

SLC (NS – 2010 – June)

PART – A

Question 1:

(a)

- (i) **Correct.** Capital market is a market for financial investments that has direct or indirect claims to capital. It is wider than Securities market and embraces all forms of lending & borrowing, whether or not evidenced by creation of a negotiable financial instrument.
- (ii) **Correct.** The statement that mandatory client code facilitates market surveillance is true because the intermediary has proper records about client.
- (ii) **Correct.** It is a uniform model for rating of banking companies every letter of term 'CAMEL' signifies some specific subject matter, on the basis of which banking companies are rated.
- (iv) **Correct.** A foreign currency convertible Bond (FCCB) is a quasi debt instrument which is issued by any corporate entity, international agency or sovereign state to the investors all over the world. These are denominated in any freely convertible foreign currency FCCBs represent equity linked debt security which can be converted into Shares or into depository receipts.
- (v) **Correct.** A venture capital fund is required to file a placement memorandum with SEBI, giving details of terms, subject to which monies are proposed to be raised from investors. After filing the placement memorandum the venture capital of 21st days, placement memorandum can be issued for private circulation.

(b)

- (i) Initial Public Offer
- (ii) Periodical settlement of contracts & differences the under.
- (iii) Lock in periods
- (iv) Indian Depository Receipts
- (v) Green Shoe Option

Question 2 :(a)

- (i) **Mortgage backed securities** means such securities which are issued on the basis of pooled assets, which are illiquid or convertible in liquid assets, after a long period.

Simply, mortgage backed securities can be referred as "securitization" or debt securitization, by which a company can convert its illiquid assets (of the balance – sheet) into liquid to meet out its' cash requirement.

It is beneficial for investors, due to less risk, company gets an opportunity to have additional source of finance on the basis of illiquid assets.

- (ii) **Basket Trading system** is a facility provided by the Bombay Stock Exchange" Where by the investors as well as its member – brokers can create sensex linked portfolio. In this system, the investors through the member – brokers are able to buy or sell all 30 of their respective weights in the sensex. The investors need not calculate the quantity of sensex scrips to be bought or sold for creating sensex linked portfolios and this function is performed by the system.
- (iii) **Market abuse** means abnormal market behaviour resulting due to
 - abnormal Price/volume movement,
 - artificial transactions
 - false & misleading impressions
 - insider trading etc.

To Counter market abuse, various tools are used and suitable actions are taken against involved persons. Few *tools, to counter market abuse* are:

- imposition of special margin
- introduction of circuit filters
- trade to trade settlement
- suspensions
- deactivation of terminals

- (iv) **Debt for equity swap** give an offer to the debt holders to exchange the debt instrument for equity shares of the same company.

The company reduce its interest burden and replace it with dividend burden by issuing equity to debt holder. For investors, they got same voting power as well as potential rise into value of shares.

- (b) (i) MCFS
(ii) SPDR
(iii) WMA

- (c) **Investment Criteria for a foreign Venture Capital Fund in India:** As per SEBI (Foreign Venture Capital Investors) Regulations, 2000, following are the investment criteria for a foreign venture capital fund:

- (1) It should disclose to SEBI its investment strategy
- (2) It can invest its total funds committed in one venture capital fund but investment in one venture capital undertaking shall not be more than 25% of the funds committed for investment to India.
- (3) It should make investment in venture capital undertaking as enumerated below:
 - (i) atleast 75% of the investible funds should be invested in unlisted equity shares or equity linked instruments.
 - (ii) not more than 25% of the investible funds may be invested by way of
 - (a) Subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed subject to lock – in – period of one (1) year.
 - (b) debt or debt instrument of a venture capital undertaken in which the foreign venture capital investor has already made or investment by way of equity.

Question 3:

- (a) (i) **Commodity Pool** : It means bonds issued for sharing the risk and profitability of future commodity prices with the investor. For example, petro bonds, silver bonds, gold bonds & coal bonds.

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

Question 3:

- (a) (ii) Depository Participant:

Please Refer answer to 2006 – June [1] {c} (v) of chapter on page S-180.

