

SECURITIES LAWS AND REGULATION OF FINANCIAL MARKETS

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer SIX questions including Question No. 1 which is **COMPULSORY**.

Question 1

- (a) State, with reasons in brief, whether the following statements are true or false :
- (i) Corporate governance is a system by which stock exchanges are generally directed and controlled.
 - (ii) A company cannot buy-back its securities listed at a stock exchange.
 - (iii) Shareholders of tracking stocks have a financial interest in a company as a whole.
 - (iv) Money market instruments do not include any equities. (2 marks each)
- (b) Choose the most appropriate answer from the given options in respect of the following :
- (i) A stock exchange is granted recognition under —
 - (a) The Companies Act, 1956
 - (b) The Securities Contracts (Regulation) Act, 1956
 - (c) The Securities and Exchange Board of India Act, 1992
 - (d) The Depositories Act, 1996.
 - (ii) A compliance officer appointed under clause 47 of the listing agreement can be —
 - (a) A Company Secretary
 - (b) A Chartered Accountant
 - (c) A Cost Accountant
 - (d) Any of the above.
 - (iii) Intermediaries which do not belong to primary market is —
 - (a) Lead Manager
 - (b) Stock Broker
 - (c) Transfer Agent
 - (d) Underwriter.
 - (iv) Settlement basis for fixed income securities and government securities is—
 - (a) T+1
 - (b) T+2
 - (c) T+3
 - (d) R+5.

- (v) *Delivery that does not take place at a stock exchange is —*
- (a) *Auto delivery*
 - (b) *Hand delivery*
 - (c) *Special delivery*
 - (d) *Spot delivery.*
- (vi) *A mutual fund is set-up in the form of —*
- (a) *Board*
 - (b) *Company*
 - (c) *Cooperative bank*
 - (d) *Trust.* (1 mark each)
- (c) *Re-write the following sentences after filling-up the blank space with appropriate word(s)/figure(s) so as to convey the correct meaning :*
- (i) *Regulation 7 of the SEBI (Merchant Bankers) Regulations, 1992 prescribes that the capital adequacy norm for a merchant banker shall be net worth of not less than Rs._____.*
 - (ii) *Close ended mutual fund schemes have _____ corpus.*
 - (iii) *_____ is an independent person appointed to hear and act upon citizens complaints about government services.*
 - (iv) *A double option called _____ is a combination of one put option and one call option with a common striking price and common expiry date.*
 - (v) *_____ debentures are those debentures which do not carry any charge on the assets of the company.*
 - (vi) *The capital market segment of National Stock Exchange (NSE) provides a fully automated screen based trading system known as _____.* (1 mark each)

Answer 1(a)(i)

The statement is false.

Corporate Governance is a system by which companies are directed and controlled. Corporate governance structure specifies the distribution of rights and responsibilities among different participants in the company such as board, management, shareholders and other stakeholders; and spells out the rules and procedures for corporate decision-making. By doing this, it provides the structure through which the company's objectives are set along with the means of attaining these objectives as well as for monitoring performance.

Answer 1(a)(ii)

The statement is false.

A company can buy-back its securities listed at a stock exchange under SEBI (Buy-Back of Securities) Regulations, 1998, through one of the following methods.

- (a) from the existing security holders on a proportionate basis; or

- (b) from the open market; or
- (c) from odd lots, that is to say, where the lot of securities of a public company whose shares are listed on a recognized stock exchange is smaller than such marketable lot as may be specified by the stock exchange; or
- (d) by purchasing securities which had been issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Answer 1(a)(iii)

The statement is false.

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. Shareholders of tracking stocks thus have a financial interest only in that unit or division of the company.

Answer 1(a)(iv)

The Statement is true.

Money market instruments do not include any equities. Money market instruments mainly include Government securities, securities issued by banking sector and securities issued by private sector. Money market also involves transfer of funds in exchange of financial assets and due to the nature of the money market, the instruments used in it represent short-term claims.

Answer 1(b)(i)

A Stock Exchange is granted recognition under *Securities Contracts (Regulation) Act, 1956*.

