution and management of a stock exchange, includes, in the case of a stock exchange which is an incorporated association, its memorandum and articles of association;

(ga) «Securities Appellate Tribunal» means a Securities Appellate Tribunal established under sub-section (1) of section 15K of the Securities and Exchange Board of India Act, 1992.[4]

(h) «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 other body corporate;

(ia) Derivative;

(ib) Units or any other instrument issued by any collective investment scheme to the investors in such schemes

(ii) Government securities;

(iia) Such other instruments as may be declared by the Central Government to be securities; and

(iii) Rights or interests in securities;

[(i) 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;][7]

(j) "stock exchange" means any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

2A. Words and expressions used herein and not defined in this Act but defined in the Companies Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 shall have the same meanings respectively assigned to them in those Acts.

Contracts and Options in Securities

Contracts in Notified Areas Illegal in Certain Circumstances

If the Central Government is satisfied, having regard to the nature or the volume of transactions in securities in any State or area, that it is necessary so to do, it may, by notification in the Official Gazette, declare this section to apply to such State or area, and thereupon every contract in such State or area which is entered into after date of the notification otherwise than between members of a recognised stock exchange in such State or area or through or with such member shall be illegal. [Additional trading floor 13A. A stock exchange may establish additional trading floor with the prior approval of the Securities and Exchange Board of India in accordance with the terms and conditions stipulated by the said Board.

Explanation

For the purposes of this section 'additional trading floor' means a trading ring or trading facility offered by a recognised stock exchange outside its area of operation to enable the investors to buy and sell securities through such trading floor under the regulatory framework of the stock exchange.

Contracts in Notified areas to be Void in Certain Circumstances

(1) 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.

(2) 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 of such consent or authority within three days from the date of the 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

(1) 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.

(2) All contracts in contravention of the provisions of sub-section (1) entered into after the date of the notification issued there under shall be illegal.

Licensing of Dealers in Securities in Certain Cases

(1) 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 licence granted by the [Securities and Exchange Board of India] in this behalf.

(2) 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.

(3) 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.

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 are (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 provision of that section shall so apply. 18A. Notwithstanding anything contained in any other law for the time being in force, 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.

Stock exchanges other than recognised stock exchanges prohibited

(1) No person shall, except with the permission of the Central Government, organise or assist in organising or be a member of any stock exchange (other than a recognised

stock exchange) for the purpose of assisting in, entering into or performing any contracts in securities.

(2) This section shall come into force in any State or area on such date, as the Central Government may, by notification in the Official Gazette, appoint.

Listing of Securities

Conditions for Listing

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.]

Right of appeal against refusal of stock exchanges to list securities of public companies

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 public company or collective investment scheme the company or scheme shall be entitled to be furnished with reasons for such refusal, any 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 (1) of section 73 of the Companies Act, 1956 (1 of 1956) (hereafter in this section referred to as the "specified time"), the application for permission for the shares or debentures to be dealt with on the stock exchange, within fifteen days from the date of expiry of the specified time or within such further period, not exceeding one month, as the Central Government may, on sufficient cause being shown, allow, appeal to the Central Government against such refusal, omission or failure, as the case may be, and thereupon the Central Government 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 Central Government 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 Central Government.

Provided that no appeal shall be preferred against refusal, omission or failure, as the case may be, under this section on and after the commencement of the Securities Laws (Second Amendment) Act, 1999.

Right of Appeal to Securities Appellate Tribunal against refusal of stock exchange to list securities of public companies

(1) 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 public company, the company shall be entitled to be furnished with reasons for such refusal, and may, -

  a. Within fifteen days from the date on which the reasons for such refusal are furnished to it, or

  b. Where the stock exchange has omitted or failed to dispose of, within the time specified in sub-section (1A) of section 73 of the Companies Act, 1956 (hereafter in this section referred to as the "specified time"), the application for permission for the shares or debentures to be dealt with on the stock exchange, within fifteen days from the date of expiry of the specified time or within such further period, not exceeding one month, as the Securities Appellate Tribunal may, on sufficient cause being shown, allow,appeal to the Securities Appellate Tribunal having jurisdiction in the matter against such refusal, omission or failure, as the case may be, and thereupon the Securities Appellate Tribunal may, after giving the stock exchange, an opportunity of being heard,-

    i. Vary or set aside the decision of the stock exchange; or

    ii. Where the stock exchange has omitted or failed to dispose of the application within the specified time, grant or refuse the permission, and where the Securities Appellate Tribunal sets aside the decision of the recognised stock exchange or grants the permission, the stock exchange shall act in conformity with the orders of the Securities Appellate Tribunal.

(2) Every appeal under sub-section (1) shall be in such form and be accompanied by such fee as may be prescribed.

(3) The Securities Appellate Tribunal shall send a copy of every order made by it to the Board and parties to the appeal.

(4) The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

Procedure and powers of Securities Appellate Tribunal

(1) The Securities Appellate Tribunal shall not 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.

(2) 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.

(3) Every proceeding before 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 b 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 Representations

The appellant may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers or present his or its case before the Securities Appellate Tribunal.

Explanation

For the purposes of this section, -

a. "chartered accountant" means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;

b. "company secretary" means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;

c. "cost accountant" means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;

d. "legal practitioner" means an advocate, vakil or an attorney of any High Court, and includes a pleader in practice.

Limitation

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

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 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 High Court

Any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal on any question of fact or law arising out of such order;

Provided that the High 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

Penalties

(1) Any person who-

(a) Without reasonable excuse (the burden of proving which shall be on him) fails to comply with any requisition made under sub- section (4) of section 6; or

(b) Enters into any contract in contravention of any of the provisions contained in section 13 or section 16; or

(c) Contravenes the provisions contained in section 17 or section 19; or

(d) Enters into any contract in derivative in contravention of section 18 A or the rules made under section 30.

(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

(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, on conviction, be punishable with imprisonment for a term which may extend to one year, or with fine, or with both.

(2) 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 with the orders of] the Central Government under section 22 or with the orders of the Securities Appellate Tribunal shall, on conviction, be punishable with fine which may extend to one thousand rupees.

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) Notwithstanding anything contained in sub-section (1), 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 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.

Certain Offences to be Cognizable

Notwithstanding anything contained in the [Code of Criminal Procedure, 1898 (5 of 1898)], any offence punishable under sub-section (1) of section 23, shall be deemed to be a cognizable offence within the meaning of that Code.

Jurisdiction to try offences under this Act 26. No court inferior to that of a presidency magistrate or a magistrate of the first class shall take cognizance of or try any offence punishable under this Act.

Miscellaneous

Title to Dividends

(1) 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.

(2) 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

(1) 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 notwithstanding that 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 investment scheme became due.

(2) Nothing contained in sub-section (1) shall 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 holder of the security 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 collective investment scheme in the name of the transferee.

Act not to Apply in Certain Cases

(1) 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.

(2) Without prejudice to the provisions contained in sub-section (1), if the Central Government is satisfied that in the interests 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.

Protection of Action Taken in Good Faith

No suit, prosecution or other legal proceeding whatsoever shall lie in any court against the governing body or any member, office bearer or servant of any recognised stock exchange or against any person or persons appointed under sub-section (1) of section 11 for anything which is in good faith done or intended to be done in pursuance of this Act or of any rules or bye-laws made there under.

Power to Delegate

The Central Government may, by order published in the Official Gazette, direct that the powers (except the power under section 30) exercisable by such conditions, if any, as may be specified in the order, be exercisable also by the Securities and Exchange Board of India or the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934.

Power to Make Rules

(1) The Central Government may, by notification in the Official Gazette, make rules for the purpose of carrying into effect the objects of this Act.

(2) 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) The documents which should be maintained and preserved under section 6 and the periods for which they should be preserved;

   (e) The 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.

  (c) 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.

(i) Any other matter which is to be or may be prescribed.

(3) Any rules made under this section shall, as soon as may be, after their publication in the Official Gazette, be laid before both Houses of Parliament. Repeal 31. Repealed by the Repealing and Amending Act, 1960 (58 of 1960), section 2 and Schedule 1.

Part - III

Companies Act 1956

The Companies Act which regulates the activities of the companies from birth to death has provided for the sources of finance for companies and the methods of marketing the public issues which are marketable. These are in the form of ownership category, namely, Equities and Preference shares and Debt capital in the form of convertible and non-convertible debentures, fixed deposits etc. Under the Companies Act, Sections 55 to 68 provided for issue of prospectus, its contents, Registration of Prospectus, civil and criminal liabilities of the Directors for any mis-statements in prospectus etc.

The Act has laid down the methods of raising new issues, namely, through prospectus, letter of offer or statement in lieu of prospectus, Rights and Bonus. Section 58 A and B deal with the conditions for acceptance of deposits, repayments of deposits, etc. while companies (acceptance of deposits) Rules of 1975 laid down the period of maturity, interest rates and other conditions. As company deposits are an avenue of investment, the details regarding them are dealt with briefly later.

Sections 69 to 73 deal with the allotment of new issues of applicants, delivery of certificates and their listing on Stock Exchanges. The allotment is also governed by the guidelines given by the Stock Exchanges as per the listing agreement in the case of listed companies.

The basic framework for trading is provided by the Companies Act in the form of

(1) Marketing the shares as movable property under Section 82.

(2) Ensuring transferability of shares in respect of public limited companies under sections 108-112.

(3) The transfer deed through which share certificates are to be transferred is provided for under Section 108 which was amended to legalise the demat form of transfer since 1999.

(4) The validity of the transfer deed under Section 111 is 12 months in the case of listed companies and 24 months in the case of non-listed companies.

(5) Section 114 provides for issue of share warrants.

So far as investors are concerned, it is desirable that they know the main provisions of the Companies Act, because the issue of prospectus, the contents of it, allotment of new issues, dispatch of certificates, transferability etc., are all laid down in it. The rights of shareholders and debenture holders, and different categories of creditors and debtors of companies are set out. The book closure for accounts, presentation of Balance Sheet and Income-Expenditure accounts, payments of dividends etc., are all provided for in this Act. In Particular, Section 82 provides for transferability of shares and Section 73 lays down the conditions for listing of Public Limited Companies. While these sections ensure the marketability of shares of listed public limited companies, trading in them is made possible by the Securities Contracts Regulation Act and the Rules made there under.

In view of the fact at purchase and sale of shares through recognized Stock Exchanges and through licensed Stock Brokers are only legal, and those are governed by the SC (R) Act, the investors have to be familiar with this Act and the Rules made there under. The relation between the Brokers and Investors and in particular, the disputes if any, between them are governed by the Rules and Bye-laws of the Stock Exchanges which are formulated under this Act.

Acceptance of Fixed Deposits

A company cannot accept deposits in excess of 35% of the paid up capital and free reserves. Of this, 25 % deposits can be accepted from the public and the rest 10% from shareholders of the company. The minimum period of acceptance of deposits is one year and the maximum period is limited to 3 years. The company is under an obligation to maintain an amount not less than 15% of the company's deposit liability maturing during the course of the year, in liquid investments such as Government securities, units, deposits with banks etc.

The maximum rate of interest that can be offered on deposits is fixed at 16% (1999). A ceiling on brokerage payable on deposits has been fixed at 1%. The interest earned on fixed deposits of companies does not enjoy any exemption from income tax. Neither does the amount of deposit qualify for any exemption under wealth tax. Under the existing provisions of the Income Tax Act, tax on interest paid/payable is deducted at source if the interest payment exceeds ₹ 2,500 in a financial year unless suitable declaration is furnished by the depositor in regard to the total income of the depositor not exceeding the minimum liable to tax in a financial year (form 15 H under I.T. Act)

The acceptance of deposits by non-bank non-financial companies is governed by the Companies (acceptance of deposits) Rules 1975 as amended from time to time. Along with the prescribed application form the terms and conditions of acceptance of deposits are required to be furnished by companies, to the RBI in the case of non-bank finance companies and a copy in case of non-bank non-finance companies.

A careful study of either the financial data in the advertisement or the prescribed particulars as available within the application form would generally reveal the working results and the financial position of the company.

Compulsory Repayment of Deposits which have matured for Repayment

The Companies Act, 1956 has been amended by the Companies (Amendment) Act, 1988 with effect from 1.9.1989 so as to provide for compulsory repayment of deposits which have matured for repayment (Section 58(9)]. Under the amended provisions, the Company Law Board has been empowered to take cognizance of non-repayment of any deposit on maturity and to direct repayment of such deposits on such conditions as may be specified by the Company Law Board in its Order. This will help and ensure repayment of public deposits and will create confidence amongst the public.

Procedure for Making Application to Company Law Board

The person holding a matured fixed deposit which he has not renewed and which the company has failed to repay, has to make an application in triplicate in Form No. 11. The application has to be accompanied by a fee payable by way of bank draft in favour of the Pay & Accounts Officer, Dept. of Company Affairs, New Delhi/Mumbai/Calcutta/Chennai.

The Company Law Board has four Regional Benches. The aggrieved depositors may make an application to the Bench of the Company Law Board having jurisdiction according to the Registered Office of the company. The Company Law Board would, after giving a reasonable opportunity of hearing to the company and other persons interested in the matter, make suitable orders for repayment of such deposits. Non-compliance of the order of the Company Law Board is a punishable offence attracting penalty by way of imprisonment up to 3 years and fine of not less than ₹ 50 for every day till such non-compliance continues.

Where the deposit which has fallen due for payment remains unpaid the depositor can seek remedy in a civil court, or can file an application for winding up of the company to the court after serving on the company written demand requiring the company to repay the deposit (Section 433, 434 and 439 of the Companies Act may be referred to for the purpose). The SEBI is not permitting such companies to make public issues.

Cases in Respect of which applications to the Company Law Board will not lie

It is essential to know that under Section 58A of the Companies Act, the power to order repayment of matured deposits can be exercised by the CLB only in respect of deposits accepted Under the Companies (Acceptance of Deposit) Rules 1975 as amended from time to time. In other words, an application to the Company Law Board of repayment of matured deposits shall not lie in the following cases:

(i) Deposits made for booking purchases of scooter, car etc.

(ii) Deposits accepted by financial companies like, hire-purchase finance company, a housing finance company, an investment company, a loan/mutual benefit financial company, a chit fund company, which are governed by the rules made by the RBI.

(iii) Deposits accepted by companies which have been notified as 'relief undertakings' under special laws enacted by various State Governments. Court rulings point to the fact that the monetary liabilities of relief undertakings during the notified period stand suspended and any proceedings including the proceedings for compulsory repayment of deposits under Section 58A (9) shall accordingly remain stayed.

(iv) Deposits accepted by a sick industrial company covered by the Sick Industrial Companies (Special Provisions) Act, 1985 in respect of which, the Board for Industrial and Financial Reconstruction has specifically, by order suspended the operations of any contract, agreement, settlement, etc. under Section 22(3) of the Act.

Facts about Company Deposits

The deposits accepted by a company are not repayable before the date of maturity. It is left to the discretion of a company to allow premature repayment of a deposit. If and when the deposits are prematurely repaid the depositors are entitled to a lower rate of interest than the contracted rate. Most importantly, the company deposits are unsecured and rank pari passu with other unsecured liabilities. Hence, the investor has no recourse to any asset of the company in case of default by a company to repay the deposit on maturity.

Care to be exercised while investing in Fixed Deposits

Invitation to deposits from public for various schemes of deposits is invariably published in newspapers in the form of a statutory advertisement giving the following details:

(i) Terms of acceptance of deposits, rate of interest on different maturities, minimum amount of deposits, cumulative or non-cumulative nature of the deposit, etc.

(ii) Brief details of the name of the company, date of its incorporation, business carried on by it, places where the company has offices and names and address of directors.

(iii) Details of profits and dividends for the last three years.

(iv) Summarized financial position to the company (i.e., assets and liabilities) as appearing in the two latest audited balance sheets, alongwith details of contingent liabilities not provided for.

(v) Details regarding maximum amount of deposits which a company can accept.

(vi) A specific declaration that deposits accepted are unsecured and would rank pari passu with other unsecured liabilities.

(vii) A statement of deposits remaining unpaid.

Problems in Securities Markets

Securities markets are highly sensitive to any socio-economic and political factors. A large element of speculation is rampant in these markets and a right dose of regulation is a necessary evil. The sensitivity of external factors has increased after 1992 economic and financial reforms. When liberalization and globalization trends began to be perceptible.

Lack of professionalisation and broker-banks nexus has led to a number of scams. Even big banks got involved in Scams, in 1991-92 and 2000-01. Corruption and malpractices including mismanagement led to many bank failures, involving the U.T.I. as we. The trust and confidence reposed in the markets by investors were rudely shaken by the failure of u.s. 64 Scheme of UTI, urban corporative banks' failures and non-refund of deposits by many financial and non-financial companies. The laxity in regulation and in supervision by C.L.B., SEBI and RBI is one obvious reason for increased malpractices in the financial system, shaking the confidence of savers and investors.

Part - IV

Foreign Institutional Investments in India (FII)

Several economic forces, operating on both demand as well as supply side, have made markets totally global. Taken literally, it means that borrowers and investors go shopping around the world, picking up funds wherever they find them convenient and cheap. A pressure has come from growing number of institutionally managed funds (pension funds, insurance companies, mutual funds), which have actively pursued a policy of diversifying their portfolios internationally. These institutions have been investing abroad, particularly in 1980s to take advantage of higher returns available on the foreign securities. British pension fund holdings of foreign securities raised from 5 per cent of their total assets at end-1978 to 12 per cent at end-1985 an increase of $16 billion. Since 1980, Japanese insurance companies and pension funds have been allowed to hold upto 10 per cent of their portfolios in foreign assets and are estimated to have invested about $ 20 billion abroad.

Rational of Foreign Institutional Investment(FII) in India

Why are FIIs so optimistic about investing in India?

1. Macro-economic fundamentals are much stronger today.
2. Fiscal reforms have succeeded in a large measure in curtailing inflation.
3. The Forex position is fine.

4. Liberalisation of trade has been accompanied by convertibility of the rupee for trade transactions.
5. Exchange rate is stable.
6. Domestic Private investment is being encouraged.
7. Government's attitude is conductive for healthy competition and industrial growth.
8. Economic activity is beginning to rely more on price and market mechanisms.

India is waking up to the possible leveraging impact of FPI, in spurring its development efforts. As of now, FIIs control, globally, a $7.5 trillion, or ₹ 2, 250.000 crore investment portfolio and this is expected to go up to an incredible $ 20 trillion by the turn of the century. Since September 1992, when the government allowed FIIs to invest in the Indian capital market, 70 FIIs registered with SEBI and the number is increasing everyday. These 70 FIIs alone hold enormous financial power. If even one per cent of their portfolio were to come to India it would be about $3 billion. So far, they are believed to have brought in only about $ 150 million. According to some estimates $ 1 billion has already come into the Indian market through three major routes, i.e., direct portfolio investment, country funds and equity and quasi equity issues in the world markets placed by Indian firms.

Key Factors Affecting Fiis

1. Progressive management with good credentials.
2. Sound technological base, quite possibly with foreign collaborations.
3. International competitiveness and good export potential.
4. A widely dispersed share holding, that rules out the possibility of family funds destabilising the management and performance.
5. Market capitalisation greater than ₹ 100 crore or so, and
6. Participation by other financial institutions.

Sebi Guidelines

As the regulatory authority of the Indian Capital Market, the SEBI has issued a list of guidelines for FIIs. Some of the important guidelines are listed below:

1. FIIs would be required to obtain an initial registration with Securities and Exchange Board of India (SEBI), nodal regulatory agency for securities markets, before any investment is made by them in the securities of companies listed on the stock exchanges in India, in accordance with these guidelines. Nominee companies,

affiliates and subsidiary companies of a FII will be treated as separate FIIs for registration and may seek separate registration with SEBI.

2. Since there are foreign exchange controls also in force, for various permissions under exchange control, along with their application for initial registration, FIIs shall also file with SEBI another application addressed to RBI for seeking various permissions under FERA, in a format that would be specified by RBI for this purpose. RBIs general permission would be obtained by SEBI before granting initial registration and RBI's FERA permission together by SEBI, under a single window approach.

3. For granting registration to the FII, SEBI shall take into account, the track record of the FII, its professional competence, financial soundness, experience and such other criteria that may be considered by SEBI to be relevant. Besides, FIIs seeking initial registration with SEBI shall be required to hold a registration from the securities commission, or the country of domicile/incorporation of the FII.

4. SEBI's initial registration would be valid for five years. RBI's general permission under FERA to the FII will also hold good for five years. Both will be renewable for similar five years period later on.

5. RBI's general permission under FERA would enable the registered FII to buy, sell and realise capital gains on investment made through initial corpus remitted to India, subscribe/renounce right offering of shares, invest on all recognised stock exchanges through a designated bank branch, and to appoint a domestic custodian for custody of investments held.

6. There would be no restriction on the volume of investment-minimum or maximum for the purpose of entry of FIIs, in the primary/secondary market. Also, there would be no lock-in period prescribed for the purposes of such investments made by FIIs. It is expected that the differential in the rates of taxation of the long-term capital gains and short-term capital gains would automatically induce the FIIs to retain their investments as long-term investments.

7. Portfolio investments in primary or secondary markets will be subject to a ceiling of 24 per cent of issued share capital for the total holding of all registered FIIs, in any one company. The ceiling would apply to all holdings taking into account the conversions out of the fully and partly convertible debentures issued by the company. The holding of a single FII in any company would also be subject to a ceiling of 5 per cent of total issued capital. For this purpose, the holdings of a FII group will be counted as holding of a single FII.

The RBI has now restricted the foreign institutional investors quota in primary issues. This decision has been taken after complaints that companies are reducing the quota for NRI's in public issue while allotting the full 24% to the FIIs.

8. The maximum holding of 24 per cent for all non-resident portfolio investments, including those of the registered FIIs, will also include NRI corporate and non-corporate investments, but will not include the following:

   (a) Foreign investments under financial collaborations (direct foreign investments), which are permitted upto 51 per cent in all priority areas.

   (b) Investments by FIIs through the following alternative routes:

   (c) Offshore single/Regional funds:

      (i) Offshore single/Regional funds;

      (ii) Global Depository Receipts; and

      (iii) Euro convertibles.

9. Disinvestments will be allowed only through stock exchange in India, including the OTC Exchange. In exceptional cases, SEBI may permit sales other than through stock exchanges, provided the sale price is not significantly different from the stock market quotations, where available.

10. All secondary market operations would be only through the recognised intermediaries on the Indian Stock Exchange, including OTC Exchange of India. A registered FII would be expected not to engage in any short selling in securities and to take delivery of purchased and give delivery of sold securities.

11. A registered FII can appoint as custodian an agency approved by SEBI to act as a custodian of securities and for confirmation of transactions in securities, settlement of purchase and sale and for information reporting. Such custodian shall establish separate accounts for detailing on a daily basis the investment capital utilisation and securities held by each FII for which it is acting as custodian. The custodian will report to the RBI and SEBI semi-annually as part of its disclosure and reporting guidelines.

12. The RBI shall make available to the designated bank branches a list of companies where no investment will be allowed on the basis of the upper prescribed ceiling of 24 per cent having been reached under the portfolio investment scheme.

13. RBI may at any time request by an order, a registered FII to submit information regarding the records of utilisation of the inward remittances of investment capital

and the statement of securities transactions. RBI and or SEBI may at any time conduct a direct inspection of the record and accounting books of a registered FII.

14. FIIs investing under this scheme will benefit from a concessional tax regime of a flat tax of 20 per cent on dividend and interest income and a tax rate of 10 per cent on long-term (one year or more) capital gains.

Problem Areas In FIIS In India

Following are some major problems faced by FII's hindering investment in India:

(a) The cumbersome rules that govern foreign institutional investment in India and the archaic system of its stock exchange have forced the FIIs to divert a substantial portion of their investments into the offshore instruments floated by Indian Companies, instead of directly investing in the Indian Capital market.

(b) Another factor that has limited grater investment in the stock market is the fact that most money managers find greater value and growth potential in the second tier of Indian Companies as the economy opens upto a greater competition.

(c) The settlement systems are complicated and fraught with risks which few of them have any experience of counterpart, risks, default, and unreasonable delays.

(d) The brokerage system is not transparent.

(e) The Indian brokers are under-capitalized.

(f) There is lack of adequate custodial services.

(g) Registration of shares can be an agonizing process.

(h) There are frequent interruptions in the working of the bourses.

(i) Trading volumes are very low and less than 20 per cent of the total volume is for delivery.

Foreign Institutional Investors- Recent Trends

With a view to facilitating the entry of Foreign Institutional Investors (FIIs) into the country SEBI has simplified the common application forms. The entry of FIIs is also to be facilitated by increasing the role of foreign brokers in the transactions of FIIs. Foreign brokers will be allowed to assist FIIs and operate on their behalf by transmitting orders to buy or sell securities to members of the Indian Stock Exchanges. These foreign brokers have been permitted to open bank and custodial accounts for this purpose. Government have also allowed some foreign firms to set up joint ventures in the financial sector.

There has been a continuous increase in the number of FIIs registered with SEBI and in the volume of investments effected by them in India. Till the middle of January 1994, SEBI and registered 134 FIIs who have 175 broad-based institutional funds under them which have also been approved for investment in the market. About US $ 1 billion have already been invested by these FIIs. The size of the inflow of investment funds and the increase in t he number of FIIs registered in India are indicative of the growing confidence of the international investing community in Indian markets and their regulatory mechanism. The short-term capital gains of FIIs will be taxed at the rate of 30 per cent while long-term capital gains are taxed at 10 per cent. The will guard against volatility in fund flow. Dividend payments will be subject to a tax rate of 20 per cent.

Part - V

Guidelines to Investors

1. Deal with a registered member of the stock exchange. If you are dealing with a sub-broker, make sure that all bills and contracts are made in the name of a registered broker.

2. Insist that all your deals are done in the trading ring, or electronically recorded.

3. Give specific orders to buy or sell within the fixed price limits and/or time periods within which orders have to be executed.

4. Insist on contract notes to be passed on to you on the dates, when the orders are executed.

5. Make sure that your deal is registered with the stock exchange in a souda Block Book or recorded electronically. In the case of a dispute, this will help trace the details of the deal easily.

6. Collect a settlement table from the stock exchange mentioning the pay-in and pay-out days. Each stock exchange has its own trading periods which are called settlements. All transactions done within this period are settled at the end of it. All payments for shares bought and their deliveries take place on the pay-in day. An awareness of pay-in and pay-out days is useful when a broker tries to make excuses.

7. Keep separate records of dealings in specified shares (Group A) and non-specified shares (Group B1, and B2). The settlement for each is on different days.

8. Execute periodic settlements of dues and delivery of shares to avoid accumulation of transactions,

9. Insist on delivery. If the company returns your papers and shares with objections, contact your broker immediately.

10. Ensure that shares bought are transferred in your name before the company's book closure date. This is necessary to make sure that you receive benefits like dividend, interest and bonus shares. All companies have a book closure date on which the list of shareholders in the company is finalised.

11. Complain if the broker does not deliver the shares bought in your name. Proceed to contact another broker with the bill/contract given to you by the earlier broker, and the Exchange authorities and the latter will purchase the shares on your behalf. In such an event, the first broker will have to pay the difference in price.

12. Do not sell shares that are not transferred in your name after the book closure as these are not valid in the market.

13. Do not sell/deal in shares where any one of the holders has passed away. In cases where the holder has died, a succession certificate is necessary. In cases where one of the joint shareholders passes away, the surviving holder should send the shares along with the death certificate to the company. Only after the name of the deceased has been deleted from the shares, can they be transferred.

14. Do not expect the money for shares to come immediately. It will take at least a fortnight at present from the date of transaction.

15. Unless you have a special arrangement with the broker, do not expect the adjustment of purchases and sales against one another. One pays first and receives later

16. Do not take delays or harassment lying down. You have to complain to the Grievance Cell of the stock exchange or the Securities and Exchange Board of India (SEBI) in case of delay or harassment.

Self Assessment Questions

1. What is Securities Market?
2. Explain SEBI Act-1992?
3. Explain the Securites Contract (Regulation) Act 1956?
4. Why are FIIs so optimistic about investing in India? Discuss SEBI Guidelines for FIIs?
5. State the SEBI guidelines to Investors?

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UNIT – II

Security Market: Primary Market

Learning Objectives

After reading this unit you can be able to understand:

- Role and functions of primary market
- Methods of selling securities in primary market
- SEBI guidelines for public issues and Procedures for new issues

Security market or capital market may be defined as a market for borrowing and lending long-term capital funds required by business enterprises. Capital market is the market for financial assets that have long or indefinite maturity. Capital market offers an ideal source of external finance. Capital market forms an important core of a country's financial systems too.

It refers to all the facilities and the institutional arrangements for borrowing and lending medium-term and long – term funds. Like any market, the capital market is also composed of those who demand funds (borrowers) and those who supply funds (lenders).

Characteristics

Following are the characteristic features of a security market:

Securities Market

The dealings in a capital market are done through the securities like shares, debentures, etc. The capital market is thus called securities market.

Security Prices

The price of securities that are dealt with in the capital market is determined through the general laws of demand and supply. The equilibrium in demand and supply of securities is brought about by the prices. The price depends upon a large number of factors such as the following.

1. Yield on securities
2. Extent of funds available from public savings
3. Level of demand for funds
4. Flow of funds from the banking system
5. Price situation in general
6. Attitude towards liquidity on the part of investors

Participants

There are many players in the capital market. The participants constitute a plethora of institutions, which provide a wide variety of services of access to capital. The capital is either directly supplied or arranged through financial intermediaries. These intermediaries form the basic edifice of a capital market. The participants in the capital market include:

1. Financial intermediaries like insurance companies, investment companies, pension funds, etc
2. Non-financial business enterprises
3. Ultimate economic units like households and Governments

Location

It is interesting to note that the capital market is not confined to certain specific locations, although it is true that parts of the market are concentrated in certain well-known centers known as Stock Exchanges. It exists all over the economy, wherever suppliers and users of capital get together and do business.

Functions

The functions that are performed by the security market are detailed below:

Allocation Function

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

Liquidity Function

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

Other Functions

In addition to the functions of funds allocation and liquidity, capital market also renders the following functions:

Indicative Function

A capital market acts as a barometer showing not only the progress of a company, but also of the economy as a whole through share price movements.

Savings and Investment function Capital market provides a means of quickly converting long-term investment into liquid funds, thereby generating confidence among investors and speeding up the process of saving and investment.

Transfer function Capital market facilitates the transfer of existing assets – tangible and intangible – among individual economic units or groups.

Merger function Capital market encourages voluntary or coercive take-over mechanism to put the management of inefficient companies into more competent hands.

Constituents of Indian Capital Market

The Indian capital market is composed of the following:

1. The gilt-edged market
2. The industrial securities market

Gilt-Edged Market

'Gilt-edged Market' also known as Government Securities market, is the market for Government and semi-Government securities. An important feature of the securities traded in this market is that they are stable in value and are much sought after by banks.

Some of the special features of the gilt-edged market are as follows:

1. Guaranteed return on investments
2. No speculation in securities
3. Institutional based investors which are compelled by law to invest a portion of their funds in these securities
4. Predominated by such institutions as LIC, GIC, the provident funds and the commercial banks.
5. Heavy volume of transactions necessitating negotiation of each transaction.

Industrial Securities Market

The market for industrial securities is known as 'Industrial Securities Market'. It offers an ideal market for corporate securities such as bonds and equities. Industrial securities market comprises of the following segments:

1. Primary market
2. Secondary market

Primary Market

Meaning

Primary market also known as New Issues Market (NIM) is a market for raising fresh capital in the form of shares and debentures. Corporate enterprises, which are desirous of raising capital funds through the issue of securities, approach the primary market.

Issues exchange financial securities for long-term funds. The primary market allows for the formation of capital in the country and the accelerated industrial and economic development.

Modes of Raising Capital

Following are the popular ways by which capital funds are raised in the primary market:

Public issue where the securities are issued to the members of the general public, it takes the form of 'public issue'. It is the most popular method of raising long-term funds.

Rights issue where the issue of equity shares of a body corporate is made to the existing shareholders as a pre-emptive right, it takes the form of 'rights issue'. Under this method, additional securities are offered fro subscription to the existing shareholders.

Private placement where the shares of a body corporate are sold to a group of small investors, it takes the form of 'private placement'.

The Secondary Market

Meaning

A market which deals in securities that have been already issued by companies is known as 'the secondary market'. It is also called the stock exchange or the share market.

Importance

The importance of the secondary market springs from the fact that it is the base upon which rests the edifice of the primary market. In other words, for the efficient growth of the primary market, a sound secondary market is an essential requirement. This is because the secondary market offers an important facility of transfer of securities.

Methods of Marketing Securities

Following are the various methods being adopted by corporate entities for marketing the securities in the New Issue Market:

Pure Prospectus Method

The method whereby a corporate enterprise mops up capital funds from the general public by means of an issue of a prospectus is called 'Pure Prospectus Method'. It is the most popular method of making public issue of securities by corporate enterprises.

Features

Exclusive Subscription

Under this method, the new issues of a company are offered for exclusive subscription of the general public. According to the SEBI norms, a minimum of 49 percent of the total issue at a time is to be offered to public.

Issue Price

Direct offer is made by the issuing company to the general public to subscribe to the securities at a stated price. The securities may be issued either at par, of at a discount or at a premium.

Underwriting

Public issue through the 'pure prospectus method' is usually underwritten. This is to safeguard the interest of the issuer in the event of an unsatisfactory response from the public.

Prospectus

A document that contains information relating to the various aspects of the issuing company, besides other details of the issue is called a 'Prospectus'. The document is circulated to the public. The general details include the company's name and address of its registered office, the names and addresses of the company's promoters, manager, managing director, directors, company secretary, legal adviser, auditors, bankers, brokers, etc the data of opening and closing of subscription list, contents of Articles, the names and addresses of underwriters, the amount underwritten and the underwriting commission, material details regarding the project, i.e. location, plant and machinery, technology, collaboration, performance guarantee, infrastructure facilities, etc nature of products, marketing set-up, export potentials and obligations, past performance and future prospects, management's perception regarding risk factor, credit rating obtained from any other recognized rating agency, a statement regarding the fact that the company will make an application to specified stock exchange(s) for listing its securities and so on.

Advantages

The pure prospectus method offers the following advantages to the issuer and the investors alike:

Benefits to Investors

The pure prospectus method of marketing the securities serves as an excellent mode of disclosure of all the information pertaining to the issue. Besides, it also facilitates satisfactory compliance with the legal requirements of transparency, etc. It also allows for good publicity for the issue. The method promotes confidence of investors through transparency and non discriminatory basis of allotment. It prevents artificial jacking up of prices as the issue is made public.

Benefits to Issuers

The pure prospectus method is the most popular method among the large issuers. In addition it provides for wide diffusion of ownership of securities contributing to reduction in the concentration of economic and social power.

Drawbacks

The raising of capital through the pure prospectus method is fraught with a number of drawbacks as specified below:

High Issue Costs

A major drawback of this method is that it is an expensive mode of raising funds from the capital market. Costs of various hues are incurred in mobilizing capital. Such costs as underwriting expenses, brokerage, administrative costs, publici9ty costs, legal costs and other costs are incurred for raising funds. Due to the high cost structure, this type of marketing of securities is followed only for large issues.

Time Consuming

The issue of securities through prospectus takes more time, as it requires the due compliance with various formalities before an issue could take place. For instance, a lot of work such as underwriting, etc should be formalized before the printing and the issue of a prospectus.

Offer for Sale Method

Meaning

Where the marketing of securities takes place through intermediaries, such as issue houses, stockbrokers and others, it is a case of 'Offer for Sale Method'.

Features

Under this method, the sale of securities takes place in two stages. Accordingly, in the first stage, the issuer company makes an en-block sale of securities to intermediaries such as the issue houses and share brokers at an agreed price. Under the second stage, the securities are re-sold to ultimate investors at a market-related price. The difference between the purchase price and the issue price constitutes 'profit' for the intermediaries. The intermediaries are responsible for meeting various expenses such as underwriting commission, prospectus cost, advertisement expenses, etc.

The issue is also underwritten to ensure total subscription of the issue. The biggest advantage of this method is that it saves the issuing company the hassles involved in selling the shares to the public directly through prospectus. This method is, however, expensive for the investor as it involves the offer of securities by issue houses at very high prices.

Private Placement Method

Meaning

A method of marketing of securities whereby the issuer makes the offer of sale to individuals and institutions privately without the issue of a prospectus is known as 'Private Placement Method'. This is the most popular method gaining momentum in recent times among the corporate enterprises.

Features

Under this method, securities are offered directly to large buyers with the help of share brokers. This method works in a manner similar to the 'Offer for Sale Method' whereby securities are first sold to intermediaries such as issues houses, etc. They are in turn placed at higher prices to individuals and institutions. Institutional investors play a significant role in the realm of private placing. The expenses relating to placement are borne by such investors.

Advantages

Private placement of securities offers the following advantages:

1. Less expensive as various types of costs associated with the issue are borne by the issue houses and other intermediaries
2. Less troublesome for the issuer as there is not much of stock exchange requirements concerning contents of prospectus and its publicity, etc to be complied with
3. Placement of securities suits the requirements of small companies

4. The method is also resorted to when the stock market is dull and the public response to the issue is doubtful

Disadvantages

The major weaknesses of the private placement of securities are as follows:

1. Concentration of securities in a few hands
2. Creating artificial scarcity for the securities thus jacking up the prices temporarily and misleading general public
3. Depriving the common investors of an opportunity to subscribe to the issue, thus affecting their confidence levels

Initial Public Offer (IPO) Method

The public issue made by a corporate entity for the first time in its life is called 'Initial Public Offer' (IPO). Under this method of marketing, securities are issued to successful applicants on the basis of the orders placed by them, through their brokers.

When a company whose stock is not publicly traded wants to offer that stock to the general public, it takes the form of 'Initial Public Offer'. The job of selling the stock is entrusted to a popular intermediary, the underwriter. An underwriter is invariably an investment banking company. He agrees to pay the issuer a certain price for a minimum number of shares, and then resells those shares to buyers, who are often the clients of the underwriting firm. The underwriters charge a fee for their services.

Stocks are issued to the underwriter after the issue of prospectus which provides details of financial and business information as regards the issuer. Stocks are then released to the underwriter and the underwriter releases the stock to the public.

The issuer and the underwriting syndicate jointly determine the price of a new issue. The approximate price listed in the red herring (the preliminary prospectus–often with words in red letters which say this is preliminary and the price is not yet set) many or may not be close to the final issue price. IPO stock at the release price is usually not available to most of the public. Good relationship between the broker and the investor is a pre requisite for the stock being acquired.

Full disclosure of all material information in connection with the offering of new securities must be made as part of the new offerings. A statement and preliminary prospectus (also known as a red herring) containing the following information is to be filed with the Registrar of Companies:

1. A description of the issuer's business
2. The names and addresses of the key company officers, with salary and a 5 year business history on each
3. The amount of ownership of the key officers
4. The company's capitalization and description of how the proceeds from the offering will be used and
5. Any legal proceedings that the company is involved in

Applications are made by the investors on the advice of their brokers who are intimated of the share allocation by the issuer. The amount becomes payable to the issuer through the broker only on final allocation. The allotment is credited and share certificates delivered to the depository account of the successful investor.

The essential steps involved in this method of marketing of securities are as follows:

1. **Order:** Broker receives order from the client and places orders on behalf of the client with the issuer.
2. **Share allocation**: The issuer finalizes share allocation and informs the broker regarding then same.
3. **The client:** The broker advises the successful clients of the share allocation. Clients then submit the application forms for shares and make payment to the issuer through the broker.
4. **Primary issue account**: The issuer opens a separate escrow account (primary issue account) for the primary market issue. The clearing house of the exchange debits the primary issue account of the broker and credits the issuer's account.
5. **Certificates:** Certificates are then delivered to investors. Otherwise depository account may be credited.

The biggest advantage of this method of marketing of securities is that there is no need for the investors to part with the money even before the shares are allotted in his favor. Further, the method allows for elimination of unnecessary hassles involved in making a public issue. Under the regulations of the SEBI, IPOs can be carried out through the secondary market and the existing infrastructure of stock exchanges can be used for this purpose.

Rights Issue Method

Where the shares of an existing company are offered to its existing shareholders, it takes the form of 'rights issue'. Under this method, the existing company issues shares to its existing shareholders in proportion to the number of shares already held by them.

The relevant guidelines issued by the SEBI in this regard are as follows:

1. Shall be issued only by listed companies
2. Announcement regarding rights issue once made, shall not be withdrawn and where withdrawn, no security shall be eligible for listing up to 12 months
3. Underwriting as to rights issue is optional and appointment of Registrar is compulsory
4. Appointment of category I Merchant Bankers holding a certificate of registration issued by SEBI shall be compulsory
5. Rights shares shall be issued only in respect of fully paid shares
6. Letter of Offer shall contain disclosures as per SEBI requirements
7. Agreement shall be entered into with the depository for materialization of securities to be issued
8. Issue shall be kept open for a minimum period of 30 days and for a maximum period of 60 days
9. A minimum subscription of 90 percent of the issue shall be received
10. No reservation is allowed for rights issue as regards FCDs and PCDs
11. A 'No Complaints Certificate' is to be filed by the 'Lead Merchant Banker' with the SEBI after 21 days from the date of issue of offer document
12. Obligatory for a company where increase in subscribed capital is necessary after two years of its formation or after one year of its first issue of shares, whichever is earlier (this requirement may be dispensed with by a special resolution

Advantages

Rights issue offers the following advantages:

Economy

The issue management procedures connected with the rights issue is easier as only a limited number of applications are to be handled.

Advantage to Shareholders

Issue of rights shares does not involve any dilution of ownership of existing shareholders. Further, it offers freedom to shareholders to subscribe or not to subscribe the issue.

Drawbacks

The method suffers from the following limitations:

Restrictive

The facility of rights issue is available only to existing companies and not to new companies.

Against Society

The issue of rights shares runs counter to the overall societal considerations of diffusion of share ownership for promoting dispersal of wealth and economic power.

Bonus Issues Method

Where the accumulated reserves and surplus of profits of a company are converted into paid up capital, it takes the form of issue of 'bonus shares'. It merely implies capitalization of existing reserves and surplus of a company. The issue of bonus shares is subject to certain rules and regulations. The issue does not in any way affect the resources base of the enterprise. It saves the company enormously of the hassles of capital issue.

Issued under Section 205 (3) of the Companies Act, such shares are governed by the guidelines issued by the SEBI (applicable to listed companies only) as follows:

SEBI Guidelines

Following are the guidelines pertaining to the issue of bonus shares by a listed corporate enterprise:

1. **Reservation:** In respect of FCDs and PCDs, bonus shares must be reserved in proportion to such convertible part of FCDs and 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 issues were made.

2. **Reserves**: The bonus issue shall be made out of free reserves built out of the genuine profits or share premium collected in cash only. Reserves created by revaluation of fixed assets are not capitalized.

3. **Dividend mode:** The declaration of bonus issue, in lieu of dividend, is not made.

4. **Fully paid**: The bonus issue is not made unless the partly paid shares, if any are made fully paid-up.

5. **No default:** The Company has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures of principal on redemption thereof and has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus, etc.

6. **Implementation**: A company that announces its bonus issue after the approval of the Board of Directors must implement the proposal within a period of 6 months from the date of such approval and shall not have the option of changing the decision.

7. **The articles**: The Articles of Association of the company shall contain a provision for capitalization of reserves, etc. If there is no such provision in the Articles, the company shall pass a resolution at its general body meeting making provisions in the Articles of Associations for capitalization.

8. **Resolution**: Consequent to the issue of bonus shares if the subscribed and paid-up capital exceeds the authorized share capital, the company at its general body meeting for increasing the authorized capital shall pass a resolution.

Rights Issue vs. Bonus Issue

Bonus issue is different from rights issue in the following respects:

Sl.No.	Feature	Rights Issue	Bonus Issue
1.	Payment	The issue is to be paid for	The issue is free
2.	Privilege	Confers a privilege on the existing members	Not a privilege issue
3.	Paid-up shares	Shares may be partly paid-up also	Shares are necessarily to be fully-paid
4.	Minimum Subscription	Minimum subscription is required	Minimum subscription is not required

5.	Separate Account	Money is to be kept in a separate bank account	No such requirement
6.	Right to Renounce	Rights issue may be renounced by a member in favor of a nominee	No such facility is available
7.	Regulation	Regulated by the provisions of the Companies Act and SEBI guidelines	Regulated by the provisions of the company's Articles and SEBI guidelines

Book-Building Method

A method of marketing the shares of a company whereby the quantum and the price of the securities to be issued will be decided on the basis of the 'bids' received from the prospective shareholders by the lead merchant bankers is known as 'book-building method'. Under the book-building method, share prices are determined on the basis of real demand for the shares at various price levels in the market. For discovering the price at which issue should be made, bids are invited from prospective investors from which the demand at various price levels is noted. The merchant bankers undertake full responsibility for the issue.