Question 3:

- (b) (i) **Auction** : It is one of the method of issuance of Government Securities. There are two methods of auction:

- (1) **Uniform price based Auction** : it is also called dutch Auction”. Under this method of auction, dated government securities are issued. The bids are accepted at the same prices as decided in cut – off.
- (2) **Multiple or variable price Based Auction**: It is called, French Auction’. This method is used for auction of both government dated securities & treasury bills. Bids are accepted at different prices/yields quoted in the individual bids.

Question 3:

(b) (ii) **Primary Dealers**: It is a non banking financial company which holds a valid letter of authorization as a primary Dealer issued by the Reserve Bank of India, in terms of the “Guidelines for Primary Dealers in Government Securities market”.

It means an eligible entity to deal in Government securities. It can purchase, hold and sell the Government Securities with the public Debt Office of Reserve Bank of India in dematerialized form accounts known as subsidiary general ledger (SGL) Accounts.

Question 3:

- (c) Market Making : Plz. Refer short notes 2004 – June [1] {c} (ii) ok chapter 6 i.e. Stock – exchange on Page – S – 104.

Question 3:

- (d) **Primary market** provides channel for sale of new securities and mobilize resources for new projects as well as for existing projects with a view to expansion, modernization, diversification & upgradation.

The Primary market is of great significance to the economy of a country. It is through the primary market that funds flow for productive purposes from investors to entre preneurs. The latter use the funds for creating new products and rendering services to customers in India & abroad. The Strength of the economy of a country is gauged by the activities of the stock exchanges. The primary market creates and offers the merchandise for the secondary market.

Question 4:

- (a) (i) **Funds Pay – In** : It means debiting the bank accounts clearing banks. This is done, when a member broker purchase the securities. If the fund is insufficients, then the request for purchase is turned down by the stock exchange.

Funds Pay – Out: It means crediting the bank accounts of the member – brokers, main tained with the clearing bank. This is done when a member broker sells the securities.

Question 4:

(a) (ii)

Basis of Diff.	Merchant Banker	Portfolio Manager
(i) Definition	It means any person engaged in the business of issue management by making arrangements regarding selling buying or subscribing to securities or acting as a manager, consultant or advisor or rendering advisor advisory services.	It means any person, who pursuant to contract or arrangement with the client, advises or directs or under takes on behalf of the client the management or administration of a portfolio of securities or the funds of the client.
(ii) Regulated By	SEBI (Merchant Bankers)	SEBI (portfolio Managers)

	Regulations, 1992	Regulation 1993
(iii) Capital Adequacy	A merchant Banker, must have a minimum net worth of Rs.5 crores.	A portfolio manager must have a minimum net worth of Rs.50 lacs.

Question 4:

(a) (iii) Plz. Refer 2008 – June [3] (a) on page S – 46

Question 4:

(b) (i) **Self Regulatory Organisation** : As per Regulation 2 (1) (k) of SEBI (Self Regulatory Organisations) Regulation, 2004, “Self Regulatory organization” means an organization of intermediaries which is representing a particular segment of securities market and which is duly recognised by the Board under these regulations, **but** excludes a stock exchange.

(II) **Functions & obligations of self Regulatory organization (SRO):** (Regulation 14)

- (a) It shall always abide by the directions of the Board.
- (b) It shall be responsible for investor Protection and education of investors or its members and shall ensure observance of securities law by its members.
- (c) It is required to specify standard of conduct of its members and also shall be responsible for the implementation of the same by its members.
- (d) It shall conduct inspection & audit of its members, on regular basis, through independent auditors.
- (e) It shall treat all its members and applications for membership in a fair and transparent manner.
- (f) It shall promptly inform the violations of the provisions of the Act, the rules, the regulations etc.