Answer 1(b)(ii)

A Compliance Officer appointed under clause 47 of the listing agreement can be *Company Secretary*.

Answer 1(b)(iii)

Intermediaries which do not belong to primary market is *Stock Broker*.

Answer 1(b)(iv)

Settlement basis for fixed income securities and government securities is *T+1*.

Answer 1(b)(v)

Delivery that does not take place at a stock exchange is *Auto delivery*.

Answer 1(b)(vi)

A mutual fund is set up in the form of *Trust*.

Answer 1(c)

- (i) Regulation 7 of the SEBI (Merchant Bankers) Regulations, 1992 prescribes that

the capital adequacy norm for a merchant banker shall be networth of not less than Rs. *five crores*.

- (ii) Close ended mutual fund schemes have *Fixed* corpus.
- (iii) *Ombudsman* is an independent person appointed to hear and act upon citizens complaints about government services.
- (iv) A double option called *straddles* is a combination of one put option and one call option with a common striking price and common expiry date.
- (v) *Naked or unsecured* debentures are those debentures which do not carry any charge on the assets of the company.
- (vi) The capital market segment of National Stock Exchange (NSE) provides a fully automated screen based trading system known as *National Exchange for Automated Trading (NEAT)* system.

Question 2

Write short notes on any four of the following :

- (i) *Rolling settlement*
- (ii) *Whistle blower policy*
- (iii) *Indian depository receipt (IDR)*
- (iv) *Money market mutual funds (MMMF)*
- (v) *Straight through processing (STP).* (4 marks each)

Answer 2(i)

Rolling Settlement

Under rolling settlements, unlike in the “account period settlements”, the trades done on a particular day are settled after a given number of business days instead of settling all trades done during an ‘account period’ of a week or fortnight. In the prevailing T+2 settlement cycle, the final settlement of transactions done on T, i.e., trade day by exchange of monies and securities between the buyers and sellers respectively takes place on second business day (excluding Saturdays, Sundays, bank and Exchange trading holidays) after the trade day.

In case of Rolling Settlements, pay-in and pay-out of both funds and securities is completed on the same day. Each trading day is considered as a trading period and trades executed during the day are netted to obtain the net obligations for the day in a rolling settlement.

Answer 2(ii)

Whistle Blower Policy

A Company may establish “Whistle Blower Policy” for its employees to enable them to report to the management concerns about unethical behavior, actual or suspected fraud or violation of the company’s code of conduct or ethics policy. The policy should provide for adequate safeguards against victimization of employees who avail of the

mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases. Once established, the existence of the mechanism of Whistle Blower should appropriately be communicated within the organization. Whistle Blower Policy is also one of the non-mandatory requirements of the revised Clause 49 of the Listing agreement.

Answer 2 (iii)**Indian Depository Receipt (IDR)**

“Indian Depository Receipt” means any instrument in the form of a depository receipt created by Domestic Depository in India against the underlying equity shares of issuing company. Domestic Depository for the purpose means custodian of securities registered with SEBI and authorised by the issuing company to issue Indian Depository Receipts. Overseas Custodian Bank in respect of issuance of IDR is a banking company which is established in a country outside India and has a place of business in India and acts as custodian for the equity shares of issuing company against which IDRs are proposed to be issued after having obtained permission from Ministry of Finance for doing such business in India.

Answer 2(iv)**Money Market Mutual Funds (MMMF)**

In India, the decision to promote Money Market Mutual Funds (MMMF) was announced by RBI while unveiling its credit policy in April 1991. MMMF is a scheme of a mutual fund set up with the objective of investing exclusively in money market instruments. These funds invest in short- term debt securities in the money market like certificates of deposits, commercial papers, government treasury bills etc. Owing to their large size, the funds normally get a higher yield on such short term investments than an individual investor. Money market funds are regarded as high liquidity oriented as investors attach more value for safety and liquidity. Money market mutual funds used to be regulated by the Reserve Bank of India on the basis of specified guidelines to be laid down by the Reserve Bank of India. However, w.e.f. March 7, 2000 Reserve Bank of India withdrew these guidelines and it was notified by SEBI later on that the MMMF schemes, like other mutual fund schemes would exclusively be governed by SEBI (Mutual Funds) Regulations, 1996.

