UNDERWRITTING OF SHARES/DEBENTURES

Underwriting: - Underwriting may be defined as contract entered into by the company with the persons or institutions, called underwriters, who undertake to take the whole or a part of such of the offered shares or debentures, as may not be subscribed by the public, in consideration of remuneration, called "Underwriting Commission". Thus, the underwriting is an undertaking or guarantee given by the underwriters to the company that the shares or debentures offered to the public will be subscribed in full, in case the response of the public is poor the underwriters will take the balance of the shares or debentures not subscribed by the public and will pay for them.

Underwriters and Brokers:-

The persons or institutions underwriting a public issue of shares or debentures are called "Underwriter"	A person who buys and sells things for other people is called 'Broker'.
Underwriters give the guarantee to procure subscriptions to the shares or debentures issued, they take responsibility of subscribing.	Brokers merely promise or try to procure subscriptions to the shares or debentures issued; they do not take any responsibility of subscribing.
If whole of the issue is not subscribed by the public, underwriter is liable to take the balance of the shares or debentures.	Broker is not liable to take any shares or debentures.
Remuneration paid to the underwriter is known as "Underwriting Commission"	Remuneration paid to the broker is known as "Brokerage".

Types of Underwriting: - Underwriting may be of three types:-

1. **Complete Underwriting: -** If the whole of the issue of shares or debentures of a company is underwritten, it is to be said as "complete underwriting". In such a case the whole of the issue of shares or debentures may be underwritten by firm or person who has agreed to take the risk.
2. **Partial Underwriting: -** If only a part of the issue of shares or debentures of a company is underwritten, it is to be said as "partial underwriting". In such a case the part of the issue of shares or debentures may be underwritten by firm or person who has agreed to take the risk.
3. **Firm Underwriting:** - It refers to a definite commitment by the underwriter to take a specified no. of shares, irrespective of the no. of the shares subscribed by the public. Firm' underwriting signifies a definite commitment to take a specified number of shares, irrespective of the number of shares subscribed by the public. In case of firm underwriting, underwriters take the agreed no. of shares in addition to the unsubscribed shares, if any, whether the issue is fully subscribed or over subscribed. In such a case, unless it has been otherwise agreed, the underwriter's liability is determined without taking into account the number of shares taken up 'firm' by him, i.e. the underwriter is obliged to take :
    1. the number of shares he has applied for 'firm'; and
    2. the number of shares he is obliged to take on the basis of the underwriting agreement.

Underwriting Commission :- the consideration payable to the underwriter for underwriting the issue of shares or debentures of a company is called as "Underwriting Commission" In general it can be paid with the following limits

- In case of Shares, 5 % of the issue price or such lower rate as provided by the Articles of the company.
- In case of Debentures, 2.5 % of the issue price or such lower rate as provided by the Articles of the company.

However, the following the rates of commission are in force:-

Particulars	On amounts devolving on the underwriters	On amount subscribed by the public
(A) Equity Shares	2.5 %	2.5 %
(B) Pref. Shares/Convertible debentures/non-convertible debentures :-		
• For amounts up to Rs. 5 lacs	2.5 %	1.5 %
• For amounts above Rs. 5 lacs	2.00 %	1.00 %

- Underwriting commission is paid on the issue price of whole of the shares or debentures underwritten, whether or not the underwriter is called upon to take any shares or debentures. i. e. commission is paid even the subscription is fully subscribed by the public.

Marked and Unmarked Applications:- When the issue of the shares of a company is underwritten by two or more underwriters, it is usual that the applications for shares sent through the underwriters should bear a stamp of the respective underwriter, other wise it would be very difficult for the company to determine that how many applications have been received from a particular underwriter. Thus, the applications bearing the stamp of the respective underwriters are called as "Marked Applications" and the applications received directly by the company which do not bear any stamp of the underwriters are called as "Unmarked Applications"

Marked Applications:-

- The application forms bearing the stamp of the underwriter, are termed as "Marked Applications"
- The benefit of marked applications is given to the concerned underwriters in whose name application forms have been marked.

Unmarked Applications:-

- The application forms which do not bear the stamp of the underwriter, are termed as "Unmarked Applications"
- The benefit of unmarked applications is given first to the company to the extent of issue not underwritten by underwriters.

- In case there is surplus, benefit of surplus will be given to the underwriters in the ratio of their “gross liability.”

Note: - If the entire issue of the shares is underwritten by only one underwriter, there is no question of marked and unmarked applications, as one underwriter will be given credit for all the applications, whether received through him or directly.

Determination of liability of underwriters:-

1. Complete Underwriting:-

- In case of one underwriter:-Underwriter will be liable to take all the shares that have not been subscribed by the public. Liability of the underwriter will be (Share underwritten/issued - total application received).
- In case of two or more underwriters: - Liability of the underwriter will be determined by subtracting the marked and unmarked applications from the gross liability of the each underwriter. (discussed in separate statement)

In case of **Complete Underwriting,** underwriter is free from liability, if the issue is over subscribed or fully subscribed.

2. Partial Underwriting:-

In such a case the gross liability of the underwriters will be that part of the issue of shares, which is underwritten say 60 % or 70 % and the net liability of the underwriter will be determined by deducting the marked and unmarked applications from the gross liability shares. Ex:- XYZ issued 75000 shares @ 10 each. 70 % of the issue was underwritten by unerwriter M/s Ram & Sons. Applications were received for 65000 shares. Calculate net liability of the underwriters? Net liability of underwriter will be 7000 shares, i.e. 70 % of (75000-65000) shares.