Question 4:

(c) While rating *manufacturing companies*, a credit rating agency must consider following factors:

- (1) **Industry Risk:** Each industry has its own risk or threat, according to its nature, size, growth prospects, demand & entry barrier.
- (2) **Company’s Position:** The market share of the company, in the industry, in which it belongs is also a factor, to be considered while giving rating.
- (3) **Operating Efficiencies** : It means ability to control costs, productivity efficiencies relative to others access to raw – materials / markets and technology.
- (4) **Accounting Quality:** Accounting policies, treatment of non – standard factors are also relevant factor for determining the rating .
- (5) **Financial Flexibility:** Evaluation of company’s financial needs, sources of finance and flexibility in terms of alternative is also consideration relevant.
- (6) **Earning protection:** Long term earning prospect in terms of return on capital employed, profit margins, Debt coverage ratios etc. are also taken care.
- (7) **Cash Flow Adequacy:** It means, capacity of the company to meet all cash needs of business.
- (8) **Management Evaluation:** The achievements of those persons, who are in charge of the company are also considered a relevant factor for determination of credit rating.

Question 5 :

- (a) Responsibilities & obligations of a debenture Trustee : Regulations 13 to 18 of SEBI (Debenture Trustees) Regulations, 1993 deals with following responsibilities & obligations of a debenture trustee:
- (1) It should not act as a debenture trustee without entering into a written agreement with the body corporate. (Regulations – 13).
 - (2) No debenture trustee shall act as such for any issue of debentures in case
 - (a) It is an associate of the body corporate, or;
 - (b) It has lent and the loan is not yet fully repaid or is proposing to lend money to the body corporate (Reg. 13A)
 - (3) It should accept such trust – deed only which contains the matter specified in schedule IV of the Regulations (Reg. 14)
 - (4) It shall fulfil its duties as specified in regulation 15 i.e. calling for periodical reports from the body corporate & other duties.
 - (5) It shall abide by its code of conduct (Reg. 16)
 - (6) Maintenance of books & accounts, records & documents relating to trusteeship functions provided, for a period of minimum five preceding financial years.

Question 5(b):

- (I) **Meaning of Short Selling:** It means selling a stock which the seller doesn't own at the time of trade.
- (II) **Broad Framework of Short Selling :**
- (a) Short sell is permissible for all classes of investors i.e. retail as well as institutional investors:
 - (b) Naked short selling shall not be permitted in the Indian securities market and accordingly, all investors would be required to mandatorily honour their obligation of delivering securities at the time of settlement.
 - (c) No institutional investor shall be allowed to do day trading i.e. square – off of their transactions intra – day.
 - (d) A scheme for securities lending & borrowing shall be put in place to provide the necessary impetus to short sell.
 - (e) SEBI may review the list of stocks that are eligible for short selling transactions from time to time.
 - (f) The institutional investors shall disclose upfront at the time of placement of order whether the transaction is a short sale. However, retail investors would be permitted to make a similar disclosure by the end of trading hours on the transaction – day.

Question 5(c)

Information's as per question

Redemption price of mutual fund	= Rs.48
Front end Load	= 2% @ 0.02
Back end Load	= 3% or 0.03

Now,

- i) Net Assets value = ?
we know Redemption price = N.A.V/ (1 + Back end Load)
Now putting figures with the help of question
 $48 = NAV / (1 + 0.03)$
Or, $48 = NAV$
 (1.03)
Or, $NAV = 48 \times (1.03) = Rs.49.44$

$$\begin{aligned}
 \text{(ii) Public offer price} &= \frac{\text{Net Asset value}}{(1 - \text{front end load})} \\
 &= \frac{49.44}{(1 - 0.02)} = \frac{49.44}{.98} \\
 &= 50.45
 \end{aligned}$$

PART – B

Question 6:

- (a) The given statement that “IPO grading is a service aimed at facilitating the assessment of the equity issue offered to the public” is correct. The grade assigned to any individual issue represents a relative assessment of the “fundamentals” of that issue in relation to the universe of other listed equity securities in India. Such grading is assigned on a five – point scale with a higher score indicating stronger fundamentals.

However, IPO grading should not be confused with an investment recommendation. Investment recommendations are expressed as ‘buy’ ‘hold’ or ‘sell’ and are based on a security specific comparison of its assessed ‘fundamental factors’ and ‘market factors’ to its price. But the security in relation to other listed securities in India.

Simply the IPO grading doesn’t take cognizance of the price of the security it is not an investment recommendation. Rather, it is one of the inputs to the investor to aid in the decision making process.

Question 6

- (b) Refer 2008 – Dec. [8] (a) at page number ----- S – 193.