Answer 2(v)**Straight Through Processing (STP)**

Straight Through Processing (STP) is generally understood to be a mechanism that automates the end to end processing of transactions of financial instruments. It involves use of a system to process or control all elements of the work flow of a financial transaction, what are commonly known as the Front, Middle, Back office and General Ledger. In other words, STP allows electronic capturing and processing of transactions in one pass from the point of order origination to final settlement. STP thus streamlines the process of trade execution and settlement and avoids manual entry and re-entry of the details of the same trade by different market intermediaries and participants. Usage of STP enables orders to be processed, confirmed, settled in a shorter time period and in a more cost effective manner with fewer errors. Apart from compressing the clearing and settlement

time, STP also provides a flexible, cost effective infrastructure, which enables e-business expansion through online processing and access to enterprise data.

Question 3

- (a) *Distinguish between any two of the following :*
- (i) *'On-line surveillance' and 'off-line surveillance'.*
 - (ii) *'Money at call' and 'money at short notice'.*
 - (iii) *'Immobilisation' and 'dematerialisation'.* (4 marks each)
- (b) *What is a 'foreign currency convertible bond' (FCCB) ? Explain its important features.* (4 marks)
- (c) *What is meant by 'custodian of securities' ? Explain the capital adequacy norms laid down by SEBI for registration as a custodian.* (4 marks)

Answer 3(a)(i)

On line Surveillance

On-line Real Time Surveillance is a system which was commissioned in 1999 with main objectives of detecting potential market abuses at a nascent stage to reduce the ability of the market participants to unduly influence the price and volumes of the scrips traded at the Exchange, improve the risk management system and strengthen the self regulatory mechanism at the Exchange. The system has a facility to generate the alerts on-line, in real time, based on certain preset parameters like price and volume variations in scrips, members taking unduly large positions not commensurate with their financial position or having large concentrated position(s) in one or few scrips, etc.

Off-Line Surveillance

The Off-Line Surveillance system comprises of the various reports based on different parameters and scrutiny thereof. The Surveillance actions or investigations are initiated in the scrips identified from the reports such as High/Low Difference in prices, Percentage of change in prices over a week/fortnight/month, Top scrips by Turnover, Trading in infrequently traded scrips and Scrips hitting New High/Low

Answer 3(a)(ii)

Money at call is outright money. Money at short notice is for maturity of or upto 14 days. Money for higher maturity is known as inter-bank deposits. The participants are banks and all India financial institutions as permitted by RBI. From April 1991, corporates with specified minimum lendable resources for transaction have also been permitted to lend in the market through the DFHI.

The market is an over-the-telephone market. Non –bank participants act as lenders only. Banks borrow for a variety of reasons to maintain their CRR, to meet heavy payments (e.g. withdrawals by customers for payment of taxes), to adjust their maturity mismatch etc. There are days of heavy borrowings on these occasions. Consequently, depending upon supply, interest rates show wide fluctuations. Corporate treasury management is not as sophisticated as in industrialized countries and through the cash credit system transfer their liquidity management to their banker who in turn resorts to the call money market.

Answer 3(a)(iii)

Immobilisation : Immobilisation of securities occurs when physical security certificates are stored or lodged with depository for safe custody. All subsequent transaction in these securities take place in book-entry form. The actual owner has the right to withdraw their physical securities as and when desired. The immobilization of fresh issue may be achieved by issuing a jumbo certificate representing the entire issue in the name of depository, as nominee of the beneficial owners.

Dematerialisation : Dematerialisation is the process by which shares in the physical/ paper form are cancelled and credits in the form of electronic balances are maintained on highly secure systems at the depository.