The option of book-building is available to all body corporate, which are otherwise eligible to make an issue of capital to the public. The initial minimum size of issue through book-building route was fixed at ₹ 100 crores. However, beginning from December 9, 1996 issues of any size will be allowed through the book-building route.

Book-building facility is available as an alternative to firm allotment. Accordingly, a company can opt for book-building route for the sale of shares to the extent of the percentage of the issue that can be reserved for firm allotment as per the prevailing SEBI guidelines. It is therefore possible either to reserve securities for firm allotment or issue them through the book-building process.

***The book-building process involves the following steps*:**

1. **Appointment of book-runners**: The first step in the book-building process is the appointment by the issuer company, of the book-runner, chosen from one of the lead merchant bankers. The book-runner in turn forms a syndicate for the book building. A syndicate member should be a member of National Stock Exchange (NSE) or Over-The-Counter Exchange of India (OTCEI). Offers of 'bids' are to be made by

investors to the syndicate members, who register the demands of investors. The bid indicates the number of shares demanded and the prices offered. This information, which is stored in the computer, is accessible to the company management or to the book-runner. The name of the book-runner is to be mentioned in the draft prospectus submitted to SEBI.

2. **Drafting prospectus**: The draft prospectus containing all the information except the information regarding the price at which the securities are offered is to be filed with SEBI as per the prevailing SEBI guidelines. The offer of securities through this process must separately be disclosed in the prospectus, under the caption 'placement portion category'. Similarly, the extent of shares offered to the public shall be separately shown under the caption 'net offer to the public'. According to the latest SEBI guidelines issued in October 1999, the stipulation that at least 25 percent of the securities were to be issued to the public has been done away with. This is aimed at enabling companies to offer the entire public issue through the book-building route.

3. **Circulating draft prospectus:** A copy of the draft prospectus filed with SEBI is to be circulated by the book-runner to the prospective institutional buyers who are eligible for firm allotment and also to the intermediaries who are eligible to act as underwriters. The objective is to invite offers for subscribing to the securities. The draft prospectus to be circulated must indicate the price-bank within which the securities are being offered for subscription.

4. **Maintaining offer records**: The book-runner maintains a record of the offers received. Details such as the name and the number of securities ordered together with the price at which each institutional buyer or underwriter is willing to subscribe to securities under the placement portion must find place in the record. SEBI has the right to inspect such records.

5. **Intimation about aggregate orders:** The underwriters and the institutional investors shall give intimation on the aggregate of the offers received to the book-runner.

6. **Bid analysis**: The bid analysis is carried out by the book-runner immediately after the closure of the bid offer date. An appropriate final price is arrived at after a careful evaluation of demands at various prices and the quantity. The final price is generally fixed reasonably lower than the possible offer price. This way, the success of the issue is ensured. The issuer company announces the pay-in-date at the expiry of which shares are allotted.

7. **Mandatory underwriting:** Where it has been decided to make offer of shares to public under the category of 'Net Offer to the Public', it is incumbent that the entire portion offered to the public is fully underwritten. In case an issue is made through book-building route, it is mandatory that the portion of the issue offered to the public be underwritten. For this purpose, an agreement has to be entered into with the underwriter by the issuer. The agreement shall specify the number of securities as well as the price at which the underwriter would subscribe to the securities. The book-runner may require the underwriter of the net offer to the public to pay in advance all moneys required to be paid in respect of their underwriting commitment.

8. **Filing with ROC**: A copy of the prospectus as certified by the SEBI shall be filed with the Registrar of Companies within two days of the receipt of the acknowledgement care from the SEBI.

9. **Bank accounts**: The issuer company has to open two separate accounts for collection of application money, one for the private placement portion and the other for the public subscription.

10. **Collection of completed applications**: The book-runner collects from the institutional buyers and the underwriters the application forms along with the application money to the securities proposed to be allotted to them or subscribed by them. This is to be done one day before the opening of the issue to the public.

11. **Allotment of securities**: Allotment for the private placement portion may be made on the second day from the closure of the issue. The issuer company, however, has the option to choose one date for both the placement portion and the public portion. The said date shall be considered to be the date of allotment for the issue of securities through the book-building process. The issuer company is permitted to pay interest on the application moneys till the date of allotment or the deemed date of allotment provided that payment of interest is uniformly given to all the applicants.

12. **Payment schedule and listing**: The book-runner may require the underwriters to the 'net offer to the public' to pay in advance all moneys required to be paid in respect of their underwriting commitment by the eleventh day of the closure of the issue. In that case, the shares allotted as per the private placement category will become eligible for being listed. Allotment of securities under the public category is to be made as per the prevailing statutory requirements.

13. **Under-subscription**: In the case of under-subscription in the 'net offer to the public' category, any spillover to the extent of under-subscription is to be permitted

from the 'placement portion' category subject to the condition that preference is given to the individual investors. In the case of under-subscription in the placement portion, spillover is to be permitted from the net offer to the public to the placement portion.

Advantages of Book-building

Book-building process is of immense use in the following ways:

1. Reduction in the duration between allotment and listing
2. Reliable allotment procedure
3. Quick listing in stock exchanges possible
4. No price manipulation as the price is determined on the basis of the bids received

Stock Option or Employees Stock Option Scheme (ESOP)

A method of marketing the securities of a company whereby its employees are encouraged to take up shares and subscribe to it is known as 'stock option'. It is a voluntary scheme on the part of the company to encourage employees' participation in the company. The scheme also offers an incentive to the employees to stay in the company. The scheme is particularly useful in the case of companies whose business activity is dominantly based on the talent of the employees, as in the case of software industry. The scheme helps retain their most productive employees in an industry, which is known for its constant churning of personnel.

SEBI Guidelines

Company whose securities are listed on any stock exchange can introduce the scheme of employees' stock option. The offer can be made subject to the conditions specified below:

1. **Issue at discount:** Issue of stock options at a discount to the market price would be regarded as another form of employee compensation and would be treated as such in the financial statement of the company regardless the quantum of discount on the exercise price of the options.
2. **Approval:** The issue of ESOPs is subject to the approval by the shareholders through a special resolution.
3. **Maximum limit**: There would be no restriction on the maximum number of shares to be issued to a single employee. However, in cases of employees being offered more

than 1 percent shares, a specific disclosure and approval would be necessary in the AGM.

4. **Minimum period**: A minimum period of one year between grant of options and its vesting has been prescribed. After one year, the company would de4termine the period during which the option can be exercised.

5. **Superintendence:** 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.

6. **Eligibility:** ESOP scheme is open to all permanent employees and to the directors of the company but not to promoters and large shareholders. The scheme would be applicable to the employees of the subsidiary or a holding company with the express approval of the shareholders.

7. Director's report The Director's report shall make a disclosure of the following:

   a. Total number of shares as approved by the shareholders

   b. The pricing formula adopted

   c. Details as to options granted, options vested, options exercised and options forfeited, extinguishments or modification of options, money realized 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 percent or more of options granted during that year

   d. Fully diluted EPS computed in accordance with the IAS

IPO SEBI's stipulations prohibiting initial public offerings by companies having outstanding options should not apply to ESOP. If any ESOPs are outstanding at the time of an IPO issue by an unlisted company, the promoters' contribution shall be calculated with reference to the enlarged that would arise if all vested options were exercised

Capital Market Instruments

The changes that are sweeping across the Indian capital market especially in the recent past are something phenomenal. It has been experiencing metamorphic changes in the last decade, thanks to a host of measures of liberalization, globalization, and privatization that have been initiated by the Government. Pronounced changes have occurred in the realm of industrial policy, licensing policy, financial services industry, interest rates, etc.

The competition has become very intense and real in both industrial sector and financial services industry.

As a result of these changes, the financial services industry has come to introduce a number of instruments with a view to facilitate borrowing and lending of money in the capital market by the participants.

Meaning

Financial instruments that are used for raising capital resources in the capital market are known as 'Capital Market Instruments'.

Types

The various market instruments used by corporate entities for raising resources are as follows:

1. Preference shares
2. Equity shares
3. Nonvoting equity shares
4. Cumulative convertible preference shares
5. Company fixed deposits
6. Warrants
7. Debentures and Bonds

Preference Shares

Meaning

Shares that carry preferential rights in comparison with ordinary shares are called 'Preference Shares'. The preferential rights are the rights regarding payment of dividend and the distribution of the assets of the company in the event of its winding up, in preference to equity shares.

Types

1. **Cumulative preference shares:** Shares where the arrears of dividends in times of no and/so lean profits can be accumulated and paid in the year in which the company earns good profits.

2. **Noncumulative preference shares:** Shares where the carry forward of the arrears of dividends is not possible.

3. **Participating preference shares**: Shares that enjoy the right to participate in surplus profits or surplus assets on the liquidation of a company or in both, if the Articles of Association provides for it.

4. **Redeemable preference shares**: Shares that are to be repaid at the end of the term of issue, the maximum period of a redemption being 20 years with effect from 1.3.1997 under the Companies Amendment Act, 1996. Since they are repayable, they are similar to debentures. Only fully paid shares are redeemed. Where redemption is made out of profits, a Capital Redemption Reserve Account is opened to which a sum equal to the nominal value of the shares redeemed is transferred. It is treated as paid-up share capital of the company.

5. **Fully convertible cumulative preference shares**: Shares comprise two parts, viz. Part A and B. Part A is convertible into equity shares automatically and compulsorily on the date of allotment. Part B will be redeemed at par/converted into equity shares after a lock-in period at the option of the investor, conversion into equity shares taking place after the lock-in period, at a price, which would be 30 percent lower than the average market price. The average market price shall be the average of the monthly high and low price of the shares in a stock exchange over a period of 6 months including the month in which the conversion takes place.

6. **Preference shares with warrants attached**: The attached warrants entitle the holder to apply for equity shares for cash, at a 'premium', at any time, in or more stages between the third and fifth year from the date of allotment. If the warrant holder fails to exercise his option, the unsubscribed portion will lapse. The holders of warrants would be entitled to all rights/bonus shares that may be issued by the company. The preference shares with warrants would be entitled attached would not be transferred/sold for a period of 3 years from the date of allotment.

Equity Shares

Meaning

Equity shares, also known as 'ordinary shares' are the shares held by the owners of a corporate entity.

Features

- Since equity shareholders face greater risks and have no specific preferential rights, they are given larger share in profits through higher dividends than those given to preference shareholders, provided the company's performance is excellent. Directors declare no dividends in case there are no profits or the profits do not justify dividend. For pervious years even when the company makes substantial profits are subsequent years. Equity shareholders also enjoy the benefit of ploughing back of undistributed profits kept as reserves and surplus for the purposes of business expansion. Often, part of these is distributed to them as bonus shares. Such bonus shares are entitled to a proportionate or full dividend in the succeeding year.

- A strikingly noteworthy, namely feature of equity shares is that holders of these shares enjoy substantial rights in the corporate democracy, namely the rights to approve the company's annual accounts, declaration of dividend, enhancement of managerial remuneration in excess of specified limits and fixing the terms of appointment and election of directors, appointment of auditors and fixing of their remuneration, amendments to the Articles and Memorandum of Association, increase of share capital and issue of further shares of debentures, proposals for mergers and reconstruction, and any other important proposal on which member's approval is required under the Companies Act.

- Equity shares in the hands of shareholders are mainly reckoned for determining in the management's control over the company. Where shareholders are widely disbursed, it is possible for the management to retain the control, as it is not possible for all the shareholders to attend the company's meeting in full strength. Furthermore, the management group can bolster its controlling power by acquiring further shares in the open market or otherwise. Equity share may also be offered to financial institutions as part of the private placement exercise. Such a method, however, if fraught with the danger of takeover attempt by financial institutions.

- Equity shareholders represent proportionate ownership in a company. They have residual claims on the assets and profits of the company. They have unlimited potential for dividend payments and price appreciation in comparison to the owners of debentures and preference share who enjoy just a fixed assured return in the form of interest and dividend. Higher the risk, higher the return and vice versa.

- Share certificates either in physical form or in the demat (with the introduction of depository system in 1996) form are issued as a proof of ownership of the share in a company. Demat facilitates electronic trading. Fully paid equity shares with detachable warrants entitle the warrant holder to apply for a specified number of shares at a determined price. Detachable warrants are separately registered with stock exchanges and traded separately. The company would determine the terms and conditions relating to the issue of equity against warrants.

- Voting rights are granted under the Companies Act (Sections 87 to 89) where in each shareholder is eligible for votes proportionate to the number of shares held or the amount of stock owned. A company cannot issue shares carrying disproportionate voting rights. Similarly, voting right cannot be exercised in respect of shares on which the shareholder owes some money to the company.

Capital

Equity shares are of different types. The maximum value of shares as specified in the Memorandum of Association of the company is called the authorized or registered or nominal capital. Issued capital is the nominal value of share offered for public subscription. In case shares offered for public subscription are not taken up, the portion of capital subscribed is called subscribed capital. This is less than the issued capital. Paid-up capital is the share capital paid-up by shareholders which is credited as paid-up on the shares.

Par Value and Book Value

The face value of a share is called its Par value. Although shares can be sold below the par value, it is possible that shares can be issued below the par value. The financial institutions that convert their unpaid principal and interest into equity in sick companies are compelled to do it at a minimum of ₹ 10 because of the par value concept even though the market price might be much less than ₹ 10 Par value can also lead to unhealthy practices like price rigging by promoters of sick companies to take market prices above ₹ 10 to get their new of shares.

Book value is the intrinsic value of a share that is calculated to reflect the net worth of the shareholders of a corporate entity.

Cash Dividends

These are dividends paid in cash. A stable payment of cash dividends is the hallmark of stability of share prices.

Stock Dividends

These are the dividends distributed as shares and issued by capitalized reserves. While net worth remains the same in the balance sheet, its distribution between shares and surplus is altered.

Nonvoting Equity Shares

Consequent to the recommendations of the 'Abid Hussain Committee' and subsequent to the amendment to the Companies Act, corporate managements are permitted to mobilize additional capital without diluting the interest of existing shareholders with the help of a new instrument called 'nonvoting equity shares'. Such share will be entitled to all the benefits except the right to vote in general meetings.

Such nonvoting equity share is being considered as a possible addition to the two classes of share capital currently in vogue. This class of shares has been included by an amendment to the Companies Act as a third category of shares. Corporates will be permitted to issue shares upto a certain percentage of the total share capital.

Nonvoting equity shares will be entitled to rights and bonus issues and preferential offer of shares on the same lines as that of ordinary shares. The objective will be to compensate the sacrifice made for the voting rights. For this purpose, these shares will carry higher dividend rate than that of voting shares. If a company fails to pay dividend, nonvoting shareholders will automatically be entitled to voting rights on a prorata basis until the company resumes paying dividend.

The mechanism of issue of nonvoting share is expected to overcome such problems as are associated with the voting shares as that the ordinary investors are more inclined towards high return on capital through sizeable dividends and capital appreciation through the issue of bonus shares and the inability of corporates to respond to the investors' just aspiration for reasonable dividends.

Moreover, there is every need for corporate to spend huge sums of money of a variety of non-so-useful items including colorful and costly annual reports. For all these above mentioned reasons, nonvoting equity shares are expected to have a ready and popular market. In effect, this kind of share is similar to preference shares with regard to nonvoting rights but may get the advantage of higher dividends as well as appreciation in share through entitlement to bonus shares which is not available to preference shares.

Convertible Cumulative Prefernce Shares (CCPS)

These are the shares that have the twin advantage of accumulation of arrears of dividends and the conversion into equity shares. Such shares would have to be to the face value of ₹ 100 each. The shares have to be listed on one or more stock exchanges in the country. The object of the issue of CCP shares is to allow for the setting up of new projects, expansion or diversification of existing projects, expansion or diversification of existing projects, normal capital expenditure for modernization and for meeting working capital requirements.

Debt-Equity Ratio

For the purpose if calculation of debt-equity ratio as may be applicable CCPS are be deemed to be an equity issue.

Compulsory Conversion

The conversion into equity shares must be for the entire issue of CCP shares and shall be done between the periods at the end of the three years and five years as may be decided by the company. This implies that the conversion of the CCP into equity shares would be compulsory at the end of five years and the aforesaid preference shares would not be redeemable at any stage.

Fresh Issue

The conversion of CCP shares into equity would be deemed as being one resulting from the process of redemption of the preference shares out of the proceeds of a fresh issue of shares made for the purposes of redemption.

Preference Dividend

The rate of preference dividend payable on CCP shares would be 10 percent.

Guideline Ratio

The guideline ratio of 1:3 as between preference shares and equity shares would not be applicable to these shares.

Arrears of Dividend

The right of receive arrears of dividend up to the date of conversion, if any, shall devolve on the holder of the equity shares on such conversion. The holder of the equity shares shall be receiving the arrears of dividend as and when the company makes profit and is able to declare such dividend.

Voting Right

CCPS would have voting rights as applicable to preference shares under the Companies Act, 1956.

Quantum

The amount of the issue of CCP shares would be to the extent the company would be offering equity shares to the public for subscription.

Company Fixed Deposits

Fixed deposits are the attractive source of short-term capital both for the companies and investors as well. Corporate favor fixed deposits as an ideal form of working capital mobilization without going through the process of mortgaging assets and the associated rigmaroles of documentation, etc. Investors find fixed deposits a sample avenue for investment in popular companies at attractively reasonable and safe interest rates. Moreover, investors are relieved of the problem of the hassles of market value fluctuation to which instruments such as shares and debentures are exposed. There are no transfer formalities either. In addition, it is quite possible for investors to have the option of premature repayment after 6 months, although such an option entails some interest loss.

Regulations

Since these instruments are unsecured, there is a lot of uncertainty about the repayment of deposits and regular payment of interest. The issue of fixed deposits is subject to the provisions of the Companies Act and the Companies (Acceptance of Deposits) Rules introduced in February 1975. Some of the important regulations in this regard as follows:

1. Advertisement Issue of an advertisement (with the prescribed information) as approved by the Board of Directors in dailies circulating in the state of incorporation.

2. Liquid assets Maintenance of liquid assets equal to 15 percent (substituted for 10% by Amendment Rules, 1992) of deposits (maturing during the year ending March 31) in the form of bank deposits, unencumbered securities of State and Central Governments or unencumbered approved securities.

3. Disclosure Disclosure in the newspaper advertisement the quantum of deposits remaining unpaid after maturity. This would help highlight the defaults, if any, by the company and caution the depositors.

4. Deemed public company Private company would become a deemed public company (from June 1998, Section 43A of the Act) where such a private company, after inviting public deposits through a statutory advertisement, accepts or renews deposits from the public other than its members, directors or their relatives. This provision, to a certain extent, enjoins better accountability on the part of the management and auditors.

5. Default Penalty under the law for default by companies in repaying deposits as and when they mature for payment where deposits were accepted in accordance with the Reserve Bank directions.

6. CLB Empowerment to the Company Law Board to direct companies to repay deposits, which have not been repaid as per the terms and conditions governing such deposits, within a time frame and according to the terms and conditions of the order.

Warrants

An option issued by a company whereby the buyer is granted the right to purchase a number of shares (usually one) of its equity share capital at a given exercise price during a given period is called a 'warrant'. Although trading in warrants are in vogue in the U.S. Stock markets for more than 6 to 7 decades, they are being issued to meet a range of financial requirements by the Indian corporates.

A security issued by a company, granting its holder the right to purchase a specified number of shares, at a specified price, any time prior to an expirable date is known as a 'warrant'.

Warrants may be issued with either debentures or equity shares. They clearly specify the number of shares entitled, the expiration date, along with the stated/exercise price. The expiration date of warrants in USA is generally 5 to 10 years from the date of issue and the exercise price is 10 to 30 percent above the prevailing market price. Warrants have a secondary market.

The exchange value between the share at its current price and the shares to be purchased at the exercise price represents the minimum value of a warrant. They have no floatation costs and when they are exercised, the firm receives additional funds at a price lower than the current market, yet higher than those prevailing at the time of issue. Warrants are issued by new/growing firms and venture capitalists. They are also issued during mergers and acquisitions. Warrants in the context are called 'sweeteners' and were issued by a few Indian companies since 1993.

Both warrants and rights entitle a buyer to acquire equity shares of the issuing company. However, they are different in the sense that warrants have a life span of three to five years whereas; rights have a life span of only four to twelve weeks (duration between the opening and closing date of subscription list). Moreover, rights are normally issued to effect current financing, and warrants are sold to facilitate future financing. Similarly, the exercise price of warrant, i.e. the price at which it can be exchanged for share, is usually above the market price of the share so as to encourage existing shareholders to purchase it. On the other hand, one warrant buys one equity share generally, whereas more than one right may be needed to buy one share. The detachable warrant attached to each share provides a right to the warrant holder to apply for additional equity share against each warrant.

Debentures And Bonds

A document that either creates a debt or acknowledges it is known as a debenture. Accordingly, and document that fulfills either of these conditions is a debenture. A debenture, issued under the common seal of the company, usually takes the form of a certificate that acknowledges indebtedness of the company.

A document that shows on the face of it that a company has borrowed a sum of money from the holder thereof upon certain terms and conditions is called a debenture. Debentures may be secured by way of fixed or floating charges on the assets of the company. These are the instruments that are generally used for raising long-term debt capital

Features

Following are the features of debenture:

1. **ISSUE:** In India, debentures of various kinds are issued by the corporate bodies, Government, and others as per the provisions of the Companies Act, 1956 and under the regulations of the SEBI. Section 117 of the Companies Act prohibits issue of debentures with voting rights. Generally, they are issued against a charge on the assets

of the company but at times may be issued without any such charge also. Debentures can be issued at a discount in which case, the relevant particulars are to be filed with the registrar of Companies.

2. **Negotiability**: In the case of bearer debentures the terminal value is payable to its bearer. Such instruments are negotiable and are transferable by delivery. Registered debentures are payable to the registered holder whose name appears both on the debenture and in the register of debenture holders maintained by the company. Further, transfer of such debentures should be registered. They are not negotiable instruments and contain a commitment to pay the principal and interest.

3. **Security:** Secured debentures create a charge on the assets of the company. Such a charge may be either fixed or floating. Debentures that are issued without any charge on assets of the company. Are called 'unsecured or naked debentures'.

4. **Duration**: Debentures, which could be redeemed after a certain period of time, are called Redeemable Debentures. There are debentures that are not to be returned except at the time of winding up of the company. Such debentures are called Irredeemable Debentures.

5. **Convertibility:** Where the debenture issue gives the option of conversion into equity shares after the expiry of a certain period of time, such debentures are called Convertible Debentures. Nonconvertible Debentures, on the other hand, do not have such an exchange facility.

6. **Return**: Debentures have a great advantage in them in that they carry a regular and reasonable income for the holders. There is a legal obligation for the company to make payment of interest on debentures whether or not any profits are earned by it.

7. **Claims**: Debenture holders command a preferential treatment in the matters of distribution of the final proceeds of the company at the time of its winding up. Their claims rank prior to the claims of preference and equity shareholders.

Kinds

Innovation debt instruments that are issued by the public limited companies in India are described below:

1. Participating debentures
2. Convertible debentures
3. Debt-equity swaps

4. Zero coupon convertible notes
5. Secured premium notes (SNP) with detachable warrants
6. Nonconvertible debentures (NCDs) with detachable equity warrant
7. Zero interest fully convertible debentures (FCDs)
8. Secured zero interest partly convertible debentures (PCDs) with detachable and separately tradable warrants
9. Fully convertible debentures (FCDs) with interest (optional)
10. Floating rate bonds (FRB)

1. **Participating Debentures**

   Debentures that are issued by a body corporate which entitle the holders to participate in its profits are called 'Participating Debentures'. These are the unsecured corporate debt securities. They are popular among existing dividend paying corporates.

2. **Convertible Debentures**

   a. Convertible debentures with options are a derivation of convertible debentures that give an option to both the issuer, as well as the investor, to exit from the terms of the issue. The coupon rate is specified at the time of issue

   b. Third party convertible debentures are debts with a warrant that allow the investor to subscribe to the equity of a third firm at a preferential price vis-à-vis market price, the interest rate on the third party convertible debentures being lower than pure debt on account of the conversion option

   c. Convertible debentures redeemable at a premium are issued at face value with a put option entitling investors to sell the bond to the issuer, at a premium later on. They are basically similar to convertible debentures but have less risk

3. **Debt-equity swaps**: They are offered from an issuer of debt to swap it for equity. The instrument is quite risky for the investor because the anticipated capital appreciation may not materialize.

4. **Zero-coupon convertible note**: These are debentures that can be converted into shares and on its conversion the investor forgoes all accrued and unpaid interest. The zero coupon convertible notes are quite sensitive to changes in the interest rates.

5. **SPN with detachable warrants**: These are the Secured Premium Notes (SPN) with detachable warrants. These are the redeemable debentures that are issued along with

a detachable warrant. The warrant entitles the holder to apply and get equity shares allotted, provided the SPN is fully paid. The warrants attached to it assure the holder such a right. No interest will be paid during the lock-in period for SPN.

6. The SPN holder has an option to sell back the SPN to the company at par value after the lock-in period. If this option is exercised by the holder, no interest/premium will be paid on redemption. The holder will be repaid the principal and the additional interest/premium amount in installments as may be decided by the company. The conversion of detachable warrant into equity shares will have to be done within the time limit notified by the company.

7. **NCDs with detachable equity warrants**: These are Non convertible debentures (NCDs) with detachable equity warrants. These entitle the holder to buy a specific number of shares from the company at a predetermined price within a definite time frame. The warrants attached to NCDs are issued subject to full payment of the NCDs' value. The option can be exercised after the specific lock-in period. The company is at liberty to dispose off the unapplied portion of shares if the option to apply for equities is not exercised.

8. **Zero interest FCDs:** These are Zero interest Fully Convertible Debentures on which no interest will be paid by the issuer during the lock-in period. However, there is a notified period after which fully paid FCDs will be automatically and compulsorily converted into shares. In the event of a company going in for rights issue prior to the allotment of equity (resulting from the conversion of equity shares into FCDs), it shall do so only after the FCD holders are offered securities.

9. **Secured zero interest PCDs with detachable and separately tradable warrants**: These are Secured Zero Interest Partly Convertible Debentures with detachable and separately tradable warrants. They are issued in two parts. Part A is a convertible portion that allows equity shares to be redeemed at par at the end of a specific period from the date of allotment. Part B is a nonconvertible portion to be redeemed at par at the end of a specific period from the date of allotment. Part B which carries a detachable and separately tradable warrant provides the warrant holder an option to receive equity shares for every warrant held, at a price worked out by the company.

10. **Fully Convertible Debentures (FCDs) with interest (Optional)**: These are the debentures that will not yield any interest for an initial short period after which the holder is given an option to apply for equities at a premium. No additional amount needs to be paid for this. The option has to be indicated in the application form itself. Interest on FCDs is payable at a determined rate from the date of first conversion to the data of second/final conversion and in lieu of it, equity shares will be issued.

11. **Floating Rate Bonds (FRBs):** These are the bonds where the yield is linked to a benchmark interest rate like the prime rate in USA or LIBOR in the Euro currency market. For instance, the State Bank of India's floating rate bond, issue was linked to the maximum interest on term deposits that was 10 percent at that time. The floating rate is quoted in terms of a margin above or below the benchmark rate. Interest rates linked to the benchmark ensure that neither the borrower nor the lender suffer from the changes in interest rates. Where interest rates are fixed, they are likely to be inequitable to the borrower when interest rates fall and inequitable to the lender when interest rates rise subsequently.

Shares vs. Debentures

Shares are different from debentures in the following manner:

1. Shareholder has a proprietary interest in the company, and debenture holder is only a creditor of the company
2. Debenture holder is entitled to fixed interest whereas the shareholder is entitled to dividends depending on and varying with profits
3. Shareholders have voting rights whereas debenture holders do not have voting rights
4. Debentures may be redeemable whereas shares except preference shares are not redeemable
5. Debenture holders get priority over shareholders when assets are distributed upon winding up

Global Debt Instruments

Following are some of the debt instruments that are popular in the international financial markets:

Income Bonds

Interest income on such bonds is paid only where the corporate commands adequate cash flows. They resemble cumulative preference shares in respect of which fixed dividend is paid only if there is profit earned in a year, but carried forward and paid in the following year. There is no default on income bonds if interest is not paid. Unlike the dividend on cumulative preference shares, the interest on income bond is tax deductible. These bonds are issued by corporates that undergo financial restructuring.

Asset Backed Securities

These are a category of marketable securities that are collateralized by financial assets such as installment loan contracts. Asset backed financing involves a disintermediating process called securitization, whereby credit from financial intermediaries in the form of debentures are sold to third parties to finance the pool. Respos are the oldest asset backed security in our country. In USA, securitization has been undertaken for the following:

1. Insured mortgages
2. Mortgage backed bonds
3. Student loans
4. Trade credit receivable backed bonds
5. Equipments leasing backed bonds
6. Certificates of automobile receivable securities
7. Small business administration loans
8. Credit and receivable securities

Junk Bonds

Junk bond is a high risk, high yield bond which finances either a Leveraged Buyout (LBO) or a merger of a company in financial distress. Junk bonds are popular in the USA and are used primarily for financing takeovers. The coupon rates range from 16 to 25 percent. Attractive deals were put together establishing their feasibility in terms of adequacy of cash flows to meet interest payments. Michael Milken (the junk bond king) of Drexel Burnham Lambert was the real developer of the market.

Indexed Bonds

These are the bonds whose interest payment and redemption value are indexed with movements in prices. Indexed bonds protect the investor from the eroding purchasing power of money because of inflation. For instance, an inflation-indexed bond implies that the payment of the coupon and/or the redemption value increases or decreases according to movements in prices. The bonds are likely to hedge the principal amount against inflation. Such bonds are designed to provide investors an effective edge against inflation so as to enhance the credibility of the anti-inflationary policies of the Government. The yields of an inflation-indexed bond provide vital information on the expected rate of inflation.

United Kingdom, Australia, and Canada have introduced index linked government securities as a segmented internal debt management operation with a view to increase the range of assets available in the system, provide an inflation hedge to investors, reduce interest costs and pick up direct signals, and the expected inflation and real rate of interest from the market.

Zero Coupon Bonds (ZCBs)/Zero Coupon Convertible Debentures

Zero Coupon Bonds first came to be introduced in the U.S. securities market. Initially, such bonds were issued for high denominations. These bonds were purchased by large security brokers in large chunks, who resold them to individual investors, at a slightly higher price in affordable lots. Such bonds were called 'Treasury Investment Growth Receipts' (TIGRs) or 'Certificate of Accruals on Treasury Securities' (CATSs) or ZEROs as their coupon rate is Zero. Moreover, these certificates were sold to investors at a hefty discount and the difference between the face value of the certificate and the acquisition cost was the gain. The holders are not entitled for any interest except the principal sum of maturity.

Advantages Zero Coupon Bonds offer a number of advantages as shown below:

a. No botheration of periodical interest payment for the issuers
b. The attraction of conversion of bonds into equity shares at a premium or at par, the investors usually being rewarded by way of a low premium on conversion
c. There is only capital gains tax on the price differential and there is no tax on accrued income
d. Possibility of efficient servicing of equity as there is no obligation to pay interest till maturity and its eventual conversion

Mahindra & Mahindra came out with the scheme of Zero Coupon Bonds for the first time in India along with 12.5 percent convertible bonds for part financing of its modernization and diversification scheme. Similarly, Deep Discount Bonds were issued by IDBI at ₹ 2,000 for a maturity of ₹ 1 lakh after 25 years.

These are negotiable instruments transferable by endorsement and delivery by the transferor. IDBI also offered Option Bonds which may be either cumulative or noncumulative bonds where interest is payable either on maturity or periodically. Redemption is also offered to attract investors.

Floating Rate Bonds (FRBs)

Bonds that carry the provision for payment of interest at different rates for different time periods are known as 'Floating Rate Bonds'. The first floating rate bond was issued by the SBI in the Indian capital market. The SBI, while issuing such bonds, adopted a reference rate of highest rate of interest on fixed deposit of the Bank, provided a minimum floor rate payable at 12 percent p.a. and attached a call option to the Bank after 5 years to redeem the bonds earlier than the maturity period of 10 years at a certain premium. A major highlight of the bonds was the provision to reduce interest risk and assurance of minimum interest on the investment provided by the Bank.

Secured Premium Notes (SPNs)

Secured debentures that are redeemable at a premium over the issue price or face value are called secured premium notes. Such bonds have a lock-in period during which period no interest will be paid. It entitles the holder to sell back the bonds to the issuing company at par after the lock-in period.

A case in point was the issue made by the TISCO in the year 1992, where the company wanted to raise money for its modernization program without expanding its equity excessively in the next few years. The company made the issue to the existing shareholders on a rights basis along with rights issue. The salient features of the TISCO issue were as follows:

1. Face value of each SPN was ₹ 300
2. No interest was payable during the first three years after allotment
3. The redemption started at the end of the fourth year of issue
4. Each of the SPN of ₹ 300 was repaid in four equal annual instalments of ₹ 75, which comprised of the principal, the interest and the relevant premium. (Low interest and high premium or high interest and low premium, at the option to be exercised by the SPN holder at the end of the third year)
5. Warrant attached to each SPN entitled the holder the right to apply for or seek allotment of one equity share for cash payment of ₹ 80 per share. Such a right was exercisable between first year and one-and-a-half year after allotment by which time the SPN would be full paid up

This instrument tremendously benefited TISCO, as there was no interest outgo. This helped TISCO to meet the difficulties associated with the cash generation. In addition, the company was able to borrow at a cheap rate of 13.65 percent as against 17 to 18 percent offered by most companies. This enabled the company to start redemption earlier through the generation of cast flow by the company's projects. The investors had the flexibility of tax planning while investing in SPNs. The company was also equally benefited as it gave more flexibility.

Euro-Convertible Bonds

Bonds that give the holders of euro bonds to have the instruments converted into a wide variety of options such as the call option for the issuer and the put option for the investor, which makes redemption easy are called 'Euro-convertible bonds'. A euro-convertible bond essentially resembles the Indian convertible debenture but comes with numerous options attached. Similarly, a euro-convertible bond is an easier instrument to market than equity. This is because it gives the investor an option to retain his investment as a pure debt instrument in the event of the price of the equity share falling below the conversion price or where the investor is not too sure about the prospects of the company.

Popularity of convertible euro bonds A convertible bond issue allows an Indian company far greater flexibility to tap the Euro market and ensures that the issue has a better market reception than would be possible for a direct equity issue. Moreover, newly industrialized countries such as Korea have chosen the convertible bond market as a stepping-stone to familiarity and acceptance of their industrial companies in the international market.

The convertible bonds offer the following advantages:

a. **Protection:** Euro convertible bonds are favored by international investors as it offers them the advantage of protection of their wealth from erosion. This is possible because the conversion is only an option, which the investors may choose to exercise only if it works to their benefit. This facility is not available for equity issues

b. **Liquidity**: Convertible bond market offers the benefit of the most liquid secondary market for new issues. Fixed income funds as well as equity investment managers purchase convertible bonds

c. **Flexibility:** The feature of flexibility in structuring convertible bonds allows the company to include some of the best possible clauses of investors' protection by incorporating the unusual features of equity investments. A case in point is the issues made by the Korean corporate sector, which contained a provision in the issue of convertible euro bonds. The provision entitled the holders to ensure the due compliance of the liberalization measures that had already been announced within a specified period of time. Such a provision enabled the investor to opt for a ‘put’ option

d. **Attractive investment**: The issue of convertible debentures facilitates removal of many of the unattractive features of equity investment. For investors, convertible bond market makers are the principal sources of liquidity in their securities

Bonds Issue–Indian Experience

In recent times, all-India financial institutions have come to design and introduce special and innovative bond instruments exclusively structured on the investors’ preferences and funds requirement of the issuers.

The emphasis from the issuer’s viewpoint is the resource mobilization and not risk exposure. Several financial institutions such as the IDBI, the ICICI, etc are engaged in the sale of such bonds. A brief description of some these bonds are presented below:

1. **IDBI’s zero coupon bonds, 1996**: These bond are sold at a discount and are paid no interest. It is of great advantage to issuers as it is not required for them to make periodic interest payment.

2. **IDBI’s regular income bonds, 1996**: These were the bonds issued by the IDBI as 10-year bonds carrying a coupon of 16 percent, payable half-yearly. The bonds provided an annualized yield equivalent to 16.64 percent. The bonds, which were priced at ₹ 5,000 can be redeemed at the end of every year, after the third year allotment. There was also a call option that entitled the IDBI to redeem the bonds five years from the date of allotment.

3. **Retirement bonds, 1996**: The IDBI Retirements Bonds were issued at a discount. The issue targeted investors who are planning for retirement. Under the scheme, investors get a monthly income for 10 years after the expiry of a wait period, the wait period being chosen by the investor. Thereafter, the investors also get a lump sum amount, which is the maturity value of the bond.

4. **IFCI’S bonds, 1996 These bonds include**:

    a. Deep Discount Bonds Issued for a face value of ₹ 1 lakh each

    b. **Regular Income and Retirement Bonds:** They had five-year tenure, a semi-annual yield of 16 percent and a front-end discount of 4 percent. The bonds had three-year put option and an early bird incentive of 0.75 percent

c. **Step-up Liquid Bonds**: The five-year bonds with a put option every year with a return of 16 percent, 16.25 percent, 16.5 percent, 16.75 percent, and 17 percent at the end of every year

d. **Growth Bonds**: An investment of ₹ 20,000 per bond under this scheme entitles investors to a ₹ 1 lakh face-value bond maturing after 10 years. Put options can be exercised at the end of 5 and 7 years respectively. If exercised, the investor gets ₹ 43, 500 after 5 years and ₹ 60,000 after a 7 year period

e. **Lakhpati:** Bonds The maturity period of these bonds varied from 5 to 10 years, after which the investor gets ₹ 1 lakh. The initial investment required was ₹ 20,000 for 10 years maturity, ₹ 23,700 for 9 years, ₹ 28,000 for 8 years, ₹ 33,000 for 7 years, ₹ 39,000 for 6 years and ₹ 46,000 for 5 year period

5. ICICI's bonds, 1997 ICICI came out with as many as five bonds in March 1997. These are encash bonds, index bonds, regular income bonds, deep discount bonds, and capital gain bonds. The bonds were aimed at meeting the diverse needs of all categories of investors, besides contributing to the widening of the bond market so as to bring the benefits of these securities to even the smallest investors.

a. **Capital gains bond**: Also called infrastructure bonds incorporated the capital gains tax relaxations under Section 54EA of the Income Tax Act announced in the Union Budget for 1997-98. They are issued for 3 and 7 years maturity. 20 percent rebate was available under Section 88 of the I.T. Act for investors on the amount invested in the capital gains bonds upto a maximum of ₹ 70,000. They can avail benefit under Section 88. the annual interest rate worked out to 13.4 percent while the annual yield came to 20.7 percent. However, investment through stock-invest will not qualify for the rebate.

b. **Encash bond:** The five-year encash bonds were issued at a face value of ₹ 2,000 and can be redeemed at par across the country in 200 cities during 8 months in a year after 12 months. The bond had a step up interest every year from 12 to 18.5 percent and the annualized yield at maturity for the bond works out to 15.8 percent. The encashing facility, however, is available only to the original bondholders. The bonds not only offer higher return but also help widen the banking facilities to investors. The secondary market price of the bonds is likely to be favorably influenced by the step up interest that results in an improved YTM every year.

c. **Index bond**: Which gives the investor both the security of the debt instrument and the potential of the appreciation in the return on the stock market. Priced at ₹ 6,000 the index bond has two parts: Part A is a deep discount bond of the face value of ₹ 22,000 issued for a 12 year period. Its calculated yield was 15.26 percent. It also has a call and a put option attached to it assuring the investor a return or ₹ 9,300 after 6 years option is exercised. Part B is a detachable index warrant issued for 12 years and priced at ₹ 2,000. The yield was linked to the BSE SENSEX. The face value of the bond will appreciate the number of times the SENSEX has appreciated. The investors' returns will be treated as capital gains.

6. **Tax Free Bonds**: *The salient features of the tax-free government of India bonds to be issued from October 1, 2002 are as follows*:

   a. **Interest rate**: The bonds will carry an interest rate of 7 percent

   b. **Tax exemption**: The bonds will be exempt from Income-tax and Wealth-tax

   c. **Maturity**: The bonds will have a maturity will have no ceiling

   d. **Ceiling**: The bonds investment will have no ceiling

   e. **Tradability:** The bonds will not be traded in the secondary market

   f. **Investors:** The eligible investors include individuals and Hindu Undivided families (HUFs). NRIs are not eligible for investing in these bonds

   g. **Issue price**: Bonds will be issued for a minimum amount of ₹ 1,000 and its multiples

   h. **Maturity value:** The cumulative maturity value of the bond will be ₹ 1,511 at the end of six years

   i. **Form of issue**: The bonds will be both in demat form as well as in the traditional form of stock certificates. Option once chosen cannot be changed

   j. **Transferability:** Bonds will not be transferable except by way of gift to relatives as defined in the Companies Act

   k. **Collaterals:** The bonds cannot be used as collaterals for obtaining loans from banks, financial institutions and non-banking financial companies

   l. **Nomination**: A sole holder or a sole surviving holder of the bond being an individual can make a nomination

New Issues Market (NIM)–Conceptual Framework

NIM also known as 'primary market' is a market, which is characterized by the presence of a set of all institutions, structures, people, procedures, services, and practices involved in raising of fresh capital funds by both new and existing companies.

NIM and Secondary Markets–An Interface

Both the primary and secondary markets are closely interrelated. This is clear from the following:

Trading

For the purpose of securities to be traded in the secondary market, it is important that they are first issued in the primary market.

Listing

In order that a corporate entity makes a successful issue of security in the primary market, it is incumbent that the terms of such an issue carry a stipulation that the issues are to be listed in a recognized stock exchange and that an application for this purpose has been made already to the stock exchange concerned.

Regulation

The activities in the primary market such as the new issues, etc are greatly influenced by the regulatory norms prescribed by the SEBI and stock exchanges. The object is to bring about orderliness in the new issues market.

Marketability

The advantage of marketability provided by the secondary market greatly helps the subscribers in the primary market. For instance, the positive trends prevailing in the secondary market immensely help the investors to off-load their existing holdings so as to subscribe for fresh issues in the NIM. This liquidity advantage helps in expansion of the NIM.

Prevailing Conditions

The conditions prevailing in the secondary market affect to a very great extent the successfulness or other wise of the issue being made in the NIM. Accordingly, where the conditions are so favorable in the secondary market that high market prices prevail, the issues made in the primary market will turn out to be encouraging and successful. Issues would fetch good premiums.

Survival

The existence and the survival of the secondary market are dependent upon the efficacy of the NIM as an avenue for fund raising. There could be no stock exchanges if there is no NIM, in the same manner that there will be no NIM in the absence of an efficiently functioning stock exchange. An efficient secondary market is therefore, a Sine-qua-non for a growing primary market.

Services of NIM

A brief description of the various services rendered by the new issues market is made below:

The Transfer

An important function rendered by NIM is to allow the transfer of resources from savers to entrepreneurs who establish new companies. It is also called the function of 'origination'. The transfer function is facilitated by specialist agencies that are engaged in the provision of investigative and advisory services as specified below:

Investigative services The merchant bankers and other agencies provide the investigative services. These include technical analysis, economic analysis financial analysis and analysis of legal and environmental aspects of the proposed business. Merchant bankers provide the above information to investors so as to enable the investors in making a choice as to the type, quality and quantity of the issue.

Advisory services Various advisory services are made available with a view to improving the quality of capital issues. The relevant services include determining the type, the mix, the price, the timing, the size, the selling strategies, the methods of floatation, and the terms and conditions of issue of securities.

The Guarantee

It is the function of 'underwriting'. Underwriting aims at guaranteeing the subscription of public issue. Underwriters ensure successful subscription of the issue by undertaking to take up the securities in the event of the public failing to subscribe the same. It benefits the issuing company, the investing public and capital market in general. The function of underwriting is undertaken for a fee.

The Distribution

The function that facilitates the sale of securities to ultimate investors is called 'distribution'. The function of distribution is rendered by the specialized agencies like brokers and dealers in securities. They maintain a constant and a close link with the issuers and the ultimate investors on the one hand, and issuers and other agencies of capital market on the other.