Question 6:

- (c) As per Regulation 26 of SEBI (Issue of capital & Disclosure Requirements) Regulations, 2009, an unlisted company must meet all the following conditions for public – issue i.e. Initial public offer.
- (i) The company has net tangible assets of at least Rs.3 crore in each of the preceding 3 full years, of which not more than 50% is held in monetary assets.
 - (ii) The company has a track record of distributable profits in terms of section 205 of companies Act, 1956, for at least @ out of immediately preceding 5 years.
 - (iii) The company has a net worth of at least Rs.1 crore in each of the preceding 3 full years.
- (d) In case the company has changed its name within the last 1 year, at least 50% of the revenue for the preceding 1 full year is earned by the company from the activity suggested by the new name.
- (e) The aggregate of the proposed issue and all previous issue made in the same financial year in terms of size doesn’t exceed 5 times its pre – issue net worth as per the audited balance sheet of the preceding financial year.
- (f) The company should ensure that the prospective allottees are not less than 1000/-

Question 6:

- (d) (i) **Pass through certificates:** When mortgages are pooled together and undivided interest in the pool are sold, pass through securities are created. The pass through securities promise that the cash flow from the underlying mortgages would be passed through to the holders of securities in the form of monthly payments of interest & principal.
- (ii) **Benchmarked Instruments:** These are certain debt instruments wherein the fixed income earned is based on a benchmark. For example, the floating interest Rate Bonds are benchmarked to either the LIBOR i.e. London inter – bank offering rate or, MIBOR i.e. Mumbai inter – bank offering rate.

- (iii) **Inflation linked bonds** : A bond is considered indexed for inflation if the payments on the instrument are indexed by reference to the change in the value of a general price or wage index over the term of the instrument. The options are that either the interest payments are adjusted for inflation or the principal repayment or both.
- (iv) **Floating interest rate.** It means a debt instrument carrying variable rate of interest. Periodically the interest rate payable for the next period is set with reference to a benchmark market rate agreed upon by both the lender and the borrower. The benchmark market rate is the state Bank of India, Prime Lending Rate in domestic markets and LIBOR or US Treasury Bill Rate in the overseas Market.

Question 7:

- (a) Please Refer 2009 – June [6] (c) on page S – 194.

Question 7:

- (b) Every issuer of an Indian depository receipts (IDRs) has to comply with the conditions, stipulated in the listing agreement for IDRs issued by SEBI.

As per clause 23 of such listing agreement, following are the required points relating to appointment of the required point relating to appointment of company secretary & undertaking of due – diligence of Registrar & Transfer Agent (RTA):

- (i) Appointment of company secretary as compliance officer who will directly liaise with the authorities such as SEBI, stock exchange etc. and investors with respect to implementation of various clauses, rules regulations & other directives of such authorities and investor service & complaints related matter.
- (ii) The issuer is required to undertake a due diligence survey to ascertain whether the RTA is sufficiently equipped with infrastructure facilities such as adequate manpower, computer hardware & software, office space, documents handling facility etc. to serve IDR holders.
- (iii) The issuer shall also furnish a copy of agreement or MOU entered into with overseas custodian bank domestic depository, merchant banker and RTA to the stock exchange.

Question 7:

- (c) **Conversion of external commercial Borrowings (ECBs) into Equity:**

- (I) **Conditions** : ECB is converted into equity subject to following conditions:
 - (a) The activity of the company is covered under Automatic Route for foreign Direct Investment or Government approval for foreign equity participation has been obtained by the company, wherever applicable.
 - (b) The Foreign equity holding after such conversion of debt into equity is within the sectoral cap if any,
 - (c) Pricing of shares is as per the SEBI guidelines/regulations in the case of listed / unlisted companies as the case may be.
- (II) **Reporting** : Conversion of ECB into equity must be reported in the Form FC – GPR to the concerned Regional office of the Reserve Bank of India as well as to the RBI, within 7 days in form ECB – 2.