Answer 3(b)

Foreign Currency Convertible Bonds (FCCBs) means bonds issued in accordance with issue of FCCBs and ordinary shares (Through Depository Receipt Mechanism) Scheme, 1993 and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole or in part, on the basis of any equity related warrants attached to debt instruments. The important features of FCCBs are as follows:

- (i) The FCCBs are unsecured, carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company.
- (ii) Interest and redemption price (if conversion option is not exercised) is payable in dollars.
- (iii) Interest rates are very low by Indian domestic standards.
- (iv) FCCBs shall be denominated in any freely convertible Foreign Currency.
- (v) FCCB issue proceeds need to conform to ECB end use requirements.
- (vi) It is considered as Foreign Direct Investment (FDI) for calculation of ceilings on FDI.

Answer 3(c)

Custodian of securities means any person who carries on or proposes to carry on the business of providing custodial services. The term “custodial services” in relation to securities of a client or gold or gold related instruments held by a mutual fund in accordance with the SEBI (Mutual Funds) Regulations, 1996 means safekeeping of securities or gold or gold related instruments and providing services incidental thereto, and includes—

- (i) maintaining accounts of securities or gold or gold related instruments of a client;
- (ii) collecting the benefits or rights accruing to the client in respect of securities or gold or gold related instruments;
- (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 points (i) to (iii).

Regulation 7(1) of SEBI (Custodian of Securities) Regulations, 1996 provides for the capital requirement. It provides that the applicant must have a net worth of a minimum of

rupees fifty crores. The term “net worth” means the paid up capital and the free reserves as on the date of the application.

Question 4

- (a) *Highlight the anti-money laundering measures taken under the SEBI guidelines.*
(4 marks)
- (b) *“Investment in mutual funds is risky.” Comment ?* (4 marks)
- (c) *Venture Cap (India) Ltd., a company listed at NSE and BSE, intends to de-list its securities. As a Company Secretary of the company, prepare a brief note on the SEBI guidelines for voluntary de-listing of securities of the company from all stock exchanges.* (8 marks)

Answer 4(a)

SEBI guidelines on anti money laundering measures require all intermediaries to ensure that a proper policy framework as per the Guidelines is put into place. It has laid down the minimum requirements / disclosures to be made by intermediaries in respect of clients. It also requires all intermediaries to designate an officer as ‘Principal Officer’ who would be responsible for ensuring compliance of the provisions of the Prevention of Money Laundering Act, 2002. It provides that every intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992 should also adopt written procedures to implement the anti money laundering provisions as envisaged under the Anti Money Laundering Act, 2002. Such procedures should include inter alia, the following three specific parameters which are related to the overall ‘Client Due Diligence Process’:

- (a) Policy for acceptance of clients
- (b) Procedure for identifying the clients
- (c) Transaction monitoring and reporting especially Suspicious Transactions Reporting (STR).

Answer 4(b)

Investing in mutual funds is less riskier than investing in securities of one or two corporates as, Mutual funds invest in a number of companies across a broad cross-section of industries and sectors. This diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion. Investors achieve this diversification through a Mutual Fund with far less money than one can do on his own. However investment in mutual funds is more riskier than investment in zero risk securities such as government securities. Mutual funds may face the following risks, leading to non-satisfactory performance:

1. Excessive diversification of portfolio, losing focus on the securities of the key segments.
2. Too much concentration on blue-chip securities which are high priced and which do not offer more than average return.
3. Necessity to effect high turnover through liquidation of portfolio resulting in large payments of brokerage and commission.
4. Poor planning of investment with minimum returns.

5. Unresearched forecast on income, profits and Government policies.
6. Fund managers being unaccountable for poor results.
7. Failure to identify clearly the risk of the scheme as distinct from risk of the market.

Answer 4(c)

02 January, 2008

To
Board of Directors
Venture Cap (India) Limited

Subject : Voluntary Delisting Procedure

As desired, the procedure for the voluntary delisting from all the stock exchanges is enumerated below.