NIM Vs. Secondary Market

NIM is different from the secondary market in the following respects:

Sl. No.	Feature	NIM	Secondary Market
1.	Issues of securities	NIM deals only with new or fresh issue of securities. Issues are considered fresh or new provided such issues are made for the first time either by the existing company or by the new company	Deals in existing securities
2.	Location	No fixed geographical location need	Needs a fixed place to house the secondary market activities, viz. trading
3.	Transfer of securities	Securities are created and transferred from corporates to investors for the first time	Securities are transferred from one investor to another through the stock exchange mechanism
4.	Entry	All companies can enter NIM and make fresh issue of securities	For the securities to enter the portals of stock exchanges for the purpose of trading, listing is mandatory
5.	Administration	Has no tangible form of administrative set-up	Has a definite administrative set-up that facilitates trading in securities
6.	Regulation	Subject to regulations mostly from outside the company– SEBI, stock Exchanges, Companies Act, etc	Subject to regulation both from within and outside the stock exchange framework
7.	Aim	Creating long-term instruments for borrowings	Providing liquidity through marketability of those instruments.
8.	Price Movement	Stock price movement in secondary market influences pricing of new issues	Both macro and micro factors influence the stock price movement

9.	Depth	Depends on number and the volume of issue	Depth depends upon the activities of the primary market at it brings into the fore more corporate entities and more instruments to raise funds

Stock Option Norms for Software Companies

The relevant guidelines issued by the SEBI as regards 'employee's stock option' for software companies are as follows:

1. **Minimum issue**: A minimum issue of 10 percent of its paid-up capital can be made by a software company which has already floated American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) or a company which is proposing to float these is entitled to issue ADR/GDR-linked stock options to its employees. For this purpose, prior permission from the Department of Economic Affairs is to be obtained.
2. **Mode of issue**: Listed stock options can be issued in foreign currency convertible bonds and ordinary shares (through depository receipt mechanism) to the employees of subsidiaries of InfoTech companies.
3. **Permanent employees**: Indian IT companies can issue ADR/GDR linked stock options to permanent employees, including Indian and overseas directors, of their subsidiary companies incorporated in India or outside.
4. **Pricing:** The pricing provisions of SEBI's preferential allotment guidelines would not cover the scheme. The purpose is to enable the companies to issue stock options to its employees at a discount to the market price which serves as another form of compensation.
5. **Approval**: Shareholders' approval through a special resolution is necessary for issuing the ESOPs. A minimum period of one year between grant of option and its vesting has been prescribed. After one year, the company would determine the period in which option can bee exercised.

Bought-Out Deals

Meaning

A method of marketing of securities of a body corporate whereby the promoters of an unlisted company make an outright sale of a chunk of equity shares to a single sponsor or the lead sponsor is known as 'bought-out deals.

Features

1. **Parties:** There are three parties involved in the bought-out deals. They are promoters of the company, sponsors and co-sponsors who are generally merchant bankers and investors.

2. **Outright sale**: Under this arrangement, there is an outright sale of a chunk of equity shares to a single sponsor or the lead sponsor.

3. **Syndicate:** Sponsor forms a syndicate with other merchant bankers for meeting the resource requirements and for distributing the risk.

4. **Sale price**: The sale price is finalized through negotiations between the issuing company and the purchaser, the sale being influenced by such factors as project evaluation, promoter's image and reputation, current market sentiments, prospects of off-loading these shares at a future date, etc.

5. **Fund-based**: Bought-out deals are in the nature of und-based activity where the funds of the merchant bankers get locked in for at least the prescribed minimum period.

6. **Listing**: The investor-sponsors make a profit, when at a future date, the shares get listed and higher prices prevail. Listing generally takes place at a time when the company is performing well in terms of higher profits and larger cash generations from projects.

7. **OTCEI:** Sale of these shares at over-the Counter Exchange of India (OTCEI) or at a recognized stock exchanges, the time of listing these securities and off-loading them simultaneously are being generally decided in advance.

Bought-Out Deals Vs. Private Placements

Following are the differences between bought-out deals and private placements:

Sl. No.	Feature	Private Placement	Bought-out Deal
1.	Trading Scrips	Listed securities	Unlisted securities
2.	Creating Securities	Results in the creation of additional securities for the buying institutions	Securities are simply transferred from promoters to sponsors who in turn off-load them to the public
3.	Lock-in Period	Five Years	18 months

Benefits

Bought-out deals provide the following benefits:

- Speedy sale Bought-out deals offer a mechanism for a speedier sale of securities at lower costs relating to the issue.
- Freedom Bought-out deals offer freedom for promoters to set a realistic price and convince the sponsor about the same.
- Investor protection Bought-out deals facilitate better investor protection as sponsors are rigorously evaluated and appraised by the promoters before off-loading the issue.
- Quality offer Bought-out deals helps enhance the quality of capital floatation and primary market offerings.

Limitations

Bought-out deals pose the following difficulties for the promoters, sponsors and investors:

1. Loss of control The apprehensions in the minds of promoters, particularly of the private or the closely held companies that the sponsors may usurp control of the company as they own large chunk of the shares of the company.
2. Loss of sales Bought-out deals pose considerable difficulties in off-loading the shares in times of unfavorable market conditions. This results in locking up of investments and entailing losses to sponsors.
3. Wrong appraisal Bought-out deals cause loss to sponsors on account of wrong appraisal of the project and overestimation of the potential price of the share.
4. Manipulation Bought-out deals five great scopes for manipulation at the hands of the sponsor through insider trading and rigging.
5. No accountability Bought-out deals pose difficult of penalizing the sponsor as there are no SEBI guidelines to regulate offerings by sponsors.
6. Windfall profits Bought-out deals offer the advantage of windfall profits by sponsors at the cost of small investors.
7. Loss to investors Where the shares taken up by issue brokers and a coterie of select clients are being bought back by the promoters at a pre-fixed higher price after allotment causing loss to investors of the company.

Intermediaries in Primary Market (NIM)

Several intermediaries carry out activities of different nature in the new issue market.

The intermediaries include:

- Merchant bankers/Lead managers
- Underwriters
- Bankers to the issue
- Brokers to the issue
- Registrars
- Share transfer agent and
- Debenture trustees

The legal frame work of operations of these intermediaries as prescribed by the SEBI, is presented below

Merchant Bankers/Lead Managers

Meaning

The intermediaries in the stock market who are responsible for public issues management are known as 'merchant bankers' or lead managers.

Category

Merchant bankers are categorized as follows:

Category I: These are the merchant bankers who carry out such functions as relating to new issues as determination of security-mix to be issued, drafting of prospectus, application forms, allotment letters and a host of other documents, appointment of registrars for handling share applicants and transfers, making arrangements for underwriting, placement of shares, selection and appointment of brokers and bankers to the issue, publicity of the issue, etc. Only these merchant bankers are permitted to act as 'Lead Managers' to an issue.

Category II: These merchant bankers act as consultants, advisers, portfolio managers and co-managers.

Category III: These merchant bankers act as underwriters, advisers and consultants.

Category IV: These merchant bankers act only as advisers or consultants to an issue.

As per the SEBI guidelines introduced on September 5, 1997, all categories of merchant bankers below category I would stand abolished. The guidelines required those merchant bankers who are functioning below the category I to upgrade themselves to category I. Merchant bankers currently carrying out underwriting and portfolio management, besides issue management, would be required to get separate registrations as portfolio managers, while underwriting could be done without any additional registration. Further, only body corporates with a net worth of ₹5 crores would be allowed as category I merchant bankers.

Registration – Conditions

Merchant bankers shall compulsorily register with the SEBI in the interest of investors. Following are the conditions to be satisfied by them before registration is done by the SEBI:

Capital Adequacy

Merchant bankers have to fulfill the prescribed minimum capital adequacy norm in terms of its net worth, i.e. Paid-up capital and free reserves.

Infrastructure

Merchant bankers should have adequate and necessary infrastructure, such as adequate office space, equipment and manpower for effective discharge of their duties and responsibilities.

Expertise

Merchant bankers should employ experts having professional qualifications in finance, law or business management competent to handle merchant banking business and who are not involved in any litigation connected with securities market.

Fees

Merchant bankers should make a payment of fee as prescribed by the SEBI.

Undertaking

Merchant bankers shall undertake to fulfill their obligations and responsibilities as may be prescribed by the SEBI from time to time. Further, they should also undertake to adhere to the prescribed code of conduct.

Role and Responsibilities

SEBI has laid down the following responsibilities for a merchant banker:

Contract

A merchant banker shall enter into a contract with the issuing company. The contract invariably specifies their mutual rights, obligations and liabilities relating to the issue, particularly relating to disclosures, allotment and refund. A copy of the above contract is to be submitted to the SEBI at least one month before the opening of the issue for subscription. The merchant banker has the right not to accept the appointment as lead manager, if the issuing company is its associate.

Registration

A registration certificate has to be obtained by the merchant banker from the SEBI

Minimum Underwriting

The merchant banker is duty-bound to accept on his own or through its associate, a minimum underwriting obligation of 5 percent of total underwriting commitment or ₹ 25 lakhs, whichever is less.

Due Diligence Certificate

The merchant banker has to submit 'Due Diligence Certificate' to SEBI at least two weeks before the opening of the issue for subscription. The certificate has to be given on the basis of the verification of the contents of the prospectus/letter of offer regarding the issue and reasonableness of the views expressed therein. For this purpose, the merchant banker should reasonably be satisfied.

That the document contains all details relevant to the issue;

That all legal requirements relating to the issue have been fully complied with; and that all disclosures are true, fair and adequate to enable the investing public to make a well-informed decision regarding investment in the proposed issue.

Documents Submission

The merchant banker shall submit to SEBI various documents containing details such as issue, draft prospectus/letter of offer and other literature to be circulated to the investors/ shareholders, etc at least two weeks before the data of filling them with the Registrar of Companies and regional stock exchanges. It has to ensure that all the modifications and suggestions made by SEBI regarding the above documents have been duly incorporated.

Disclosure to SEBI

The merchant bankers shall make a disclosure of the following to the SEBI:

- * Its responsibilities regarding the management of the issue
- * Any change in the information/particulars previously furnished with SEBI having a bearing on certificate of registration granted to it.
- * Details relating to the breach of capital adequacy norms
- * Names and addresses of the companies whose issues it has managed or has been associated with and
- * Information regarding its activities as manager, underwriter, consultant or adviser to the issue.
- Other duties In addition to the above, the merchant banker has to fulfill the following obligations too:
- * Continuing to remain fully associated with the issue till the subscribers have received share/debenture certificates or the refund of excess application money.
- * not to acquire securities of any company on the basis of unpublished price sensitive information obtained in the course of discharge of his professional assignment.

Underwriter

A set all institution and agencies that provide a commitment to take up issue of securities in the event of a failure of the issue to get full subscription from the public, are known as ‘underwriters’.

They are compensated for their services by a payment of commission as agreed upon between the issuing company and the underwriters and subject to the ceiling under the companies act. Brokers, Investment companies, Commercial Banks and term lending institution provide underwriting services.

Although underwriting of issues in not obligatory, underwriters play a significant role in the development of the primary market. The issuing company in consultation with the merchant bankers/lead managers appoints underwriters. A statement to this effect is also to be incorporated in the prospectus.

Role and Responsibilities

Under the SEBI guidelines, underwriters have the following duties and responsibilities as regards the public issue:

Registration

A certificate of registration has to be obtained by the agencies that wish to carry out underwriting activities from the SEBI. SEBI grants the certificate of registration on the fulfillment of the following conditions:

- Availability of adequate and necessary infrastructure like sufficient office space, equipment and manpower to effectively function and discharge his duties.
- Previous experience in underwriting or having a minimum of two persons with experience in underwriting
- Meeting capital adequacy requirement of a minimum net worth of ₹ 20 lakhs.
- That the applicant (director, principal, officer or partner) has not been convicted of any offence involving moral turpitude or found guilty of any economic offence.
- Undertaking to fulfill obligations under the SEBI Act, rules and regulations
- Undertaking to abide by the prescribed code of conduct and Payment of the prescribed fee for grant of registration certificate and for its renewal, which is ₹ 2 lakhs for the first and the second years from the initial grant of certificate and ₹ 20,000 per annum subsequently for keeping the certificate in force or for its renewal. The Certificate of Registration can be suspended by SEBI in case of failure to pay the fee. Thereupon, the underwriter ceases to act as underwriter.

Agreement

In order that the issues are taken up by the underwriters, an agreement has to be entered into between the underwriter and the issuing company. The agreement should, among others, contain such details as the period during which the agreement will remain in force, the amount of underwriting obligation, the maximum period within which the underwriter will have to subscribe to the offer, after being intimated by or on behalf of the issuing company, the rate and amount of commission/brokerage chargeable by the underwriter, within the limits imposed by the Companies Act, and any other details regarding the arrangements made by the underwriter for fulfilling the underwriting obligations.

Code of Conduct

An underwriting agency shall follow the necessary codes of conduct as framed by the SEBI. These include duty not to derive any other direct or indirect benefit from underwriting the issue except receiving the underwriting commission at the agreed rate, the ceiling for which is 5 percent in case of underwriting of shares and 2.5 percent in case of debentures, duty not to take up total underwriting obligation, at any point of time under all underwriting agreements, exceeding 20 times his net worth and duty to subscribe for securities under the agreement within 45 days of the receipt of information from the issuing company.

Compliance

Underwriters are required to comply with all the formalities regarding registration with SEBI, agreement with the Client Company and general responsibilities. These include ensuring that all terms and conditions regarding disclosure in the prospectus and its filing with ROC have been complied with before signing the underwriting agreement with the issuing company, ensuring that the prospectus is delivered to ROC within 30 days of the underwriting agreement or within such an extended time as approved by the underwriter in writing, subject to the limits within the law, complying with any additional disclosures that may be made in the interest of investors as stipulated by SEBI/lead managers, and such disclosure requirements shall not give any right to the underwriter to avoid or reduce his obligations, unless certified by SEBI as material in nature and essential for underwriting agreement, arranging for sub-underwriting but continues to be responsible for any failure or default on the part of such sub-underwriters, etc.

Termination of agreement An underwriter is entitled to terminate an underwriting agreement at any time before the opening of the issue as notified in the prospectus under such circumstances as where the issuing company has made any incorrect representation or statement to the underwriter, in the application form, in negotiations and correspondences and in the prospectus, where a complete breakdown or dislocation of business has occurred in major financial markets in Mumbai, Calcutta, New Delhi and Chennai and where any other major disturbance such as declaration of war, open and wide insurgency, civic upheaval has taken place which has adversely affected the major financial markets.

Bankers to an Issue

Meaning

Bankers who are engaged in the function of acceptance of applications for shares and debentures along with application money from investors in respect of issue of securities and also refund of application money to the applicants to whom securities could not be allotted, are called 'bankers to an issue'. They play an important role in the working of the primary market.

Roles and Responsibilities

The intermediary to act as a banker has the following responsibilities as ordained by the SEBI:

- Registration Bankers who are desirous of acting as bankers to an issue are required to obtain the necessary certificate of registration from the SEBI. For this purpose, the conditions to be fulfilled include adequacy of the necessary infrastructure such as office space, equipment, communication facilities, data processing facilities and manpower to effectively perform activities relating to the issue, and a stipulation that the banker or any of its directors is not involved in any litigation connected with securities market nor they are convicted for any economic offence. If the applicant is a scheduled bank, the grant of certificate of registration would serve the interest of investors and the applicant pays the registration fee.

- **Fees to SEBI**: Annual registration fee of ₹ 2.5 lakhs for the first two years is payable to the SEBI by the intending banker and ₹ 1 lakh is to be paid for the third year. An application for the renewal of the registration can be made three months before the expiry of registration certificate. The renewal fees are ₹ 1 lakh annually for the first two years and ₹ 20,000 for the third year.

- **Contract**: The issuer company has to enter into a contract with the banker to an issue. The contract shall include detailed information about the number and address of collection centres at which applications and application money are to be received, the fee for the services and other terms and conditions of the appointment.

- **Daily statement**: A daily statement giving the details regarding the number of applications and amount of money received from the investors shall be submitted by the banker to the issuing company/registrar to an issue.

- Information to SEBI Information pertaining to such details as to the profile of the issue, the number of applications and the details of application money received the date-wise details of application money collected and refunds, if any, to the SEBI. Similarly information about any disciplinary action initiated by the RBI entailing the suspension or cancellation of the banker is also to be sent to the SEBI.

- Books and records Books of accounts, records and documents pertaining to all matters regarding which the banker may be required to submit details to SEBI shall be maintained by the banker. This is to be done for a minimum period of three years from the completion of the issue.

Code of Conduct

In addition to the code of conduct prescribed for the merchant bankers and underwriters, a banker to an issue has to adhere to the following code of conduct:

- Not to keep blank application forms bearing broker's stamp at the bank premises or at the entrance of the bank
- Not to accept applications after office hours, or on bank holidays, or after the date of the closure of the issue.
- Not to act at any time in collusion with other agents in a manner detrimental to the interest of small investors and
- Abide by all acts, rules, regulations, notifications, directions, circulars, instructions and guidelines issued by the Government, RBI, Indian Banks Association and SEBI that are relevant to his operations as banker to an issue.

RBI's Role

RBI is empowered to carry out the inspection of the bankers to the issue with a view to protecting the investors instrument and also promoting compliance with SEBI Act, rules and regulations. SEBI may order the suspension of the registration of the banker in such circumstances as the violation of the provisions of SEBI Act, rules and regulations, failure to submit the required information, submission of wrong of false information, failure to resolve investors complaints or give satisfactory reply to SEBI, guilty of misconduct or unprofessional conduct, etc.

Brokers to an Issue

Intermediaries that are responsible for procuring the subscription to the issue from the prospective investors are called 'brokers to the issue'. They provide a vital connecting link between the prospective investors and the issuer. They assist in the speedy subscription of issue by the public. Appointment of brokers is however not compulsory.

Unless permitted by the stock exchange, the issuing company abides by the prescribed listing requirements and also undertakes to get its securities listed on a recognized stock exchange. Moreover, its members can neither act as managers or brokers to an issue, nor can they make any preliminary arrangement for floatation of an issue.

The brokers to the issue must have an expert knowledge, professional competence and integrity in order to be able to carry out the various functions of an issue. They help the investors make a right choice of the company for making investments. Consent must be obtained from the stock exchange broker to act as the brokers to the issuer company. For this purpose, the approval of stock exchanges is required. Copies of consent letters of brokers are to be filed with ROC along with the copy of prospectus. The names and addresses of the brokers to the issue are to be disclosed in the prospectus.

Brokerage has to be paid by the issuer company according to the provisions in the Companies Act and rules and regulations, the agreement between the broker and the company, and guidelines prescribed by SEBI. Maximum brokerage rate, applicable to all types of industrial securities, whether underwritten or not, is 1.5 percent. The brokers have to meet all mailing costs, canvassing expenses and all other out-of-pocket expenses relating to the subscription of the issue out of their brokerage. The maximum rate of brokerage payable by listed companies on private placement of capital is 0.5 percent.

Registrars to an Issue and Share Transfer Agents

Registrars and transfer agents are of two categories such as category I which carry on activities of both registrars to an issue and also of share transfer agents and category II which carry on activities either of a registrar to an issue or as a share transfer agent.

Functions

Registrars to an issue carry out such functions as keeping a proper record of applications and moneys received from investors, assisting issuing companies in determining the basis of allotment of securities as per stock exchange guidelines and in consultation with stock exchanges, assisting in the finalization of allotment of securities, and processing and dispatching of allotment letters, assisting in processing and dispatching refund orders, share and debenture certificates and other documents related to the capital issue, functioning as Depository Participants (DPs) etc.

Share Transfer Agents perform such functions as maintaining records of holders of securities of the company for and on behalf of the company, handling all matters related to transfer and redemption of securities of the company and functioning as Depository Participants (DPs).

Role and Responsibilities

The role and responsibilities of registrars and share transfer agents are as follows:

Registration

A certificate of registration is to be obtained from the SEBI. For this purpose, the SEBI considers such factors as their ability to discharge their duties with efficiency and integrity, the adequacy of infrastructure and past experience in this line of activity and capital adequacy. Capital adequacy requirement is net worth of ₹ 6 lakhs for category I and ₹ 3 lakhs for category II registrars and share transfer agents. They have to pay an annual fee of ₹ 15,000 and ₹ 10,000 respectively for initial registration and annual renewal.

Maintenance of Records

Registrars and share transfer agents shall show such details as applications received from investors relating to the issue, rejected applications together with the reasons for rejection, basis of allotment of securities in consultation with the stock exchanges, terms and conditions of purchase of securities, allotment of securities, list of allottees and non-allottees, refund orders, etc and names of transferors and transferees, and the dates of transfer of securities. Such records and books are to be preserved for three years from the date of issue. SEBI can also ask them to file these books and records with it whenever required.

Absorbing code of conduct Registrars and share transfer agents should adopt those codes of conduct prescribed for merchant bankers and underwriters.

Besides, they should ensure that enquiries from investors are adequately dealt with and adequate steps are taken for proper allotment of securities and refund of excess application money as per law and without delay.

SEBI's Role

SEBI is empowered to undertake inspection of books of accounts, records and documents of registrars and share transfer agents.

The certificate of registration issued to registrars and share transfer agents will be suspended of their registration by the SEBI under such circumstances as violation of SEBI Act, rules and regulations, violations of SCRA rules and regulations, and stock exchange bye-laws, rules and regulations, failure to furnish information to SEBI, furnishing wrong and false information, non-cooperation in an inspection, investigation or an enquiry, failure to resolve investor complaints, failure to give satisfactory reply to SEBI regarding investor complaints, involvement in manipulation, price rigging and cornering activities, guilty of misconduct, failure to maintain capital adequacy requirement, etc.

The registration of the registrars and transfer agents will be cancelled by the SEBI under such circumstances as repeated defaults leading to suspension of registration certificate, deliberate manipulation, price rigging and cornering activities adversely affecting the securities market and the investor interest, violating provisions relating to insider trading and take over regulations, guilty of fraud, conviction for a criminal offence and violating SEBI Act, rules and regulations.

Debenture Trustees

Meaning

Trustees who are appointed to safeguard the interests of debenture holders are called 'debenture trustees'. They are to be appointed before issue of debentures by a company. No person can act as debenture trustee unless a certificate of registration has been obtained from SEBI for the purpose.

Eligibility

To be appointed as a debenture trustee, the following are eligible:

1. A scheduled bank carrying on commercial activity; or
2. A public financial institution within the meaning of Section 4-A of the Companies Act, 1956; or
3. An insurance company; or
4. A body corporate

Role and Responsibilities

1. **Registration:** An institution shall be registered with the SEBI to be in a position to function as a debenture trustee. For this purpose, the institution concerned shall have an adequate and necessary infrastructure like adequate office space, equipments and manpower to effectively discharge his activities, relevant experience of a debenture trustee, professional qualification for a debenture trustee from an institution recognized by the government in finance, accountancy, law or business management and the applicant or any of its director or principal officers has not at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence.
2. **Consent:** Consent in writing must be given to the body corporate to act as debenture trustee before the debenture issue.
3. **Inspection:** Debenture trustee shall carry out the inspection of books of accounts, records, registers of the body corporate and the trust property to the extent necessary for discharging his obligations.
4. **Possession**: A debenture trustee shall carry out any act as would be necessary for the protection of the interest of and the resolution of grievances of the debenture holders.
5. **Protection of interest**: A debenture trustee shall carry out any act as would be necessary for the protection of the interest of and the resolution of grievances of the debenture holders. He must also ensure that debenture certificates have been dispatched to the debenture holders in accordance with the provisions of the Companies Act. Besides, he must also ensure that interest warrants for interest due on the debentures have been dispatched to the debenture holders on or before the due dates.

6. **Due diligence**: A debenture trustee should exercise due diligence to ascertain whether or not the assets of the body corporate which are available by way of security or otherwise are sufficient or are likely to be or become sufficient to discharge the claims of debenture holders as and when they become due. It must also inform the Board immediately of any breach of trust deed or provision of any law.

7. **Meeting:** A debenture trustee shall call, or cause to be called by the body corporate, a meeting of the entire debenture holders where a requisition for the meeting has been made at least one-tenth of the debenture holders or the happening of any event, which constitutes a default or which in the opinion of the debenture trustees affects the interest of the debenture holders.

8. **Code of conduct**: Every debenture trustee shall abide by the prescribed code of conduct.

9. Maintenance of books of accounts, etc, Subject to the provisions of any law, every debenture trustee has to keep and maintain proper books of accounts, records and documents relating to the trusteeship functions for a period of not less than 5 financial years preceding the current financial year. Every debenture trustee has to intimate to SEBI, the place where the books of accounts, records and documents are maintained.

10. Information to SEBI Every debenture trustee shall furnish information relating to the following to the SEBI:

    a. Number and nature of the grievances of debenture holders received and resolved

    b. Copies of the trust deed

    c. Non-payment or delayed payment of interest to debenture holders, if any, in respect of each issue of debentures of a body corporate.

    d. Details of dispatch and transfer of debenture certificates giving therein the dates, mode, etc

    e. Inspection and Disciplinary Proceedings and

    f. Any other particulars or documents that are relevant to debenture trustee.

SEBI's Role

SEBI is empowered to carry out the inspection of the books of accounts, other records and documents of the debenture trustee for the purpose of ensuring that the records and documents which are relevant to debenture trustees are being maintained in the manner required by the Board, that the provisions of the Companies Act, 1956, rules and regulations are being complied with, that there exists any circumstances, which would render the debenture trustee ineligible for grant of registration or continuance thereof, that the complaints received from investors, other debenture trustees are investigated into, and that the interest of the investors is protected.

SEBI can suspend the certificate of registration granted to a debenture trustee under the following circumstances:

1. Violation of the provisions of the SEBI Act, rules and regulations
2. Not following the prescribed code of conduct
3. Failure to furnish information relating to his business as debenture trustee as required by the Board
4. Furnishing wrong or false information
5. Not submitting reports as required by SEBI
6. Non-cooperation in any enquiry conducted by SEBI
7. Indulging in manipulating or price rigging or cornering activities.
8. Guilty of misconduct or improper or unbusinesslike or unprofessional conduct
9. Failure to pay the fees.
10. Violation of the conditions subject to which the certificate has been granted and
11. Failure to fulfill the obligations under the trust deed

Under the following circumstances, SEBI can cancel the certificate of registration granted to debenture trustees:

- Repeated defaults of the type leading to suspension of certificate
- Indulging in deliberate manipulation or price rigging or cornering activities affecting the securities market and the investors interests.
- Guilty of fraud, or is convicted of a criminal offence
- Violation of any provision of insider trading regulations.
- Trustee being removed by the debenture holders by a resolution passed by not less than 75 percent of the debenture holders.

Unless permitted by the stock exchange, the issuing company abides by the prescribed listing requirements and also undertakes to get its securities listed on a recognized stock exchange. Moreover, its members can neither act as managers or brokers to an issue, nor can they make any preliminary arrangement for floatation of an issue.

The brokers to the issue must have an expert knowledge, professional competence and integrity in order to be able to carry out the various functions of an issue. They help the investors make a right choice of the company for making investments. Consent must be obtained from the stock exchange broker to act as the brokers to the issuer company. For this purpose, the approval of stock exchanges is required. Copies of consent letters of brokers are to be filed with ROC along with the copy of prospectus. The names and addresses of the brokers to the issue are to be disclosed in the prospectus.

Brokerage has to be paid by the issuer company according to the provisions in the Companies Act and rules and regulations, the agreement between the broker and the company, and guidelines prescribed by SEBI. Maximum brokerage rate, applicable to all types of industrial securities, whether underwritten or not, is 1.5 percent. The brokers have to meet all mailing costs, canvassing expenses and all other out-of-pocket expenses relating to the subscription of the issue out of their brokerage. The maximum rate of brokerage payable by listed companies on private placement of capital is 0.5 percent.

Registrars to an Issue and Share Transfer Agents

Registrars and transfer agents are of two categories such as category I which carry on activities of both registrars to an issue and also of share transfer agents and category II which carry on activities either of a registrar to an issue or as a share transfer agent.

Functions

Registrars to an issue carry out such functions as keeping a proper record of applications and moneys received from investors, assisting issuing companies in determining the basis of allotment of securities as per stock exchange guidelines and in consultation with stock exchanges, assisting in the finalization of allotment of securities, and processing and dispatching of allotment letters, assisting in processing and dispatching refund orders, share and debenture certificates and other documents related to the capital issue, functioning as Depository Participants (DPs) etc.

Share Transfer Agents perform such functions as maintaining records of holders of securities of the company for and on behalf of the company, handling all matters related to transfer and redemption of securities of the company and functioning as Depository Participants (DPs).

Role and Responsibilities

The role and responsibilities of registrars and share transfer agents are as follows:

Registration

A certificate of registration is to be obtained from the SEBI. For this purpose, the SEBI considers such factors as their ability to discharge their duties with efficiency and integrity, the adequacy of infrastructure and past experience in this line of activity and capital adequacy. Capital adequacy requirement is net worth of ₹ 6 lakhs for category I and ₹ 3 lakhs for category II registrars and share transfer agents. They have to pay an annual fee of ₹ 15,000 and ₹ 10,000 respectively for initial registration and annual renewal.

Maintenance of Records

Registrars and share transfer agents shall show such details as applications received from investors relating to the issue, rejected applications together with the reasons for rejection, basis of allotment of securities in consultation with the stock exchanges, terms and conditions of purchase of securities, allotment of securities, list of allottees and non-allottees, refund orders, etc and names of transferors and transferees, and the dates of transfer of securities. Such records and books are to be preserved for three years from the date of issue. SEBI can also ask them to file these books and records with it whenever required.

Absorbing code of conduct Registrars and share transfer agents should adopt those codes of conduct prescribed for merchant bankers and underwriters. Besides, they should ensure that enquiries from investors are adequately dealt with and adequate steps are taken for proper allotment of securities and refund of excess application money as per law and without delay.

SEBI's Role

SEBI is empowered to undertake inspection of books of accounts, records and documents of registrars and share transfer agents. The certificate of registration issued to registrars and share transfer agents will be suspended of their registration by the SEBI under such circumstances as violation of SEBI Act, rules and regulations, violations of SCRA rules and regulations, and stock exchange bye-laws, rules and regulations, failure to furnish information to SEBI, furnishing wrong and false information, non-cooperation in an inspection, investigation or an enquiry, failure to resolve investor complaints, failure to give satisfactory reply to SEBI regarding investor complaints, involvement in manipulation, price rigging and cornering activities, guilty of misconduct, failure to maintain capital adequacy requirement, etc.

The registration of the registrars and transfer agents will be cancelled by the SEBI under such circumstances as repeated defaults leading to suspension of registration certificate, deliberate manipulation, price rigging and cornering activities adversely affecting the securities market and the investor interest, violating provisions relating to insider trading and take over regulations, guilty of fraud, conviction for a criminal offence and violating SEBI Act, rules and regulations.

Debenture Trustees

Meaning

Trustees who are appointed to safeguard the interests of debenture holders are called 'debenture trustees'. They are to be appointed before issue of debentures by a company. No person can act as debenture trustee unless a certificate of registration has been obtained from SEBI for the purpose.

Eligibility

To be appointed as a debenture trustee, the following are eligible:

5. A scheduled bank carrying on commercial activity; or
6. A public financial institution within the meaning of Section 4-A of the Companies Act, 1956; or
7. An insurance company; or
8. A body corporate

Role and Responsibilities

11. **Registration**: An institution shall be registered with the SEBI to be in a position to function as a debenture trustee. For this purpose, the institution concerned shall have an adequate and necessary infrastructure like adequate office space, equipments and manpower to effectively discharge his activities, relevant experience of a debenture trustee, professional qualification for a debenture trustee from an institution recognized by the government in finance, accountancy, law or business management and the applicant or any of its director or principal officers has not

at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence.

12. **Consent**: Consent in writing must be given to the body corporate to act as debenture trustee before the debenture issue.

13. **Inspection:** Debenture trustee shall carry out the inspection of books of accounts, records, registers of the body corporate and the trust property to the extent necessary for discharging his obligations.

14. **Possession**: A debenture trustee shall carry out any act as would be necessary for the protection of the interest of and the resolution of grievances of the debenture holders.

15. **Protection of interest**: A debenture trustee shall carry out any act as would be necessary for the protection of the interest of and the resolution of grievances of the debenture holders. He must also ensure that debenture certificates have been dispatched to the debenture holders in accordance with the provisions of the Companies Act. Besides, he must also ensure that interest warrants for interest due on the debentures have been dispatched to the debenture holders on or before the due dates.

16. **Due diligence**: A debenture trustee should exercise due diligence to ascertain whether or not the assets of the body corporate which are available by way of security or otherwise are sufficient or are likely to be or become sufficient to discharge the claims of debenture holders as and when they become due. It must also inform the Board immediately of any breach of trust deed or provision of any law.

17. **Meeting**: A debenture trustee shall call, or cause to be called by the body corporate, a meeting of the entire debenture holders where a requisition for the meeting has been made at least one-tenth of the debenture holders or the happening of any event, which constitutes a default or which in the opinion of the debenture trustees affects the interest of the debenture holders.

18. **Code of conduct**: Every debenture trustee shall abide by the prescribed code of conduct.

19. **Maintenance of books of accounts, etc**, Subject to the provisions of any law, every debenture trustee has to keep and maintain proper books of accounts, records and documents relating to the trusteeship functions for a period of not less than 5 financial years preceding the current financial year. Every debenture trustee has to intimate to SEBI, the place where the books of accounts, records and documents are maintained.

20. **Information to SEBI**: Every debenture trustee shall furnish information relating to the following to the SEBI:

    a. Number and nature of the grievances of debenture holders received and resolved

    b. Copies of the trust deed

    c. Non-payment or delayed payment of interest to debenture holders, if any, in respect of each issue of debentures of a body corporate.

    d. Details of dispatch and transfer of debenture certificates giving therein the dates, mode, etc

    e. Inspection and Disciplinary Proceedings and

    f. Any other particulars or documents that are relevant to debenture trustee.

SEBI's Role

SEBI is empowered to carry out the inspection of the books of accounts, other records and documents of the debenture trustee for the purpose of ensuring that the records and documents which are relevant to debenture trustees are being maintained in the manner required by the Board, that the provisions of the Companies Act, 1956, rules and regulations are being complied with, that there exists any circumstances, which would render the debenture trustee ineligible for grant of registration or continuance thereof, that the complaints received from investors, other debenture trustees are investigated into, and that the interest of the investors is protected.

SEBI can suspend the certificate of registration granted to a debenture trustee under the following circumstances:

1. Violation of the provisions of the SEBI Act, rules and regulations
2. Not following the prescribed code of conduct
3. Failure to furnish information relating to his business as debenture trustee as required by the Board
4. Furnishing wrong or false information
5. Not submitting reports as required by SEBI
6. Non-cooperation in any enquiry conducted by SEBI
7. Indulging in manipulating or price rigging or cornering activities.
8. Guilty of misconduct or improper or unbusinesslike or unprofessional conduct
9. Failure to pay the fees.

10. Violation of the conditions subject to which the certificate has been granted and
11. Failure to fulfill the obligations under the trust deed

Under the following circumstances, SEBI can cancel the certificate of registration granted to debenture trustees:

- Repeated defaults of the type leading to suspension of certificate
- Indulging in deliberate manipulation or price rigging or cornering activities affecting the securities market and the investors interests.
- Guilty of fraud, or is convicted of a criminal offence
- Violation of any provision of insider trading regulations.
- Trustee being removed by the debenture holders by a resolution passed by not less than 75 percent of the debenture holders.

E-Trading

The structure of stock market in India has undergone a vast change due to the liberalization process initiated by the Government. A number of new structures have come to be added to the existing structure of the Indian stock exchange. A brief description of these structures in the Indian stock market system is presented below:

Over-the-Counter Market System

Basically this market is meant for small size companies. The primary objective of this market was to enable the small start-up companies or companies in green field ventures to obtain their capital requirements at the minimum cost. On the basis of the recommendations of the High Powered Committee on Stock Exchange Reforms (G.S. Patel) and Committee (Abid Hussain) on Capital Market Reforms, the Over-The-Counter Exchange of India (OTCEI) was incorporated in October 1990 under the Companies Act, 1956. Granted recognition under section 4 of the Securities Contract (Regulation) Act 1956, the OTCEI was promoted by various public financial institutions like Unit Trust of India (UTI), Industrial Development Bank of India (IDBI), Industrial Credit and Investment Corporation of India (ICICI), Industrial Finance Corporation of India (IFCI), Life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC), SBI Capital Market, CanBank Financial Services, etc. Commencing its operations on September 29, 1992 at Bombay, the OTCEI introduced screen-based automatic singular trading system. Although companies enjoy the same status as listed on the other stock exchanges, it is not possible that a company listed at OTCEI can be listed on other stock exchanges.

National Stock Market System (NSMS)

National stock market system was advocated by the "High Powered Group on the Establishment of New Stock Exchanges" headed by Shri. M.J.Pherwani (popularly known as Pherwani Committee). The committee recommended in June 1991, the following three tier-stock market structure:

Principal Stock exchanges comprising 5 major stock exchanges at Bombay, Calcutta, Madras, Delhi and Ahmedabad

Regional stock exchanges like those in major state capitals

Additional Trading Floors (ATFs) sponsored or managed by Principal or Regional stock exchanges

At present the National Stock Market in India comprises the following:

1. National Stock Exchange of India Limited (NSE)
2. Stock Holding Corporation of India Limited (SHCIL)
3. National Clearing and Depository System (NCDS)
4. Securities Trading Corporation of India (STCI)

National Stock Exchange (NSE)

The National Stock Exchange (NSE) was set up for the purpose of providing a nation wide stock trading facility to investors so as to bring the Indian financial market in line with international financial market. It started its operations by the end of 1993. The NSE used the electronic trading system and computerized settlement system aimed at extending the facility of electronic trading to every corner of the country.

The exchange has two separate segments, viz. capital market segment and money market segment. While the capital market segment is concerned with trading in equity shares, convertible debentures and debt instruments as nonconvertible debentures, the money market segment facilitates high value trading in debts, public sector bonds, mutual fund units, treasury bills, government securities, call money instruments, etc. The main participants, in this market are usually banks, financial institutions, and other financial agencies.

Stock Holding Corporation of India Limited (SHIL)

This Corporation was set up in October 1987, under the Companies Act, by 7 All India financial institutions viz. IDBI, IFCI, ICICI, LIC, GIC, UTI and RBI. The range of services that are made available by this institution includes quick transfer of shares among its member institutions, clearing services, depository services, support services, management information services, and development services. This is a board-managed company and has a whole time Managing Director in charge of the day-to-day management of the corporation. It has set up regional centers at New Delhi, Calcutta and Madras. It is providing facilities in the major market centers in India.

National Clearance and Depository System (NCDS)

This system was created chiefly to help overcome the problem of settlement and clearance of transactions consequent to enormous workload on the clearing agencies and share transfer agencies. The problems mainly arose out of systematic risk like counter party risk, credit risk, bad deliveries, long delayed delivery, counterfeit scrips, and forged scrips.

Securities Trading Corporation of India (STCI)

The Reserve Bank of India set up Securities Trading Corporation of India Limited (STCI) in May 1994, under the provisions of the Indian Companies Act, 1956, jointly with public sector banks and All-India financial institutions. The main objective of establishing the Corporation was to foster the development of an active secondary market for Government securities and bonds issued by public sector undertakings. It had an authorized and paid-up capital of ₹ 500 crores of which, RBI contributed 50.18 percent. The RBI in December 1997 divested part of its equity in STCI in favor of the Bank of India, an existing shareholder of the Company.

Corporitization and Demutualization

Of late, efforts are on by the SEBI to corporatize and demutulize the Indian stock exchanges. For this purpose a Study Group under the Chairmanship of Justice M.H. Kania has been constituted. The object is to put in place a common structural model for the Indian stock market system. Accordingly, stock exchange will have to undergo changes in organizational structure.

Corporitization and Demutualization refer to the process of conversion of a stock exchange from a not-for-profit entity to a for-profit company. The process of transition from ‘mutually-owned’ association to a company ‘owned by shareholders’ is called ‘demutualization’. Demutualization involves the segregation of members’ right into distinct segments, viz. ownership rights and trading rights. It changes the relationship between members and the stock exchange. Members, while retaining their trading rights, acquire ownership rights in the stock exchange, which have a market value, and they also acquire the benefits of limited liability.

Interconnected Stock Exchange of India (ISE)

Genesis

Interconnected Stock Exchange of India Limited (ISE) has been promoted by 15 Regional Stock Exchanges to provide cost-effective trade linkage/connectivity to all the members of the Participating Exchanges, with the objective of widening the market for the securities listed on these exchanges. ISE is a national-level stock exchange which provides trading, clearing, settlement, risk management and surveillance support to its traders and dealers.
ISE aims to address the needs of small companies and retail investors, with the guiding principle of optimizing the existing infrastructure and harnessing the potential of regional markets, so as to transform them into a liquid and vibrant market, through the use of state-of-the-art technology and networking.

The participating Exchanges of ISE. In order to leverage its infrastructure and to expand its nation wide reach, ISE has also appointed around 450 ‘dealers’ across 70 cities other than the Participating Exchange centers. These dealers are administratively supported by the regional offices of ISE at Delhi (north), Kolkata (east), Coimbatore (south) and Nagpur (central), besides Mumbai (west).

ISE has also floated a wholly–owned subsidiary, ISE Securities and Services Limited (ISS), which has taken up corporate membership of the National Stock Exchange of India Ltd. (NSE) in the Capital Market Futures and Options segments and the Stock Exchange, Mumbai, in the Equities segment, so that the traders and dealers of ISE can access other markets, in addition to the ISE market and their local markets. ISE thus provides the investors in smaller cities, a one-stop solution for cost-effective and efficient trading, and settlement in securities.

With the objective of broadbasing the range of its services, ISE has started offering the full suite of DP facilities to its traders, dealers and their clients.

ISE endeavors to consolidate the small, fragmented and less liquid markets into a national-level, liquid market by using state-of-the-art infrastructure and support systems.

Objectives/Features

The Interconnected Stock Exchange of India Limited was constituted to realize the following objectives:

1. Create a single integrated national-level solution with access to multiple markets for providing high cost-effective service to millions of investors across the country
2. Create a liquid and vibrant national-level market for all listed companies in general and small capital companies in particular
3. Optimally utilize the existing infrastructure and other resources of participating stock exchanges, which are under-utilized now
4. Provide a level playing field to small traders and dealers, by offering an opportunity to participate in a national-market having investment-oriented business
5. Reduce transaction cost
6. Provide clearing and settlement facilities to the traders and dealers across the country at their doorstep in a decentralized mode
7. Spread demat trading across the Country

Achievements

Following are the achievements of ISE:

1. **Network of intermediaries**: A broad base of members form the bedrock for any exchange. In this respect, ISE has a large pool of registered intermediaries who can be tapped for any new line of business. As at the beginning of the financial year 2003-04, 548 intermediaries (207 traders and 341 dealers) are registered on ISE.

2. **Robust operational systems**: The trading, settlement and funds transfer operations of ISE and ISS are completely automated and state-of-the-art systems have been deployed. The communication network of ISE, which has connectivity with over 400 trading software and settlement software, along with the electronic funds transfer arrangement established with HDFC Bank and ICICI Bank, give ISE and ISS, the required operational efficiency and flexibility, to not only handle the secondary market functions effectively, but also by leveraging them for new ventures.

3. Skilled and experienced manpower ISE and ISS have experienced and professional staff, which has wide experience in Stock Exchanges/Capital Market institutions. The staff has the skill-set required to perform a wide range of functions, depending upon the requirements from time to time.

4. **Aggressive pricing policy:** The philosophy of ISE is to have an aggressive pricing policy for the various products and services offered by it. The aim is to penetrate the retail market and strengthen the position, so that a wide variety of products and services having appeal for the retail market can be offered, using a common distribution channel. The aggressive pricing policy also ensures that the intermediaries have sufficient financial incentive for offering these products and services to the end-clients.

5. **Trading, risk management and settlement software systems**: The ORBIT (Online Regional Bourses Inter-connected Trading) and AZIS [Automated Exchange Integrated Settlement] software developed on the Microsoft NT platform, with consultancy assistance from Microsoft, are the most contemporary of the trading and settlement software, introduced in the country. The applications have been built on a technology platform, which offers low cost of ownership, facilitates simple maintenance, and supports easy up gradation and enhancement. The software is so designed, that the transaction processing capacity depends on the hardware used; capacity can be enhanced by just adding inexpensive hardware, without any additional software work.

6. Vibrant subsidiary operations ISS, the wholly owned subsidiary of the biggest exchange subsidiaries in the country, on an average more than 250 registered intermediaries of ISS trade from 46 cities across the length and breadth of the country.