- If all the shares are fully subscribed by the public, then underwriter is free from liability.

3. Firm Underwriting:-

In case of firm underwriting, underwriters take the agreed no. of shares in addition to the unsubscribed shares, if any, whether the issue is fully subscribed or over subscribed. In such a case underwriter’s liability is determined without taking into account the number of shares taken up ‘firm’ by him, i.e. the underwriter is obliged to take :

1. the number of shares he has applied for ‘firm’; and
2. the number of shares he is obliged to take on the basis of the underwriting agreement.

In case of under subscription, underwriter is liable to take the agreed no. of shares in addition to the unsubscribed shares and in case of full subscription and over subscription, underwriter is liable to take the agreed no. shares (firm shares) and application money for that shares is returned to the public. Ex: A co. issued 80000 shares through underwriter. Firm underwriting shares are 4000 shares. Calculate the net liability of the underwriter if applications were received for :- (it indicates that, in case public subscribes for 76000 shares, he will be liable for only 4000 shars of firm underwriting but if public subscribe for less than 76000 shares, he will be liable to take shares as per agreement in addition to the firm underwriting shares, in every case firm underwriting shars will be 4000 i.e. issued to public can not exceed 76000 shares)

	Application Received					
	70000	**75000**	**76000**	**78000**	**82000**	**86000**
Liability for firm underwriting	4000	4000	4000	4000	4000	4000
Liability as per agreement	6000	1000	-	-	-	-
Net Liability	***10000***	***5000***	***4000***	***4000***	***4000***	***4000***
Issued to public	70000	75000	76000	76000	76000	76000
Refund	-	-	-	2000	6000	10000

The firm underwriting shares may be treated by any of the following two methods, while computing net liability of underwriter:

1. *Treating as marked application*: - In such a case, the firm underwriting shares are to be adjusted from the gross liability of the each underwriter as marked application, i.e. “firm underwriting shares” are subtracted from the gross liability with the marked applications.
2. *Treating as unmarked application*: In such a case, the firm underwriting shares are to be adjusted at par with unmarked applications i.e. firm underwriting shares will be included in the total unmarked applications and will be divided amongst the underwriters in their gross liability ratio, along with the other unmarked applications.

Note: In case of firm underwriting, in the absence of any information regarding the treatment of firm underwriting shares, any of the above treatment may be followed by giving a footnote.

JOURNAL ENTRIES

BOOKS OF COMPANY (XYZ Ltd.)

1. **For Direct Applications from public (Applications Subscribed by public)**

   Bank A/c Dr.
   Discount on issue of shares/debentures A/c Dr. (If issued at discount)
   To Share Capital A/c
   To …% Debentures A/c
   To Securities Premium A/c (If issued at premium)

2. **For Shares/Debentures taken by Underwriters (Applications not Subscribed by public)**

   Underwriter's A/c Dr.
   Discount on issue of shares/debentures A/c Dr. (If issued at discount)
   To Share Capital A/c
   To …% Debentures A/c
   To Securities Premium A/c (If issued at premium)

3. **For Underwriting Commission payable to underwriter**

   Underwriting Commission A/c Dr.
   To Underwriter's A/c

4. **For amount received from Underwriter in final settlement**

   Bank A/c Dr.
   To Underwriter's A/c

5. **For amount paid to Underwriter in final settlement**

   Underwriter's A/c Dr.
   To Bank A/c

BOOKS OF UNDERWRITER

1. **For Shares/Debentures taken by Underwriters (Applications not Subscribed by public)**

   Investment in Shares/ Debentures of XYZ Ltd. A/c Dr.
   To XYZ Ltd (Name of Company)

- Premium/Discount on issue of shares, if any, will be netted off i.e. net amount will be shown as an Investment made in XYZ.

2. **For Underwriting Commission :**

   XYZ Ltd. (Name of Company) A/c Dr.
   To Underwriting Commission A/c

3. **For amount received from Company in final settlement:**

   Bank A/c Dr.
   To XYZ Ltd (Name of Company) A/c

4. **For amount paid to Company in final settlement :**

   XYZ Ltd. (Name of Company) A/c Dr
   To Bank A/c

Statement Showing Calculation of Net Liability of Underwriter

PARTICULARS	A	B	C	TOTAL
Gross Liability of the Underwriter	xxx	xxx	xxx	xxx
Less:- Marked Applications (Including firm underwriting shares, if they are treated as marked shares)	(xxx)	(xxx)	(xxx)	(xxx)
	xxx	**xxx**	**xxx**	**xxx**
Less:- Unmarked Applications (In the gross liability ratio)	(xxx)	(xxx)	(xxx)	(xxx)
	xxx	**xxx**	**xxx**	**xxx**
Less:- Surplus of underwriter, if any, to be adjusted from the liability of the remaining underwriters (In the gross liability ratio)	xxx	xxx	xxx	xxx
	xxx	**xxx**	**xxx**	**xxx**
Add:- firm underwriting applications	xxx	xxx	xxx	xxx
Net Liability of the Underwriter	**xxx**	**xxx**	**xxx**	**xxx**

Explanations:-

1. Firm underwriting shares can be treated as marked shares or unmarked shares. If the same is treated as marked shares, then will be subtracted as marked shares, otherwise as unmarked shares.

2. Unmarked Shares:-

Total Applications Received - Marked Applications