- (a) Under the provisions of SEBI Delisting Guidelines, 2003 prior approval of shareholders of the company shall be obtained by a special resolution passed at its general meeting.
- (b) The promoter shall appoint a merchant banker registered with SEBI, who is not an associate of the promoter.
- (c) An exit price for the securities in accordance with the book building process described in Schedule II to Delisting Guidelines, 2003 shall be determined.
- (d) The offer price shall have a floor price, which will be the average of 26 weeks traded price quoted on the stock exchange where the shares of the company are most frequently traded during preceding 26 weeks from the date of the public announcement and without any ceiling of maximum price.
- (e) A public announcement shall be made, in newspapers containing, *inter alia*, information specified in Schedule I to the Delisting Guidelines, 2003.
- (f) If the quantity eligible for acquiring securities at the final price offered does not result in public shareholding falling below required level of public holding for continuous listing, the company shall remain listed.
- (g) The paid up share capital shall not be extinguished as in the case of buyback of securities.
- (h) On determination of the final price pursuant to the book building, within a period of two working days from such determination: (a) a public announcement shall be made in the newspapers of the final price as discovered by the book building process and whether or not the promoter or the acquirer has accepted the price; and, (b) it shall be communicated to, exchange or exchanges from which delisting is sought to be made, the final price discovered and whether the promoter has accepted the price.
- (i) If the offer price so determined is not acceptable:
 - (a) an application shall be made to the exchange for delisting of the securities; and

- (b) it shall be ensured that the public shareholding is brought up to the minimum limits specified under the listing conditions within a period of 6 months from the date of such decision either by issue of new shares by the company or by the promoter making an offer for sale of his holdings or the promoter making sale of his holdings through the secondary market in a transparent manner.
- (j) Make an application to the stock exchange (delisting exchange) from where it is proposed to delist shares.
- (k) Additional conditions as may be specified by the concerned stock exchanges from where securities are to be delisted shall be complied with.
- (l) In the event of securities being delisted, the acquirer shall allow a further period of 6 months for any of the remaining shareholders to tender securities at the same price.

Submitted please.

Yours sincerely,

XYZ

Company Secretary

Question 5

- (a) From the following data, determine the 'net asset value' (NAV) of a regular income scheme :

	(Rs. in Lakhs)
Listed shares at cost (ex-dividend)	20.00
Cash in hand	1.23
Bonds and debentures at cost	4.30
Of the above, bonds and debentures not listed and quoted	1.00
Other fixed interest securities at cost	4.50
Dividend accrued	0.80
Amounts payable on shares	6.32
Expenditure accrued	0.75
Current realisable value of fixed income securities of face value of Rs.100 each	106.50
Number of units (face value of Rs.10 each) is 2,40,000.	

All the listed shares were purchased at a time when index was 1,200. On NAV date, the index is ruling at 2,120. Listed bonds and debentures carry a market value of Rs. 5 lakh on NAV date. (8 marks)

- (b) Explain briefly any two of the following investment instruments :
- (i) Shares with differential voting rights.

(ii) Carrot and stick bond.

(iii) Capital indexed bonds.

(2 marks each)

(c) Comment on the role of stock-brokers and sub-brokers in Indian stock market.
(4 marks)

Answer 5(a)

<i>Particulars of assets (or liabilities)</i>	<i>Adjustment</i>	<i>Value in lacs</i>
Equity Shares	Index (2120/1200) x 20	35.33
Cash in hand	Book Value	1.23
Bonds and Debentures (not listed)	Book Value	1.00
Bonds and Debentures (listed)	Market Value	5.00
Dividend Accrued		0.80
Fixed income Securities	MV(106.50/100) x 4.50	4.7925
Total Assets(A)		48.1525
Less Liabilities		
Due on shares		6.32
Expenses payable		0.75
Total (B)		7.07
Net Asset Value (A-B)		41.0825
Unit under scheme		2.4 lacs
NAV = 41.0825/2.4 = Rs.17.12 per unit		

Answer 5(b)(i)

A share with differential voting rights means a share that is issued with differential rights in accordance with the provisions of section 86 of the Companies Act, 1956. The Central Government notified Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 vide GSR No. 167(E) dated 9th March, 2001. Rule 3 of the said Rules enables companies limited by shares to issue shares with differential rights as to dividend, voting or otherwise, subject to fulfillment of certain conditions. The conditions are required to be fulfilled at the time of issue of equity shares with differential rights.