7. **Fine liquidity**: ISE is addressing the problem of illiquidity in small capital companies at various exchanges by providing the securities of all such companies, an exposure to a larger investor base across the country. Currently, the ISE participating exchanges, directly account for about 5 percent of the total turnover and this is expected to increase with this integration, as indirectly, the ISE exchanges have been routing large volumes to BSE and NSE. NSE and BSE, both receive 50 percent of their business from outside Mumbai, from the Regional Exchange centers. This indicates the true potential of the ISE Exchanges and it would further increase after Internet trading and on-line IPO distribution systems that are being implemented by ISE.

8. **One-stop solution**: ISE provides national reach instantaneously. Listing of shares on ISE helps improve visibility of securities amongst the retail investors across the country. Further, all traders and dealers also have access to NSE, through the ISE

Securities and Services Ltd. (ISS), a wholly owned subsidiary of ISE, which is a member of NSE All the traders and dealers who have registered with this subsidiary also act as sub-brokers. Thus, ISE and ISS provide a one-stop multiple market solution to the investors and the listing of securities on ISE would attract instant attention of all its investors.

It would further have the advantage of giving the company a positive image of being an outward looking technology savvy and investor friendly company. This concept of consolidation is now being implemented in U.S. and Europe, because of the advantages of the one-stop solution and cost benefits, which improves the competitiveness of the exchange.

Listing Advantages

Location advantage of ISE, focuses on retail investors, concentration of technology companies within its jurisdiction, and convenience of compliance through decentralized support. It is expected that the ISE would provide the best mix of all features required by a company, to list on any exchange.

ISE offers the advantage of a Regional Exchange, for 'convenient and cost effective compliance'. This is expected to promote decentralized regional development and internalize the regulatory support as far as possible within that area of jurisdiction. This would make the regions self sufficient, for all regulatory compliance in tune with the decentralization policy of the Government.

ISE, being the most recent exchange, is also the most technology-savvy exchange which is indicated not only from the complexity of the technology it uses, but also from the fact that the exchange is located in an International Technology Park at Vashi, Navi, Mumbai. The exchange is located strategically in this technology park, which has two other technology parks within its vicinity, and this entire corridor between the Vashi, MIDC and Belapur is being treated as 'technology corridor' to attract Foreign Direct Investment in technology companies within the State of Maharashtra. Thus, all the companies located in this area are expected to have ISE as the regional exchange.

In addition to the large number of companies that are expected to develop in this area, many other companies spread across the country would also choose to list with ISE as an additional exchange, because of the large reach of ISE amongst the retail investors across the country. ISE has positioned itself as an exchange for the retail investors and it has evinced great interest in attracting listing from the companies during the short period when it started listing securities.

The advantages of a company listing on ISE is unique due to the following reasons:

1. **Moderate fees**: ISE is the only national-level recognized Stock Exchange, having moderate listing fees and grants listing and trading permission to the small and medium sized companies having a post public issue paid-up capital, of ₹ 3 to 5 crores, (subject to the appointment of market-markers) apart from companies above ₹ 5 crores.

2. **Easy compliance**: It would be possible for the companies to do listing compliance from the four metros and Nagpur. This will improve the compliance of listing requirements by the companies, merely due to the convenience and cost of a single compliance.

3. **Improved visibility**: Listing on ISE improves visibility of a company across 15 exchanges with convenience and cost of a single compliance.

4. **Infrastructure:** ISE infrastructure and the network of large number of traders and dealers are treated as a large distribution channel available for marketing of all financial products. These could be shares, mutual fund units, bonds, etc. All traders and dealers of ISE also have access to NSE, though ISE Securities and Services Ltd. (ISS), a wholly owned subsidiary of ISE, which has taken NSE membership, which ensures continuous attention of investors. Since investors get used to obtaining all services from one intermediary, the success of any company listed with ISE is large, as the intermediaries can sell these issues better and that too directly, to the target audience which improves the success rate of an issue marketed through this system, using our large sales force.

5. **IPO Distribution system**: The introduction of the 'IPO Distribution System'. For offering primary market issue by the ISE, would reduce the time and cost of marketing a new issue. This would be possible once the new system is finally notified by SEBI.

6. **Additional facility**: Although the jurisdiction of ISE for listing of companies as Regional Stock Exchange is Navi Mumbai, Maharashtra, securities of companies, which are located elsewhere are also listed.

7. **Investor protection:** ISE has set up an 'Investors Grievance and Service Cell' which looks after all types of complaints of investors located across the country and provides decentralized support.

8. **Website:** The facility of website where the publicly disclosed information on all companies would be placed for easy access by the investors would be a great advantage. In effect, all companies listed on this exchange would be able to update their site independently for greater investor information.

Trading Methodology

Transactions for the ISE segment are routed from the trader's workstation to the central trading computers, (i.e. Tandem system) installed at ISE's office in Vashi, through the regional Gate Way Server (GWS) system, installed at the participating Stck Exchanges using a VAST communication network.

As far as the NSE segment is concerned, all orders are forwarded to NSE through the central trading and settlement software that is installed at Mumbai on a high-end Compaq computer. This Compaq computer is connected to the NES trading system through a 2 mbps leased line, as the primary link between ISS and NSE and it also has a VSAT link as a backup. In the case of traders, the existing VAST links connecting the Participating Stock Exchanges with ISE will be used for accessing the NSE segment too. Within the Participating Stock Exchange premises, the trader workstations (TWSs) required for NSE, access would be connected on a separate LAN segment to the VSAT infrastructure already established.

Settlement System

The total delivery-in/delivery-out of traders is computed on a netting basis. After netting of the traders and dealers, the net position of the center is computed. If there is pay-in position of that center, then funds or securities are moved out from one center to another center, having a corresponding pay-out position of funds or securities. The movement is based on a transportation model to ensure minimum distance and delivery time.

Clearing System

ISE has appointed ABN-AMRRO-Vysya Bank consortium and HDFC Bank to provide learning bank services. Act the operational level, pay-in of funds is done by way of direct debit of the pay-in/settlement accounts maintained by the traders and dealers with Vysys Bank or HDFC Bank. Similarly, in case of margins, debits are carried out on T+1, by electronically debiting the pay-in accounts of traders and dealers. The traders/dealers have to keep funds available in their accounts, as required for the purposes of pay-in and margins, in accordance with the statements downloaded to their TWSs, at the end of the settlement.

Indian Public Offering Distribution system

A system whereby market issue of securities in the primary market is made through the stock exchange mechanism, utilizing the network of the stock exchange, the ISE is known as 'Indian Public Offering Distribution System.' This would serve as an additional issue system against the present non-computerized public offering system. The aim is to reduce the time taken for allotment of securities to the investors, as well as bring down discrepancies/errors inherent in any manual system

The proposed system would reduce the time taken for allotment of securities from the date of closing of the issue. Under this system, the investor would part with his funds, only when he has been provisionally allocated the securities. There will be no question of refund of the application money.

Mechanism

1. **Appointment of agents**: The issuer company appoints members of the stock exchange as agents or collection centers for accepting applications from investors. The agents would place orders on behalf of the client-investor, besides underwriting the issue. Members act as agents when the issue is open to the public for subscription.
2. **Order placement**: Interested investors approach their members and place suitable orders for subscribing to the issue. The order placement is done through the Stock Exchange trading network.
3. **Allotment information:** Registrars to the issue send information on allotment, to the stock exchange after finalizing the allotment. Members are then informed accordingly. The members in turn inform clients. Details of allotment are also made available on the ISE's website, which can be accessed by the investors directly.
4. **Application**: The applications for shares are filled in by successful applicants, electronically, where the facility of internet is available or in the usual fashion, where the internet facility is unavailable.
5. **Payment**: When the application is made through internet, payment for shares allotted, is made through the 'payment Gateway System' and through the normal physical instruments in case of other modes.
6. **Actual allotment**: The registrar to the issue makes a formal allotment of shares, after receiving the entire data and money in full. Allotment is made both in physical as well as in demats form, depending on the request.

Indonext

Indonext is the proposed common trading platform for regional stock exchanges. It is planned to obey introduced, by the SEBI on the basis of recommendations by the, 'Justice

Kania Committee on Corporatization and Demutalization of Stock Exchanges. Indonext is to be set up as the third National Stock Exchange, on the lines of 'Euronext'. Indonext is to be established by merging regional stock exchanges with, the Over-The-Counter Stock Exchange (OTCEI). The scheme aims at giving a new lease of life for the regional stock exchanges in India.

Need

The need for setting up Indonext rose, owing to the rapid expansion of the national and Bombay stock exchanges, into small centers and cities, and the struggle of regional exchanges to survive of all the national exchanges, seven of them do not conduct any business at all. Further, the capital market regulator, SEBI, has permitted companies to cut down their multiple listings and to eventually delist from the regional bourses. Good quality stocks started vanishing from the bourses and new stocks are not being listed, due to lack of initial public offerings. The idea behind Indonext is, to have a single trading segment.

Features

Indonext seeks to be different from the ISE in the following respects:

1. Exclusive trading Indonext aims at offering exclusive trading in the case of companies with paid-up capital of ₹ 20 lakhs, very small and medium capital companies.
2. Liquidy Indonext proposes to generate liquidity in the thinly traded stocks so as to ensure survival of small stock exchanges.
3. Wide trading Trading on Indonext will be open to all members including NSE, BSE, ISEI, OTCEI and regional exchanges.
4. Trading model Trading segment of all regional exchanges and OTCEI will be modeled along lines of Euronext, Paris of Amesterdam.
5. Eliminating conflict of interest Indonext seeks to eliminate a conflict of interest among regional stockbrokers by disallowing participating exchanges to retain a separate trading platform. Members will be permitted to trade only on the Indonext platform.

'S Group' Companies

The Federation of Indian Stock Exchanges (FISE) representing the regional stock exchanges gave the idea of 'S Group' Companies. Corporates such as Alfa Laval, Tata Coffee, Tata Honeywell, Tata Infomedia, Texmaco, Jindal Strips, Crisil, Godfrey Phillips and Forbs

Gokak are among the 2,260 scrips that BSE has agreed to be traded on the Indonext. For this purpose, agreement is to be worked out between FISE and BSE, to create a single order book for companies with a paid-up capital of upto ₹ 20 crores. These companies with small capital single order book for companies with a paid-up capital of Upto ₹ 20 crores. These companies with small capital bases will be called 'S Group' companies. Scrips that are traded on BSE 'A Group,' would not be included even if they have a small capital base. Similarly, all 'Z Group' scrips at BSE that have not paid listing fee at the regional stock exchanges would be excluded from this group. Once a company is admitted, it cannot come out of the 'S Group,' even if its paid-up capital increases beyond ₹ 20 crores.

Benefits

Indonext offers the advantage of sharing common trading platform, whereby all the shares listed exclusively in the regional stock exchanges are placed on a common order book. This would facilitate trading of shares in all participating exchanges. This would in turn, entail increase of shares traded and also increase the number of players in this segment.

Members of NSE and BSE would be permitted to trade in Indonext through limited trading rights, which could be formed at a low entry price. This would activate the segment with the increase in the number of players, too. Some of the regional stock exchanges that are set to form a common trading platform are the stock exchanges of Madras, Bangalore, Cochin, Coimbatore, Mangalore and Hyderabad.

Self Assessment Questions

1. What is the role and functions of Primary market?
2. What are various methods of issuing securities in primary markets?
3. Give guidelines of SEBI for public issues of the following:_
   a) Pricing of issue
   b) Promoters' contribution,
   c) Appointment and role of merchant bankers
   d) Underwriters, Brokers, Registrars and Managers, bankers etc.,
   e) Underwriting of issues
   f) Allotment of shares
   g) Procedures for new issues and e-trading.

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UNIT - III

Secondary Market

Learning Objectives

After reading this lesson you can be able to understand:-

- Role and importance of stock exchange
- Listing of securities in stock exchanges
- Trading Mechanism and Insider Trading
- Takeovers and Internet based trading.

Role and Importance

Stock exchanges are intricately inter-woven in the fabric of nation's economic life. Without a stock exchange, the saving of the community - sinews of economic progress and productive efficiency - would remain underutilized. The task of mobilisation and allocation of savings could be attempted in the old days by a much less specialised institution than the stock exchange. But as business and industry expanded and the economy assumed more complex nature, the need for "permanent finance" arose. Entrepreneurs needed money for long term whereas investors demanded liquidity - the facility to convert their investments into cash at a given time. The answer was a ready market for investments and this was how the stock exchange came into being. Stock exchange means anybody of individuals whether incorporated or not, constituted for the purpose of regulating or controlling the business of buying, selling or dealing in securities.

These securities include:

(i) Shares, scrips, stocks, bonds, debentures stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ii) Government securities; and

(iii) Rights or interest in securities.

Nature and Function of Stock Exchange

There is an extraordinary amount of ignorance and of prejudice born out of ignorance with regard to the nature and functions of stock exchange. As economic development proceeds, the scope for acquisition and ownership of capital by private individuals also grows. Alongwith it, the opportunity for stock exchange to render the service of stimulating private savings and channelling such savings into productive investment exists on a vastly great scales. These are services which the stock exchange alone can render efficiently. It is no exaggeration to say that hi a modern industrialist society, which recognises the rights of private ownership of capital, stock exchanges are not simply a convenience, they are essential. In fact, they are the markets which exist to facilitate purchase and sale of securities of companies and the securities or bonds issued b the government in the course of its borrowing operation. As our country moves towards liberalisation, this tendency is certain to be strengthened. The task facing the stock exchanges is to devise the means to reach down to the masses, to draw the savings of the man in the street into productive investment, to create conditions in which many millions of little investors in cities, towns and villages will find it possible to make use of the facilities, which have so far been limited to the privileged few. This calls for far-reaching changes, institutional as well as operational.

The stock exchanges in India, thus, have an important i-ole to play in the building of a real shareholders democracy. Aim of the stock exchange authorities is to make it as nearly perfect in the social and ethical sense as it is in the economic. To protect the interests of the investing public, the authorities of the stock exchanges have been increasingly subjecting not only its members to a high degree of discipline, but also those who use its facilities—joint stock companies and other bodies in whose stocks and shares it deals. There are stringent regulations to ensure that directors of joint stock companies keep their shareholders fully informed of the affairs of the company. In fact, some of the conditions that the stock exchange imposes upon companies before their shares are listed are more rigorous and wholesome than the statutory provision such as those contained in the Companies Act.

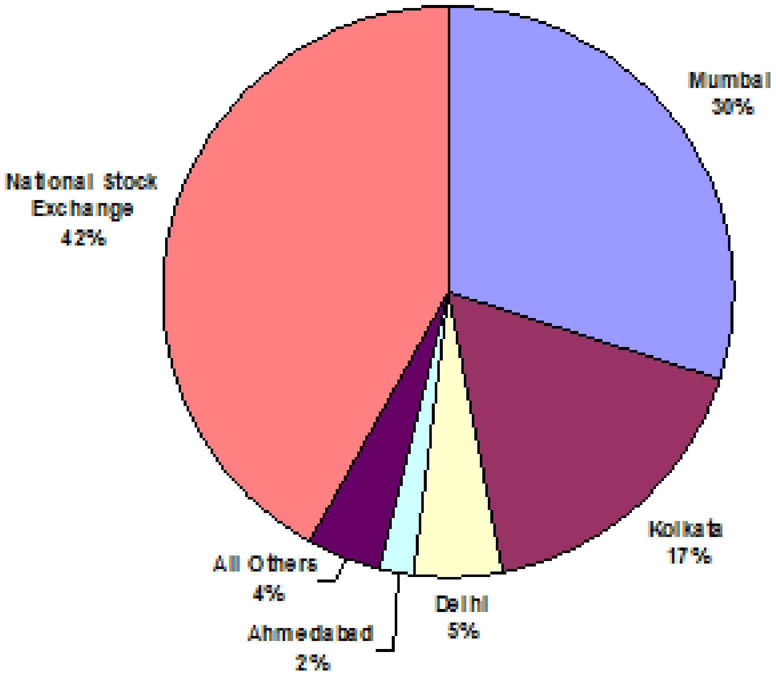
Apart from providing a market that mobilises and distributes the nation's savings, the stock exchange ensures that the flow of savings is utilised for the best purpose from the community's point of view. Free markets are not simply a matter of many buyers and sellers. If the prices at which stocks and shares change hands are to be 'fair' prices, many important conditions must be satisfied. It is the whole vast company of investors, competing with one another as buyers and sellers, that decide what the level of security prices shall be. But the public is prone to sudden swings of hope and fear. If left entirely to itself it would produce needlessly violent and often quite irrational fluctuations. The professional dealers inside the stock exchange and those outside who depend upon them absorb a large part of the stock of these movements. These are valuable activities. So as to ensure that the investors reap the full benefit of them, they (dealers as well as investors) need to be regulated by a recognised code of conduct. Fair prices and free markets require, above all things, clean dealings both by professionals and by the investors—and dealings based upon up to date and reliable information easily accessible to all.

In case the investment markets are not active and free or adequate information were not available promptly and widely, the unscrupulous people would be able to manipulate particular prices for their own ends. In any of these contingencies, the relative values of securities would no longer be 'true' values, so that the relative yields obtainable from them would be mutually distorted. The signposts which, in a well regulated market, show the way along which savings ought to move, would point u the wrong directions. Good businesses would get less, and indifferent or bad businesses more finance than they deserved. The savings of the community would be misdirected and wasted. In addition, some investors would incur losses which they might otherwise have avoided, and others might reap profits which not otherwise could have been made.

Free and active market in stock and shares has become a pre requisite for the mobilisation and distribution of the nation's savings on the scale needed to support modern business, The exchange by a process of prolonged trial and error, which is b no means complete, has been continuously streamlining its structure to meet these wide and. ever growing responsibilities to the pub1ic.

Stock exchanges provide an organised market for transactions in shares and other securities. As of 2003, there are 23 stock exchanges in the country, out of that 20 being regional ones with allocated areas of operation. Of the 9,855 or so public companies that have listed their shares in stock exchanges, around 500 account for 99.6 per cent of the trading turnover, nearly all of which is on the primary exchanges i.e. Bombay Stock Exchange and National Stock Exchange. The pie chart in figure below shows the distribution of trading activity in terms of volume in the exchanges. The Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) together account for nearly 72 per cent of all capital market activity in India. The other major exchanges are the Calcutta, Delhi, and Ahmedabad stock exchanges. The remaining ex changes account for only 4 per cent of the Indian capital market activity.

The number of regional stock exchanges in each of the four zones—east, west, north, south—that the country can be divided into is given in Table. The north zone has five stock exchanges. The east zone has three stock exchanges. The west and south zones have six stock exchanges each.



Distribution of trading activity among stock exchanges in India

Regional Stock Exchanges

North Zone	East Zone	West Zone	South Zone
Kanpur		Ahmedabad	Bangalore
Ludhiana	Bhubaneswar	Vadodara	Chennai
New Delhi	Kolkata	Indore	Kochi
Jaipur	Guwahati	Mumbai	Coimbatore
Meerut		Pune	Hyderabad
		Rajkot	Mangalore

The share of the 20 regional bourses, which accounted for about 45.63 per cent of the total trading volumes in 1995-96, had reduced alarmingly to only about 16 per cent by 2001-02. The Bombay Stock Exchange, though initially established as a regional stock exchange has assumed a national perspective in recent years with the introduction of networking and online trading mechanisms.

Besides the regional stock exchanges, three national stock exchanges have been set up in India. They are the National Stock Exchange, Over the Counter Exchange of India Limited (OTCEI), and Inter connected Stock Exchange of India Limited (ISE). All these exchanges have their head office at Mumbai

History of Stock Exchanges in India

The origin of the stock exchanges in India can be traced back to the later half of 19th century. After the American Civil War (1860-61) due to the share mania of the public, the number of brokers dealing in shares increased. The brokers organised an informal association in Mumbai named "The Native Stock and Share Brokers Association" in 1875.

Increased activity in trade and commerce during the First World War and Second World War resulted in an increase in the stock trading. Stock exchanges were established in different centres like Chennai, Delhi, Nagpur, Kan Hyderabad and Bangalore. The growth of stock exchanges suffered a setback after the end of World War. Worldwide depression affected them.

Most of the stock exchanges in the early stages had a speculative nature of working without technical strength. Securities and Contract Regulation Act, 1956 gave powers to the central government to regulate the stock exchanges. The stock exchanges in Mumbai, Calcutta, Chennai, Ahmedabad, Delhi, Hyderabad and Indore were recognised by the SCR Act. The Bangalore stock exchange was recognised only in 1963. At present we have 23 stock exchanges and 21 of them had hardware and software compliant to solve Y2k problem.

Till recent past, floor trading took place in all the stock exchanges. In the floor trading system, the trade takes place through open outcry system during the official trading hours. Trading posts are assigned for different securities where buy and sell activities of securities took place. This system needs a face to face contact among the traders and restricts the trading volume. The speed of the new information reflected on the prices was rather slow. The deals were also not transparent and the system favoured the brokers rather than the investors.

The setting up of NSE and OTCEI with the screen based trading facility resulted in more and more exchanges turning towards the computer based trading. Bombay stock exchange introduced the screen based trading system in 1995, which is known as BOLT (Bombay On-line Trading System.

Organisation of Stock Exchange

The Bombay Stock Exchange

The Indian stock market is one of the oldest in Asia. By the 1830s, business in corporate stocks and shares in bank and cotton presses took place in Bombay. Though the trading list was broader in 1839, there were only half a dozen brokers recognised by banks and merchants.

In 1860-61, the American Civil War broke out and cotton supply from the United States of America and Europe was stopped. This resulted in the "Share Mania" for cotton trading in India. The number of brokers increased to between 200 and 250. However, at the end of the American Civil War, in 1865, a disastrous slump began - for example, a Bank of Bombay share that had touched ₹ 2,850 could only be sold at ₹ 87.

At the same time, brokers found a place in Dalal Street, Bombay, where they could conveniently assemble and transact business. In 1887, they formally established the "Native Share and Stock Brokers' Association". In 1895, the association acquired premises in the same street; it was inaugurated in 1899 as the Bombay Stock Exchange.

The Bombay Stock Exchange is governed by a board, chaired by a non-executive chairman. The executive director is in charge of the administration of the exchange and is supported by elected directors, Securities Exchange Board of India (SEBI) nominees, and public representatives.

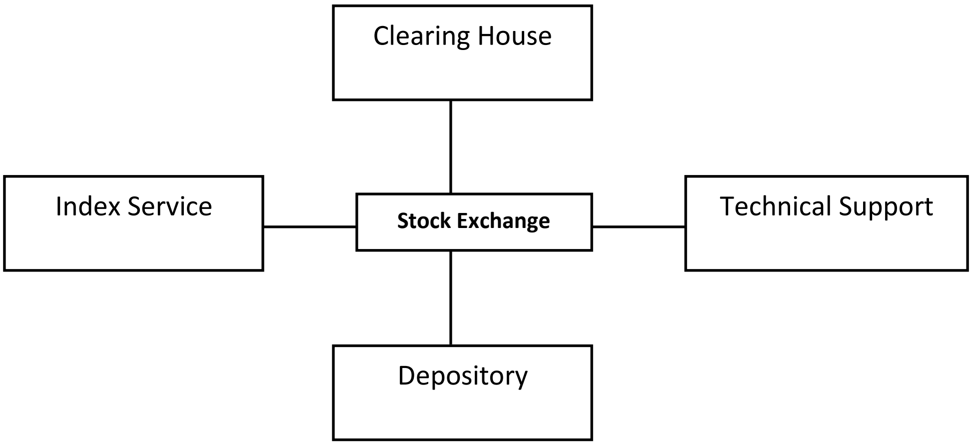
The objectives of the stock exchange are

- To safeguard the interest of investing public having dealings on the exchange.
- To establish and promote honourable and just practices in securities transactions.
- To promote, develop and maintain well-regulated market for dealing in securities.
- To promote industrial development in the country through efficient resource mobilisation by the way of investment in corporate securities.

The National Stock Exchange

The National Stock Exchange of India Limited was set up to provide access to investors from across the country on an equal footing. NSE was promoted by leading financial institutions at the behest of the 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, NSE commenced operations in the wholesale debt market (WDM) segment in June 1994. The capital market (equities) segment commenced operations in November 1994, and operations in the derivatives segment commenced in June 2000. The organisational structure of NSE (Figure) is through the link between National Securities Clearing Corporation Ltd. (NSCCL), India Index Services and Products Ltd. (IISL), National Securities Depository Ltd. (NSDL), DotEx International Limited (DotEx) and NSE.IT Ltd. The National Securities Clearing Corporation Ltd., a wholly owned subsidiary of NSE, was incorporated in August 1995. It was set up to bring and sustain confidence in the clearing and settlement of securities, to promote and maintain short and consistent settlement cycles, and to provide counterparty risk guarantee.



Organisational structure of National Stock Exchange

India Index Services and Products Limited, a joint venture between NSE and the Credit Rating Information Services of India Limited (CRISIL), was set up in May 1998 to provide a variety of indices and index- related services and products for the Indian capital market. It has a consulting and licensing agreement with Standard and Poor's (S&P) for co-branding equity indices.

In order to counteract the problems associated with trading in physical securities, NSE joined hands with the Industrial Development Bank of India (IDBI) and Unit Trust of India (UTI) to promote dematerialisation of securities. Together they set up the National Securities Depository Limited, the first depository in India.

NSDL commenced operations in November 1996. It has since established a national infrastructure of international standard to handle trading and settlement in dematerialised form and thus has completely eliminated the risks associated with fake/bad/stolen paper documents.

NSE.IT, a 100 per cent subsidiary of NSE, provides technical services and solutions in the area of trading, broker front-end and back-office, clearing and settlement, web-based trading, risk management, treasury management, asset liability management, banking, insurance, and so on. The company also plans to provide consultancy and implementation services in the areas of data warehousing, business continuity plans, mainframe facility management, site maintenance and backups, real time market analysis and financial news, and so on. NSE.IT is an export-oriented unit with Straight Through Processing (STP).

NSE.IT and i-flex Solutions Limited, a leader in e-enabling the global financial services industry, promoted DotEx International Limited. DotEx provides customer fulfillment infrastructure for the securities industry. The initial offering of DotEx is the DotEx Plaza where multiple market participants such as brokers, depository participants, and banks can offer web-based services to their customers. As a neutral aggregator and infrastructure provider, DotEx offers choice and convenience to investors.

The National Stock Exchange (NSE) of India became operational in the capital market segment on 3rd, November 1994 in Mumbai. The genesis of the NSE lies in the recommendations of the Pherwani Committee (1991). Apart from NSE, it had recommended for the establishment of National Stock Market System also. Committee pointed out five major defects in the Indian stock market. The defects specified are

1. Lack of liquidity in most of the markets in terms of depth and breadth.
2. Lack of ability to develop markets for debt.
3. Lack of infrastructure facilities and outdated trading system.
4. Lack of transparency in the operations that affect investors' confidence.
5. Outdated settlement systems that are inadequate to cater to the growing volume, leading to delays.
6. Lack of single market due to the inability of various stock exchanges to function cohesively with legal structure and regulatory frame work. These factors led to the establishment of NSE.

The main objectives of NSE are as follows

- To establish a nation wide trading facility for equities, debt instruments and hybrids.
- To ensure equal access to investors all over the country through appropriate communication network.
- To provide a fair, efficient and transparent securities market to investors using an electronic communication network.
- To enable shorter settlement cycle and book entry settlement system.
- To meet current international standards of securities market.

Promoters of NSE IDBI, ICICI, IFCI, LIC, GIC, SBI, Bank of Baroda, Canara Bank, Corporation Bank, Indian Bank, Oriental Bank of Commerce, Union Bank of India, Punjab National Bank, Infrastructure Leasing and Financial Services, Stock Holding Corporation of India and SBI Capital Market are the promoters of NSE.

Membership

Membership is based on factors such as capital adequacy, corporate structure, track record, education, experience, etc. Admission is a two stage process with applicants requiring to go through a written examination followed by an interview. Candidates are interviewed by a committee consisting of experienced people from the industry to assess the applicant's capability to operate as an exchange member. The exchange admits members separately to Wholesale Debt Market (WDM) segment and the Capital Market segment. Only corporate members are admitted on the debt market segment whereas individuals and firms are also eligible on the capital market segment. Eligibility criteria for Trading Membership on the segment of WDM are as follows

i) The persons eligible to become Trading Members are bodies corporate, companies, institutions including subsidiaries of banks engaged in financial services and such other persons or entities as may be permitted from time to time by RBI/SEBI.

ii) The whole-time directors should possess at least two years' experience in any activity related to banking or financial services or treasury.

iii) The applicant must possess a minimum networth of ₹ 2 crores.

iv) The applicant must be engaged solely in the business of securities and must not be engaged in any fund based activities.

The eligibility criteria for the Capital Market segment are

i) Individuals, registered firms, bodies corporate, companies and such other persons may be permitted under the SCRA, 1957.

ii) The applicant must be engaged solely in the business of securities and must not be engaged in any fund based activities.

iii) The minimum networth requirements prescribed are as follows

   a) Individuals and regi3tered firms—₹ 75 lakh

   b) Corporate bodies—₹ 100 lakh

In the case of registered partnership firm, each partner should contribute at least 5 per cent of the minimum networth requirement of the firm.

iv) A corporate trading member should consist only of individuals (maximum 4) who should directly hold atleast 40 per cent of the paid-up capital in case of listed companies and at least 51 per cent in case of other companies.

v) The minimum prescribed qualification of graduation and two years experience of handling securities as broker, sub-broker, authorised assistant,etc. must be fulfilled by

   a) Minimum two directors in case the applicant is a corporate,

   b) Minimum two partners in case of partnership firms and

   c) The individual in case of individual or sole proprietary concerns.

The two experienced directors in a corporate applicant or trading member should hold minimum 5 per cent of the capital of the company.

Advantages of NSE

Wider Accessibility

The NSE ensures wider accessibility through satellite linked trading facility. Computer terminals and links with VSAT help the traders to contact their counterparts in other parts of the country quickly. The quick trading system ensures better pricing.

Screen Based Trading

Originally, the basic advantage of NSE is computer based trading. The back office loads have been reduced as everything is stored in the computer. At present, BSE and many other stock exchanges have introduced the computer based trading. The ring based trading is vanishing in the recent days.

Non-Disclosure of the Trading Members Identity

While placing the orders there is no need to disclose the identity of the member on the screen. It depends upon the wish of the trading member. So without any fear of influencing the prices, any member can place large size orders.

Transparent Transactions

The major advantage of the NSE trading is the complete transparency. The investor can find out the rate of the deal, the counterparty and the time of execution of the deal. The enquiry facilities offered in the terminals help the investor to find out the price and the depth of the market of the particular security. The investor can have the high and low quotations and the last traded price of the particular security. This information enables him to make a healthy decision regarding his investment.

Matching of Orders

Once the order has been fed into the computer, the computer searches and finds out the suitable matching order subject to the conditions placed by the investor or the trader. The conditions are related to the price, volume and time of the trade. While matching the order, priority is given on the basis of price and time. If the matching order is found, the deal Is struck, otherwise as per the instructions the order would be kept pending or cancelled.

Effective Settlement of Corporate Benefit

All monetary benefits lodged, dividend, interest and redemption amount, claims on company objections, are debited/credited directly in the clearing account of the clearing members. This reduces the problems faced by the members in settlement of corporate benefits.

Trading in dematerialised Form

According to the SEBI directives, trading in the depository segment is carried out only on the rolling (T + S) settlement basis. This rolling settlement basis helps the traders to settle the accounts quickly without waiting for a fixed settlement date. The total number of compulsorily dematerialised stock was 30 in June 1998. The dematerialised trading helps the institutions to effect the transfer of shares immediately after the payment.

SGL Facility in the Debt Market

The SGL (Subsidiary General Ledger) facility provided by the NSE allows the trusts and other retail constituents to hold and settle their trades through electronic book transfer. This speeds up the transfer process. Settlement of trades in Government Securities would become paperless, more prompt and safer. The constituents get their securities registered in their names immediately after making payments. They would also get the interest on due dates without delay.

Recent Trends in NSE

The NSE has managed to prove itself successful and maintained its position as the country's premier stock exchange. The exchange has faired well compared to other stock exchanges in terms of expansion of network, market share, volume traded, liquidity and clearance of deals.

Expansion

After establishing its operation in Mumbai, the NSE had expanded its operation to other cities. NSE has installed 2580 VSATS in 317 cities across the country. A break up of VSATs across 317 cities is given below

NSE Network (Feb 2004)

Numbers of VSATs	Number of cities	Total VSATs
1	156	156
2	76	152
3	24	72
4-10	72	447
11-20	20	281
21-50	9	257
51-199	5	342
>100	3	1190
Total	**365**	**2897**

Quality

Apart from the consolidation of the market at national level, the transaction cost along with the bad deliveries has declined. Dematerialisation of shares has helped in the reduction of the bad deliveries. The effective functioning of National Securities Clearing Corporation Limited is another reason for it.

More Liquidity

With its on-line system and quick trading facilities, the NSE has introduced some liquidity into the capital market. In the last quarter of 1997, the NSE was more liquid for the 835 scrips that accounted for 97 per cent of the total trading volume. In number of trades, an indicator of the presence of the retail investor, the NSE was ahead of the BSE.

Less Brokerage

Transparency in NSE allows the breaking up of the costs into brokerage fees, market impact costs and clearing and settlement. The brokerage fee at the BSE terminals outside Mumbai is 0.5 per cent of the value transacted. On the NSE, it is around 0.1 per cent of the value transacted.

Insurance Against Risk

When an investor deals with a broker or two brokers deal with each other there is a possibility of either of the parties in the transaction, defaulting on the payment. National Securities Clearing Corporation, a wholly owned subsidiary of the NSE offers legal guarantee and protection against such risk. Till 1996, there was no insurance against such risks.

Quick Clearing and Settlement

NSE has introduced a full range of clearing house facilities. A part of the securities is processed at the regional clearing centres (Delhi, Chennai and Calcutta). The inter-region clearing facility provided at present, reduces the risk of the members because of not getting timely delivery of shares or loss of shares in transit. The facility is also expected to boost delivery based trading.

Foreign Institutional Investors Trading

The identity of the broker remains undisclosed till the transactions are executed. Secrecy being important to FIIs, which is unavailable on the BSE, it encouraged FIIS to trade on the NSE. The corporate becoming members of NSE is on the increase. Out of 780 NSE members corporates are 668 in March 2000.

NSE poses a healthy threat for the existing exchanges, especially to the BSE. It is the competitive threat from the NSE which made the BSE to embark on the reforms and the introduction of the Bombay on-line trading mechanism.

Over the Counter Exchange of India

Over the Counter Exchange of India was started in 1992 after the role models of NASDAQ (National Association of Securities Dealers Automated Quotation) and JASDAQ (Japanese Association of Securities Dealers Automated Quotation). The OTCE! was started with the objective of providing a market for the smaller companies that could not afford the listing fees of the large exchanges and did not fulfill the minimum capital requirement for listing. It aimed at creating a fully decentralised and transparent market. Over the counter means trading across the counter in scrips. The counter refers to the location of the member or dealer of the OTCEI where the deal or trade takes place. Every counter is treated as a trading floor for the OTCEI where the investor can buy and sell. The members or dealers of OTCEI counters are linked to the central OTCEI computer. The member should have the computer and telecommunication facility.

The Promoters

OTCEI is incorporated as a company under sec. 25 of the Indian Companies Act 1956. As per the registration norms, OTCEI will be obliged to plough back all its profits and will not be allowed to declare dividends on its share capital. The promoters are as follows

UTI	GIC
ICICI	SBI Capital Markets
IDBI	Canbank Financial Services
IFCI	LIC

Players in the OTCEI market

The players on the OTCEI exchange are the members and dealers. The activities of the members and dealers are:

1. Act as brokers, buy and sell securities according to the instructions of the investors.
2. Market Makers in securities, they quote the prices at which members are willing to buy and sell the specified number of securities.

Members can be the public financial institutions, scheduled banks, mutual funds, SEBI approved merchant bankers, banking subsidiaries, venture capital funds and other non-banking financial companies with mini mum net worth of ₹ 2.5 crores. Members pay a onetime non-refundable admission fee of ₹ 10 lakh and ₹ 5 lakh after one year. The annual subscription fee is ₹ 1 lakh.

The dealers are: individuals, partnership firms and corporate entities with a minimum net worth of ₹ 5 lakh. They should have adequate office space and telecommunication facilities. They have to pay onetime non-refundable admission fee of ₹ 2 lakh and annual subscription fee of ₹ 5,000. OTCEI may collect additional security deposit if it considers necessary, depending upon the business experience of the applicant.

Scrips to be Traded

Guidelines are issued for the companies whose scrips have to be traded in the OTCEI by the Government. As per the guidelines

1. The minimum capital requirement for a company to be listed on the OTCEI is ₹ 3 crores and the maximum is ₹ 50 crores.
2. For companies with an issued capital of more than ₹ 30 lakhs but less than 300 lakhs, the minimum public offer should be 25 per cent of the issued capital or 20 lakhs worth of shares in face value, whichever is higher.
3. Companies with an issued capital of more than ₹ 30 Cr seeking to be listed have to comply with listing requirements and guidelines that are applicable to such companies in other stock exchanges.

Revised Listing Norms

To broaden the base of exchange membership the guidelines have been revised. The ministry allowed

(a) Closely held existing corporate houses upto 100 Cr
(b) New companies with a paid up base of upto 50 Cr and
(c) All currently listed companies on various stock exchanges

The procedure adopted for the listing of the scrips

1. An OTCEI member is appointed as a sponsor for the companys's issue. The sponsor appraises the project or company on technical, managerial, commercial, economical and financial aspects. The sponsor certifies the OTCEI regarding its appraisal.
2. The sponsor determines the price of the company shares offered to the public, members and dealers of the OTCEI.
3. The sponsor gets all statutory consent and compliance with all SEBI guidelines.

4. The sponsor registers the issue with OTCEI and places the equity.
5. The listing application has to be made to the DICEI as per its rules and regulations.
6. After getting the approval, the allotment is made.

Once the allotment is over, the equity is listed and the trading commences. In the primary issue the sponsor carries the activities of issue management and he is the sole underwriter for the issue. He can sub write his liability with the syndicate of members and dealers.

National Securities Depository Limited

To meet the capital requirements companies turn towards the capital market that is more flexible and responsive source of funds. The savers of Indian economy a decade ago held simple pass books of the post office and banks. Today they hold plenty of paper or marketable financial assets or securities. The stock brokers have to move large number of paper certificates to give delivery on behalf of their clients. Each transfer of a deed involves different manual checks. Many of the share transfers are rejected because of some technical defect and investors who sell their shares often, wait a couple of months before they receive their money. Because of this tiring procedure, many of the foreign institutional investors restrict their trading with sensex scrips. To remove these difficulties, National Securities Depository Limited was established.

NSDL is an organisation promoted by the Industrial Development Bank of India, the Unit Trust of India and the National Stock Exchange of India Ltd., to provide electronic depository facilities for securities traded in the equity and the debt market. The depositories' ordinances promulgated by the Government of India in September 1995 enabled the setting up of multiple depository system. The securities and Exchange Board of India (SEBI) issued the guidelines for depositories in May 1996. The Bill was passed by the parliament in July 1996. NSDL was registered by SEBI on June 7, 1996.

The Functioning

NSDL performs the following functions through its various participants

a) Enables surrender and withdrawal of securities to and from the depository.
b) Maintains investors' holdings in the electronic form.
c) Effects settlement of securities traded on exchanges.
d) Carries out settlements of trader that have not been done on the stock exchanges.

NSDL (DP) Depository Participant can be a public financial institution, bank, custodian, registered stock broker or a NBFC subject to approval from the depository company and the SEBI. Brokers and NBFCs are required to have a minimum net worth of ₹ 50 lakhs. DP has to pay a security deposit of ₹ 10 lakhs and an admission fee of ₹ 25,000 to NSDL. The depository participants are likely to pass on these charges to the investors.

NSDL operates on two tier structures wherein it maintains accounts of its DP and the DP's maintain the accounts of their clients. With the help of the continuous electronic connectivity, reconciliation of all accounts is done on daily basis to balance the number of stocks issued and dematerialised.

Initially, NSDL makes use of VSAT network of the NSE for communications as it is easier for the depository participants who have leased lines with NSE to join. After ascertaining its requirement on the volume of trade, NSDL would set up its own network. At present NSE only has the clearing corporation, the National Securities Clearing Corporation and it can participate in the functioning of NSDL. The SEBI has now made it mandatory for all stock exchanges to have clearing corporation. The stock exchanges are setting up their own clearing corporation.

Individual Investor and NSDL

The investor has to open an account with the depository participant that is similar to the opening of a bank account. Investors can get a list of depository participant from NSDL. The depository participants may also advertise the services offered by them once they are registered. The investor can choose any depository participant of his choice and fill up an account opening form. Reasonable charges are received by the depositories for the opening of accounts and every transaction in the accounts. The investor receives a passbook or a statement of holdings, just like the bank passbook from the depository agent. The statement of holdings is despatched to the investors periodically. The investor can contact the depository participant for any disparity in the statement of holding. If the discrepancy cannot be resolved at the depository participant level, he could approach NSDL for clarification. There is absolutely no restriction with the number of depository participants the investor can open accounts.

Rights and Bonus Issue

Depository gives all the details about the corporate events to the clients. The registrar calculates the corporate benefits due to all the shareholders. The disbursement of cash benefits such as dividend or interest is done by the registrar whereas the distribution of the securities entitlements is done by the depository, based on the information provided by the registrar. In case of corporate events such as issuing of right issues, the investor can have the option of having it either in the form of physical or electronic mode of holdings. However, corporate entitlements such as bonus are made in the same form of the original holdings.

Advantages to the Investor

1. Depositing the securities with NSDL would give the freedom from the worry of loss of share certificates through theft, mutilation due to careless handling, fire, etc.
2. In selling the shares, the paper work required is reduced to a minimum. Investors also prefer to buy shares that are already in the depository mode. The investor would find it easy to sell the shares whenever he wants to do it.
3. The investor can become the owner of the shares within a day of the settlement being completed, if the shares bought are in the depository mode. There is no need to apply to the company for registering the share in the name of investors. There is no possibility of loss or theft when the share certificates are posted to the company. There is no fear of any fake or stolen shares being delivered to the investor. In the physical transfer of shares, it takes nearly 40-60 days to get the shares registered in his name.

2. Listing of Securities

Listing refers to the admission of the security of a public limited company on a recognised stock exchange for trading. Listing of securities is undertaken with the primary objective of providing marketability, liquidity and transferability to securities. After the promulgation of Companies (Amendment) Act 1988, listing of securities offered to the public, became compulsory. The section 73, of the Companies Act states that any company intending to offer shares or debentures to the public through the issue of prospectus should make an application to one or more recognised stock exchanges for permission to be traded in the respective stock exchange. After the permission is granted, the company becomes eligible to list its securities in the stock exchanges.

Merits of Listing

Liquidity

Listed shares can be sold at any recognised stock exchange and converted into cash quickly. Finding out buyers would be easy in the security market through brokers and screen based trading.

Best Prices

The price quotations and the volume traded regarding the listed shares appear in the news papers. According to the demand and supply of the shares, prices are determined. This results in best price.

Regular Information

The transactions of the listed shares regularly appear in the news paper, providing adequate information regarding the current worth of the securities. Buying and selling activities can be decided on the basis of the price quotations.

Periodic Reports

Listed companies have to provide periodic report to the public. Half yearly financial reports should be published in the financial news papers or in any other news papers. In 1985, it has been made obligatory for all listed companies to submit unaudited financial results on a half yearly basis within 2 months of the expiry of that half year. At present quarterly reports have to be published.

Transferability

Listing provides free transferability of securities. After the incorporation of Section 22- A in the Securities Contract (Regulation) Act, free transfer of shares has been ensured.

Income Tax Benefit

Income-tax Act treats the listed companies as widely held companies. The advantages available to a widely held company are applicable to the listed company.

Wide Publicity

Since the prices are quoted in the newspaper, the listed companies get wide publicity. This not only does good to the investor but also to the corporate to attract the public for further issues.

Demerits

1 Listed companies are subjected to various regulatory measures of the stock exchanges and SEBI.

2 Essential information has to be submitted by the listed companies to the stock exchanges.

3. Annual General Meeting, Annual reports have to be sent to a large number of shareholders. This creates large amount of unnecessary expenditure.