Question 7(d):

(I) Requirements for right issue : As per SEBI (issue of capital & Disclosure Requirements) Regulations 2009, the requirement for right issue are summarized as :

- (a) Record Date: The Great India Ltd. (hereinafter called issuer company), shall announce a record date for the purpose of determining the shareholders eligible to apply for specified securities in the proposed right issue.
- (b) Restriction on rights issue: The issuer shall reserve equity shares for FCD or PCD, while making right issue.
- (c) Letter of offer, abridged letter of offer pricing & period of subscription:
 - (i) The abridged letter of offer, alongwith application form, shall be dispatched through registered post or speed post to all the existing share holders at least 3 days before the date of opening of the issue:
 - (ii) The issue price shall be decided before determining the record – date which shall be determined in consultation with the designated stock – exchange.
 - (iii) A right issue shall be open for a minimum period of 15 days and for a maximum period of 30 days.
- (d) Pre – issue Advertisement for right issue: The issuer shall issue an advertisement containing particulars like – the date of completion of dispatch of abridged letter of offer and the application form or the place from. Where application form can be obtained.
- (e) Reservation for employee: A maximum value of reservation for each employee upto Rs.1 lakh can be made.
- (f) utilization of funds : The funds raised in right issue shall be utilized onl after finalization of the basis of allotment;

(II) Steps involved in Right – issue:

- (a) Ensure that right issue is within the authorized share capital of the company otherwise take necessary steps for increasing the authorized capital.
- (b) Notify at least 2 days in advance to the stock exchange about the Board – meeting at which proposal of right issue will be considered.
- (c) convene & hold the Board Meeting and notify the stock exchange immediately about the decisions taken in Board meeting.
- (d) If shares are proposed to offered to persons other than share holders of the company, convene a G.M. and pass resolution U/S 81(IA) of the companies Act, -1956.
- (e) Forward 6 sets of letter of offer to concerned stock exchange(s).
- (f) Despatch letters of offer to shareholders by registered post
- (g) Publish the advertisement giving date of completion of dispatch of letter of offer in atleast an English National Daily, one Hindi National Paper and a Regional language Daily, where registered office of the company is situated.
- (h) make arrangement with bankers for acceptance of share application forms.
- (i) Prepare a scheme of allotment in consultation with stock exchange
- (j) Convene Board meeting and make allotment of shares.
- (k) make an application to the stock exchange(s) Where the company's shares are listed for permission of listing of new shares.

Question 8:

(a) (i) Legal Provisions for investor protection with regard to “Misstatements in a prospectus” are given under companies Act-1956, comprising sec.63 & sec.68. These are discussed as.

(1) Criminal liability for misstatement (sec. 63):

As per this section, misstatement in prospectus will attract criminal liability, which is

- Imprisonment upto 2 years or
- Fine, which ma extend to Rs.50,000/- or

- With both.

However, offence under this section is compoundable

(2) Penalty for fraudulently inducing persons (sec.68)

This section deals with the penalty for fraudulently inducing persons to invest money in security of a company and provides for imprisonment upto 5 year or fine upto Rs.1 lakh.

Question 8:

(a) (ii) In case the company fails to send financial statements, the legal provision of companies Act, 1956 are as :

(1) Penalty for fault in sending financial statements : As per sec.219 of companies Act, - 1956, members has a right for copies of Balance sheet and auditors Report. If company makes default in complying with this requirement, a penalty will be imposed up to Rs.5000/-

(2) Proceeding Against the company & its officer (sec.621):

This section permits the shareholder to proceed against the company & its officers in a court of law generally for offences committed under the companies Act.

Question 8:

(b) Plz., refer 2008 – June [7] (6) Page S – 243

Question 8:

(c) **yes**, an issuer company can offer specified securities at different prices. However, it has to satisfy following conditions.

(i) retail individual investors or retail individual shareholder can be offered specified securities at a price lower than the price at which net – offer is made to other categories of applicant like institutional investors:

However, such difference shall not be more than 10% of the price of which specified securities are offered to other categories of applicant.

(ii) in case of a book built issue, the price of the specified securities offered to an anchor investor should not be lower than the price offered to other applicants.

(iii) in case of a composite issue, the price of the specified securities offered in the public issue can be different from the price offered in right issue and justification for such price difference should be given in the offer document.

Question 8:

(d) Plz. Refer 2004 – June [4] (a) on Page S – 210.