Answer 5(b)(ii)

In Carrot and Stick Bonds, carrot is the lower than normal conversion premium i.e. the premium over the present market price of the equity shares is fixed at a reasonable level so that the price of the equity shares need not increase significantly to make conversion practical. The stick is the issuer's right to call the issue at a specified premium if the price of the equity shares is traded above a specified percentage of the conversion price.

Answer 5(b)(iii)

Capital indexed bonds are inflation-protection securities and provide good hedge against inflation risk. Capital index bonds can also be used as a market indicator for inflation expectation. This will help investors take a more intelligent decision on their current consumption.

Answer 5(c)

A stock broker plays a very important role in the secondary market helping both the seller and the buyer of the securities to enter into a transaction. The buyer and seller may be either a broker or a client. When executing an order the stock broker may on behalf of his client buy or sell securities from his own account i.e. as principal or act as an agent. For each transaction he issues necessary contract note indicating whether the transaction has been entered into by him as a principal or as an agent for another. While buying or selling securities as a principal, the stock broker has to obtain the consent of his client and the prices charged should be fair and justified by the conditions of the market.

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

Question 6

- (a) *What do you understand by 'non-banking finance companies' (NBFCs) ? State their investment norms as laid down under the Reserve Bank of India Act, 1934. (4 marks)*
- (b) *Highlight the provisions relating to issuance of equity shares in respect of the following :*
 - (i) *Par value of shares.*
 - (ii) *Denomination of shares. (2 marks each)*
- (c) *As a Company Secretary in practice, how would you conduct securities audit in a listed company ? (4 marks)*
- (d) *Describe in brief the important measures for investors' protection in Indian capital market. (4 marks)*

Answer 6(a)

Under Section 45-I of the Reserve Bank of India Act, 1934, a Non-Banking Financial Company is defined as—

- (i) a financial institution which is a company;
- (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits under any scheme or arrangement or in any other manner, or lending in any manner;
- (iii) such other non-banking institution or class of such institutions as the bank may, with the previous approval of the Central Government and by notification in the Official Gazette specify.

The provisions of the RBI (Amendment) Act, 1997 (section 45B) stipulated the requirement of maintenance of assets in the approved securities whose market value shall not be less than 5 per cent or such higher percentage not exceeding 25 per cent as the RBI may specify the deposits outstanding at the end of the last working day of the second preceding quarter.

Every NBFC shall create reserve fund and transfer therein at least 20 per cent of its net profit every year. NBFCs are required to maintain liquid assets equivalent to 10 per cent of their deposit liabilities in specified approved securities. Similarly norms have been prescribed considering the nature and types of NBFCs including loan and investment companies, leasing and hire-purchase companies, residuary non-banking companies etc.

Answer 6(b)(i)

- (i) In case of initial public offer by an unlisted company:
 - (a) if the issue price is Rs. 500/- or more, the issuer company shall have a discretion to fix the face value below Rs. 10/- per share subject to the condition that the face value shall in no case be less than Re. 1 per share.
 - (b) if issue price is less than Rs. 500 per share, the face value shall be Rs. 10/- per share.
- (ii) The disclosure about the face value of shares (including the statement about the issue price being "X" times of the face value) shall be made in the advertisement, offer documents and in application forms in identical font size as that of issue price or price band.

Answer 6(b)(ii)

An eligible company shall be free to make public or rights issue of equity shares in any denomination determined by it in accordance with the Companies Act, 1956 and other norms as may be specified by SEBI from time to time.

The companies which have already issued shares in the denomination of Rs. 10/- or Rs. 100/- may change the standard denomination of the shares by splitting or consolidating the existing shares.