4 Public offer itself is an expensive exercise. But, this is a pre-requisite for the company's shares to be listed.

Qualification For Listing

There are certain minimum requirements for a security to be listed in a stock exchange. They are given below

Minimum Issued Capital

According to the regulation laid down by The Ministry of Finance and Department of Economic affairs the minimum issued capital should be ₹ 3 crores and the minimum public offer is ₹ 75 lakhs. In 1995 the Bombay Stock Exchange raised the limit from Rs Cr to Rs. Cr. In 1996, it has been further raised to ₹ 10 Cr. Some other stock exchanges have also increased the limit to ₹ 5 Cr.

Payment of Excess Application

Money According to the direction given by the SEBI, the amended listing agreement of Mumbai Stock Exchange (1996) made the allotment of securities to be done within 30 days of the closure of the public issue. The refund orders should be dispatched within the specified period. Beyond the period they shall be liable to pay an interest rate of 15 p.a. Similar amendments are made in the Delhi Stock Exchange agreement too.

Listing on Multiple Exchanges

When the paid up capital of the company is above ₹ 5 crores, it obligatory for the company to seek listing on more than one stock exchange.

The Number of Shareholders

To ensure wide distribution of shares among the general public and to prevent undue concentration of large holdings with the company, minimum number of shareholders are prescribed. For every ₹ 1 lakh of fresh issue of capital, there should be atleast 10 shareholders. In the case of sale of existing capital of ₹ 1 lakh, it should ensure atleast 20 public shareholders. In 1996, Bombay Stock Exchange has reduced the above said numbers to 5 and 10 respectively. If the number of shareholders falls below the prescribed number, then the concerned company's security would be delisted.

Appointment of Market Maker

A company where the paid up capital is ₹ 3 cr but not more than ₹ 5 cr and having a commercial operation for less than two years should appoint a market maker. The market maker should provide two way quotes for the concerned stock for a minimum period of 18 months from the date of trading on stock exchange. The difference between quotations for the sale and purchase bid, ask spread should not exceed 10 per cent. The market maker should have an inventory of 5 per cent of the post issue capital as on the date of allotment.

Articles of Association

The articles of association of the company should be in tune with the sound corporate practice. If veto power has been provided to a director or a class of directors to over rule the majority decision, the security of the company is not qualified for listing.

Cost of Public Issue

To be listed the company should adhere to the ceiling in the expenditure of public issue as prescribed by the SEBI.

Advertisement

The company should not advertise in newspapers that 'issue over subscribed' or 'Thanks to the investing public for their overwhelming response,' etc during the subscription period. If the company gives such an advertisement, listing will be refused by the stock exchange -after intimation to the stock exchange division of the Ministry of Finance.

Minimum Subscription

A minimum of ₹ 5,000 (500 shares of Rs each) subscription has been fixed by SEBI. But, due to the slackness in the primary market, it is reduced to Rs of 200 shares of RsJO each. This should be given in the prospectus.

Applying Mode

The prospectus should provide information on how the investor should apply. It should clearly state that the application must be made in the prescribed form stating the number of shares applied for.

It should be applied in single name or joint names of not more than three. Application can be made in the name of limited companies, corporations or institutions and not in the name of a trust firm or partnership. The names should be given in block letters in English. An individual can make only one application.

Public offer size

The size of the public offer and value of the share should be stated in the first page of the prospectus. If the shares are issued at premium, that also should be stated. Preferential allotment to the directors and workers of the company and the reservation for allotment to the non-resident Indians should be indicated clearly on the prospectus.

Listing Procedure

Obtaining the listing permission from stock exchanges involves various steps. The steps are as follows:

Preliminary Discussion

The Company desirous of getting its security listed on the stock exchange should have detailed discussion with the stock exchange authorities. The discussion enables it to understand the various compliances to be complied with for listing its securities.

Article of Association Approval

The articles of association will be approved only if it fulfills certain requirements. They are:

1. Common form of transfer should be used
2. Once the shares are fully paid, they should be free from all lien and in the case of partly paid shares the company's lien is restricted to the call money alone.
3. The calls carried out in advance are entitled to interest rate but not for dividends or any other declared profits.

4. The free dealings in company's shares should not be restricted by any provision.
5. The company should comply with the section 205-A of Companies Act in the case of dividends.

If the company is not able to comply with any of the requirements of the Rule 19(2) (a) of the Securities Contract Regulation Act, the company should give an undertaking to make necessary amendments in the articles of association as required in the next annual general meeting of the company. On the basis of the undertaking, the security will be permitted to trade on the stock exchanges. If the article of association provides veto powers to any director/or group of directors, the relevant article should be amended to remove such powers to get the security listed.

Draft Prospectus Approval

Getting approval for the draft prospectus is the essential pre-requisite for the security to be listed. Before finalising the draft prospectus the company authority should hold a discussion with the stock exchange authorities. While seeking approval, the prospectus should contain all the conditions put by the stock exchange. The prospectus should clearly state the following:

1. The name of regional stock exchange and any other stock exchanges(s) where it intends to enlist its securities,
2. It should specify the date of commencement of the subscription and the date of closing of the subscription. It is essential to keep the subscription list open for a minimum period of three working days. It may extend up to 10 working days at the discretion of the Board of Directors. The date of closure of subscription list should be notified to the stock exchange where listing is sought.

Listing Application

Any company when it intends to offer shares to the public through prospectus, should make an application to the stock exchange or exchanges where the share is to be listed. A formal application form should be filed before filing the prospectus with the Registrar of Companies. A number of certificates have to be submitted with the application. They are listed below

1. Three certified copies of memorandum and articles of association and debenture trust deed.

2. Copies of prospectus, offer for sale made during the last five years and circulars and advertisement regarding the offer made during the last five years.

3. Copy of every letter, report, balance sheet, valuation, contract, court order or any other document that is given in the prospectus.

4. Certified copies of underwriting, brokerage, vendors, promoter's selling agents and sales managers agreement.

5. Certified copies of the service agreements of secretaries, treasures, managing director, technical directors, general manager and manager.

6. Particulars regarding the material contract, technical advice and collaboration, concessions and similar other documents.

7. Copies of agreements with the Industrial Finance Corporation, Industrial Credit and Investment Corporation and such other bodies.

8. Details regarding the reorganisation, reconstruction, amalgamation and details of the companies' activities.

9. Specimen copies of the share certificate, debenture certificate, letters of allotment, letters of acceptance, letters of renunciation, transfer receipts and renewal receipts.

The above mentioned documents are ordinarily required by the listing application. But sometime additional documents also may b called for.

The stock exchange generally acknowledges the receipt of the application and gives instructions regarding various other formalities to be fulfilled before getting the listing permission. Once the subscription list is closed, the process of allotment should be closed within 30 days of the closure. Originally it was 10 weeks from the closure of the subscription list. The allocation of shares should be intimated to the stock exchange concerned.

Listing Agreement Regarding Projection of Profitability

Generally companies make projections regarding the profitability of the company at the time of issue of capital and give an abridged statement of the balance sheet and profit and loss account. Many times the projections are not met with. To provide protection to the investors, SEBI amended the listing agreement by inserting a new clause 43. Accordingly the company has to submit yearly statement showing the variation between projections given in the prospectus and the actuals achieved. The reasons for the variation in the profitability projections and actuals should be given. If the projections are provided for five years, the company has to furnish explanation for the unattained projected figures for all the five years. This information also should be published in the news paper. The listed company has to give a copy of the complete and full balance sheet, profit and loss account, and the directors' report to each shareholder.

Listing Agreement and Cash Flow Statement

The representatives of SEBI, the stock exchanges of Mumbai, Calcutta, Delhi, Ahmedabad, National stock exchange and the Institute of Chartered Accountant of India framed the norms for the inclusion cash flow statement in the annual reports. The cash flow statement discloses the actual cash flow operations in the company. This would provide better quality information to the shareholders. To comply with the international standards this has been imposed as a part of listing agreement. The company has to provide the cash flow statement along with the balance sheet profit and loss account. The cash flow statement has to be prepared according to the instructions given by the SEBI.

The cash flow statement helps the shareholders to analyse the pattern of resources deployed and evaluate the changes in net assets of a company. It helps to assess the ability of the company to generate cash and cash equivalents. Briefly, it is useful to the shareholders to assess the liquidity, viability and financial adaptability of the company.

Listing Fee

The stock exchange charges a fee from the company for permitting the company's scrip to be traded. The listing fee varies from major stock exchanges to regional stock exchanges. The fees charged by the regional stock exchanges are comparatively less than the major stock exchanges. The fee also differs according to the equity base of the company. The following table gives the listing fee charged by the NSE.

Listing Fees of NSE (1999)

Particulars	Amount ₹.
1. Initial Listing Fees	7500
2. Annual Listing Fees	
a) Companies with paid share and! or debenture capital of ₹ 1 Cr	4200
b) Above ₹ 1 Cr and up to ₹ 5 Cr	8400
c) Above Rs S Cr and up to ₹ 10 Cr	14000
d) Above ₹ 10 Cr and up to ₹ 20 Cr	28000
e) Above ₹ 20 Cr and up to ₹ 50 Cr	42000
f) Above ₹ 50Cr	70000

Companies that have a paid up capital of more than ₹ 50 Cr will pay additional listing fees of ₹ 1400 for every increase of ₹ 5 Cr or part thereof in the paid up share or debenture capital.

Listing of Right Shares

The formalities that have to be fulfilled in the case of right shares are given below.

1. The company should notify the stock exchange, the date of meeting of Board of Directors at which the proposal of the right shares or debenture is to be considered.

2. The company should inform the decision taken regarding the right issue to the stock exchange immediately.

3. As per section 81 of the Companies Act 1956 the company should obtain the consent of the shareholders by way of a special resolution in general body meeting.

4. The record date for closure of register of members should be intimated to the stock exchanges.

5. The letter of offer should give financial information before one month of the date of letter of offer and from the date of company's last balance sheet. The working results regarding the sales/turnover and other income, estimated gross profit/loss should be provided. The provisions made for depreciation and taxes should be presented. Estimated amount of profit and loss also should be given.

   The current market price of the share, highest and lowest price of the equity during the related period and the week end prices for the last four weeks should be provided. The shareholders can renounce the rights in favour of their nominees. The company has power to reject any nominee of whom it does not approve. If the nominee is rejected, the shareholders have the right to take up shares applied by the rejected nominee.

   The shareholders are entitled to apply for additional shares. If the shareholders have renounced their shares in whole or in parts in favour of any other person, they cannot apply for additional shares. If the shares are not quoted at premium this condition would be relaxed by the stock exchanges.

6. The applications are accepted at all centres where recognised stock exchanges are situated. If the company is not able to make such arrangements at all centres, it can have the centres of its own choice subject to the condition that bank commission and collection charges for out station cheques would be borne by the company.

7. The letter of offer should be made within six weeks after the closure of the transfer books.

8. The shareholders should be given reasonable time to record their interest or exercise their rights. It should not be not less than four weeks.

9. The renunciation forms should be made available to the shareholders freely on request.

10. The company should inform the stock exchange the last date fixed for submission of rights application, split/renunciation application and consolidated coupons.

11. The company should forward a specimen copy of the letter of offer and application form for the rights issue to the stock exchange.

12. After despatching the allotment letters or share certificates the company should apply for listing in the prescribed form. The company has to submit the distribution, an analysis form and new issue statement forms.

13. After receiving the application form along with the required documents, the stock exchange would permit the shares to be listed for official dealing by its members.

The Securities and Exchange Board of India is taking steps to facilitate the speedy disposal of right issues. It has directed all stock exchanges to amend their listing rules. The appraisal of the rights issue is left with the merchant bankers. The provisions relating to the fixing of record dates for the purpose of right issue has been ignored. The companies can apply for record date simultaneously with the filing of the letter of offer with SEBI.

High Powered Committee Recommendation

The High P Committee's recommendations on Stock Exchanges on listing of industries securities are given below

1. Once the completed listing application is submitted to the stock exchanges, it should not take more than three working days for the admission of securities for dealings.

2. Stock exchanges should set up guidance cells to provide required help to the companies seeking enlistment. A uniform check list exhibiting the standard set norms required by the stock exchanges for the admission of the securities for trading should be prepared.

3. An updated brochure on matters related to listing should be prepared by the stock exchanges. An annual review should be made regarding the compliances of

the provisions of listing agreement by the companies. It should also publicise the names of the companies that have not complied with the listing requirement and the Government also has to be informed.

These recommendations have been accepted by the Government.

Delisting

In December 1998, the Mumbai Stock Exchange has threatened to delist shares of over 700 companies for non-payment of listing fee for 1997-98 by December 1998. Over the past years, several companies incurred loss and many of them were unable to pay the listing fee. But many companies purposefully avoided paying the listing fee. Delisting the company's share prevents the public scrutiny of performance. Many companies made public issue itself a business. Thus delisting may be compulsory or voluntary. Some of the common causes for delisting are given below.

Compulsory

a) Non-payment of listing fee or violation of listing agreement.
b) Thin/negligible trading or thin shareholding base.
c) Non redressal of grievances.
d) Unfair trade practices at the behest of promoters or managers, and malpractice such as issuing of duplicate fake shares by management.

Voluntary

a) Unable to pay the listing fee. Listing fee is prohibitive.
b) Business sick/suspended/closed.
c) Capital base is small.
d) Mergers, demergers, amalgamations and takeovers.

Voluntary delisting is at present provided to the companies if three conditions are satisfied.

(i) Company must have incurred losses in the preceding three years, with net worth less than the paid-up capital.
(ii) Securities have been infrequently traded.
(iii) Securities remain listed at least on the regional stock exchange.

If these conditions are not fulfilled, Central Government approval would be needed. The other ground under which voluntary delisting can be allowed by a stock exchange is for thin public share holding.

Chandratre Committee Report (1997)

The committee studied the problem of delisting and felt that the listing process at present does not have any degree of transparency. The committee felt that disclosures should be made at every stage of the process. Advance public notice should be given by the stock exchange on the proposed delisting.

(i) Intimation to other stock exchanges where the securities are listed.

(ii) Public notice of delisting should be given after the process is completed.

(iii) The annual report must contain details of delisting on any stock exchange with reasons and justification.

(iv) An appeal made against the decision to delist would lie with the Central Government.

(v) Dealing facility should be allowed for some time to provide a liquidity window after delisting.

These detailed procedures must be made applicable even in the case of a voluntary delisting too. As far as the voluntary delisting, the proposal is to give public notice explaining the justification for delisting and requires a special resolution authorising voluntary delisting.

Suggested Framework

The contents of the Listing Agreement (LA) are to be made part of the Conditions for Listing and Continued Listing under the rules of SCRA. The LA is to have two parts: Part A to stipulate the minimum conditions for listing to all stock exchanges (SE) and Part B to prescribe additional conditions by any SE.

(i) Basic minimum listing norms for listing on any recognised SE must be uniform; additional norms may be specified by SEs.

(ii) The LA may contain terms and conditions that serve investor interests though the law may allow greater leeway to a company on a particular issue.

(iii) Violation of the LA should be a punishable offense, with penalties of ₹ 10,000 and ₹ 1,000 per day of continuing default.

(iv) SEs have to be empowered to prosecute a company and its directors/officers for violation of LA.

(v) SEs have to strengthen their machinery for strict enforcement of LA and institution of prosecution.

(vi) SEBI to be nodal authority for any amendments to the LA with due consultation of SEs to ensure uniformity and avoid confusion.

(vii) Pre-listing scrutiny of draft offer documents to be made mandatory for all stock exchanges before any SEs are cited in the final offer document as SEs on which the securities would be listed.

(viii) Listing norms should be disclosed and well publicised to ensure desired transparency in the pre-listing scrutiny of offer documents.

(ix) Compulsory listing on Regional Stock Exchanges has to be dispensed with. SEs have to operate competitively and companies should have freedom of choice in seeking listing on any SE.

(x) Recovery of listing fee from shareholders in case of default by the company is not a feasible proposition though they may be the beneficiaries of the SE's services.

(xi) There is no need to bring uniformity in listing fee structure across SEs.

(xii) SEs should be free to decide the quantum of 'listing fee', manner of payment and periodicity of payment.

(xiii) The listing fee should not be prohibitive and disproportionate to the services offered by the SE.

(xiv) SEs must improve services to investors-especially redressal of investor grievances and investor education.

Recent Developments

Share of the companies listed on exchanges other than the Bombay Stock Exchange and seeking listing on it, will be required to have a minimum market capitalisation of ₹ 20 crores as against the previous criterion of ₹ 10 crores of issued capital.

The BSE board has decided that companies should have necessarily recorded profits for the last three years, traded on at least half the total trading days with a minimum of five trades and 500 shares on any given day and have 20 per cent of the stock held with the public.

The board also decided to institute awards for investor friendly companies. Categorised into three, companies would be awarded for best returns, being proactive in servicing investor needs and corporate governance. Non friendly companies are classified into 'Z' category; the exchange has identified 300 such companies.

3. Trading Mechanism

Mechanics Of Security Trading In Stock Exchanges

An investor must have some knowledge of how the securities markets operate. The marketing old or new securities on the stock markets can be done only through members of the Stock Exchange. These members are either individuals or partnership firms. An individual must use the facilities of these members for trading in securities unless he himself is a registered dealer or member of an organised stock exchange. Trading among the members of a recognised stock exchange is to be done under the statutory regulations of the stock exchange. The members carrying on business are known as 'brokers' and can trade only on listed securities. The se members execute customer's orders to buy and sell on the exchange and their firms receive negotiated commissions on those transactions. About one-fourth of all members of the exchange are 'specialists', so called because they specialise in 'making a market' for one or more particular kind of stock. In the process of trading in stock exchanges, there is the basic need for a 'transaction' between an individual and the broker. A transaction to buy and sell securities is also called 'trades.' This is to be done through the selection of a broker.

1. Finding a Broker

The selection of a broker depends largely on the kind of services rendered by a particular broker as well as upon the kind of transaction that a person wishes to undertake. An individual usually prefers to select a broker who can render the following services:

(a) Provide information: A broker to be selected should be able to give information about the available investments)These may be in the form of capital structure of companies' earnings, dividend policies and prospects. These could also take the form of advice about taxes, portfolio planning and investment management.

(b) Availability of In vestment Literature: Secondly, a broker should be able to supply financial periodicals, prospectuses and reports. He should also prepare and analyse valuable advisory literature to educate the investor.

(c) Appoint Competent Representatives: Brokers should have registered competent representatives who can assist customers with most of their problems.

2. Kinds of Brokers - Selection

(a) **Commission Broker:** All brokers buy and sell securities for earning a commission. From the investor's point of view, he is the most important member of the exchange because his main function and responsibility is to buy and sell stock for his customers. He acts as an agent for his customer and earns a commission for the service performed. He is an independent dealer in securities. He purchases and sells securities in his own name. He is not allowed to deal with the non-members. He can either deal with a broker or another jobber.

(b) **Jobber:** A jobber is a professional speculator. He works for a profit called 'turn.'

(c) **Floor Broker:** The floor broker buys and sells shares for other brokers on the floor of the exchange He is an individual member owns his own seat and receives commissions on the orders the executes. He helps other brokers when they are busy and as compensation, receives a portion of the brokerage charged by the commission agent to his customer.

(d) **Taraniwalla:** The Taraniwalla is also called a jobber. He makes an orderly and continuous auction in the market in the stock in which he specialises. He is a localised dealer and often handles transactions on a commission basis for other brokers who are acting for their customers. He trades in the market even for small differences in prices and helps to maintain liquidity in the stock exchange.

(e) **Odd Lot Dealer:** The standard trading unit for listed stocks is designated as a round lot which is usually a hundred shares. Anything less than the round lot is an odd lot which is traded on the floor of the exchange because odd lots appear in odd quantities — 8 shares, 10 shares or 15, 20, 25, 27, 33 and it is impossible to match buying and selling orders in them. The specialists handle odd lots. They buy odd lots which other members wish to sell for their customers and sell odd lots which others wish to buy. If dealers buy more than they sell or sell more than they buy, they can clear their position by engaging in round lot transactions. The price of the odd lot is determined by the round lot transactions. The odd lot dealer earns his profit on the difference between the price at which he buys and sells the securities. He does not rely on commission.

(f) **Budliwalla:** The financier in the stock exchange is also called the Budliwalla. For giving credit facilities to the market, he charges a fee called 'contango' or 'backwardation' charge. The budliwalla gives a fully secured loan for a short period of two to three weeks. This loan is governed according to the prevailing rate of interest in the market. The Budliwalla's technique of lending is to take up delivery on the due date at the end of the clearing to those who wish to carry over their sales. These transactions help him to make a profit on the prevailing rates of interest, subject to regulations of the stock exchange.

(g) **Arbitrageur:** An arbitrageur is a specialist in dealing with securities in different stock exchange centres t the same time. He makes a profit by the difference in prices prevailing in different centres of market activity. He maintains an office with a good communication system and telephonic and tele-printer facility. His profit depends on the ability to get the prices from different centres before others trading in the stock exchange.

(h) **Security Dealers:** The purchase and sale of government securities is carried on the stock exchange by Security Dealers. Each transaction of purchase or sale has to be separately negotiated. The dealer takes risk in ready purchase and sale of securities for current requirements. The dealer has information about several kinds of government securities as well as statutory public bodies, but the presence of large investors like the Life Insurance Corporation (LIC) and commercial banks makes his role rather restricted.

3. Opening an Account with Broker

After a broker has been selected, the investor has to place an 'order' on the broker. The broker will open an account in the name of the investor in his books. He will also ask the investor for a small sum of money called margin-money as advance. In case, the investor wishes to sell his securities, he will have to deposit with the broker share certificates and transfer deeds. He will also have to sign in the transferor's column on the transfer deed. The physical presence of share certificates is not required anymore in India if shares have been through the 'demat' process.

4. Order

Brokers receive a number of different types of buying and selling orders from their customers.

5. Choice of Orders

Buy and sell orders are placed with the members of the stock exchanges by the investors. The orders are of &e types.

Limit orders: Orders are limited by a fixed price. 'Buy Reliance Petroleum at ₹ 50. Here, the order has clearly indicated the price at which it has to be bought and the investor is not willing to give more than ₹ 50.

Best rate order Here, the buyer or seller gives the freedom to the broker to execute the order at the best possible rate quoted on that particular date for buying. It may be the lowest rate for buying and the highest rate for selling.

Discretionary order The investor gives the range of price for purchase and sale. The broker can use his discretion to buy within the specified limit. Generally the approximate price is fixed. The order stands as this 'Buy BRC 100 shares around ₹ 40'.

Stop loss order The orders are given to limit the loss due to unfavourable price movements in the market. A particular limit is given for waiting. If the price falls below the limit, the broker is authorised to sell the shares to prevent further loss. Ex. Sell BRC Ltd at ₹ 25, stop loss at ₹ 22.

Kinds of Trading Activity

Options: An 'Option' is a contract which involves the right to buy or sell securities (usually 100 shares) at specified prices within a stated time. There are various types of such contracts, of which 'puts' and 'calls' are most important. A 'put' is a negotiable contract which gives the holder the right to sell a certain number of shares at a specified price within a limited time. A 'call' is the right to buy under a negotiable contract.

Sometimes, these option transactions are combined. These are called options and are exercised through the following strategies:

(a) **Establishing a Spread:** A spread involves the simultaneous purchase and sale of different options of the same security. A vertical spread is the purchase of two options with the same expiry date but different striking prices. In a horizontal spread, the striking price is the same but the expiry date differs.

(b) **Buying a Call:** Buyers of a Call look for option profits from some probable advance in the price of specified stock with a relatively small investment compared with buying the stock outright. The maximum that can be lost is the cost of the option itself.

(c) **Writing Options:** A written option may be 'covered' or 'uncovered.' A covered option is written against an owned stock position. An uncovered or 'naked' option is written without owning the security. A covered option is very conservative. The income derived from the sale of a covered option offsets the decline in the value of the specified security.

(d) **Wash Sales:** A wash sale is a fictitious transaction in which the speculator sells the security and then buys it at a higher price through another broker This gives a misleading and incorrect position about the value of the security in the market The price of the security in the market rises in such a misleading situation and the broker makes a profit by 'selling or 'unloading his security to the public This kind of trading is considered undesirable by the stock exchange regulations and a penalty is charged for such sales.

(e) **Rigging the Market**: This is a technique through which the market value of securities is artificially forced up in the stock exchange. The demands of the buyers force up the price. The brokers holding a large chunk of securities buy and sell to be able to widen and improve the market and gradually unload their securities. This activity interferes with the normal interplay of demand and supply functions in the stock market.

(f) **Cornering:** Sometimes, brokers create a condition where the entire supply of particular securities is purchased by a small group of individuals In this situation, those who have dealt with 'short sales' will be 'squeezed' and will not be able to make their deliveries in time The buyers, therefore assume superior position and dictate terms to short sellers This is also an unhealthy technique of trading in stock exchange.

(g) **Blank Transfers:** A blank transfer is one in which the transferor signs the form but does not fill-in the name of the transferee while transferring shares. Such a transfer facilitates speculation in securities It involves temporary purchases and sales of securities without regulation.

Arbitrage

Arbitrage is a technique of making a profit on stock exchange trading through difference in price of two different markets. If an advantage of price is taken between two markets in the same country, it is called 'domestic arbitrage.' Sometimes, arbitrage may also be between one country and another. It is called 'foreign arbitrage.' Such an advantage in prices between two countries can be taken when the currencies of both the countries can be easily converted.

Arbitrage usually equalises the price of security in different places. When the security is sold at a high price in a market, more of the supply of the security will tend to bring a fall in the price, thus neutralisirig the price and making it equal to the price in the cheaper market.

On placing an order, the brokers get busy through different kinds of trading activities, which may also include options and other speculations such as wash sales, rigging, cornering, blank transfers or arbitrage. The sp in the stock market are generally represented by 'bull', 'bear', 'stag', and 'lame duck'.

(a) **Bull:** A bull is a person on the stock exchange who expects a rise in the price of a certain security. A bull is also called a 'tejiwala', because of his expectation of price rise.

(b) **Bear:** A bear is the opposite of a bull. He expects a fall in prices always. He is popularly known as 'Mandiwalla.'

(c) **Bullish and Bearish:** When the price is rising and the 'bulls' are active in the market, there "buoyancy and optimism in the share market. The market in this situation is reigning 'bullish.' When there is decline in prices, the market is said to go 'bearish.' This is followed by pessimism and decline in the share market activity.

(d) **Bull Campaign and Bear Raid:** The bulls begin to spread rumours in the market about rise ii when there is an over-bought condition in the market, i.e. the purchases made by the speculators exceed sales made by them. This is called a 'bull campaign.' Similarly, a 'bear raid' is a condition when speculative sales made by bear speculators exceed the purchases made by them and they spread rumours to bring the price down.

(e) **Lame Duck:** A Bear cannot always keep his commitments because the price does not move the way he wants the shares to move. He is, therefore, said to be struggling like a 'lame duck.

(f) **Stag:** A stag is a cautious speculator. He does not buy or sell securities but applies for shares in the new issue market just like a genuine investor on the expectation that the price of the share will soon rise and be sold for a premium. The stag shares the same approach as a bull, always expecting a rise in price. As soon as the stag receives an allotment of his shares, he sells them. He is, therefore, taking advantage in the rise in price of shares and is called 'premium hunter.'

(g) **Hedging:** Hedging is a device through which a person protects himself against loss. A 'bull agreeing to purchase a security for someone may 'hedge' or protect himself by buying a 'put option' so that any loss that he r suffer in his transaction may be offset. Similarly, a seller can hedge against loss through 'call'.

Giving Margin Money to Broker

Margin

Margin is the amount of money provided by customers to the brokers who have agreed to trade their securities. It may also be called a provision to absorb any probable loss.

Execution of Order in the Stock Exchange

Making a Deal

When the broker receives the margin money and is clear about the order received by him, he puts the details in the 'order book.' The broker in the beginning of his career makes the deals himself. Once his business grows, he employs clerks to transact his orders.

The stock exchange 'hail' also called a 'floor' is divided into a number of markets according to the security which is being dealt with. The authorised clerk goes to the particular part of the floor called the 'pit' and makes his quotation for the purchase or sale according to the order. The dealer to whom the quotation is given quotes his own price, if it does not suit the clerk, he asks for a lower price to be quoted When both the sides are satisfied, the price is settled and the 'bargain' is made.

Preparing Contract Note in the Stock Exchange

Contract Note: The clerk takes the details of the day's transaction to the broker at the end of the working day. The broker scrutinises all transactions of the day and prepares a contract note and signs it on a prescribed form. The contract note gives the details of the contract for the purchase or sale of securities; it records the number of shares, rate and date of purchase or sale. It also gives the 'brokerage' entitlement to the broker.

Settlement of Contracts

Settlement

The last step is the settlement of the contract by the broker for his client. The procedure for settlement is to be made (a) for ready delivery contracts and (b) for forward delivery contracts.

Ready Delivery Contracts

A ready delivery contract is to be settled within three days in Kolkata Stock Exchange and 7 days at the Mumbai and Chennai Stock Exchange. A ready delivery contract is also called a 'spot' contract. The settlement under this contract can be made on the same day or during the maximum period of 7 days and there can be no extension, or postponement of the time of settlement. Ready delivery contracts can be settled in two ways:

(i) **By Actual Delivery:** The securities may be purchased or sold and the price is paid or received in full.

(ii) **By Paying the Difference:** The securities are not actually delivered but on the settlement day the transaction is squared by paying the difference.

Carry Over' or 'Badla'

Carry Over' or 'Badla' is the facility of postponing a transaction till the next settlement day. This facility is available only in forward delivery contracts. Postponement of a transaction is effected by payment of an amount called 'Badla Charge.' Badla is transacted in the following manner:

First, cancel the existing contract by squaring it up. Cancellation is to be made at the price determined by Stock Exchange authorities.

Second, prepare a new transaction through the original transaction for settlement on the next settlement day.

Third, payment of a 'badla' charge. When a Bull speculator wishes to defer his transaction, he pays a 'contango charge' to the Bear speculator for carrying over of his purchase agreement to the next settlement.

Screen Based Trading System

In March 1995, the Bombay (Mumbai) Stock Exchange has introduced screen based trading called BOLT (BSE on-line Trading). The BOLT is designed to get best bids and offers from jobbers' book as well as the best buy and sell orders from the order book. Slowly the network is being extended to other cities too. Now the BOLT has a nationwide network. Trading Work Stations are connected with the main computer at Mumbai through Wide Area Network (WAN). The capacity of the Tandem hardware of BOLT is 5,00,000 trades per day (in 6 hours i.e. from 9:30 a.m. to 3:30 p.m.). After getting specific approval from

SEBI, BOLT connections have been installed in Ahmedabad, Rajkot, Pune, Vadodara and Calcutta. The number of scrips on BSE was 4,702 in March 1995 and has increased to 5,853 in March 1998. The following table indicates the trend of trade in the BSE.

Trade in BSE

Year	Number of Listed Companies	Market Capitalisation	Annual Turnover	Average Daily Turnover (₹ in Billion)
1994-95	4702	4355	677	1.8
1995-96	5602	5365	501	2.2
1996-97	5832	4639	1243	5.2
1997-98	5853	5603	2706	8.5

Securities Traded

The securities traded in the BSE are classified into three groups namely, specified shares or 'A' group and non-specified securities. The latter is sub-divided into 'B 1' and 'B' groups. 'A' group contains the companies with large outstanding shares, good track record and large volume of business in the secondary market. Carry forward transactions for a period of 90 days are permitted in A group shares. A group contains 150 companies. Relatively liquid securities come under the 'B 1' group and it comprises 746 companies. The remaining shares are placed under the 'B' group. Settlements of all the shares are carried out through the Clearing House. The settlement period is reduced from 14 days to 7 days for all scrips.

Surveillance System

There is a separate surveillance department in the stock exchange. The surveillance department aims at providing free and fair market, arresting unsystematic risk from entering into the system and managing risks. The surveillance can be classified into price surveillance and pre-monitoring.

Price Surveillance

The surveillance department keeps a close watch over the price movements of scrips and aims at an early detection of market manipulation like price rigging. The price surveillance is effectively carried out mainly through

1. Circuit filters and
2. Margins.

Circuit Filters

The circuit filters decide the range within which the traded prices of a scrip can vary on a day compared to the previous day's closing price. The filter percentages are entered into the system. The quote orders outside the prescribed filter band cannot be traded. The filter percentages for various scrips are changed at the end of the day. If there is a need, it may be changed even when the trade is going on. In spite of the price filters if there is a manipulation in the price, the trading of the particular scrip is suspended for a day or more depending upon the situation.

Margins

The trading members deposit part of their trades as a margin to the exchange. The margin amount varies for Type-I members who trade in 'A' group shares and Type-I members who have not opted for carry forward trade. Type-I members pay a daily margin of 15% on their trades both on delivery and carry forward. For Type-H members, the margin is computed on the basis of gross exposure or net exposure and the higher of the margin is charged. Mark-to-market margins are collected on all notional losses on a daily basis. Carry over margin is collected when traders' transactions are carried forwarded in 'A' or specified group scrip from one settlement to another settlement.

Special Margin

To curb the unwanted risk in the price and volume special margin has been imposed. The special margin is levied on the net cumulative purchase of the scrip in which the rise in price is abnormally high. It ranges from 25% to 100%.

Concentration Margina

Apart from daily margin if the member's trade is concentrated on limited number of scrips say one to three scrips, concentration margin is levied. If the sale or purchase position exceeds 50%, 65% and 80% respectively, the member has to pay concentration margin.

Additional Volatility Margin

This margin is imposed on scrips quoting above ₹ 40. If the price of the scrip changes by 16% or more in one settlement compared to the closing price at the close of the previous settlement, additional volatility margin is imposed on the traders.

Ad-Hoc Margin

The exchange imposes ad-hoc margin above the daily margins. To have an effective risk management, it is levied when there is an excessive purchase or concentrated purchase position in some scrips. It is also imposed if the member's financial position may not appear to be sound compared to the market exposure.

Check on the Bolt Terminals

The work stations of the members are deactivated generally on two occasions: the member's failure to pay the fee and violation of the trade restrictions given by the authorities. The decision to deactivate is taken on case- to-case basis.

Position Monitoring

The position monitoring means watching of the member's trade position and the outstanding exposure. This is carried out to ensure a smooth completion of pay-in and pay-out settlement. Towards this purpose, various Market Monitoring Reports (MMR) are prepared from the trading data. The Information System Department (ISD) of the exchange provides available data on trade.

Outstanding Market Position

The trade exposure beyond a limit is monitored. The trade outstanding market position is R 10 million and above for A + B1 group scrips. It is ₹ 5 million and above in the case of B group scrip. It is ₹ 1 million and above for individual scrips. The market exposures of the members are compared with the financial soundness of the members and their normal volume of business. If the margin cover is not adequate against their outstanding position corrective steps are taken. Adhoc margins are imposed and details of members' dealings are obtained. The member is advised to square up the outstanding position.

Concentrated Purchase or Sales

Sometimes the members concentrate their trading only on certain scrips and it may end in price rigging. The exchange takes appropriate surveillance against it. The judgment of risk is made on the basis of fundamentals of the scrips, daily turnover and market transactions. The market transactions are scrutinised by cross deals, negotiated deals for settlement, transactions for international investors, Indian financial institutions (IFI), Mutual funds (MFs) and corporate clients.

Carry Forward Positions

The exchange limits the carry forward settlement also. The limit given by the exchange is ₹ 200 million for the members at the end of settlement and ₹ 300 million at the end of any day within a settlement. Adherence to these limits has been closely monitored by the Surveillance Department. The department also inspects certain dealings and books of accounts of the members. Irregularities are referred to the Disciplinary Action Committee (DAC) of the Exchange and Scrutiny Committee of the Exchange.

4. Insider Trading

The most profitable technique employed in the stock market is using one's access to rice sensitive information ahead of others. For example, Hindustan Lever announced the merger of Broke Bond Lipton India with itself on April 16, 1996. But hectic trading took place on the two scrips preceding the announcement. Once the information became public, the trading volume and price declined. Several examples like this can be cited. To prove this SEBI has come out with the SEBI Insider Trading Regulation 1992. The act has defined the insider and the price sensitive information as

- Who is or was connected with the company
- Who is deemed to have been connected with the company and is reasonably expected to have access by virtue of such connection to unpublished price information or
- Who has received or has had access to unpublished price sensitive information.

Connected person is any person:

- Who is a director or is deemed to be a director as per the definition in the Companies Act
- Who is an officer or employee of the company
- Who holds a position involving a professional or business relationship with the company and who may reasonably be expected to have access to unpublished price sensitive information
- A subsidiary as per section (370) (IB) on 372 (11)
- An official or member of a stock exchange
- A dealer in securities or an employee of such dealer member
- A merchant banker, share transfer agent, registrar, debenture trustee, broker, portfolio manger, investment advisor, sub-broker, investment company or an employee thereof,

a trustee of a mutual fund, or director on the board of an asset management company

- a director or employee of a public financial institution
- An official or employee of a self-regulatory organisation
- A relative of any of the above
- Banker to the company

Unpublished price sensitive information areas are given below

- Financial results of the company
- Intended declaration of dividends
- Rights or bonus share offers
- Major expansion plans or execution of new projects
- Amalgamation, mergers and takeovers
- Disposal of the whole of the undertaking
- Such other information as may affect the earnings of the company
- Any changes in policies, plans or operations of the company

Prohibition of Deals

SEBI prohibits an insider from dealings. SEBI is empowered to investigate cases of insider trading. The person being investigated by SEBI is required to produce books, accounts and other documents which the investigating authority may require. SEBI has the authority to restrain the insider from dealing in securities. Any person violating the provision of the insider trading regulation is liable to be punished with fine or imprisonment under the Securities and Exchange Board of India Act, 1992.

5. Internet Trading

The Net is used as a medium of trading in internet trading. Orders are communicated to the stock exchange through website. Internet trading started in India on 1St April 2000 with 79 members seeking permission for online trading. The SEBI committees on internet based securities trading services has allowed the net to be used as an Order Routing System (ORS) through registered stock brokers on behalf of their clients for execution of transaction.

Under the Order Routing System the client enters his requirements (security, quantity, price, and buy/sell) in broker's site. They are checked electronically against the clients account and routed electronically to the appropriate exchange for execution by the broker. The client receives a confirmation on execution of the order. The customer's portfolio and ledger accounts get updated to reflect the transaction.

The user should have the user id and password to enter into the electronic ring. He should also have a demat account and bank account. The system permits only a registered client to log in using user ID and password. Order can be placed using place order window of the website.

- The client has to enter stock code and other parameters such as quantity and price of the scrip on the place order window.
- The client can review the order placed by clicking the review option. He can also reset to clear the values.
- Satisfactory orders are sent by clicking the Send option.
- The client receives an order confirmation message with order number and value of the order.
- If the order is rejected by the broker or stock exchange for certain reasons such as invalid price limit, a related message appears at the bottom of the screen. The time taken to execute the order is 10 seconds.
- When the trade is executed, the broker asks for the transfer of funds by the investor to his account. Stocks are credited/debited according to the buy/sell order in the demat accounts.

Internet trading provides total transparency between a broker and an investor in the secondary market. In the open outcry system, only the broker knew the actually transacted price. Screen based trading provides more transparency. With online trading investors can see themselves the price at which the deal takes place.

The time gap has narrowed in every stage of operation. Confirmation and execution of trade reaches the investor within the least possible time, mostly within 30 seconds. Instant feedback is available about the execution. Some of the websites also offer;

News and research report

BSE and NSE movements

Stock analysis

Freebies

IPO and mutual fund centers and

Movements of international stock exchanges.

6. Takeovers & Merger

Terms such as merger, amalgamation, take-over, consolidation, etc., are used int to denote the process of corporate re-structuring. There is no common definition and these terms may be used to describe a re-structuring of one type of the other. Generally, these terms are used to denote a particular type of re-structuring as follows:

Merger

The term merger includes consolidation, amalgamation and absorption. It refers to a situation when two or more existing firms combine together and form a new entity. Either a new company may be incorporated for this purpose or one existing company (generally a bigger one) survives and another existing company (which is smaller) is merged into it. If a new company is incorporated, it is known as a case of consolidation/amalgamation. However, if an existing company is merged into another existing company, it is known as absorption.

The merger of Tata Oil Mills Ltd. and Brook Bond Lipton (India) Ltd. into Hindustan Lever Ltd. were cases of absorption. On the other hand, merger of 4 companies into HCL Ltd. was a case of consolidation. In year 2000, Times Bank had been merged with HDFC Bank, in line with the wave of consolidation that is sweeping across the global banking industry. SmithKline Beecham Pharmaceutical Ltd. has been merged into Glaxo Ltd. ICICI Ltd., a financial institution has been merged into ICICI Bank Ltd.

Merger is an arrangement for bringing the assets of two firms under control of one. It signifies the transfer of all assets and liabilities of one or more existing companies to another existing or new company. A basic feature of merger is that one company takes the ownership of another company and combine its operations with that of its own operations. The term merger is used to denote the fusion of two or more companies.

Takeovers

In general takeovers refer to the acquiring of ownership right in the property and assets. It denotes a situation when one company acquires (i) ownership in the assets, and to control of monies of another company. The other company of which the control is so acquired remains a separate company and is not liquidated, but there is a change in control.

A.V. Birla Group has acquired controlling interest in Larsen & Toubro Ltd. Acquisition results when one company purchases the controlling interest in the share capital of another existing company in any of the following ways:

(a) By entering into an agreement with a person or persons holding controlling interest in the other company.

(b) By subscribing new shares being issued by the other company.

(c) By purchasing shares of the other company at a stock exchange.

(d) By making an offer to buy the shares of other company, to the existing shareholders of that company.

The term take-over is used to denote the acquisition, which is hostile in nature and the company which is being taken-over may put resistance and oppose the take-over bid. Two companies, i.e., DCM Ltd. and Escorts Ltd. had successfully resisted the take-over bid on their companies by the Caparo Group of the U.K. Arun Bajoria made an unsuccessful bid to take over the controlling interest in Bombay Dyeing Ltd.

Another form of acquisition may take place in the form of holding-subsidiary relationship between two companies. A company is called a holding company if it controls the composition of the Board of Directors of the other company, or holds more than half in nominal value of the equity share capital of the other company. The other company in such a case is known as the subsidiary company.

Both holding and the subsidiary companies maintain their individual identity in the eyes of law as well as in practice. Generally, the relationship between holding and subsidiary companies takes place at the time of incorporation of the latter. Reliance Petro Chemical Ltd. was incorporated as a subsidiary of Reliance Industries Ltd. and later it was merged into the holding company. Hindustan Lever Chemical Ltd. (erstwhile Stepan Chemical Ltd.) is a subsidiary of Hindustan Lever Ltd. In most of the cases, subsidiary companies are small in size and operate as an investment or financing arm of the holding company.

In accounting, the term merger is taken in a different way. The Accounting Standard, AS- 14, issued by the Institute of Chartered Accountants of India has defined the term amalgamation by classifying

(i) Amalgamation in the nature of merger, and

(ii) Amalgamation in the nature of purchase.

Mergers and Take-Overs: Indian Scene

In India, the concept of mergers, acquisitions and take-overs had not been popular and kept a low profile, and the reason for this is quite obvious. The regulatory and prohibitory provisions of MRTP Act, 1969 provided for a cumbersome procedure to get approval for mergers and acquisitions under the Act. However, most of the previsions of the MRTP Act, 1969, have been repealed as a part of economic liberalization drive of the Government of India. In most of the cases, merger in India used to be friendly amalgamation resulting as a consequence of a negotiated deal, untill 1988 when there was the well-known unsuccessful hostile take-over bid by Swaraj Paul (of Caparo Group of the U.K) to get control over DCM Ltd. and Escorts Ltd. Many other Non-resident Indians, such as Chabrias, Hindujas, etc., also attempted to take over many Indian companies by buying shares of these companies at stock exchanges.

During recent years, there has been a spate of merger moves by various industrial groups. Voirho Ltd., a loss-making company, was amalgamated with Voltas Ltd. Hindustan Lever Ltd., first, acquired Tata Oil Mills from the Tata Group and then merged other group ccmpanies, i.e., Brook Bond Lipton (India) Ltd. and Ponds (India Ltd.) with it. The SCICI Ltd., which was initially promoted by ICICI Ltd., has been merged with the latter. Jindal Ferroy Alloys Ltd. has been merged with Jindal Strips Ltd. ITC Classic Ltd. has been merged with ICICI Ltd. British Gas Company has taken over Gujarat Gas Company. Company like Nicholas Piramal has been built only by mergers and acquisitions. India Cement Ltd.'s offer for Raasi Cement Ltd. and the offer of Sterlite Ltd, for taking over Indian Aluminum Company have heralded a new era of hostile take-overs in India.

Regulatory Framework in India

Initially, the regulatory framework for mergers and acquisitions was contained in MRTP Act, 1969. As a measure for reviving the sick enterprises, the Government introduced certain fiscal concessions through the Finance Act, 1976 under Section 72A of the Income Tax Act, 1961.

A profit-making enterprise taking over a sick firm was allowed to carry forward and set off accumulated losses of the later (subject to certain conditions). Presently, the mergers and acquisitions of corporate entities are regulated by provisions contained in (i) Companies Act, 1956; (ii) Security Contracts (Regulations) Act, 1956; (iii) Income-Tax Act, 1961; (iv) Sick Industries Companies (Special Provisions) Act, 1985; (v) Securities and Exchange Board of India Act, 1992, and (vi) Listing Agreement of the Stock Exchanges.

Tax Aspects of Mergers and Takeovers

Income Tax Act, 1961 is vital among all tax laws which affect the merger of firms from the point of view of tax savings/liabilities. However, the benefits under this Act are available only if the following conditions mentioned in Section 2 (1B) of the Act are fulfilled:

(a) All the amalgamating companies should be companies within the meaning of the Section 2 (17) of the Income Tax Act, 1961;

(b) All the properties of the amalgamating company (i.e., the target firm) should be transferred to the amalgamated company (i.e., the acquiring firm);

(c) All the liabilities of the amalgamating company should become the liabilities of the amalgamated company; and

(d) The shareholders of not less than 90% of the share capital of the amalgamating company should become the shareholders of amalgamated company.

In case of mergers and amalgamations, a number of issues may arise with respect to tax implications. Some of the relevant provisions may be summarized as follows:

Depreciation

The amalgamated company continues to claim depreciation on the basis of written down value of fixed assets transferred to it by the amalgamating company. The depreciation charge may be based on the consideration paid and without any re-valuation. However, unabsorbed depreciation, if any, cannot be assigned to the amalgamated company and hence no tax benefit is available in this respect.

Capital Expenditures

If the amalgamating company transfers to the amalgamated company any asset representing capital expenditure on scientific research, then it is deductible in the hands of the amalgamated company under Section 35 of the Income Tax Act, 1961.

Exemption from Capital Gains Tax

The transfer of assets by amalgamating company to the amalgamated company, under the scheme of amalgamation is exempted for capital gains tax subject to conditions, namely (i) that the amalgamated company should be an Indian Company, and (ii) that the shares are issued in consideration of the shares, to any shareholder, in the amalgamated company. The exchange of old shares in the amalgamated company by the new shares in the amalgamating company, is not considered as sale by the shareholders and hence no profit or loss on such exchange is taxable in the hands of the shareholders of the amalgamated company.

Carry Forward Losses of Sick Companies

Section 72A(1) of the Income Tax Act, 1961 deals with the mergers of the sick companies with healthy companies and to take advantage of the carry forward losses of the amalgamating company. But the benefits under this Section with respect to unabsorbed depreciation and carry forward losses are available only if the following conditions are fulfilled:

(i) The amalgamating company is an Indian Company;
(ii) The amalgamating company should not be financially viable;
(iii) The amalgamation should be in public interest;
(iv) The amalgamation should facilitate the revival of the business of the amalgamating company;
(v) The scheme of amalgamation is approved by a specified authority; and
(vi) The amalgamated company should continue to carry on the business of the amalgamating company without any modification.

Amalgamation Expenses

In case, an expenditure is incurred red towards professional charges of Solicitors for the services rendered in connection with the scheme of amalgamation, then such expenses are deductible in the hands of the amalgamated firm.

Self Assessment Questions

1. What is listing of share? Describe the advantages provided for listing. What document should be filed for listing of shares?
2. What is the methodology adopted in security trading on stock exchange?
3. What are the different kinds of brokers operating in the stock market? How do they trade securities in the stock market?
4. Explain the screen based trading system adopted in BSE.

5. Define OTCEI. Explain the trading & settlement system of OTCEI.
6. Explain the functionary of NSDL.
7. What is meant by stock exchange? Explain its main function.
8. Explain the role played by stock exchange in the economic development.
9. Define Takeover & SEBI regulations regarding takeover.
10. How has SEBI regulated Insider trading in the stock exchanges?

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UNIT - IV

Depository

Learning Objectives

After reading this lesson you can be able to understand:-

- Role and importance of Depository
- Depositories Act, 1996
- SEBI Act (Depositories and Participants Regulation) 1996
- National Securities Depositories Ltd.

Meaning

A depository can be compared to a bank. A depository holds securities (like shares, debentures, bonds, Government Securities, units etc.) of investors in electronic form. Besides holding securities, a depository also provides services related to transactions in securities.

Role and Need

Depository plays a vital role in the following areas:

1. Immediate transfer of securities;
2. No stamp duty on transfer of securities;
3. Elimination of risks associated with physical certificates such as bad delivery, fake securities, etc.;
4. Reduction in paperwork involved in transfer of securities;
5. Reduction in transaction cost;
6. Nomination facility;
7. Change in address recorded with DP gets registered electronically with all companies in which investor holds securities eliminating the need to correspond with each of them separately;
8. Transmission of securities is done by DP eliminating correspondence with companies;
9. Convenient method of consolidation of folios/accounts ;

10. Holding investments in equity, debt instruments and Government securities in a single account;

Depositories Act, 1996

[22 of 1996]

An Act to provide for regulation of depositories in securities and for matters connected therewith or incidental thereto.

BE it enacted by Parliament in the Forty-seventh Year of the Republic of India as follows: —

Chapter - I

Preliminary

Short title, extent and commencement.

1. (1) This Act may be called the Depositories Act, 1996.
   (2) It extends to the whole of India.
   (3) It shall be deemed to have come into force on the 20th day of September, 1995.

Definitions.

2. (1) In this Act, unless the context otherwise requires, —

   (a) "beneficial owner" means a person whose name is recorded as such with a depository;

   (b) "Board" means the Securities and Exchange Board of India Established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);

   (*c*) "bye-laws" means bye-laws made by a depository under section 26;

   (d) "Company Law Board" means the Board of Company Law Administration constituted under section 10E of the Companies Act, 1956 (1 of 1956);

   (e) "Depository" means a company formed and registered under the Companies Act, 1956 (1 of 1956), and which has been granted a Certificate of registration under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);

   (*f*) "Issuer" means any person making an issue of securities;

(g) "Participant" means a person registered as such under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);

(*h*) "Prescribed" means prescribed by rules made under this Act;

(i) "record" includes the records maintained in the form of books or Stored in a computer or in such other form as may be determined by Regulations;

(j) "registered owner" means a depository whose name is entered as such in the register of the issuer;

(*k*) "Regulations" means the regulations made by the Board;

(*Ka*) "Securities Appellate Tribunal" means a Securities Appellate

Tribunal established under sub-section (1) of section 15K of the Securities and Exchange Board of India Act, 1992 (15 of 1992);]

(*l*) "Security" means such security as may be specified by the Board;

(m) "service" means any service connected with recording of allotment of securities or transfer of ownership of securities in the record of a Depository.

(2) Words and expressions used herein and not defined but defined in the Companies Act, 1956 (1 of 1956), or the Securities Contracts (Regulation) Act, 1956 (42 of 1956), or the Securities and Exchange Board of India Act, 1992 (15 of 1992), shall have the meanings respectively assigned to them in those Acts.

Chapter - II

Certificate of Commencement of Business

Certificate of commencement of business by depositories.

3. (1) No depository shall act as a depository unless it obtains a certificate of commencement of business from the Board.

(2) A certificate granted under sub-section (1) shall be in such form as may be specified by the regulations.

(3) The Board shall not grant a certificate under sub-section (1) unless it is satisfied that the depository has adequate systems and safeguards to prevent manipulation

of records and transactions:

Provided that no certificate shall be refused under this section unless the depository concerned has been given a reasonable opportunity of being heard.

Chapter III

Rights and obligations of depositories, participants, issuers and beneficial owners

Agreement Between Depository and Participant

4. (1) A depository shall enter into an agreement with one or more participants as its agent.

(2) Every agreement under sub-section (1) shall be in such form as may be specified by the bye-laws.

Services of Depository

5. Any person, through a participant, may enter into an agreement, in such form as may be specified by the bye-laws, with any depository for availing its services.

Surrender of Certificate of Security

6. (1) Any person who has entered into an agreement under section 5 shall surrender the certificate of security, for which he seeks to avail the services of a depository, to the issuer in such manner as may be specified by the regulations.

(2) The issuer, on receipt of certificate of security under sub-section (1), shall cancel the certificate of security and substitute in its records the name of the depository as a registered owner in respect of that security and inform the depository accordingly.

(3) A depository shall, on receipt of information under sub-section (2), enter the name of the person referred to in sub-section (1) in its records, as the beneficial owner

Registration of Transfer of Securities with Depository

7. (1) Every depository shall, on receipt of intimation from a participant, register the transfer of security in the name of the transferee.

(2) If a beneficial owner or a transferee of any security seeks to have custody of such security the depository shall inform the issuer accordingly.

Options to Receive Security Certificate or Hold Securities with Depository

8\. (1) Every person subscribing to securities offered by an issuer shall have the option either to receive the security certificates or hold securities with a depository.

(2) Where a person opts to hold a security with a depository, the issuer shall intimate such depository the details of allotment of the security, and on receipt of such information the depository shall enter in its records the name of the allottee as the beneficial owner of that security.

Securities in depositories to be in fungible form.

9\. (1) All securities held by a depository shall be dematerialized and shall be in a fungible form.

(2) Nothing contained in sections 153, 153A, 153B, 187B, 187C and 372 of the Companies Act, 1956 (1 of 1956), shall apply to a depository in respect of securities held by it on behalf of the beneficial owners.]

Rights of depositories and beneficial owner.

10\. (1) Not withstanding anything contained in any other law for the time being in force, a depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner.

(2) Save as otherwise provided in sub-section (1), the depository as a registered owner shall not have any voting rights or any other rights in respect of securities held by it.

(3) The beneficial owner shall be 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

11\. Every depository shall maintain a register and an index of beneficial owners in the manner provided in sections 150, 151 and 152 of the Companies Act, 1956 (1 of 1956).

Pledge or hypothecation of securities held in a depository.

12. (1) Subject to such regulations and bye-laws, as may be made in this behalf, 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.

(2) Every beneficial owner shall give intimation of such pledge or hypothecation to the depository and such depository shall thereupon make entries in its records accordingly.

(3) Any entry in the records of a depository under sub-section (2) shall be evidence of a pledge or hypothecation.

Furnishing of Information and Records by Depository and Issuer

13. (1) 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.

(2) 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

14. (1) If a beneficial owner seeks to opt out of a depository in respect of any security he shall inform the depository accordingly.

(2) The depository shall on receipt of intimation under sub-section (1) make appropriate entries in its records and shall inform the issuer.

(3) Every issuer shall, 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.

Act 18 of 1891 to Apply to Depositories

15. The Bankers' Books Evidence Act, 1891 shall apply in relation to a depository as if it were a bank as defined in section 2 of that Act.

Depositories to Indemnify loss in Certain Cases

16. (1) Without prejudice to the provisions of any other law for the time being in force, any loss caused to the beneficial owner due to the negligence of the depository or

the participant, the depository shall indemnify such beneficial owner.

(2) Where the loss due to the negligence of the participant under sub-section (1) is indemnified by the depository, the depository shall have the right to recover the same from such participant.

Rights and obligations of depositories, etc.

17. (1) Subject to the provisions of this Act, the rights and obligations of the depositories, participants and the issuers whose securities are dealt with by a depository shall be specified by the regulations.

(2) The eligibility criteria for admission of securities into the depository shall be specified by the regulations.

Chapter - IV

Enquiry and Inspection

Power of Board to call for information and enquiry.

18. (1) The Board, on being satisfied that it is necessary in the public interest or in the interest of investors so to do, may, by order in writing,—

(*a*) 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

(*b*) Authorize 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.

(2) 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.

Power of Board to give directions in certain cases.

19. Save as provided in this Act, if after making or causing to be made an enquiry or

inspection, the Board is satisfied that it is necessary—

(*i*) In the interest of investors, or orderly development of securities market; or

(*ii*) To prevent the affairs of any depository or participant being conducted in the manner detrimental to the interests of investors or 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. [Penalty for failure to furnish information, return, etc.

19A. Any person, who is required under this 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 therefore, 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 each such failure;

(b) To file any return or furnish any information, books or other documents within the time specified therefore in the regulations or bye-laws, fails to file return or furnish the same within the time specified therefore, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;

(c) To maintain books of 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 an agreement.

19B. If a depository or participant or any issuer or its agent or any person, who is registered as an intermediary under the provisions of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), 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 depository or participant or issuer or its agent or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less for every such failure.

Penalty for failure to redress investors' grievances.

19C. If any depository or participant or any issuer or its agent or any person, who is registered as an intermediary under the provisions of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), after having been called upon by the Board in writing, to redress the grievances of the investors, fails to redress such grievances within the time specified by the Board, 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 Dematerialization or Issue of Certificate of Securities.

19D. If any issuer or its agent or any person, who is registered as an intermediary under the provisions of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), fails to dematerialize 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 hereunder or abets in delaying the process of dematerialization or issue the certificate of securities on opting out of a depository of securities, such issuer or its agent or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for Failure to Reconcile Records.

19E. If a depository or participant or any issuer or its agent or any person, who is registered as an intermediary under the provisions of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), fails to reconcile the records of dematerialized securities with all the securities issued by the issuer as specified in the regulations, such depository or participant or issuer or its agent or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure to comply with directions issued by Board under section 19 of the Act.

19F. If any person fails to comply with the directions issued by the Board 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

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

Power to Adjudicate

19H. (1) For the purpose of adjudging under sections 19A, 19B, 19C, 19D, 19E, 19F and 19G, the Board shall appoint any officer not below the rank of a Division Chief of the Securities and Exchange Board of India 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 of any of the sections specified in sub-section *(1)*, he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.

Factors to be taken into account by adjudicating officer.

19-I. While adjudging the quantum of penalty under section 19H, the adjudicating officer shall have due regard to the following factors, namely:—

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

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

(c) The repetitive nature of the default.

Crediting sums realized by way of penalties to Consolidated Fund of India.

19J. All sums realized by way of penalties under this Act shall be credited to the Consolidated Fund of India.]

Chapter - V

Penalty

Offences.

20. *(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 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.

(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.]

Offences by Companies.

21. (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 sub-section (1), 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.

Explanation.—for the purposes of this section,—

(*a*) "Company" means any body corporate and includes a firm or other association of individuals; and

(*b*) "Director", in relation to a firm, means a partner in the firm.

Chapter - VI

Miscellaneous

Cognizance of offences by courts.

22. *(1) No court shall take cognizance of any offence punishable under this Act or any rules or regulations or bye-laws made there under, save on a complaint made by the Central Government or State Government or the Securities and Exchange Board of India or by any person.*

(2) No court inferior to that of a Court of Session shall try any offence punishable under this Act.

Composition of certain offences.

22A. *Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), 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.

22B. *(1)* The Central Government may, on recommendation by the Board, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made there under, has made a full and true disclosure in respect of alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made there under or also from the imposition of any penalty under this Act with respect to the alleged violation:

Provided that 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:

Provided further that recommendation of the Board under this sub-section shall not be 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.]

Appeals.

23. (1) Any person aggrieved by an order of the Board made [before the commencement of the Securities Laws (Second Amendment) Act, 1999] under this Act, or the regulations made there under may prefer an appeal to the Central Government within such time as may be prescribed.

(2) No appeal shall be admitted if it is preferred after the expiry of the period prescribed therefore:

Provided that an appeal may be admitted after the expiry of the period prescribed therefore if the appellant satisfies the Central Government that he had sufficient cause for not preferring the appeal within the prescribed period.

(3) 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.

(4) 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.

23A. (1) Save as provided in sub-section (2), any person aggrieved by an order of the Board made, on and after the commencement of the Securities Laws (Second Amendment) Act, 1999, under this Act, or the regulations made there under, [*or by an order made by an adjudicating officer under this Act*] may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.

(2) No appeal shall lie to the Securities Appellate Tribunal from an order made by the Board with the consent of the parties.

(3) Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order made by the Board is received by the person referred to in sub-section (1) 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.

(4) On receipt of an appeal under sub-section (1), the Securities Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

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

(6) The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavor 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.

23B. (1) The Securities Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 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.

(2) 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 (5 of 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.

(3) 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 (45 of 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 (2 of 1974).

Right to Legal Representation.

23C. The appellant may either appear in person or authorize one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the Securities Appellate Tribunal.

Explanation.—For the purposes of this section,—

(*a*) "chartered accountant" means a chartered accountant as defined in clause (*b*) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;

(*b*) "Company secretary" means a company secretary as defined in clause (*c*) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 (56 of 1980) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;

(*c*) “cost accountant” means a cost accountant as defined in clause (*b*) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of 1959) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;

(*d*) “legal practitioner” means an advocate, vakil or an attorney of any High Court, and includes a pleader in practice.

Limitation

23D. The provisions of the Limitation Act, 1963 (36 of 1963) shall, as far as may be, apply to an appeal made to a Securities Appellate Tribunal.

Civil court not to have jurisdiction.

23E. 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 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.

23F. 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.]]

Power of Central Government to make rules.

24. (1) The Central Government may, by notification in the Official Gazette, make rules for carrying out the provisions of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely [(a*) the manner of inquiry under sub-section (1) of section 19H;*

(a) *The time within which an appeal may be preferred under sub-section (1) of section 23;*]

(*b*) The form in which an appeal may be preferred under sub-section (3) of Section 23 and the fees payable in respect of such appeal;

(*c*) The procedure for disposing of an appeal under sub-section (4) of section 23;

(*d*) 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 Board to make Regulations.

25. (1) Without prejudice to the provisions contained in section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board may, by notification in the Official Gazette, make regulations consistent with the provisions of this Act and the rules made there under to carry out the purposes of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for—

(*a*) The form in which record is to be maintained under clause (*i*) of sub-section (1) of section 2;

(*b*) The form in which the certificate of commencement of business shall be issued under sub-section (2) of section 3;

(*c*) The manner in which the certificate of security shall be surrendered under sub-section (1) of section 6;

(*d*) The manner of creating a pledge or hypothecation in respect of security owned by a beneficial owner under sub-section (1) of section 12;

(*e*) The conditions and the fees payable with respect to the issue of certificate of securities under sub-section (3) of section 14;

(*f*) The rights and obligations of the depositories, participants and the issuers under sub-section (1) of section 17;

(*g*) The eligibility criteria for admission of securities into the depository under sub-section (2) of section 17.

Power of Depositories to make Bye-Laws.

26. (1) A depository shall, with the previous approval of the Board, make bye-laws consistent with the provisions of this Act and the regulations.

(2) In particular, and without prejudice to the generality of the foregoing power, such bye-laws shall provide for—

(a) The eligibility criteria for admission and removal of securities in the Depository;

(*b*) The conditions subject to which the securities shall be dealt with;

(*c*) The eligibility criteria for admission of any person as a participant;

(*d*) The manner and procedure for dematerialization of securities;

(*e*) The procedure for transactions within the depository;

(*f*) The manner in which securities shall be dealt with or withdrawn from a Depository;

(*g*) The procedure for ensuring safeguards to protect the interests of participants and beneficial owners;

(*h*) The conditions of admission into and withdrawal from a participant by a beneficial owner;

(*i*) 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;

(*j*) The manner of distribution of dividends, interest and monetary benefits received from the company among beneficial owners;

(*k*) The manner of creating pledge or hypothecation in respect of securities held with a depository;

(*l*) *Inter se* rights and obligations among the depository, issuer, participants, and beneficial owners;

(*m*) The manner and the periodicity of furnishing information to the Board, issuer and other persons;

(*n*) The procedure for resolving disputes involving depository, issuer, company or a beneficial owner;

(*o*) 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;

(*p*) The internal control standards including procedure for auditing, reviewing and monitoring.

(3) Where the Board considers it expedient so to do, it may, by order in writing, direct a depository to make any bye-laws or to amend or revoke any bye-laws already made within such period as it may specify in this behalf.

(4) If the depository fails or neglects to comply with such order within the specified period, the Board may make the bye-laws or amend or revoke the bye-laws made either in the form specified in the order or with such modifications thereof as the Board thinks fit.

Rules and regulations to be laid before Parliament.

27. 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 rule or regulation.

Application of other laws not barred.

28. The provisions of this Act shall be in addition to, and not in derogation of, any other law for the time being in force relating to the holding and transfer of securities.

Removal of difficulties.

29. (1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order published in the Official Gazette, make such provisions not inconsistent with the provisions of this Act as appear to it to be necessary or expedient for removing the difficulty:

Provided that no order shall be made under this section after the expiry of a period of two years from the commencement of this Act.

(2) Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

Amendments to certain enactments.

30. [*Repealed by Repealing & Amending Act, 2001*].
Repeal and saving.

31. (1) The Depositories (Third) Ordinance, 1996 (Ord. 28 of 1996), is hereby repealed.

(2) Notwithstanding such repeal, anything done or any action taken under the said Ordinance shall be deemed to have been done or taken under the corresponding provisions of this Act.

Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996

Chapter I

Preliminary

Short title & Commencement

1. (1) These regulations may be called the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996.

(2) They shall come into force on the date of their publication in the Official Gazette.

Definitions

2. (1) In these regulations, unless the context otherwise requires, -

(a) "Act" means the Securities and Exchange Board of India Act, 1992 (15 of 1992);

1[(b) (i) "Depositories Act" means the Depositories Act, 1996 (22 of 1996);

(ii) In these regulations, wherever the words "Depositories Ordinance" occur, they shall be replaced by the words "Depositories Act".]

(d) "Form" means any of the forms specified in the First Schedule;

(e) “inspecting officer” means any person authorised by the Board under regulation 59

(f) “Schedule” means any of the Schedules annexed to these regulations;

4 [Explanation

Any person who acting alone or in combination with others holds not less than 51 percent of the share capital of the depository as a sponsor and undertakes to perform the obligation under these regulations shall be deemed to be a sponsor for the purpose of these Regulations]

(2) Words and expressions used and not defined in these regulations but defined in the Act or in the Depositories Ordinance shall have the meanings respectively assigned to them in the Act or the Depositories Ordinance.

(g) “sponsor” means any person or persons who, acting alone or in combination with another person proposes to establish a depository and undertakes to perform the obligations of a sponsor under these regulations.

Chapter - II

Registration of Depository

Application for grant of certificate of registration

3. (1) An application for the grant of a certificate of registration as a depository shall be made to the Board by the sponsor in Form A, shall be accompanied by the fee specified in Part A of the Second Schedule and be paid in the manner specified in Part B thereof.

(2) The application shall be accompanied by draft bye-laws of the depository that is proposed to be set up.

Application to conform to the requirements

4. An application in Form A, which is not complete in all respects and does not conform, to the instructions specified therein shall be rejected:

Provided that before rejecting any such application, the sponsor shall be given in writing an opportunity to remove, within thirty days of the date of communication in this regard, the objections indicated by the Board.

Provided further that the Board may, on being satisfied that it is necessary to extend the period specified in the first proviso, extend such period by such further time as it thinks necessary in order to enable the applicant to remove the objections indicated by the Board.

Furnishing of information, clarification and personal representation

5. (1) The Board may require the sponsor to furnish such further information or clarification regarding matters relevant to the activity of the depository for the purpose of consideration of the application.

(2) The sponsor or his authorised representative shall, if so required, appear before the Board for personal representation, in connection with the grant of certificate of registration.

Consideration of application for grant of certificate of registration

6. The Board shall not consider an application under regulation 3, unless the sponsor belongs to one of the following categories, namely: -

(i) A public financial institution as defined in section 4A of the Companies Act, 1956 (1 of 1956);

(ii) A bank included for the time being in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

(iii) A foreign bank operating in India with the approval of the Reserve Bank of India;

(iv) A recognized stock exchange within the meaning of clause (j) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);

(v) A body corporate engaged in providing financial services where not less than seventy five percent of the equity capital is held by any of the institutions mentioned in sub-clause (i), (ii), (iii) or (iv) jointly or severally;

(vi) A body corporate constituted or recognised under any law for the time being in force in a foreign country for providing custodial, clearing or settlement services in the securities market and approved by the Central Government; or

(vii) AAn institution engaged in providing financial services established outside India and approved by the Central Government.

5*[(viii) The applicant is a fit and proper person.]

Grant of certificate of registration

7. After considering the application under regulation 3, with reference to the qualifications specified in regulation 6, if the Board is satisfied that the company established by the sponsor is eligible to act as depository, it may grant a certificate of registration in Form B to the depository subject to the following, namely: -

   (a) The depository shall pay the registration fee specified in Part A of the Second Schedule in the manner specified in Part B thereof, within fifteen days of receipt of intimation from the Board;

   (b) The depository shall comply with the provisions of the 6*[Act], the Depositories Ordinance, the bye-laws, agreements and these regulations;

   (c) The depository shall not carry on any activity other than that of a depository unless the activity is incidental to the activity of the depository;

   (d) The sponsor shall, at all times, hold at least fifty one per cent of the equity capital of the depository and the balance of the equity capital of the depository shall be held by its participants;

   (e) No participant shall at any time, hold more than five per cent of the equity capital of the depository;

7*[Provided that for the purposes of clause (d) and Clause (e) no foreign entity individually or collectively either as a sponsor or as a participant or as a sponsor and participant together shall hold more than 20% of the equity capital of a depository.]

Explanation

For the purpose of this regulation, a foreign entity shall mean a body corporate or an entity where more than 51% of its equity is held by persons who are not citizens of India.

   (f) If any information previously submitted by the depository or the sponsor to the Board is found to be false or misleading in any material particular, or if there is any change in such information, the depository shall forthwith inform the Board in writing;

   (g) The depository shall redress the grievances of the participants and the beneficial owners within thirty days of the date of receipt of any complaint from a participant or a beneficial owner and keep the Board informed about the number and the nature of redressals;

(h) The depository shall make an application for commencement of business under regulation 14 within one year from the date of grant of certificate of registration under this regulation; and

(i) The depository shall amend its bye-laws from time to time as may be directed by the Board.

Payment of annual fee

8. A depository who has been granted a certificate of registration under regulation 7, shall pay annual fee specified in Part A of the Second Schedule in the manner specified in Part B thereof.

Procedure where certificate of registration is not granted

9. (1) Where an application for the grant of certificate of registration under regulation 3 does not satisfy the requirements specified in regulation 7, the Board shall reject the application after giving the applicant an opportunity of being heard.

(2) The decision of the Board to reject the application shall be communicated to the applicant in writing within thirty days of such decision, stating therein the grounds on which the application has been rejected.

Chapter - III

Certificate of Commencement of Business

Application for grant of certificate of commencement of business

10. A depository, which has been granted a certificate of registration under regulation 7, shall within one year from the date of issue of such certificate make an application to the Board for commencement of business in Form C.

Application to conform to the requirements

11. Any application in Form C, which is not complete in all respects and does not conform to instructions specified therein shall be rejected:

Provided that before rejecting any such application, the applicant shall be given in writing an opportunity to remove within thirty days of the date of communication in this regard, the objections indicated by the Board.

Provided further that the Board may, on being satisfied that it is necessary to extend the period specified in the first proviso, extend such period by such further time as it thinks necessary in order to enable the applicant to remove the objections indicated by the Board.
Furnishing of information, clarification, and personal representation

12. (1) The Board may require the depository to furnish such further information or clarification regarding matters relevant for the grant of certificate of commencement of business.

(2) The depository or its authorised representative, if so required, shall appear before the Board for personal representation in connection with the grant of certificate of commencement of business.

Consideration of application for grant of certificate of commencement of business

13. (1) The Board shall take into account for considering grant of certificate of commencement of business, all matters which are relevant to the efficient and orderly functioning of the depository and in particular, the following, namely, whether:

(a) The depository has a net worth of not less than rupees one hundred crore;

(b) The bye-laws of the depository have been approved by the Board;

(c) The automatic data processing systems of the depository have been protected against unauthorised access, alteration, destruction, disclosure or dissemination of records and data;

(d) The network through which continuous electronic means of communications are established between the depository, participants, issuers and issuers' agents is secure against unauthorised entry or access;

(e) The depository has established standard transmission and encryption formats for electronic communications of data between the depository, participants, issuers and issuers' agents;

(f) The physical or electronic access to the premises, facilities, automatic data processing systems, data storage sites and facilities including back up sites and facilities and to the electronic data communication network connecting the depository, participants, issuers and issuers' agents is controlled, monitored and recorded;

(g) The depository has a detailed operations manual explaining all aspects of its functioning, including the interface and method of transmission of information between the depository, issuers, issuers' agents, participants and beneficial owners;

(h) The depository has established adequate procedures and facilities to ensure that its records are protected against loss or destruction and arrangements have been made for maintaining back up facilities at a location different from that of the depository;

(i) The depository has made adequate arrangements including insurance for indemnifying the beneficial owners for any loss that may be caused to such beneficial owners by the wrongful act, negligence or default of the depository or its participants or of any employee of the depository or participant; and

(j) The grant of certificate of commencement of business is in the interest of investors in the securities market.

(2) The Board shall, before granting a certificate of commencement of business under this Chapter make a physical verification of the infrastructure facilities and systems established by the depository.

Grant of certificate of commencement of business

14. After considering the application under regulation 13 with reference to the matters specified in sub-regulation (1) of regulation 13 and making physical verification under sub- regulation (2) of that regulation, if the Board is satisfied that the depository is eligible to commence business as a depository, shall grant a certificate of commencement of business in Form D.

Procedure where certificate of commencement of business is not granted

15. (1) If the Board, after considering the matters specified in sub-regulation (1) of regulation 13 and making physical verification under sub- regulation (2) of that regulation, is of the opinion that the depository shall not be granted a certificate of commencement of business, it may either-

(a) Direct the depository to conform to the matters specified in regulation 13; or

(b) Reject the application after giving the applicant an opportunity of being heard.

(2) The decision of the Board to reject the application shall be communicated to the depository in writing within thirty days of such decision, stating therein the grounds on which the application has been rejected.

Chapter - IV

Registration of Participant

Application for grant of certificate of registration

16. (1) An application for the grant of a certificate of registration as a participant shall be made to the Board in Form E, through each depository in which the applicant proposes to act as a participant, shall be accompanied by the fee specified in Part A of the Second Schedule and be paid in the manner specified in Part B thereof.

(2) The depository shall forward to the Board the application in Form E as early as possible, but not later than thirty days along with its recommendations and certifying that the participant complies with the eligibility criteria including adequate infrastructure as provided for in these regulations and the bye- laws of the depository.

Application to conform to the requirements

17. An application in Form E, which is not complete in all respects and does not conform to the instructions specified therein, shall be rejected:

Provided that before rejecting any such application, the applicant shall be given in writing an opportunity to remove within thirty days of the date.

Provided further that the Board may, on being satisfied that it is necessary to extend the period specified in the first proviso, extend such period by such further time as it thinks necessary in order to enable the applicant to remove the objections indicated by the Board. Furnishing information, clarification, and personal representation of communication in this regard, the objections indicated by the Board

18. (1) The Board may require the applicant, or the depository to which the applicant is to be admitted as a participant, to furnish such further information or clarification

as may be considered necessary for the grant of a certificate of registration to the applicant.

(2) The applicant or his authorised representative shall, if so required, appear before the Board for personal representation in connection with the grant of a certificate of registration.

Consideration of application for grant of certificate of registration

19. For the purpose of grant of certificate of registration, the Board shall take into account all matters which are relevant to or relating to the efficient and orderly functioning of a participant and in particular, whether the applicant complies with the following requirements, namely: -

(a) The applicant belongs to one of the following categories,-

(i) A public financial institution as defined in section 4A of the Companies Act, 1956 (1 of 1956);

(ii) A bank included for the time being in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

(iii) a foreign bank operating in India with the approval of the Reserve Bank of India;

(iv) A state financial corporation established under the provisions of section 3 of the State Financial Corporations Act, 1951 (63 of 1951);

(v) An institution engaged in providing financial services, promoted by any of the institutions mentioned in sub clause (i), (ii), (iii), (iv) jointly or severally;

(vi) A custodian of securities who has been granted a certificate of registration by the Board under sub- section (1A) of section 12 of the Act;

(vii) A clearing corporation 8*[or a clearing house] of a stock exchange;

(viii) A stock broker who has been granted a certificate of registration by the Board under sub-section (1) of section 12 of the Act:

9 *[Provided that the stock-broker shall have a minimum net worth of rupees 50 lakhs and the aggregate value of the portfolio of securities of the beneficial owners held in dematerialised form in a depository through him, shall not exceed

10 *[100 times of the net worth of the stock broker]

Provided further that if the stock broker seeks to act as a participant in more than one depository, he shall comply with the criteria specified in the first proviso separately for each such depository; or

11 *[Provided further that where the stockbroker has a minimum networth of Rupees Ten crore, the limits on the aggregate value of the portfolio of securities of the beneficial owners held in dematerialized form in a depository through him shall not be applicable.]

(ix) A non-banking finance company, having a net worth of not less than rupees fifty lakhs:

Provided that such company shall act as a participant only on behalf of itself and not on behalf of any other person;

12 [Provided further that a non-banking finance company may act as a participant on behalf of any other person, if it has a networth of ₹ 50 crores in addition to the networth specified by any other authority]

13 [(x) A registrar to an issue or share transfer agent who has a minimum net worth of

14 [rupees ten crores] and who has been granted a certificate of registration by the Board under sub – section (1) of Section 12 of the Act.]

15 (b) The applicant is eligible to be admitted as a participant of the depository through which it has made the application to the Board;

(c) The applicant has adequate infrastructure, systems, safeguards and trained staff to carry on activity as a participant; and

16(cc) The applicant is a fit and proper person.]

(d) The grant of certificate of registration is in the interests of investors in the securities market

Grant of Certificate of Registration

20. (1) After considering the application under regulation 16, with reference to the matters specified in regulation 19, if the Board is satisfied that the applicant is

eligible for grant of certificate of registration, grant a certificate in Form F.

(2) The grant of certificate of registration in Form F shall be subject to the following namely:-

(a) The participant shall pay the registration fee specified in Part A of the Second Schedule in the manner specified in Part B thereof, within fifteen days of the receipt of intimation from the Board;

(b) The participant shall comply with the provisions of the 17*[Act], Depositories Ordinance, the bye-laws, agreements and these regulations;

(c) The depository through which an application for certificate of registration has been forwarded holds a certificate of commencement of business under regulation 14;

(d) If any information previously submitted by the participant to the Board is found to be false or misleading in any material particular, or if there is any change in such information, the participant shall forthwith inform the Board in writing;

(e) The participant shall redress the grievances of beneficial owners within thirty days of the date of the receipt of the complaint and keep the depository informed about the number and the nature of redressals; and

(f) The participant shall pay annual fees specified in Part A of the Second Schedule in the manner specified in Part B thereof.

18*[Participants to abide by Code of Conduct

20A. The Participant holding a certificate shall, at all times, abide by the Code of Conduct as specified in Third Schedule.]

Period of validity of the certificate of registration

21. The certificate of registration issued under regulation 20, or renewed under regulation 22 shall be valid for a period of five years from the date of its issue or renewal, as the case may be.

Renewal of Certificate of Registration

22. (1) Three months before the expiry of the period of validity of a certificate of registration, the participant shall, if it so desires, make an application for renewal

in Form E through the depository in which it is a participant.

(2) The application for renewal under sub-regulation (1) shall accompany the fee specified for issue of certificate of registration and shall be dealt with in the same manner as if it were a fresh application for grant of certificate of registration.

Conditions of renewal of certificate of registration

23. The Board may renew a certificate of registration granted to a participant subject to the conditions of certificate of registration specified in regulation 22.

Procedure where certificate of registration is not granted

24. (1) Where an application for the grant of certificate of registration under regulation 16 or for its renewal under regulation 22 does not satisfy the requirements specified in regulation 19, the Board shall reject the application after giving the applicant an opportunity of being heard.

(2) The decision of the Board to reject the application shall be communicated to the applicant in writing within thirty days of such decision, stating therein the grounds on which the application has been rejected.

Effect of refusal to renew a certificate of registration

25. Any participant whose application for a certificate of registration as a participant has been rejected by the Board under regulation 24 shall from the date of expiry of the certificate of registration sought to be renewed, cease to carry on any activity as a participant:

Provided that the Board may, in the interest of the investors in the securities market permit the participant to carry on activities undertaken prior to the receipt of the intimation of refusal subject to such condition as the Board may specify.

Chapter - V

Rights and Obligations of Depositories, Participants, Issuers, Manner of Surrender of Certificate of Security and Creation of Pledge or Hypothecation

Rights and obligations of depositories, etc

26. The depositories, participants, issuers, and issuers' agents, in addition to the rights and obligations laid down in the Depositories 19*[Act] and the bye-laws shall have the rights and obligations arising from the agreements entered into by them.

Depository to declare specific securities eligible arising from the agreements entered into by them

27. Every depository shall, in its bye-laws, state the specific securities which are eligible for being held in dematerialised form in the depository.

Securities eligible for dematerialisation

28. The following securities shall be eligible for being held in dematerialised form in a depository:-

(a) Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(b) Units of mutual funds, rights under collective investment schemes and venture capital funds, commercial paper, certificates of deposit, securitised debt, money market instruments and 20*[government securities] unlisted securities shall also be similarly eligible for being held in dematerialised form in a depository.

Agreement between depository and issuer

29. 21(1) Either on the issuer or on the investors exercising an option to hold his securities with a depository in dematerialised form, the issuer shall enter into an agreement with a depository to enable the investor to dematerialise the securities."]

22 [Provided that no agreement shall be required to be entered into where depository itself is an issuer of securities]

23 [Provided further that no agreement shall be required to be entered into where State or Central Government is the issuer of Government securities]

(2) Where the issuer has appointed a Registrar to the Issue or Share Transfer Agent, who has been granted certificate of registration by the Board under sub-section (1) of section 12 of the Act, the depository shall enter

into a tripartite agreement with the issuer and the Registrar to the Issue or Share Transfer Agent, as the case may be, in respect of the securities to be declared by the depository as eligible to be held in dematerialised form.

Systems and Procedures

30. Every depository shall have systems and procedures which will enable it to co-ordinate with the issuer or its agent, and the participants, to reconcile the records of ownership of securities with the issuer or its agent, as the case may be, and with participants, on a daily basis.

Connectivity

31. Every depository shall maintain continuous electronic means of communication with all its participants, issuers or issuers' agents, as the case may be, clearing houses and clearing corporations of the stock exchanges and with other depositories.

Transfer to be affected only after payment

32. The depository shall satisfy the Board that it has a mechanism in place to ensure that the interest of the persons buying and selling securities held in the depository are adequately protected and shall register the transfer of a security in the name of the transferee only after the depository is satisfied that payment for such transfer has been made.

Withdrawal by participant

33. Every depository shall allow any participant to withdraw or transfer its account, if the request for such withdrawal or transfer is in accordance with conditions stipulated therefor in the bye-laws of the depository.

Internal Monitoring, Review and Evaluation of Systems and Controls

34. Every depository shall have adequate mechanisms for the purposes of reviewing, monitoring and evaluating the depository's controls, systems, procedures and safeguards.

External monitoring, review and evaluation of systems and controls

35. Every depository shall cause an inspection of its controls, systems, procedures and safeguards to be carried out annually and forward a copy of the report to the Board.

Insurance Against Risks

36. Every depository shall take adequate measures including insurance to protect the interests of the beneficial owners against risks likely to be incurred on account of its activities as a depository.

Manner of Keeping Records

37. Where records are kept electronically by the depository, it shall ensure that the integrity of the automatic data processing systems is maintained at all times and take all precautions necessary to ensure that the records are not lost, destroyed or tampered with and in the event of loss or destruction, ensure that sufficient back up of records is available at all times at a different place.

Records to be Maintained

38. (1) Every depository shall maintain the following records and documents, namely: -

(a) Records of securities dematerialised and rematerialised;

(b) The names of the transferor, transferee, and the dates of transfer of securities;

(c) A register and an index of beneficial owners;

24 *[(cc) details of the holdings of the securities of the beneficial owners as at the end of each day.]

(d) Records of instructions received from and sent to participants, issuers, issuers' agents and beneficial owners;

(e) Records of approval, notice, entry and cancellation of pledge or hypothecation, as the case may be;

(f) Details of participants;

(g) Details of securities declared to be eligible for dematerialisation in the depository; and

(h) Such other records as may be specified by the Board for carrying on the activities as a depository.

(2) Every depository shall intimate the Board the place where the records and documents are maintained.

(3) Subject to the provisions of any other law, the depository shall preserve records and documents for a minimum period of five years.

Co-operation with other entities

39. Every depository shall extend all such co-operation to the beneficial owners, issuers, issuers' agents, custodians of securities, other depositories and clearing organizations as is necessary for the effective, prompt and accurate clearance and settlement of securities' transactions and conduct of business.

Prohibition of Assignment

40. No depository shall assign or delegate to any other person its functions as a depository, without the prior approval of the Board.

Agreement by participant

41. Every participant shall enter into an agreement with a beneficial owner before acting as a participant on his behalf, in a manner specified by the depository in its bye-laws.

Separate Accounts

42. (1) Separate accounts shall be opened by every participant in the name of each of the beneficial owners and the securities of each beneficial owner shall be segregated, and shall not be mixed up with the securities of other beneficial owners or with the participant's own securities.

(2) A participant shall register the transfer of securities to or from a beneficial owner's account only on receipt of instructions from the beneficial owner and thereafter confirm the same to the beneficial owner in a manner as specified by the depository in its bye-laws.

(3) Every entry in the beneficial owner's account shall be supported by electronic instructions or any other mode of instruction received from the beneficial owner in accordance with the agreement with the beneficial owner.

Statement of Accounts

43. Every participant shall provide statements of account to the beneficial owner in such form and in such manner and at such time as provided in the agreement with the beneficial owner.

Transfer or withdrawal by beneficial owner

44. Every participant shall allow a beneficial owner to withdraw or transfer from his account in such manner as specified in the agreement with the beneficial owner.

Connectivity

45. Every participant shall maintain continuous electronic means of communication with each depository in which it is a participant.

Monitoring, reviewing and evaluating internal systems and controls

46. Every participant shall have adequate mechanism for the purposes of reviewing, monitoring and evaluating the participant's internal accounting controls and systems.

Reconciliation

47. Every participant shall reconcile his records with every depository in which it is a participant, on a daily basis.

Returns

48. Every participant shall submit periodic returns to the Board and to every depository in which it is a participant in the format specified by the Board or the bye-laws of the depository, as the case may be.

Record of services

49. (1) Every participant shall maintain the following records and documents, namely: -

(a) Records of all the transactions entered into with a depository and with a beneficial owner;

(b) Details of securities dematerialised, rematerialised on behalf of beneficial owners with whom it has entered into an agreement;

(c) Records of instructions received from beneficial owners and statements of account provided to beneficial owners; and

(d) Records of approval, notice, entry and cancellation of pledge or hypothecation, as the case may be.

(2) Every participant shall make available for the inspection of the depository in which it is a participant all records referred to in sub-regulation (1).

(3) Every participant shall allow persons authorised by the depository in which it is a participant to enter its premises during normal office hours and inspect its records.

(4) Every participant shall intimate the Board the place where the records and documents are maintained.

(5) Subject to the provisions of any other law, the participant shall preserve records and documents for a minimum period of five years.

Manner of Keeping Records

50. Where records are kept electronically by the participant, it shall ensure that the integrity of the data processing systems is maintained at all times and take all precautions necessary to ensure that the records are not lost, destroyed or tampered with and in the event of loss or destruction, ensure that sufficient back up of records is available at all times at a different place.

Records to be Maintained Depository-Wise

51. If a participant enters into an agreement with more than one depository, it shall maintain the records specified in regulation 49 separately in respect of each depository.

Prohibition of assignment systems

52. No participant shall assign or delegate its functions as participant to any other person, without the prior approval of the depository.

Agreement by issuer

53. Every issuer whose securities have been declared as eligible to be held in dematerialised form in a depository shall enter into an agreement with the depository in accordance with the provisions of regulation 29.

25 [Provided that no agreement shall be required to be entered into in case: -

(i) The depository is the issuer of securities; or

(ii) The State or the Central Government is the issuer of Government securities.]

26 [Manner of Handling Share Registry Work

53A All matters relating to transfer of security, maintenance of records, holders of security, handling of physical security and establishing connectivity with the depositories shall be handled and maintained at a single point i.e., either in-house by the issuer or a share transfer agent registered with the Board.]

Redressal for Investor Grievances

53B Every issuer or its agent or any person who is registered as an intermediary under this Act, shall redress the grievances of beneficial owners within thirty days of the date of receipt of complaint and keep a depository informed about the number and nature of grievances redressed by it and the number of grievances pending before it.]