The companies proposing to issue shares in any denomination or changing the standard denomination are required to comply with the following:

- (a) the shares shall not be issued in the denomination of decimal of a rupee;
- (b) the denomination of the existing shares shall not be altered to a denomination of decimal of a rupee;
- (c) at any given time there shall be only one denomination for the shares of the company;
- (d) the companies seeking to change the standard denomination may do so after amending the Memorandum and Articles of Association, if required;
- (e) the company shall adhere to the disclosure and accounting norms specified by SEBI from time to time.

Answer 6(c)

A company is subject to compliance of various provisions in the Companies Act, 1956, Securities and Exchange Board of India Act, 1992, Foreign Exchange Management Act, 1999, Securities Contracts (Regulation) Act, 1956 and other securities related laws.

Securities Audit is a mechanism relieving the company and its directors from the consequences of unintended non-compliance by timely corrective actions.

The Securities Audit shall be conducted by a company secretary in practice encompassing compliance of all rules, applicable regulations, guidelines in relation to issue of securities, issue of certificates in relation to all transactions of company's securities, physical verification of relevant records and documents and also entering qualification, if any. The company shall be at the option to either take a comprehensive Securities Audit or a transaction specific audit such as Audit under Public Issue, Takeover Code, Insider Trading Regulations or Buy-back of Securities Regulations.

Answer 6(d)

Investor protection is to protect the investors from being deceived or being put to loss by the companies. During the last twelve years, various important measures have been initiated in the Indian Capital Market. SEBI has been constantly reviewing and re-appraising its existing policies and programmes, formulating new policies and regulations, to foster developments in these areas and implementing them to ensure growth of the market with efficiency, integrity and protection of interests of investors. All throughout, enforcement and surveillance has been a major priority for SEBI. It introduced several reforms in primary market and acted as a catalyst for modernization of market infrastructure. It streamlined and simplified the issue procedure, gave flexibility to the issue process and strengthened the criteria for accessing the securities market. In secondary market, it improved market efficiency, integrity and transparency. Trading infrastructure was modernized in most of the traditional stock exchanges, clearing and settlement systems were improved and depositories were established. Mutual funds were reformed drastically so as to provide greater operational flexibility to the fund manager and increase their accountability and supervision. Substantial acquisition of takeover of shares and insider trading was regulated and regulations for foreign institutional investors were liberalized. SEBI action has resulted in number of complaints coming down. SEBI launched prosecution against companies apart from serving show cause notices, inspections and investigations.

Question 7

- (a) *"Every credit rating agency is required to abide by the code of conduct as per the SEBI Regulations."* Comment and discuss briefly the code of conduct for credit rating agencies. (4 marks)
- (b) Explain briefly the following concepts under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 :
- (i) Acquirer.
 - (ii) Control. (2 marks each)

(c) Explain briefly the following terms of primary capital market :

- (i) Qualified institutional buyers
- (ii) Shelf prospectus
- (iii) Green shoe option
- (iv) Unique client code.

(2 marks each)

Answer 7(a)

Every credit rating agency is required to abide by code of conduct as per SEBI (Credit Rating Agencies) Regulations, 1999.

Accordingly they should observe high standards of integrity and fairness in all its dealings with its clients; fulfil its obligations in an ethical manner; render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment; avoid any conflict of interest of any member of its rating committee participating in the rating analysis; not indulge in unfair competition nor they wear away client of any other rating agency on assurance of higher rating; not make any exaggerated statement, whether oral or written, to the client either about its qualification or its capability to render certain services or its achievements in regard to services rendered to other clients; endeavour to ensure that all professional dealings are effected in a prompt and efficient manner; not divulge to other clients, press or any other party any confidential information about its client, which has come to its knowledge, without making disclosure to the concerned person of the rated company/client; not make untrue statement or suppress any material fact in any documents, reports, papers or information furnished to SEBI or to public or to stock exchange; should not generally and particularly in respect of issue of securities rated by it be a party—(a) to creation of false market (b) passing of price sensitive information to brokers, members of the stock exchanges, other players in the capital market or to any other person or take any other action which is unethical or unfair to the investors.

Answer 7(b)(i)

Acquirer : According to takeover code, acquirer means any person who, directly or indirectly, acquires or agrees to acquire shares or voting rights in the target company, or acquires or agrees to acquire control over the target company, either by himself or with any person acting in concert with the acquirer.