Manner of Surrender of Certificate of Security

54. (1) Any beneficial owner, who has entered into an agreement with a participant, shall inform the participant of the details of the certificate of security, which is to be dematerialised, and shall surrender such certificate to the participant:

Provided that where a beneficial owner has appointed a custodian of securities, then he may surrender the certificates of security to the participant through his custodian of securities.

(2) The participant shall, on receipt of information under sub- regulation (1), forward such details of the certificate of security to the depository and shall confirm to the depository that an agreement has been entered into between the participant and the beneficial owner.

(3) The participant shall maintain records indicating the names of beneficial owners of the securities surrendered the number of securities and other details of the certificate of security received.

27 *[(4) The participant shall, within 7 days of the receipt of certificate of security refer to in sub-regulation (1) furnish to the issuer details specified in regulation 2 along with the certificate of security.]

28 *[(5) Within 15 days of receipt of the certificate of security from the participant shall confirm to the depository that the security comprised in the said certificate have been listed on the stock exchange or exchanges where the earlier issued securities

are listed and shall also after due verification immediately mutilate and cancel the certificate of security and substitute in its record the name of the depository as the registered owner and shall send a certificate to this effect to the depository and to every stock exchange where the security is listed.

Provided that in case of unlisted companies the condition of listing in all stock exchanges where earlier issued shares are listed shall not be applicable.]

(6) Immediately upon receipt of information from the issuer under sub-regulation (5), the depository shall enter in its records the name of the person who has surrendered the certificate of security as the beneficial owner, as well as the name of the participant from whom it has received intimation under sub-regulation (2), and shall send an intimation of the same to the participant.

(7) The issuer shall maintain a record of certificates of securities, which have been dematerialised.

Reconciliation

55. The issuer or its agent shall reconcile the records of dematerialised securities with all the securities issued by the issuer, on a daily basis.

29 [Provided that where the State or the Central Government is the issuer of Government securities, the depository shall, on a daily basis, reconcile the records of the dematerialised securities.]

30Audit

55A (1) Every issuer shall submit audit report on a quarterly basis starting from September 30, 2003 to the concerned stock exchanges audited from a qualified chartered accountant or a practicing company secretary, 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 stock exchanges where it is listed in respect of such further issued capital.

(2) The audit report under sub-regulation (1) shall also give the updated status of the register of members of the issuer and confirm that security have been dematerialized as per requests within 21 days from the date of receipt of request from the issuer and where the dematerialization has not been effected within the

said stipulated period, the report shall disclose the reasons for such delay.

(3) The issuer shall immediately bring to the notice of depositories and the stock exchanges, any difference observed in its issue, listed, and the capital held by depositories in dematerialized form.]

Connectivity

56. Every issuer or its agent shall establish continuous electronic means of communication with the depository with which it has entered into an agreement.

Information

57. Every issuer whose securities have been declared as eligible for dematerialisation in a depository shall give information to the depository about book closures, record dates, dates for the payment of interest or dividend, dates for annual general meetings and other meetings, dates for redemption of debentures, dates for conversion of debentures and warrants, call money dates and such other information at the time and in the manner as may be specified by the depository in its bye-laws or agreement.

31 [Provided that no such information would be required to be given to the depository where the State or the Central Government is the issuer of Government securities.]

Manner of creating pledge or hypothecation

58. 32(1) If a beneficial owner intends to create a pledge on a security owned by him, he shall make an application to the depository through the participant who has his account in respect of such securities.

(2) The participant after satisfaction that the securities are available for pledge shall make a note in its records of the notice of pledge and forward the application to the depository.

33 (3) The depository after confirmation from the pledgee that the securities are available for pledge with the pledgor shall within fifteen days of the receipt of the application create and record the pledge and send an intimation of the same to the participants of the pledgor and the pledgees.

(4) On receipt of the intimation under sub-regulation (3) the participants of both the pledgor and the pledgee shall inform the pledgor and the pledgee respectively of the entry of creation of the pledge.

(5) If the depository does not create the pledge, it shall send along with the reasons intimation to the participants of the pledgor and the pledgee.

(6) The entry of pledge made under sub-regulation (3) may be cancelled by the depository if the pledgor or the pledgee makes an application to the depository through its participant.

Provided that no entry of pledge shall be cancelled by the depository with the prior concurrence of the pledgee.

(7) The depository on the cancellation of the entry of pledge shall inform the participant of the pledgor.

(8) Subject to the provisions of the pledge document, the pledgee may invoke the pledge and on such invocation, the depository shall register the pledgee as beneficial owner of such securities and amend its records accordingly.

(9) After amending its records under sub-regulation (8) the depository shall immediately inform the participants of the pledgor and pledgee of the change who in turn shall make the necessary changes in their records and inform the pledgor and pledgee respectively.

(10) (a) If a beneficial owner intends to create a hypothecation on a security owned by him he may do so in accordance with the provisions of sub-regulations (1) to (9).

(b) The provisions of sub – regulations (1) to (9) shall mutatis mutandis apply in such cases of hypothecation.

Provided that the depository before registering the hypothecatee as a beneficial owner shall obtain the prior concurrence of the hypothecator.

(11) No transfer of security in respect of which a notice or entry of pledge or hypothecation is in force shall be effected by a participant without the concurrence of the pledgee or the hypothecatee as the case may be.]

34 *[Investment Advice

58A (1) A depository or a participant or any of their employees shall not render, directly or indirectly, any investment advice about any security in the publicly accessible media whether real-time or non-real-time, unless a disclosure of his interest including long or short position in the said security has been made, while rendering such advice.

(2) In case an employee of the depository or the participant 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.

Appointment of compliance officer

58B (1) A depository and a participant shall appoint a compliance officer who shall be responsible for monitoring of the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by the Board or the Central Government and for redressal of investor's grievances.

(2) The compliance officer shall immediately and independently report to the Board any non-compliance observed by him]

Chapter - VI

Inspection

Board's right to inspect

59. The Board may appoint one or more persons as inspecting officer to undertake inspection of the books of accounts, records, documents and infrastructure, systems and procedures, or to investigate the affairs of a depository, a participant, a beneficial owner, an issuer or its agent for any of the following purposes, namely:-

(a) To ensure that the books of account are being maintained by the depository, participant, issuer or its agent in the manner specified in these regulations;

(b) To look into the complaints received from the depositories, participants, issuers, issuers' agents, beneficial owners or any other person;

(c) To ascertain whether the provisions of the Act, the Depositories 35*[Act], the bye-laws, agreements and these regulations are being complied with by the depository, participant, beneficial owner, issuer or its agent;

(d) To ascertain whether the systems, procedures and safeguards being followed by a depository, participant, beneficial owner, issuer or its agent are adequate;

(e) To suo motu ensure that the affairs of a depository, participant, beneficial owner, issuer or its agent, are being conducted in a manner which are in the interest of the investors or the securities market.

Notice before inspection and investigation

60. (1) Before ordering an inspection or investigation under regulation 59, the Board shall give not less than 10 days notice to the depository, participant, beneficial owner, issuer or its agent, as the case may be.

(2) Notwithstanding anything contained in sub-regulation (1), where the Board is satisfied that in the interest of the investors no such notice should be given, it may, by an order in writing direct that such inspection be taken up without such notice.

(3) During the course of an inspection or investigation, the depository, a participant, a beneficial owner, an issuer or its agent against whom the inspection or investigation is being carried out shall be bound to discharge his obligation as provided in regulation 61.

Obligations on inspection by the Board

61. (1) It shall be the duty of the depository, a participant, a beneficial owner, an issuer or its agent whose affairs are being inspected or investigated, 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 as a depository, a participant, a beneficial owner, an issuer or its agent, as the inspecting officer may require, within such reasonable period as the inspecting officer may specify.

(2) The depository, a participant, a beneficial owner, an issuer or its agent shall allow the inspecting officer to have reasonable access to the premises occupied by him 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 depository, a participant, a beneficial owner, an issuer or its agent 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.

(3) The inspecting officer, in the course of inspection of investigation, shall be entitled to examine or to record the statements of any director, officer or employee of the depository, a participant, a beneficial owner, an issuer or its agent.

(4) It shall be the duty of every director, officer or employee of the depository, a participant, a beneficial owner, an issuer or its agent to give to the inspecting officer all assistance in connection with the inspection, which the inspecting officer may reasonably require.

Submission of Report to the Board

62. The inspecting officer shall, as soon as possible, on completion of the inspection or investigation as the case may be, submit a report to the Board:

Provided that if directed to do so by the Board, he may submit interim reports.

36 *[Action on inspection or investigation report

63. The Board or the Chairman shall after consideration of inspection or investigation report take such action as the Board or Chairman may deem fit and appropriate including action under the Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002]

37 *[Application of Chapter

63A Nothing contained in this Chapter shall be applicable to the State or the Central Government where it is the issuer of the Government securities]

38 *[Appointment of Auditor

63A The Board shall have the power to appoint an auditor to inspect or investigate, into the books of accounts, records, documents, infrastructures, systems and procedures or affairs of a depository, a participant, a beneficial owner, an issuer or its agent.

Provided that the auditor so appointed shall have the same powers of the inspecting or investigating officer as stated in regulations 59 and 60, and the obligation of the depository, participant, beneficial owner, issuer or its agent and their respective directors, officers and employees, as the case may be, as stated in Regulation 61, shall be applicable to the inspection or investigation under this Regulation.

Board to Recover the Expenses

63B The Board shall be entitled to recover from the depository, a participant, a beneficial owner, an issuer or its agent as the case may be, such expenses including fees paid to the auditors as may be incurred by it for the purposes of inspecting or investigating the books of accounts, records, documents, infrastructures, systems and procedures of the depository, a participant, a beneficial owner, a issuer or its agent, as the case may be.]

Foot Notes

35. Substituted for "Ordinance" by Securities and Exchange Board of India (Depository and Participants) (Amendment) Regulations, 1997 published in the official Gazette of India dated 07.02.1997.

36. Following regulation 63 was substituted by Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002.

"Communication of findings etc.

63. (1) The Board shall, after consideration of the inspection report or the investigation report referred to in regulation 62, communicate the findings of the inspecting officer to the depository, participant, issuer or its agent, as the case may be, and give him an opportunity of being heard.

(2) On receipt of the reply if any, from the depository, participant, issuer or its agent, as the case may be, the Board may call upon him to take such measures as the Board may deem fit in the interest of the securities market and for due compliance with the provisions of the Act, the Depositories a*[Act], regulations, the bye- laws and agreements.

a. Substituted for "Ordinance" by Securities and Exchange Board of India (Depository and Participants) (Amendment) Regulations, 1997 published in the official Gazette of India dated 07.02.1997.

37. Regulation 63A inserted by Securities and Exchange Board of India (Depository and Participants) (Second Amendment) Regulations, 1998 published in the official Gazette of India dated 21.01.1998.

38. Regulations 63A and 63B were inserted by Securities and Exchange Board of India (Depository and Participants) (Second Amendment) Regulations, 1999 published in the official Gazette of India dated 07.07.1999

Chapter - VII

Procedure for Action in Case of Default

39 [Liability for action in case of default

64. A depository or a participant who-

a. Contravenes any of the provisions of the Act, the Depositories Act, the bye-laws, agreements and these regulations;

b. Fails to furnish any information relating to its activity as a depository or participant as required under these regulations;

c. Does not furnish the information called for by the Board under clause (a) of sub-section (1) of section 18 of the Depositories Act or furnishes information which is false or misleading in any material particular;

d. Does not co-operate in any inspection or investigation or enquiry conducted by the Board;

e. Fails to comply with any direction of the Board issued under section 18 of the Depositories Act;

f. Fails to pay the annual fee referred to in regulation 8, shall be dealt with in the manner provided under the Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002.]

Securities And Exchange Board Of India (Custodian Of Securities) Regulations, 1996

Chapter - I

Preliminary

Short title and Commencement

1. (1) These regulations may be called the Securities and Exchange Board of India (Custodian of Securities) Regulations, 1996.

   (2) They shall come into force on the date of their publication in the Official Gazette.

Definitions

2. In these regulations, unless the context otherwise requires:-

   (a) "Act" means the Securities and Exchange Board of India Act, 1992 (15 of 1992);

   (b) "Certificate" means a certificate of registration granted by the Board under these regulations;

   (c) "Client" means any person who has entered into an agreement with a custodian of securities to avail of custodial services provided by the custodian of securities;

   (d) "Custodian of securities" means any person who carries on or proposes to carry on the business of providing custodial services;

   (e) "Custodial services" in relation to securities means safekeeping of securities of a client and providing services incidental thereto, and includes-

      (i) Maintaining accounts of securities of a client;

      (ii) Collecting the benefits or rights accruing to the client in respect of securities;

      (iii) 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

      (iv) Maintaining and reconciling records of the services referred to in sub-Clauses (i) to (iii). (f) "Custody account" means an account of a client maintained by a custodian of securities in respect of securities;

   (g) "enquiry officer" means an enquiry officer appointed by the Board, under regulation 29;

   (h) "Form" means any of the forms set out in the First Schedule;

   (i) "inspecting officer" means an inspecting officer appointed by the Board under regulation 21;

Chapter - II

Registration of Custodians of Securities

Application for Grant of Certificate

3. (1) Any person proposing to carry on business as custodian of securities on or after the commencement of these regulations shall make an application to the Board for grant of a certificate.

(2) Any person who is carrying on business as a custodian of securities on the date of commencement of these regulations shall make an application to the Board for grant of certificate within a period of three months from the date of such commencement.

Provided that the Board may, 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 up to a maximum of six months from the date of such commencement.

(3) An application for grant of a certificate under sub- regulation (1) or sub-regulation (2) shall be made in Form A and shall be accompanied by an application fee as specified in Part A of the Second Schedule and be paid in the manner specified in Part B thereof.

(4) Any person referred to in sub-regulation (2) who fails to make an application for grant of certificate within the period or the extended period specified therein, shall cease to carry on any activity as custodian of securities and shall be subject to the directions of the Board with regard to the transfer of records, documents or securities relating to his activities as custodian of securities.

Application to conform to requirements

4. An application under regulation 3 which is not complete in all respects or which does not conform to the instructions specified therein shall be rejected;

Provided that, before rejecting any such application, the Board shall give the applicant an opportunity to remove the objection, within such time as may be specified by the Board.

Furnishing of information, clarification, and personal representation

5. (1) The Board 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.

(2) The applicant or his authorized representative shall, if so required, appear before the Board for personal representation, in connection with the grant of certificate.

Consideration of application for grant of certificate

6. (1) For the purpose of the grant of a certificate, the Board shall take into account all matters which are relevant to the activities of a custodian of securities and, in particular, whether:-

(a) The applicant fulfils the capital requirement in accordance with regulation 7;

(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 in his employment adequate and competent persons who have the experience, capacity and ability of managing the business of the custodian of securities;

(d) 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;

(e) The applicant is a person who has been refused a certificate by the Board or whose certificate has been cancelled by the Board;

(f) The applicant, his director, his principal officer or any of his employees is involved in any litigation connected with the securities market;

(a) 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; and

(b) The applicant is a fit and proper person] and

(h) the grant of certificate is in the interest of investors.

(2) Notwithstanding anything contained in sub-regulation (1) the Board shall not consider an application made under regulation 3 unless the applicant is a body corporate.

Capital Requirement

7. (1) The capital requirement referred to in clause (a) of sub- regulation (1) of

regulation 6 shall be a net worth of a minimum of rupees fifty crores.

Explanation

For the purposes of this regulation, the expression "net worth" means the paid up capital and the free reserves as on the date of the application.

(2) Notwithstanding anything contained in sub-regulation (1), any custodian of securities which;

(a) Has been approved by the Board under the provisions of Securities and Exchange Board of India (Mutual Fund) Regulations, 1993, or the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995, or the Government of India Guidelines for Foreign Institutional Investors dated September 14, 1992, even if it does not have the net worth specified in sub- regulation (1) may continue to function as a custodian of securities and shall within a period of one year from the date of commencement of these regulations raise its net worth to that specified in sub- regulation (1);

[Provided that the period specified above may be extended by the Board upto a maximum of 5 years;]

(b) Has made an application under regulation 3 shall be permitted to fulfil his capital adequacy requirements within one month of the receipt of certificate under regulation 8.

Procedure and grant of certificate

8. (1) After considering the application under regulation 3, with reference to the matters specified in regulation 6, if the Board on being satisfied that all particulars sought have been furnished and the applicant is eligible for the grant of a certificate, shall send an intimation of the same to the applicant.

(2) On receipt of an intimation from the Board under sub- regulation (1), the applicant shall pay to the Board a registration fee specified in Part A of Second Schedule in the manner specified in Part B thereof.

(3) The Board shall thereafter grant a certificate in Form B to the applicant on receipt of the registration fee.

Conditions of certificate

9. The certificate granted to the custodian of securities shall be subject to the following conditions, namely:-

   (a) It shall not commence any activities as custodian of securities unless it fulfils the capital requirement specified in regulation 7;

   (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 Part A of the Second Schedule in the manner specified in Part B thereof;

   (e) If any information previously submitted by it to the Board 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 the Board in writing; and

   (f) Besides providing custodial services, it shall not carry on any activity other than activities relating to rendering of financial services.

Procedure where Certificate is not Granted

10. (1) After considering an application for grant of certificate made under regulation 3, if the Board is satisfied that a certificate should not be granted, the Board may reject the application after giving the applicant a reasonable opportunity of being heard.

   (2) The decision of the Board to reject 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.

   (3) An applicant, who is aggrieved by the decision of the Board under sub-regulation (1) may, within a period of thirty days from the date of receipt of communication under sub- regulation (2), apply to the Board for re-consideration (4) The Board shall, as soon as possible, in the light of the submissions made in the application for re-consideration made under sub-regulation (3) and wherever necessary, after giving the applicant a reasonable opportunity of being heard, convey its decision in writing to the applicant. of its decision.

Effect of Refusal to Grant Certificate

11. Any custodian of securities whose application for grant of certificate has been rejected by the Board shall, on and from the date of the receipt of the communication under sub- regulation (2) of regulation 10, cease to carry on any activity as custodian of securities and shall be subject to the directions of the Board with regard to the transfer of records, documents or securities that may be in its custody or control relating to its activity as custodian of securities.

Chapter - III

General Obligations and Responsibilities of Custodians

Code of Conduct

12. Every custodian of securities shall abide by the Code of Conduct as set out in the Third Schedule.

Segregation of Activities

13. Where a custodian of securities is carrying on any activity besides that of acting as custodian of securities, then,-

    (i) The activities relating to his business as custodian of securities shall be separate and segregated from all other activities;

    (ii) Its officers and employees engaged in providing custodial services shall not be engaged in any other activity carried on by him.

Monitoring, review evaluating and inspecting systems and controls

14. (1) Every custodian of securities shall have adequate mechanisms for the purposes of reviewing, monitoring and evaluating the custodian's controls, systems, procedures and safeguards.

    (2) The custodian of securities shall cause to be inspected annually the mechanism referred to in sub-regulation (1) by an expert and forward the inspection report to the Board within three months from the date of inspection.

Prohibition of Assignment

15. 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.

Separate custody account

16. Every custodian of securities shall open a separate custody account for each client, in the name of the client whose securities are in its custody and the assets of one client shall not be mixed with those of another client.

Agreement with the client

17. Every custodian of securities shall 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 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

18. (1) Every custodian of securities shall 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.

(2) Every custodian of securities shall have appropriate safekeeping measures to ensure that such securities are protected from theft and natural hazard.

Maintenance of records and documents and furnishing of information

19. (1) Without prejudice to the provisions of any other law for the time being in force, every custodian of securities shall maintain the following records and documents, namely:-

(a) Records containing details of securities received and released on behalf of each client;

(b) Records containing details of monies received and released on behalf of each client;

(c) Records containing details of rights or entitlements of each client arising from the securities held on behalf of the client;

(d) Records containing details of registration of securities in respect of each client ;(e) Ledger for each client;

(f) Records containing details of instructions received from and sent to clients; and records of all reports submitted to the Board.

(2) Every custodian of securities shall intimate to the Board the place where the records and documents under sub- regulation (1) are maintained.

(3) Every custodian of securities shall preserve the records and documents maintained under sub-regulation (1) for a minimum period of five years.

Appointment of Compliance Officer

19A. (1) Every custodian of securities 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 the Board or the Central Government and for redressed of investors' grievances.

(2) The compliance officer shall immediately and independently report to the Board any non-compliance observed by him.]

Information to the Board

20. (1) The Board 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.

(2) Where any information is called for by the Board under sub-regulation (1), it shall be the duty of the custodian of securities to furnish such information, within such reasonable period as the Board may specify.

Chapter - IV

Inspection and Audit

Board's Right to Inspect

21. (1) The Board may appoint one or more persons as inspecting officer to undertake inspection of the books of accounts, records and documents of the custodian of securities for any of the following purposes, namely:-

(a) To ensure that the books of account, records and documents are being maintained by the custodian of securities in the manner specified in these regulations;

(b) To investigate into complaints received from investors, clients or any other person, on any matter having a bearing on the activities of the custodian of securities;

(c) To ascertain whether the provisions of the Act and these regulations are being complied with by the custodian of securities; and

(d) To investigate suo motu into the affairs of the custodian of securities, in the interest of the securities market or in the interest of investors.

Notice Before Inspection

22. (1) Before ordering an inspection under regulation 21, the Board shall give not less than ten days notice to the custodian of securities.

(2) Notwithstanding anything contained in sub-regulation (1), where the Board is satisfied that in the interest of the investors no such notice should be given, it may by an order in writing direct that the inspection of the affairs of the custodian of securities be taken up without such notice.

(3) During the course of an inspection, the custodian of securities against whom the inspection is being carried out shall be bound to discharge his obligations as provided in regulation 23.

Obligations of custodian on inspection by the Board

23. (1) It shall be 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.

(2) The custodian of securities shall 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.

(3) The inspecting officer, in the course of inspection, shall be entitled to examine or to record the statements of any director, officer or employee of the custodian of securities.

(4) It shall be the duty of every director, officer or employee of the custodian of securities to give to the inspecting officer all assistance in connection with the inspection, which the inspecting officer may reasonably require.

Submission of Report to the Board

24. The inspecting officer shall, as soon as possible, on completion of the inspection submit an inspection report to the Board:

Provided that if directed to do so by the Board, he may submit an interim report.

Communication of findings etc. to the custodian of securities

25. (1) The Board shall, after consideration of the inspection report or the interim report referred to in regulation 24, communicate the findings of the inspection officer to the custodian of securities and give him an opportunity of being heard.

(2) On receipt of the reply if any, from the custodian of securities, the Board may

call upon the custodian of securities to take such measures as the Board may deem fit in the interest of the securities market and for due compliance with the provisions of the Act, the rules framed there under and these regulations.

Appointment of Auditor

25A. The Board shall have the power to appoint an auditor to inspect or investigate, as the case may be, into the books of accounts, records, documents or affairs of the applicant or the custodian as the case may be;

Provided that the auditors so appointed shall have the same powers as vested in the investing officer under regulation 21 and the applicant or custodian and its directors, officers and employees shall be under the same obligations, towards the auditor so appointed, as are mentioned in regulation 23.

Board to Recover the Expenses

25B. The Board shall be entitled to recover from the custodian or the applicant as the case may be, such expenses including fees paid to the auditors a s may be incurred by it for the purposes of inspecting the books of accounts, records and documents of the applicant or the custodian as the case may be.

Chapter - V

Procedure for Action in Case of Default

Suspension of certificate

26. The Board may suspend the certificate granted to a custodian of securities where the custodian of securities:

(a) Contravenes any of the provisions of the Act, the rules framed there under or these regulations;

(b) Fails to furnish any information relating to his activity as custodian of securities as required by the Board;

(c) Furnishes to the Board information which is false and misleading in any material particular;

(d) Does not submit periodic returns or reports as required by the Board;

(e) Does not co-operate in any enquiry or inspection conducted by the Board;

(f) Fails to update its systems and procedures as recommended by the Board;

(g) Fails to resolve the complaints of clients or fails to give a satisfactory reply to the Board in this behalf;

(h) Is guilty of misconduct or makes a breach of the Code of Conduct specified in the Third Schedule;

(i) Fails to pay annual fees.

Cancellation of Certificate

27. The Board may cancel the certificate granted to a custodian of securities:-

(a) When it is guilty of fraud or has been convicted of an offence involving moral turpitude; or

(b) It has been guilty of repeated defaults of the nature specified in regulation 26

Explanation

In this regulation, "fraud" has the same meaning as is assigned to it in section 17 of the Indian Contract Act, 1872. (9 of 1872)

Manner of making order of cancellation or suspension

28. No order of suspension or cancellation of certificate shall be made by the Board against a custodian of securities, except after holding an enquiry in accordance with the procedure specified in regulation 29

Manner of holding enquiry before suspension or cancellation

29. (1) For the purpose of holding an enquiry under regulation 28, the Board may appoint one or more enquiry officer.

(2) The enquiry officer shall issue to the custodian of securities, at its registered office or its principal place of business, a notice setting out the grounds on which action is proposed to be taken against it and calling upon it to show cause against such action within a period of fourteen days from the date of receipt of the notice.

(3) The custodian of securities may, within fourteen days from the date of receipt of such notice, furnish to the enquiry officer a written reply, together with copies of documentary or other evidence relied on by it or sought by the Board from the custodian of securities.

(4) The enquiry officer shall give a reasonable opportunity of hearing to the custodian of securities to enable him to make submissions in support of its reply made under sub-regulation (3).

(5) Before the enquiry officer, the custodian of securities may either appear in person or through any person duly authorized by the custodian of securities;

Provided that no lawyer or advocate shall be permitted to represent the custodian of securities at the enquiry;

Provided further that where a lawyer or an advocate has been appointed by the Board as a presenting officer under sub- regulation (6), it shall be lawful for the custodian of securities to present its case through a lawyer or advocate.

(6) The enquiry officer may, if he considers it necessary, ask the Board to appoint a presenting officer to present its case.

(7) The enquiry officer shall, after taking into account all relevant facts and submissions made by the custodian of securities, submit a report to the Board and recommend the penal action, if any, to be taken against the custodian of securities as also the grounds on which the proposed action is justified.

Show-cause notice and order

30. (1) On receipt of the report from the enquiry officer, the Board shall consider the same and issue to the custodian of securities a show-cause notice as to why the penal action as proposed by the enquiry officer should not be taken against it.

(2) The custodian of securities shall, within fourteen days of the date of the receipt of the show-cause notice, send a reply to the Board.

(3) The Board, after considering the reply of the custodian of securities to the show-cause notice, if received within a period of fourteen days shall, as soon as possible but not later than thirty days from the receipt of the reply or the date of hearing, if any, which ever is later, pass such order as it deems fit,

including an order for the suspension or cancellation of the certificate.

(4) Every order made under sub-regulation (3) shall be self-contained and shall give reasons for the conclusions stated therein, including the justification for the penalty if any, imposed by that order.

Effect of suspension and cancellation of certificate

31. (1) On and from the date of the suspension of the certificate, the custodian of securities shall cease to carry on any activity as a custodian of securities during the period of suspension, and shall be subject to the directions of the Board with regard to any records, documents or securities that may be in its custody or control, relating to its activities as custodian of securities.

(2) On and from the date of cancellation of the certificate, the custodian of securities shall, with immediate effect, cease to carry on any activity as a custodian of securities, and shall be subject to the directions of the Board with regard to the transfer of any records, documents or securities that may be in its custody or control, relating to its activities as custodian of securities.

Publication of order of suspension or cancellation

32. The order of suspension or cancellation of certificate passed under sub-regulation 3 of Regulation 30 shall be published by the Board in at least two daily newspapers.

National Securities Depository Limited

Although India had a vibrant capital market which is more than a century old, the paper-based settlement of trades caused substantial problems like bad delivery and delayed transfer of title till recently. The enactment of Depositories Act in August 1996 paved the way for establishment of NSDL, the first depository in India.

This depository promoted by institutions of national stature responsible for economic development of the country has since established a national infrastructure of international standards that handles most of the securities held and settled in dematerialised form in the Indian capital market

Using innovative and flexible technology systems, NSDL works to support the investors and brokers in the capital market of the country. NSDL aims at ensuring the safety and soundness of Indian marketplaces by developing settlement solutions that increase efficiency, minimise risk and reduce costs. At NSDL, we play a quiet but central role in developing products and services that will continue to nurture the growing needs of the financial services industry

In the depository system, securities are held in depository accounts, which is more or less similar to holding funds in bank accounts. Transfer of ownership of securities is done through simple account transfers. This method does away with all the risks and hassles normally associated with paperwork. Consequently, the cost of transacting in a depository environment is considerably lower as compared to transacting in certificates.

Depository Participant:

NSDL depository reaches its services to investors through market intermediaries called Depository Participants (DP), who as per SEBI regulations could be organisations involved in the business of providing financial services like banks, brokers, custodians, financial institutions, etc. This system of using the existing distribution channel helps NSDL to reach to a wide cross section of investors spread across a large geographical area

The admission of the DPs involves a detailed evaluation by NSDL and a further evaluation and approval by SEBI.

Realising the potential in this market, all the custodians in India and a number of banks, financial institution and major brokers have already joined NSDL as DPs and they are providing services in a number of cities. Many more organisations are in various stages of establishing connectivity with NSDL.

Self Assessment Questions

1. What is depository? Explain the role and need of depository?
2. Explain briefly the rights & obligations of depositories as per Depositories Act 1996
3. Explain the procedure of Registration of transfer of securities with depository under Depositories Act 1996
4. Explain briefly the Powers of Board to give Directions in certain cases under Depositories Act 1996
5. Explain the procedure for application of grant of certificate of registration under SEBI (Depositories Participation and Regulation) Act 1996
6. Explain the procedure of inspection under SEBI (Depositories Participation and Regulation) Act1996

7. Explain the procedure of Registration of custodian of services inspection under SEBI (Custodian of Securities and Regulation) Act1996
8. Briefly explain the procedure of inspection and audit under SEBI (Custodian of Securities and Regulation) Act1996
9. Briefly explain the procedure for action in case of default under SEBI (Custodian of Securities and Regulation) Act1996
10. Explain general obligations and responsibilities of custodian under SEBI (Custodian of Securities and Regulation) Act1996

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UNIT - V

Security Market Instruments

Learning Objectives

After reading this unit you can be able to understand:-

- Various Capital Market Instruments
- Money Market Instruments

Capital Market Instruments

Meaning

A real or virtual document representing a legal agreement involving some sort of monetary value. These financial instruments are tradable assets used for generating funds for companies, corporations and sometimes national governments. These are used by the investors to make a profit out of their respective markets and enable channelizing funds from surplus units to deficit units.

It is an easily tradable package of capital. These instruments can be classified generally as equity based, representing ownership of the asset, or debt based, representing a loan made by an investor to the owner of the asset. Foreign exchange instruments comprise a third, unique type of instrument. Different subcategories of each instrument type exist, such as preferred share equity and common share equity

Classification of Capital Market Instruments

There are number of Capital market instruments used in the Capital market. Basically these instruments are classified into three categories. These are

1. **Pure Instrument**: Equity shares, Preference shares and debenture or bonds which are issued with the basic characteristics without mixing the instruments are called Pure Instrument.

2. **Hybrid Instrument**: Those instruments which are created by combining the features of equity with bond, preference or equity shares are called as Hybrid Instrument. This is created in order to fulfill the needs of investors. For example: Convertible Preference Shares, Partial convertible debentures etc.

3. **Derivative:** are those instruments whose value is determined from the reference of other financial instruments. For example: future and option.

Various Types Capital Market Instruments

1. **Equity**

   i. A stock or any other security representing an ownership interest.

   ii. On a company's balance sheet, the amount of the funds contributed by the owners (the stockholders) plus the retained earnings (or losses).

   iii. In the context of margin trading, the value of securities in a margin account minus what has been borrowed from the brokerage.

   iv. In the context of real estate, the difference between the current market value of the property and the amount the owner still owes on the mortgage. It is the amount that the owner would receive after selling a property and paying off the mortgage.

   v. In terms of investment strategies, equity (stocks) is one of the principal asset classes. The other two are fixed-income (bonds) and cash/cash-equivalents. These are used in asset allocation planning to structure a desired risk and return profile for an investor's portfolio.

2. **Preference shares:** Sec. 85(1) of the Companies Act defines preference shares as those shares which carry preferential rights as the payment of dividend at a fixed rate and as to repayment of capital in case of winding up of the company. Thus, both the preferential rights include (a) preference in payment of dividend and (b) preference in repayment of capital in case of winding up of the company, must attach to preference shares.

3. **Cumulative Preference Shares:** are those preference shares which gets dividend in first claim as and when dividends are declared. If the company is not earned profit, then the dividend get accumulated and whenever company earns profit the shareholder will get all the accumulated dividend.

4. **Non – Cumulative Preference Shares:** are those preference shares which do not accumulate the profit *if* the company has not earned the profit. As and when the company declare dividend then only it goes to non- cumulative preference shares.

5. **Convertible Preference Shares:** *If the Preference Share holders have termed in issue of shares that they can convert the preference shares into equity shares. These type of convertible shares are called as* Convertible Preference Shares. Preference shares are convertible because to get various rights like voting rights, bonus issue and higher dividend. So for these issues, *companies issue* these shares with premium.

6. **Redeemable Preference Shares:** When the preference shares are issued with the stipulation that these shares are to be redeemed after a certain period of time, then such preference shares are known as redeemable preference shares. If a company collects the money through redeemable preference shares, this money must be returned on its maturity whether company is liquidated or not. These shares are issued only to raise the capital for temporary period.

7. **Irredeemable Preference Shares:** *are those shares which are issued with the terms that shares will be not redeemed for indefinite period except certain instances like winding up.*

8. **Participating Preference Shares:** If a company earns profit then it gets distributed to preference shareholders, equity shareholders etc. But after that also profit is left, then such profit can again distribute as dividend to participating preference shareholder as well as company can also issue bonus shares.

9. **Debentures:** includes stocks, bonds etc which are issued by the company as a certificate of indebtness. For the issue of debentures, date of the repayment of principle and interest is decided. It is created on the charge of undertaking of assets of the company. If the company is not able to make the payment on the time, so the investors can redeem the debentures by undertaking the assets or from the sale of assets.

10. **Unsecured debentures:** are those debentures which are not secured from the asset for the repayment of principle and interest.

11. **Secured debentures:** are those debentures which are secured by registered asset of the company.

12. **Secured Premium Notes:** SPN is a secured debenture redeemable at premium issued along with a detachable warrant, redeemable after a notice period, say four to seven years. The warrants attached to SPN gives the holder the right to apply and get allotted equity shares; provided the SPN is fully paid.

i. There is a lock-in period for SPN during which no interest will be paid for an invested amount. The SPN 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 will be paid on redemption. In case the SPN holder holds it further, the holder will be repaid the principal amount along with the additional amount of interest/ premium on redemption in installments as decided by the company. The conversion of detachable warrants into equity shares will have to be done within the time limit notified by the company

13. **Redeemable debentures:** are those debentures which are redeemable after a certain period or on their expiry date.

14. **Perpetual debentures**: are those debentures which are issued for the redemption on any specific event like winding up which may happen for any indefinite period.

15. **Bearer debentures:** *are the debentures payable to bearer and also transferrable and the name of the holder will not be registered in the books of the company. SO whoever is the holder can bear the principle and interest as on due.*

16. **Equity shares with detachable warrants:** are those warrants whose holder apply for a specific numbers of shares on appointed date at a pre- determined price. These warrants are separately registered with stock exchange and also traded separately. In Indian Market, Reliance applies on such warrants.

17. **Sweat Equity Shares:** are shares allotted to employees o companies, as rewards, free of cost or at a price which is considerable below the ruling market price. It is given as a reward for performance to further encourage them to put in their best in the organization. Under the Companies act, 1956, sweat equity shares means equity shares issued by a company to its employees or directors at a discounts or for consideration other than cash for providing know how or making available rights in the nature of intellectual property rights. Such issue may be made only if it is authorized by a special resolution passed by the company in the general meeting specifying the number of shares to be issued, class of the employees or directors to whom such shares are to be issued, the consideration and the current market price of the equity shares. Sweat equity shares can be issued if more than one year has elapsed from the commencement of the business. All limitations, restriction and provisions relating to equity shares shall be applicable to such sweat equity shares.

18. **Deep discount bonds:** A bond that sells at a significant discount from par value and has no coupon rate or lower coupon rate than the prevailing rates of fixed-income securities with a similar risk profile. They are designed to meet the long term funds

requirements of the issuer and investors who are not looking for immediate return and can be sold with a long maturity of 25-30 years at a deep discount on the face value of debentures.

19. **Equity shares with detachable warrants**: A warrant is a security issued by company entitling the holder to buy a given number of shares of stock at a stipulated price during a specified period. These warrants are separately registered with the stock exchanges and traded separately. Warrants are frequently attached to bonds or preferred stock as a sweetener, allowing the issuer to pay lower interest rates or dividends.

20. **Fully convertible debentures with interest:** This is a debt instrument that is fully converted over a specified period into equity shares. The conversion can be in one or several phases. When the instrument is a pure debt instrument, interest is paid to the investor. After conversion, interest payments cease on the portion that is converted. If project finance is raised through an FCD issue, the investor can earn interest even when the project is under implementation. Once the project is operational, the investor can participate in the profits through share price appreciation and dividend payments.

21. **EQUIPREF**: They are fully convertible cumulative preference shares. This instrument is divided into 2 parts namely Part A& Part B. Part A is convertible into equity shares automatically /compulsorily on date of allotment without any application by the allottee. Part B is redeemed at par or converted into equity after a lock in period at the option of the investor, at a price 30% lower than the average market price.

22. **Tracking stocks**: A tracking stock is a security issued by a parent company to track the results of one of its subsidiaries or lines of business; without having claim on the assets of the division or the parent company. It is also known as "designer stock". 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. Oftentimes, this is done to separate a subsidiary's high-growth division from a larger parent company that is presenting losses. The parent company and its shareholders, however, still control the operations of the subsidiary.

23. **Disaster bonds**: Also known as Catastrophe or CAT Bonds, Disaster Bond is a high-yield debt instrument that is usually insurance linked and meant to raise money in case of a catastrophe. It has a special condition that states that if the issuer (insurance or Reinsurance Company) suffers a loss from a particular pre-defined

catastrophe, then the issuer's obligation to pay interest and/or repay the principal is either deferred or completely forgiven.

24. **Mortgage backed securities** (MBS): MBS is a type of asset-backed security, basically a debt obligation that represents a claim on the cash flows from mortgage loans, most commonly on residential property. Mortgage backed securities represent claims and derive their ultimate values from the principal and payments on the loans in the pool. These payments can be further broken down into different classes of securities, depending on the riskiness of different mortgages as they are classified under the MBS.

25. **Global depository receipts/ American depository receipts**: A negotiable certificate held in the bank of one country (depository) representing a specific number of shares of a stock traded on an exchange of another country. GDR facilitate trade of shares, and are commonly used to invest in companies from developing or emerging markets. GDR prices are often close to values of related shares, but they are traded and settled independently of the underlying share. Listing on a foreign stock exchange requires compliance with the policies of those stock exchanges. Many times, the policies of the foreign exchanges are much more stringent than the policies of domestic stock exchange. However a company may get listed on these stock exchanges indirectly – using ADRs and GDRs. If the depository receipt is traded in the United States of America (USA), it is called an American Depository Receipt, or an ADR. If the depository receipt is traded in a country other than USA, it is called a Global Depository Receipt, or a GDR. But the ADRs and GDRs are an excellent means of investment for NRIs and foreign nationals wanting to invest in India. By buying these, they can invest directly in Indian companies without going through the hassle of understanding the rules and working of the Indian financial market – since ADRs and GDRs are traded like any other stock, NRIs and foreigners can buy these using their regular equity trading accounts.

26. **Foreign currency convertible bonds** (FCCBs): A convertible bond is a mix between a debt and equity instrument. It is a bond having regular coupon and principal payments, but these bonds also give the bondholder the option to convert the bond into stock. *FCCB is issued in a currency different than the issuer's domesticcurrency*. The investors receive the safety of guaranteed payments on the bond and are also able to take advantage of any large price appreciation in the company's stock. Due to the equity side of the bond, which adds value, the coupon payments on the bond are lower for the company, thereby reducing its debt-financing costs.

27. **Derivatives**: A derivative is a financial instrument whose characteristics and value depend upon the characteristics and value of some underlying asset typically

commodity, bond, equity, currency, index, event etc. Advanced investors sometimes purchase or sell derivatives to manage the risk associated with the underlying security, to protect against fluctuations in value, or to profit from periods of inactivity or decline. Derivatives are often leveraged, such that a small movement in the underlying value can cause a large difference in the value of the derivative. Derivatives are usually broadly categorised by:

i. The relationship between the underlying and the derivative (e.g. forward, option, swap)

ii. The type of underlying (e.g. equity derivatives, foreign exchange derivatives and credit derivatives)

iii. The market in which they trade (e.g., exchange traded or over-the-counter)

28. Futures: A financial contract obligating the buyer to purchase an asset, (or the seller to sell an asset), such as a physical commodity or a financial instrument, at a predetermined future date and price. Futures contracts detail the quality and quantity of the underlying asset; they are standardized to facilitate trading on a futures exchange. Some futures contracts may call for physical delivery of the asset, while others are settled in cash. The futures markets are characterized by the ability to use very high leverage relative to stock markets. Some of the most popular assets on which futures contracts are available are equity stocks, indices, commodities and currency.

29. Options: A financial derivative that represents a contract sold by one party (option writer) to another party (option holder). The contract offers the buyer the right, but not the obligation, to buy (call) or sell (put) a security or other financial asset at an agreed-upon price (the strike price) during a certain period of time or on a specific date (excercise date). A call option gives the buyer, the right to buy the asset at a given price. This 'given price' is called 'strike price'. It should be noted that while the holder of the call option has a right to demand sale of asset from the seller, the seller has only the obligation and not the right. For eg: if the buyer wants to buy the asset, the seller has to sell it. He does not have a right. Similarly a 'put' option gives the buyer a right to sell the asset at the 'strike price' to the buyer. Here the buyer has the right to sell and the seller has the obligation to buy. So in any options contract, the right to exercise the option is vested with the buyer of the contract. The seller of the contract has only the obligation and no right. As the seller of the contract bears the obligation, he is paid a price called as 'premium'. Therefore the price that is paid for buying an option contract is called as premium. The primary difference between options and futures is that options give the holder the right to buy or sell the underlying asset at expiration, while the holder of a futures contract is obligated to fulfill the terms of his/her contract.

30. **Participatory notes:** Also referred to as "P-Notes" Financial instruments used by investors or hedge funds that are not registered with the Securities and Exchange Board of India to invest in Indian securities. Indian-based brokerages buy India-based securities and then issue participatory notes to foreign investors. Any dividends or capital gains collected from the underlying securities go back to the investors. These are issued by FIIs to entities that want to invest in the Indian stock market but do not want to register themselves with the SEBI.

31. **Hedge fund**: A hedge fund is an investment fund open to a limited range of investors that undertakes a wider range of investment and trading activities in both domestic and international markets, and that, in general, pays a performance fee to its investment manager. Every hedge fund has its own investment strategy that determines the type of investments and the methods of investment it undertakes. Hedge funds, as a class, invest in a broad range of investments including shares, debt and commodities.

    i. As the name implies, hedge funds often seek to hedge some of the risks inherent in their investments using a variety of methods, with a goal to generate high returns through aggressive investment strategies, most notably short selling, leverage, program trading, swaps, arbitrage and derivatives.

    ii. Legally, hedge funds are most often set up as private investment partnerships that are open to a limited number of investors and require a very large initial minimum investment. Investments in hedge funds are illiquid as they often require investors keep their money in the fund for at least one year.

32. **Fund of funds**

    a. A "fund of funds" (FoF) is an investment strategy of holding a portfolio of other investment funds rather than investing directly in shares, bonds or other securities. This type of investing is often referred to as multi-manager investment. A fund of funds allows investors to achieve a broad diversification and an appropriate asset allocation with investments in a variety of fund categories that are all wrapped up into one fund.

Equity

In accounting and finance, **equity** is the residual claim or interest of the most junior class of investors in assets, after all liabilities are paid. If liability exceeds assets, negative equity exists. In an accounting context, **Shareholders' equity** (or stockholders' equity, shareholders' funds, shareholders' capital or similar terms) represents the remaining interest in assets of a company, spread among individual shareholders of common or preferred stock.

In simple Words, a share or stock is a document issued by a company, which entitles its holder to be one of the owners of the company. A share is issued by a company or can be purchased from the stock market.

Equity Shares are those shares which refer to a part of ownership as a shareholde. These type of shareholder undertakes the maximum entrepreneurial risk associate with the business.

Equity Shareholders are called RESIDUAL OWNERS of the company. After all the obligations of the company are over, the Equity Share Holders get their share. Preference Share Holders get paid their dividends ahead of Equity Shareholders.

It is a COMMON STOCK and most frequently issued class of stock; usually it provides a voting right but is secondary to preferred stock in dividend and liquidation rights.

Shareholders Equity

A firm's total assets minus its total liabilities. Equivalently, it is share capital plus retained earnings minus treasury shares. Shareholders' equity represents the amount by which a company is financed through common and preferred shares.

Shareholders' Equity = Total Assets - Total Liabilities
OR
Shareholders' Equity = Share Capital + Retained Earnings - Treasury Shares

Also known as "share capital", "net worth" or "stockholders' equity"

When you invest in a stock, you are essentially buying part ownership of a company, including its physical plant, output and everything it owns. As a shareholder, you are entitled to a proportionate share of the corporation's profits and assets.

Businesses issue stock to raise capital. By issuing stock, a company generally can raise more capital than it could borrow. In addition, the company does not have to make periodic interest payments to creditors or make principal payments.

Conversely, by issuing stock, the principal owners have to share their ownership with other shareholders. And, shareholders have a voice in policies that affect the company's operations.

Common Stock

People who own shares of common stock expect one or both of two things in return - dividends and/or capital appreciation. Dividends are taxable payments given to shareholders from the company's current or retained earnings. The continuation of the dividend payments depends on the company's ability to maintain or grow its current or retained earnings. Therefore, there is no assurance that dividends will continue to be paid. Dividends are generally paid quarterly and are usually distributed in cash, although stock or other property can also be given as dividends. Capital appreciation is the difference between the price you paid for a stock and its current value.

Owning shares of common stock entitles you to vote in the election of the corporation's directors and other issues. Each share that you own represents one vote.

Features of Equity Capital

Limited Liability

Equity capital is issued with limited liability. This means, if the creditors to a business are not able to recover their dues, equity shareholders will not be asked to pay up. The liability of equity shareholders in a company is limited to their contribution made or on any amount unpaid which they have agreed to pay.

Face Value

The total equity capital required by a company is divided into smaller denomination called the face value or par value of the equity shares.

For example, if a company has an equity capital of ₹ 10,00,000, this can be divided into:

- One lakh shares with a face value of ₹ 10; or
- Two lakh shares with a face value of ₹ 5; or
- Ten lakh shares with a face value of Re 1.

Equity shares were earlier issued as certificates; now they are invariably issued in electronic/dematerialised form.

The par value or face value of the shares can be changed subsequently, if the company so desires. This is called a split or a consolidation of shares. If a share with a face value of ₹ 10 is divided into two shares with par values of ₹ 5 each, it is called a split. If 5 shares of ₹ 2 face value each are clubbed into one share of ₹ 10, it is called a consolidation of shares.

Authorised Capital

The maximum amount of equity capital that a company will have is defined in the Memorandum of Association (MoA) of the company and is called its authorised capital. The authorised capital of a company can be raised or reduced subsequently by the company.

Issued Capital

The company may issue a portion of its authorised capital as and when it requires capital.

The capital may be issued to the promoters, public or to specified investors. The portion of authorised capital that has been issued to investors is called issued capital. Capital can be raised at various times as and when the company requires it, provided the sum of all capital issued is less than or equal to the authorised capital of the company.

The capital may be issued by the company either at its face value or at a premium (higher than the face value) or at a discount (lower than the face value). The issued capital will take into account only the face value of the shares issued. The remaining portion paid by the investor is accounted under the share premium account (liability side of the balance sheet) or share discount account (asset side of the balance sheet).

Paid-up capital

When investors subscribe to the capital issued by a company, they may be required to pay the entire price at the time of issue or in tranches (instalments) as application money, allotment money and call money. The portion of the issued capital that has been fully paidup by the allottees is the paid-up capital of the company.

A company decides that the maximum equity capital it needs is ₹ 20 cr. In the initial stages, the need is ₹ 10cr. It issues equity shares of ₹ 10 face value, at par. Investors are required to pay ₹ 5 per share with application, ₹ 2 on allotment, and balance ₹ 3 after it has been called. What is the authorised, issued and paid-up capital of the company, before the issue, after application, after allotment and after the call?

Authorised capital: ₹ 20 Cr

Before the Issue

Authorised capital: ₹ 20 Cr

After Application

Issued capital: ₹ 10 Cr

Paid up capital: ₹ 5 Cr

After Allotment

Issued capital: ₹ 10 Cr

Paid up capital: ₹ 7 Cr

Authorised capital: ₹ 20 Cr

After First Call

Issued capital: ₹ 10 Cr

Paid up capital: ₹ 10 Cr

Thus it can be seen that the paid up capital is always less than or equal to issued capital; issued capital is always less than or equal to authorised capital. Authorised capital is the maximum amount that can be issued or paid up.

Ownership Rights

Equity represents ownership of the company. Equity share holders are part-owners of the company, the extent of their ownership is defined by their portion of the shares held in issued capital.

For example, if a company has an issued capital of ₹ 10cr made up of 1cr shares of ₹ 10 each, an investor who holds 10lakh equity shares is a part-owner with a 10% stake in the company.

Equity shareholders have the right to participate in the management of the company. They can do this through voting rights. Each equity share carries one vote. Major decisions of the company require resolutions to be passed, which have to be voted by a majority or more of the equity shareholders.

Equity capital entitles its contributors to participate in the residual profits of the company. After meeting all expenses and provisions, whatever is the profit that remains in the books belongs to equity share holders.

Liquidity and Return

Equity shares are first issued by a company. They are then listed on the stock exchange, where they can be transferred from one investor to another. Such transactions are between existing shareholders, and therefore do not result in change in the capital structure of the company. Equity capital is for perpetuity.

It cannot be redeemed and the company does not have to repay it. The return from equity capital is in the form of dividends from the profits of the company and appreciation in the value of the holdings. There is no guarantee of dividends or capital appreciation on equity capital.

Characteristics of Equity Shares

Investors in Equity Shares

A company raises equity capital to meet its need for long-term funds for expansion or continuing operations of the company. Equity capital does not impose any liability on the company in terms of returns or repayment. However, when a company issues equity capital, the investors also get control and ownership. Their ownership rights depend on the proportion of issued capital that they hold.

A company can raise capital from different categories of investors. Different categories of investors have different requirements in terms of returns, risk and management control.

Promoters

Promoters are the group of investors who set up the company and bring in the initial capital required to start the business. This is the risk capital that allows the business to leverage and to protect it from fluctuations in earnings. At this stage the entire control of the company is with the promoters. They bring in additional capital as and when required.

As the capital needs of the business grow, promoters find that they cannot meet the company's need for funds. Equity is then issued to eligible investors such as institutions and retail public investors.

Promoters usually retain the majority shareholding in the company so that they can continue to control its affairs even after their stakes are diluted. The stage at which the promoters bring in the initial capital is the riskiest as the business is in the nascent stage and has a high risk of failure.

Institutional Investors

Institutional investors include financial institutions, venture capital companies, mutual funds and foreign financial institutions, banks among others. These are professional investors who have the ability to evaluate the business proposition, the risks associated with it and the expected returns.

The company may allot shares to such investors through a private placement of shares where the regulatory requirements are much less as compared to a public issue of shares. The risks and returns will depend upon the stage at which the institutional investors bring in capital.

Some like venture capital firms may be willing to bring in capital for companies in the startup stage or even later while others like financial institutions invest in more established firms. Institutional investors such as venture capital firms may be actively involved in the management of the company while others like mutual funds may be more passive investors who are more interested in the returns that their investment can generate rather than in the management of the company.

Apart from the attractiveness of the business proposition, institutional investors would also be interested in factors such as exit options, since many of them may hold a significant proportion of the equity capital. Many institutional investors like venture capitalists, encourage a company to offer its shares to the public investors as an exit option for themselves.

Public Investors

When the equity shares are held by promoters and a few investors, it is said to be closely held. Such companies are also private companies, which are not required to disclose too much of information about themselves to the public.

When a company offers its equity shares to the public at large, it moves from being a privately held company, to a publicly held company, which agrees to disclose periodic information about its operations and business to the public.

Investors, other than promoters, participate in the equity of a company when a company comes out with a public issue of shares. A public issue of shares requires regulatory compliance with SEBI's guidelines and regulations governing listing of the shares on a stock exchange.

Public investors in shares may be retail investors, high net worth individuals (HNI), non institutional investors or institutional investors. Retail investors, and to a great extent HNIs, are more interested in the returns that they can generate from their investment from capital appreciation in the value of the shares and dividend rather than in the control and management of the company. They hardly exercise their voting rights.

Large stake holders and institutional shareholders actively participate in the affairs of the company. Some large institutional investors are also given a seat on the board of the company. Regulations require extensive and timely disclosures of all information that affects the interests of the public investors in a company.

Risks in Equity Investing

No Fixed Return

The return in the form of dividend from equity is not pre-defined either in terms of the percentage of dividend or the date on which the payment will be made. Dividend is paid If the company makes sufficient profits and the management of the company feels it is appropriate for some of the profits to be distributed among the shareholders.

In case the company makes losses or the profits made by the company is ploughed back for the expansion and other operations of the company, the shareholders may not get a dividend.

The other source of return for the holder of equity shares is the appreciation in the price of the share in the secondary market. This constitutes the major portion of the return for the equity investor.

If the company's performance is bad or if the stock markets are going through a downturn, the value of the shares may actually depreciate leading to a loss for the investor. There is no guarantee that the principal amount invested in equity shares will remain intact.

No Fixed Tenor

Equity shares are issued for perpetuity. This means that there is no period of maturity after which the money will be returned to the shareholders. Investors who want to exit their investments may do so by selling the shares on the stock exchange to other investors.

The investor who is selling all his shares ceases to be a shareholder of the company. The shares are transferred to the buyer who now gets all the rights and obligations associated with it. Transactions between investors on the secondary market do not increase or decrease the share capital of the company. The risk to the shareholder arises if the shares are illiquid and not easily sold at its market value or if the shares are unlisted. The investor's investment may get struck without an exit option.

No Collateral Security

Equity capital is not secured by the assets of the company. The cash and assets of the company are first applied to settle the claims of the lenders and creditors. The claims of the equity shareholders always rank last in order of preference. During the normal course of operations of the company, dividends are payable to the equity shareholders only after the expenses, interest and taxes are provided for. In the event of liquidation of the company, the equity shareholders are only entitled to a refund of capital after the claims of all the other creditors are satisfied from the sale of the company's assets.

Preferred Stock

Preferred stock offers investors certain advantages over common stock. Preferred stock represents ownership units in a company, but, unlike common stock, most preferred stock does not carry voting rights. However, preferred shareholders have priority over owners of common shares regarding payment of dividends. This means that they get paid their dividends, even if the common stockholders get none. Also, if the company goes bankrupt, preferred stockholders have priority over common stockholders in the distribution of corporate assets. Bond investors, though, have priority over preferred stockholders.

The market price of most preferred stock is not as volatile as common stock, which means prices of preferred stocks do not move up or down as quickly as common stock prices. Like bonds, preferred stock prices are interest-rate sensitive - when interest rates go up, the price of preferred stocks generally goes down; when interest rates go down, the price of the preferred stocks generally goes up.

There are a number of types of preferred stock, including:

- **Straight or Fixed Rate Perpetual**

  The dividend rate is fixed for the life of the issue, and it has no maturity date.

- **Convertible Preferred Stock**

  A preferred stock that can be converted to the company's common stock at a conversion price that is determined at issuance.

- **Adjustable Rate Preferred Stock**

  It generally pays a quarterly dividend that is tied to a Treasury bill or other rate. The dividend is adjusted to changing interest rates according to a predetermined formula.

- **Participating Preferred Stock**

Holders of this type of preferred stock receive dividend increases in years during which common stock dividends are greater than those of the preferred stock.

Stock Splits

A stock split is an increase in the number of shares of a company's outstanding common stock. Since each shareholder's equity cannot be affected by the split, the market price per share is adjusted. For example, if you own 100 shares of XYZ Company at ₹ 50 a share, your stock is worth ₹ 5,000. If XYZ declares a 2 for 1 split, you will then own 200 shares of stock. The price per share is adjusted to ₹ 25 per share, which leaves the total value unchanged (₹ 5,000).

Companies generally declare stock splits to reduce the price of their stock to make it more attractive to investors. For example, investors might be more apt to invest in a stock that is priced at $50 a share than one priced at ₹ 100 a share.

Stock Dividends

Stock dividends are paid in common shares, and can be used to pay shareholders instead of a cash dividend. For example, if you own 100 shares of a company that declared a 1% stock dividend, you will receive one more share of stock from the company's reserve of shares.

If a company needs to tighten its fiscal belt, it may decide to declare a stock dividend rather than a cash dividend. A stock dividend will conserve cash while still allowing shareholders to benefit from the firm's earnings.

Types of Stock

There are many different types of stocks available and in order to meet your financial goals, it's important that you understand the differences between them.

Blue Chip Stocks

Blue chip stocks are well-established, nationally known, and generally financially sound companies. Blue chip companies have consistently demonstrated good earnings and industry leadership. Blue chips are typically less volatile than other stocks and have a record of paying dividends in both good and bad times.

Growth Stocks

Growth-stock companies have earnings and market share expansion that exceeds the industry average and the economy in general. Growth stock companies typically reinvest their profits to expand and strengthen their businesses, retaining most of their earnings to finance expansion and paying little, if any, dividends to shareholders. Investors are attracted to these stocks because they expect the stock price to go up as the company grows.

Penny Stocks

The term penny stock generally refers to low-priced (below $5) stock, which is traded over the counter (OTC). Penny stocks are generally considered a very high-risk investment.

Value Stocks

Value stocks are those that are considered undervalued by value investors. Value investors typically define undervalued stocks by their book/market and price/earnings ratios. Often value stocks represent companies with past financial difficulties, whose potential for growth has been underestimated, or that are part of an industry that is currently out of favor with investors.

Defensive Stocks

These are stocks of companies that provide necessary services, such as utilities that provide electric and gas, supermarkets that provide food, etc. Because the companies representing these stocks fulfill basic human needs, these stocks tend to provide a degree of stability for investors during recessions or economic slowdowns.

Income Stocks

Income stocks typically pay high dividends in relation to their market price, making them attractive to people who buy stocks for current income. Historically, these have been public utilities, but some blue chip stocks may fall into this category as well.

Cyclical Stocks

Cyclical stocks represent companies whose earnings are closely tied to the business cycle. When business conditions are good, a cyclical company generally prospers and its common stock price generally rises. When the economy slows or falls into recession, these companies' earnings and stock prices typically fall. Airlines, automobiles, furniture manufacturers, steel and paper producers are examples of cyclical stocks.

Seasonal Stocks

The performance of these stocks fluctuates with the seasons. For example, retail companies' sales and profits often increase at Christmas and the start of the school year.

International Stocks

Many investors use domestic (U.S.-based) equities as an integral part of their investment portfolios. However, the U.S. equity markets represent only about one-third of the total world markets. To be truly diversified, you should consider international equity investments.

In additional to the risks associated with equity investments, international stock investments have additional risks. Market volatility, reduced liquidity, a lack of public information, and social, political and currency risks are inherent to international investments.

Market Capitalization

Market capitalization refers to the total market value of a company. Investors find this information useful because companies that fall within the same market capitalization category (small, mid, or large) often have similar performance characteristics.

Market capitalization is calculated by multiplying the current market price of the stock by the total number of shares outstanding. For example, if XYZ Corporation has 100,000 shares outstanding at ₹ 10 a share, its market capitalization would be ₹ 10,00,000.

Generally, companies fall into one of the three categories of market capitalization:

- Large Capitalization (large-cap) stocks
- Mid Capitalization (mid-cap)
- Small Capitalization (small-cap) stocks

When using market capitalization as an investment tool, it is important to remember that generally, no one class consistently outperforms the others. A diversified portfolio containing stocks of different sizes can be a practical means of seeking long-term investment success while managing risk.

Investing in Small-Cap Companies

Small-cap companies are usually young and unproven, without many products to sell and thin financial reserves. Because these companies are small and unknown, it may be difficult to find information on them. They may not be covered by analysts and may be inaccurately valued. Small-cap companies are vulnerable to economic slowdowns and recessions and their stocks tend to be volatile. While investing in small cap stocks carries substantial risk, they offer investors greater earnings potential than larger, more established companies.

Investing in Mid-Cap Companies

Mid-cap stocks have a large volume of shares to trade on major and regional exchanges. But the companies are smaller and less mature than large-cap stocks. Typically, they offer a greater potential for growth than larger companies, but the risk is also slightly greater.

Investing in Large-Cap Companies

Large-cap companies are typically well-known companies with a variety of products and services. Given their size and success, most have proved to be capable of surviving recessions and other temporary setbacks. But despite their market presence and strength, they are not immune to bad news and should not be considered risk-free investments.

Analysts carefully track these companies since they are large, established corporations. However, their earnings growth potential is not as great as that of a developing small-cap. Consequently, because large-caps are not compelled to reinvest all their profits into the growth of the company, a portion can be distributed to shareholders as dividends.

Secured Premium Notes (SPNs)

SPNs are bonds issued by corporations which are medium term in nature, maturing between 3 to 8 years. The advantage is the flexibility it offers in giving the returns as premium or interest payments depend upon the preferences of the holders.

The only issuer of SPNs in the Indian markets till now is TISCO Ltd. It issued SPNs of ₹ 300 each. The repayment started after three years, and there was no payment of interest in between. The repayment went on for four years starting from the fourth year to seventh year. Every year there will be a payment of ₹ 150 (totalling ₹ 150*4 = ₹ 600 in four years). ₹ 75 in this would be accounted for as principal repayment and the rest ₹ 75 could be taken as a mixture of interest and premium at the option of the investor. (₹ 25 as interest + ₹ 50 as premium; ₹ 37.50 interest + ₹ 37.50 premium; ₹ 50 interest + ₹ 25 premium).

The advantage of this was easier tax planning for the investor, but the tax authorities were not happy with this kind of an arrangement. TISCO also attached an equity warrant which was convertible into equity at a price which was at considerable discount to the market price prevailing at that time.

Secured Premium Notes is also issued along with a detachable warrant and is redeemable after a notified period of say 4 to 7 years. The conversion of detachable warrant into equity shares will have to be done within time period notified by the company.

Warrants

Warrants are securities usually issued by companies along with a debenture to make the debt issue more attractive to the investors. Warrants give the investors in the debentures, the right to buy shares of the company in the future.

Warrants are usually attached to a debenture issue of the company to make the debenture more attractive. The number of shares that the warrant entitles the holder to subscribe to, the price at which such shares can be bought and the period during which the warrant can be exercised are specified at the time of the issue.

Warrants will be exercised if the share price at the time of exercise is higher than the price at which the investors have the option to buy the shares.

For example, assume a warrant enables an investor to buy an equity share of a company at ₹ 100. The warrant will be exercised if, when it is due to be exercised, the price of the share in the markets is more than ₹ 100. If the market price is less than ₹ 100, the investor can always buy from the market, rather than use the option to buy the same share at a higher price. When warrants are exercised they result in additional shares being issued by the company and a dilution in the stake of the existing shareholders.

Warrants may be traded on the stock exchange as a security separate from the debenture with which it was issued. Warrants usually have a longer lifetime (usually in years) as compared to option contracts which they closely resemble.

Warrants may be used by promoters to increase their stake in the company. SEBI requires that shares issued to promoters as a result of exercising the option on the warrant will have a lock-in of three years from the date the shares are allotted.

Sweat Equity Shares

Sweat equity shares are equity shares issued by a company to its employees or directors at a discount, or as a consideration for providing know-how or a similar value to the company.

A company may issue sweat equity shares of a class of shares already issued if these conditions are met:

The issue of sweat equity shares should be authorised by a special resolution passed by the company in a general meeting

The resolution should specify the number of shares, current market price, consideration, if any, and the section of directors /employees to whom they are to be issued As on the date of issue, a year should have elapsed since the company was entitled to commence business.

The sweat equity shares of a company whose equity shares are listed on a recognised stock exchange should be issued in accordance with the regulations made by the Securities and Exchange Board of India (SEBI).

In the case of a company whose equity shares are not listed on any recognised stock exchange, sweat equity shares can be issued in accordance with such guidelines as may be prescribed.

In the case of unlisted companies, sweat equity shares cannot be issued before one year of commencement of operations. Moreover, there is a cap of 15 percent on the number of sweat equity shares that can be issued without a specific central government approval.

Sweat equity shares are no different from employee stock options with one year vesting period. It is essential when a company is formed, to assure the financial investors that the knowhow providers will stay on, or for a start-up with limited resources to attract highly-qualified professionals to join the team as long-term stakeholders.

These shares are given to a company's employees on favourable terms, in recognition of their work. Sweat equity usually takes the form of giving options to employees to buy shares of the company, so they become part owners and participate in the profits, apart from earning salary.

Section 79A of the Companies Act lays down conditions for the issue of sweat equity shares. For listed companies, there are regulations made by the SEBI. The SEBI also prescribes the accounting treatment of sweat equity shares. Thus, sweat equity is expensed, unless issued in consideration of a depreciable asset, in which case it is carried to the balance sheet.

Sweat equity is a device that companies use to retain their best talent. Usually, it is given as part of a remuneration package. However, start-ups sometimes use sweat equity to retain talent. If the company fails, its employees may end up with worthless paper in the form of sweat equity shares.

Unlisted companies cannot issue more than 15 percent of the paid-up capital in a year or shares with a value of more than ₹ 5 crores - whichever is higher - except with the prior approval of the central government. If the sweat equity is being issued for consideration other than cash, an independent valuer has to carry out an assessment and submit a valuation report.

The company should also give 'justification for the issue of sweat equity shares for consideration other than cash, which should form a part of the notice sent for the general meeting'.

The board of directors' decision to issue sweat equity has to be approved by passing a special resolution at a shareholders' meeting later in the year. The special resolution must be passed by 75 percent of the members attending voting for it.

Non-Voting Shares

Non-voting shares carry no rights to vote and usually no right to attend general meetings either What voting rights do shares have?. Such shares are widely used to issue to employees so that some of their remuneration can be paid as dividends, which can be more tax-efficient for the company and the employee.

The same is also sometimes done for members of the main shareholders' families. Preference shares are often non-voting.

Tracking Stocks

A tracking stock is a special type of stock issued by a company to represent a particular division of segment of the business. It allows management to retain control of the operation without having to sell it or spin it off to shareholders as a legally separate entity while providing investors the opportunity to value various aspects of an enterprise on different terms and price to earnings multiples.

Many companies issue "tracking" stocks—also known as "targeted" stocks—in addition to their traditional common stock. 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. Tracking stocks trade as separate securities.

As a result, if the unit or division does well, the value of the tracking stock may increase—even if the company as a whole performs poorly. The opposite may also be true.

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 will depend on the performance of the business unit or division. But not all tracking stocks pay dividends.

Preference Shares

When we talk of shares of a company we usually refer to the ordinary shares of a company. A company may also raise capital with varying rights and entitlements. These are called preference shares because they may offer certain special features or benefits to the investor.

Some benefits that investors in ordinary equity capital have, such as, voting rights, may instead not be available to preference share holders. Preference shares are usually given preference over equity shares in the payment of dividends and the repayment of capital if the company is wound up.

Dividend is paid to the preference share holder at a fixed rate mentioned at the time of the issue of the shares. The terms of issue may allow the preference share holders to participate in the residual profits too in some defined ratio. These are called participating preference shares.

Preference shareholders are paid dividend only if the company has sufficient profits. The unpaid dividend may be carried forward to the following year(s) and paid if there are profits to pay the dividends, if the terms of issue of the shares so allow. Such shares are called cumulative preference shares.

The returns for the preference shares are only from the dividend the company pays. These shares are usually not listed and there is not much scope for capital appreciation. This is because these shares do not participate in the profits of the company. Their value is not affected by the over-performance or under-performance of the company.

Though preference shares are similar to debentures, they differ on the following points: - A preference share holder is a shareholder of the company. A debenture holder is a creditor of the company. - A debenture is usually secured on the assets of the company. A preference share is not secured since it is not a borrowing. -

The coupon interest on the debenture is an expense to be paid by the company before calculating the profits on which tax has to be paid. Dividends on preference shares are paid from the residual profits of the company after all external liabilities, including tax, have been paid.

Types of Preference Shares

Following are the major types of preference shares:

1. Cumulative Preference Shares

When unpaid dividends on preference shares are treated as arrears and are carried forward to subsequent years, then such preference shares are known as cumulative preference shares. It means unpaid dividend on such shares is accumulated till it is paid off in full.

2. Non-cumulative Preference Shares

Non-cumulative preference shares are those type of preference shares, which have right to get fixed rate of dividend out of the profits of current year only. They do not carry the right to receive arrears of dividend. If a company fails to pay dividend in a particular year then that need not to be paid out of future profits.

3. Redeemable Preference Shares

Those preference shares, which can be redeemed or repaid after the expiry of a fixed period or after giving the prescribed notice as desired by the company, are known as redeemable preference shares. Terms of redemption are announced at the time of issue of such shares.

4. Non-redeemable Preference Shares

Those preference shares, which cannot be redeemed during the life time of the company, are known as non-redeemable preference shares. The amount of such shares is paid at the time of liquidation of the company.

5. Participating Preference Shares

Those preference shares, which have right to participate in any surplus profit of the company after paying the equity shareholders, in addition to the fixed rate of their dividend, are called participating preference shares.

6. Non-participating Preference Shares

Preference shares, which have no right to participate on the surplus profit or in any surplus on liquidation of the company, are called non-participating preference shares.

7. Convertible Preference Shares

Those preference shares, which can be converted into equity shares at the option of the holders after a fixed period according to the terms and conditions of their issue, are known as convertible preference shares.

8. Non-Convertible Preference Shares

Preference shares, which are not convertible into equity shares, are called non-convertible preference shares.

Debentures

A debt security denotes a contract between the issuer (company) and the lender (investor) which allows the issuer to borrow a sum of money at pre-determined terms.

These terms are referred to as the features of a bond and include the principal, coupon and the maturity of the bond. In Indian securities markets, a debt instrument denoting the borrowing of a government or public sector organizations is called a bond and the borrowings by the private corporate sector is called debenture. The terms bonds and debentures are usually used interchangeably these days. The principal is the amount which is being borrowed by the issuer. Each debenture represents a portion of this principal amount borrowed. The face value or par value of the debenture is the amount of the principal that is due on each debenture. The face value of a debenture is usually ₹ 100.

The coupon is the rate of interest to be paid by the borrower to the lender. This is a percentage that is applied to the face value or par value of the bond. The periodicity (annual, semi-annual, or quarterly.) with which the interest will be paid is also agreed upon.

The maturity of a bond refers to the date on which the contract requires the borrower to repay the principal amount. Once the bond is redeemed or repaid, it is extinguished and ceases to exist.

Each of these features of a bond can be modified to create instruments that meet the specific requirements of the borrower or the lender. A plain vanilla bond will have a fixed term to maturity with coupon being paid at pre-defined periods and the principal amount is repaid on maturity. The bond is usually issued at its face value, say ₹ 100 and redeemed at par, the same ₹ 100.

The simple variations to this structure could be a slightly varied issue price, higher or lower than par and a slightly altered redemption price, higher or lower than par. In some cases, the frequency of the interest payment could vary, from monthly, to quarterly and annual. All these variations still come under the plain vanilla definition of a bond, where the interest is paid at a fixed rate periodically, and principal returned when the bond is retired. There are however many ways in which bonds are differently structured, by tweaking their features.

Varying Coupon Structures

Zero Coupon Bond

In such a bond, no coupons are paid. The bond is instead issued at a discount to its face value, at which it will be redeemed. There are no intermittent payments of interest. When such a bond is issued for a very long tenor, the issue price is at a steep discount to the redemption value. Such a zero coupon bond is also called a deep discount bond. The effective interest earned by the buyer is the difference between the face value and the discounted price at which the bond is bought. There are also instances of zero coupon bonds being issued at par, and redeemed with interest at a premium. The essential feature of this type of bonds is the absence of periodic interest payments.

Floating Rate Bonds

Instead of a pre-determined rate at which coupons are paid, it is possible to structure bonds, where the rate of interest is re-set periodically, based on a benchmark rate. Such bonds whose coupon rate is not fixed, but reset with reference to a benchmark rate, are called floating rate bonds.

For example, a company can issue a 5 year floating rate bond, with the rates being re-set semi-annually with reference to the 1- year yield on central government securities and a 50 basis point mark-up. In this bond, every six months, the 1-year benchmark rate on government securities is ascertained.

The coupon rate the company would pay for the next six months is this benchmark rate, plus 50 basis points. The coupon on a floating rate bond thus varies along with the benchmark rate, and is reset periodically.

The other names, by which floating rate bonds are known, are variable rate bonds and adjustable rate bonds. These terms are generally used in the case of bonds whose coupon rates are reset at longer time intervals of a year and above. These bonds are common in the housing loan markets.

Other Variations

Some of other structures are: (a) deferred interest bonds, where the borrower could defer the payment of coupons in the initial 1 to 3 year period; (b) Step-up bonds, where the coupon is stepped up periodically, so that the interest burden in the initial years is lower, and increases over time.

Other Types of Bonds

Callable Bonds

Bonds that allow the issuer to alter the tenor of a bond, by redeeming it prior to the original maturity date, are called callable bonds. The call option provides the issuer the option to redeem a bond, if interest rates decline, and re-issue the bonds at a lower rate. The investor, however, loses the opportunity to stay invested in a high coupon bond, when interest rates have dropped.

Puttable Bonds

Bonds that provide the investor with the right to seek redemption from the issuer, prior to the maturity date, are called puttable bonds. A put option provides the investor the right to sell a low coupon-paying bond to the issuer, and invest in higher coupon paying bonds, if interest rates move up. The issuer will have to re-issue the put bonds at higher coupons.

Amortising Bonds

The structure of some bonds may be such that the principal is not repaid at the end/ maturity, but over the life of the bond. A bond in which payments that are made by the borrower includes both interest and principal, is called an amortising bond. Auto loans, consumer loans and home loans are examples of amortising bonds. The maturity of the amortising bond refers only to the last payment in the amortising schedule, because the principal is repaid over time i.e. redemption in more than one instalment.

Asset-Backed Securities

Asset backed securities represent a class of fixed income products, created out of pooling together assets, and creating bonds that represent participation in the cash flows from the asset pool. For example, select housing loans of a loan originator (say, a housing finance company) can be pooled, and bonds can be created, which represent a claim on the repayments made by home loan borrowers. Such bonds are called mortgage–backed securities.

In some markets like India, these bonds are known as structured obligations (SO). Assets with regular streams of cash flows are ideally suited for creating asset-backed securities.

Classification of Debt Instruments

Issuers in Bond Markets

There are two broad ways in which bond markets can be segmented. - Based on the type of borrower, we can segment the market between the bonds issued by governments, and those issued by non-government agencies like banks, corporations and other such entities. - Based on the tenor of the instrument, we can segment the bond markets as short-term, medium term and long term. These are not mutually exclusive segments. The government issues bonds to meet its requirements for various periods as does the private sector. Each issued bond has an issuer and a tenor.

Government Securities comprises the central government bonds, and quasi-government bonds issued by local governments, state governments and municipal bodies. Government securities do not have credit or default risk.

Corporate bond markets comprise pre-dominantly of short-term commercial papers and long-term bonds. Another segment comprises of short term paper issued by banks, in the form of certificates of deposit. The rate at which this segment borrows depends upon the credit quality of the borrower. The credit or default risk of the borrower is defined by the credit rating of the bond. Higher the credit rating lower is the risk of default.

Companies also raise fixed deposits from the retail investors to meet their borrowing requirements. Such deposits are for a fixed term and carry a pre-defined interest rate. The interest can either be paid periodically, such as annual, semi-annual, or quarterly or it is paid cumulatively at the end of the term along with the repayment of the principal.

Company deposits are credit rated but unsecured borrowings of companies and as such pay a higher interest rate on the deposit. Since these are deposits and not a security, there is no liquidity in such fixed deposits. The investors hold the deposits to maturity.

Treasury Bills

The government borrows for periods such as 91 days, 182 days and 364 days using these instruments. Treasury bills are issued through an auction process which is managed by the RBI. Banks, mutual funds, insurance companies, provident funds, primary dealers and FIs bid in these auctions. The treasury bills are usually issued as zero-coupon bonds.

CBLO

A Collateralised Borrowing and Lending Obligation (CBLO) is created using government securities as collateral and held with the Clearing Corporation of India Ltd. (CCIL) to enable borrowing. It is a discounted instrument available for maturities from one day to up to one year. Banks use the CBLO to borrow from mutual funds and insurance companies.

Certificates of Deposit (CD)

Banks use CDs to meet their short-term needs for funds. CDs are different from deposits because they involve creation of paper. This makes the CD transferable before maturity. Secondary market activity in CDs are however low.

Commercial Paper (CP)

CPs are short-term papers issued by companies or financial institutions to meet their working capital requirements. They can be issued for various maturities between a minimum of 7 days and maximum of up to one year from the date of issue. A company is eligible to issue a CP if the tangible net worth is not less than ₹ 4 crore, the company has a sanctioned working capital limit by banks or FIs and the borrowal account of the company is classified as a Standard Asset by the bank/FI. The popular CP is the 90-day CP. CPs are unsecured credit-rated borrowings with a limited secondary market.

Government Securities

Government securities, also called treasury bonds, are predominantly issued to fund the fiscal deficit of the government. Treasury bonds also set benchmark for pricing corporate paper of varying maturities. All other borrowers in the system borrow at a spread over this benchmark rate on government securities.

The instruments used in this segment are many, including fixed coupon bonds, commonly referred to as dated securities, treasury bills, floating rate bonds, zero coupon bonds and inflation index bonds.

Treasury Bonds may have tenors ranging from a year to 30 years.

Corporate Bonds

The market for corporate debt securities is dominated by private placements with large institutional investors. Public issue of corporate debt securities are regulated by SEBI's regulations for the same.

The regulations require the issue to be credit-rated, appointment of a debenture trustee, creation of debenture redemption reserve and creation of a charge on the assets of the company.

The secondary market for long-term bonds is concentrated in the government securities segment. In this segment too, trading primarily happens in the benchmark securities. Trades in the government securities segment as well as the corporate bond segment are reported to the exchanges.

Yield from Debt Instruments

The returns to an investor in bonds, is primarily made up of the coupon payments. However, if the investor acquires or sells the bond at a price that is different from the par value the returns can vary from the coupon.

Therefore, the coupon rate of the bond is not an indicator of the returns on the bond, but merely helps in computing what cash flows would accrue periodically, to the investor.

We use the term 'yield', rather than 'coupon rate', to denote the returns to the investor.

Current Yield

Current yield simply compares the coupon of a bond with its market price. For example, if a bond paying an annual coupon of 12% is trading in the markets for ₹ 109.50, we compute the current yield as: 12/109.5 =10.95%

Yield to Maturity (YTM)

Yield to maturity (YTM) is a popular and extensively used method for computing the return on a bond investment. Every bond is made up of a set of cash flows that accrue at various points in time, from the time the bond is acquired, until it is sold or redeemed. We can then use the very well known principle in finance, to value the bond: the price at which a series of future cash flows should sell is the sum of the discounted value of these cash flows. The rate which equates the discounted value of the cash flows with the price of the bond is the yield to maturity of the bond.

New Instruments

1. Deep Discount Bonds.
2. Secured premiums notes.
3. Zero interest fully convertible debentures.
4. Zero coupon bonds
5. Double option Bonds.
6. Option Bonds
7. Inflation Bonds.
8. Floating Rate Bonds.

Deep Discount Bonds:

Deep Discount Bonds is a form of Zero-interest bonds. These bonds are sold at a discounted value and on maturity face value is paid to the investors. In such bonds, there is no interest payout during lock in period.

Secured Premium Notes

Secured Premium Notes is issued along with a detachable warrant and is redeemable after a notified period of say 4 to 7 years. The conversion of detachable warrant into equity shares will have to be done within time period notified by the company.

Zero Interest Fully Convertible Debentures

These are fully convertible debentures which do not carry any interest. The debentures are compulsory and automatically converted a after specified period of time and holders thereof are entitled to new equity shares of the company at predetermined price.

From the point of view of company this kind of instrument is beneficial in the sense that no interest is to be paid on it, if the share price of the company in the market is very high then the investors tines to get equity shares of the company at the lower rate.

Zero Coupon Bonds

A Zero Coupon Bonds does not carry any interest buy it is sole by the issuing company at a discount. The difference between the discounted value and maturing or face value represents the interest to be earned by the investor on such bonds.

Double Option Bonds

These have also been recently issued by the IDBI. The face value of each bond is ₹ 5000. The bond carries interest at 15% per annum compounded half yearly from the date of allotment. The bond has maturity period of 10 years. Each bond has two parts in the form of two separate certificates, one for principal of ₹ 5000 and other for interest (including redemption premium) of ₹ 16,500. Both these certificates are listed on all major stock exchanges. The investor has the facility of selling either one or both parts anytime he likes.

Option Bonds

These are cumulative and non-cumulative bonds where interest is payable on maturity or periodically. Redemption premium is also offered to attract investors. These were recently issued by IDBI, ICCI etc.

Inflation Bonds

Inflation bonds are the bonds in which interest rate is adjusted for inflation. Thus, the investor gets interest which is free from the effect of inflation. For example, if the interest rate is 11 per cent and the inflation is 5 per cent, the investor will earn 16 per cent meaning thereby that the investor is protected against inflation.

Floating Rate Bonds

This as the name suggests is bond where the interest rate is not fixed and is allowed to float depending upon the market conditions. This is an ideal instrument which can be resorted to by the issuer to hedge themselves against the volatility in the interest rates. This has become more popular as money market instrument and has been successfully issued by financial institutions like IDBI, ICICI etc.

Self Assessment Questions

1. Write Short notes on the following Capital Market instruments:-

Equity, Secured Premium Notes, Equity Shares with detachable warrents, Sweat Equity, Non-Voting shares, Tracking stocks, Preference shares, Debentures, Disaster Bonds, Option Bonds, Easy Exit Bonds, Split Coupon Debentures, Floating Rate Bonds and Notes, Clip and strip Bonds, Dual Convertible Bonds, Debt instruments with Debt warrants, Indexed Rate Notes, Stepped Coupon Bonds, Dual Option Warrants, Extendable Notes, Commodity Bonds, Mortgaged Backed Securities, Carrot and Stick Bond, Capital Indexed Bonds, Debt for Equity Swap, Zero Coupon Convertible Notes, Global Depository Receipts, Foreign Currency Convertible Bonds – New Instruments of Capital Market – Pure, Hybrid and Derivatives;

2. What is Money Market Instruments? Explain the following:

Treasury bills, Commercial Bills, Commercial Paper, and Participatory Notes.

CASE STUDY

I. Case Study

Discuss the roles and responsibilities of the following key persons in promoting new issue.

(a) Lead managers to the issue.
(b) Bankers to the issue.
(c) Registrars and transfer agents to the issue.
(d) Under writers to the issue.

II. Case Study

In India many underwriters come forward to under write the shares and hesitate to take venture on debentures. Do you think the reason is poor control over the capital market? Give reasons.

III. Case Study

Trace out the evaluation of Stock Exchanges. Also bring out the recent innovations in Capital Market.

IV. Case Study

Why would U.S.A. Investors have any interest in investing in Indian Securities ? Should they ? Why or Why not?

V. Case Study

The regulatory framework in India is based on the recommendations made by two committees, headed by L.C.Gupta and J.R.Verma. These were set up by SEBI for the smooth introduction of derivatives in India. The regulations are mostly in agreement with the International Organisation of Security Commissions report on the International Regulation of Derivative Markets and products (1996). The government and SEBI have been trying to protect the interest of the investors. Indian regulatory framework has awarded official recognition and legal acceptance to exchange traded Derivatives. The products are standardized. The intermediaries in the market argue that Derivatives prevent volatility and wide fluctuations. They provide liquidity also. But many people think that speculation is responsible for many problems.

Do you agree that speculators cause volatility? Give your views with reasons. How will you control excessive speculation?

VI. Case Study

Volatile Stock Market

Sensex has been moving between 12300 and 14500. Through it has crossed 14000, still the investor's confidence level in low. The stagnation continues despite volatile movements. Retail investors and the fund managers appear to be confused. The market is moving like a see-saw.

The opinions vary. Two questions are frequently asked: will the Sensex go below 10000? Will it cross 15000? Of course, no one likes the kind of volatility that is pushing the market around. The situation is really disturbing as not many have made money in the first four months of 2007. This is manifested by the fact that is the first quarter of 2007, only six equity mutual fund schemes could generate positive returns, with the highest being seven percent.

(a) What are the problems of our stock markets? How do you explain 'the volatility'?

(b) What will be your strategies to protect the investors?

VII. Case Study

What is the world's largest bank? Prior to the merger of Citicorp and Travellers in 1998, it was the Hong Kong and Shanghai Banking Corporation (HSBC) form is 1865 by Scotsman in the then British Colony of Hong Kong, HSBC grew to cover 6,500 bank offices in 78 countries by 2001. In the process it became the world's first truly global bank, offering a full range of financial services from retail to corporate banking to insurance and financial management. The HSBC built this global business based on its strong Hong Kong base. The bank owns the Hong Kong Bank and most of the Hong Seng Bank, giving it over 40 percent of the market in the Hong Kong Special Administrative Region of China that was created on July 1, 1977.

Perhaps less well known in the HSBC is also the owner of the former Midland Bank Chain Britain, the Marine Midland Banks in the US, and the Hong Kong Bank of Cananda. It has also acquired large banks in Latin America including Banco Barmerindus in Brazil. In all these cases HSBS greatly improved the efficiency of the under performing local banks through better systems and processes. Over recent years HSBC has implemented a rebanding strategy of all its subsidiaries under the HSBC title and logo. This is meant to build HSBC into a global brand.

Today HSBC is well developed across the triad regions of Asia, Europe and the Americas. Its diversification strategy has helped to insulate it from the Asian financial crisis of 1997/1998. And its first mover advantage as a truly global bank will prove hard to match by banks in the still regulated markets of North America and Europe. There is constant pressure in banking to reduce costs through greater scale economies and improved information technology HSBC is well positioned to continue as an industry leader because of its successful globalization strategy.

In retrospect, one of the world's largest banks came from one of the World's smallest economies. And it did this despite the regulatory barriers to entry for foreign-owned firms in the Europe and North America. As a result the HSBC is an example of a bank using modern management systems and market forces to win out over old fashioned protectionism in a highly regulated worldwide industry.

Perhaps the biggest influence of HSBC and its new efficient banking methods had been on British banking. A further restricting occurred in British banking in November 1999 when one of the country's four major banks (Lloyds, Barclays, Natwest and HSBC) was taken over by a much smaller bank. Natwest was acquired by the Royal Bank of Scotland, only one-third the asset size of Natwest, in a drawn out and controversial takeover. Another bank, the bank of Scotland, the first bid for Natwest and the take over efforts of both the Royal Bank of Scotland and the Bank of Scotland were defended by Nat West Chairman, Sir David Rowland, who is also president of Templeton College, University of Oxford.

The takeover was successful because investors were critical of Natwest's old style management and were supportive of the cost-cutting and new information technology methods of the Royal Bank of Scotland. After the acquisition, many Natwest branches were closed, bank buildings were turned into coffee bars, restaurants and hotels and a leaner, more efficient bank emerged to reclaim its place in British retail banking.

More recently the bank of Scotland and Halifax, the largest mortgage lender in the country, finalized a merger. This has fast-forwarded Halifax into main stream banking and greatly increased the bank of Scotland's scope of operations. It would also allow both banks to streamline their businesses and increase their market focus.

These efforts toward restructuring operations and eliminating waste are not going unnoticed by rival banks. Barclays, for example, has now begun closing some of its branches and is introducing a wide array of tools and techniques that are designed to cut costs and increase operational efficiency. It realizes that, to be a successful international operation, it must not only have wide geographic coverage but also be able to offer efficient services. In looking at these recent developments, it is clear that the steps taken by HSBC to modernize its own operations are providing to be a wakeup call for British banks as well.

Questions

(a) If the HSBC were to do business with the people's Republic of China and have substantial holdings of Chinese Yuan (renminbi) on hand, what risk might this pose for the bank?

(b) How could the HSBC manage its currency exchange rate risk?

(c) As the British retail banks are merged to achieve cost savings and economies, do this increases or decrease the barriers to entry for foreign banks wishing to do business in the EU?

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