Answer 7(b)(ii)

Control has been defined in clause (c) of regulation (2) of SEBI Regulations and includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

Answer 7(c)(i)

“Qualified Institutional Buyer” means:

- (a) public financial institution as defined in section 4A of the Companies Act, 1956;

- (b) scheduled commercial banks;
- (c) mutual funds;
- (d) foreign institutional investor registered with SEBI;
- (e) multilateral and bilateral development financial institutions;
- (f) venture capital funds registered with SEBI;
- (g) foreign venture capital investors registered with SEBI;
- (h) state industrial development corporations;
- (i) insurance companies registered with the Insurance Regulatory and Development Authority (IRDA);
- (j) provident funds with minimum corpus of Rs. 25 crores;
- (k) pension funds with minimum corpus of Rs. 25 crores.

Answer 7(c)(ii)

Shelf Prospectus is a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus. It should comply with the requirements specified in section 60A of Companies Act, 1956.

Answer 7(c)(iii)

Green Shoe Option means an option of allocating shares in excess of the share included in the public issue and operating as post listing price stabilizing mechanism. A company making a public offer of equity shares and desirous of availing this option, should in the resolution of the general meeting authorizing the public issue, seek authorization also for the possibility of allotment of further shares to the Stabilising Agent at the end of stabilization period.

Answer 7(c)(iv)

All brokers are required to provide a unique ID to every investor. It was made mandatory for all brokers to use unique client codes for all clients. For this purpose, brokers are required to collect and maintain in their back office the Permanent Account Number (PAN) allotted by Income Tax Department for all their clients which will form part of client code.

Question 8

- (a) *Comment briefly on the following statements :*
 - (i) *Put not your trust in money, put your money in trust.*
 - (ii) *The process of financial reforms is still in progress and are likely to bring in even more drastic changes to make the markets healthier and stronger.*
(3 marks each)
- (b) *Explain briefly the provisions related to 'escrow account' in order to make offer for buy-back of shares by an Indian company.*
(5 marks)
- (c) *"Listing of securities with stock exchanges is a matter of great importance for companies and investors." Comment on this statement and list out the benefits of listing for the companies and investors.*
(5 marks)

Answer 8(a)(i)

The small investors who generally lack expertise to invest on their own in the securities market have reinforced the saying "Put not your trust in money, put your money in trust". They prefer some kind of collective investment vehicle like, MFs, which pool their marginal resources, invest in securities and distribute the returns therefrom among them on cooperative principles. The investors benefit in terms of reduced risk and higher returns arising from professional expertise of fund managers employed by the MFs. This approach was conceived in the USA in the 1930s. In developed financial markets, MFs have almost overtaken bank deposits and total assets of insurance funds.

Answer 8(a)(ii)

Financial reforms have brought about many changes. These reforms have removed the shackles of control and have promoted free flow of investments, new instruments of investments and state of the art technologies and procedures which are in operation in the other developed markets. The process of financial reforms is still in progress and is likely to bring in even more drastic changes to make the markets healthier and stronger. India's approach to financial sector reforms, in general, and to the management of external sector, in particular has served the country well, in terms of aiding growth, avoiding crisis, enhancing efficiency and imparting resilience to the system.

Answer 8(b)

The company should deposit in an escrow account opened with a scheduled commercial bank on or before the opening of the offer for buy-back of securities, such sum as is specified below:

- (i) Where the (estimated) consideration payable for buy-back does not exceed Rs. 100 crores, 25% of the consideration payable;
- (ii) In case the consideration payable for buy-back exceeds Rs. 100 crores, 25% upto Rs. 100 crores and 10% of the balance. [Regulation 10(1) and (2)] of SEBI (Buy Back of Securities) Regulations.

Where a company opts to deposit cash in an escrow account, it should empower the merchant banker to instruct the bank to issue a banker's cheque or demand draft for the amount lying to the credit of the escrow account in his favour. [Regulation 10(4)].

Apart from cash, the escrow account may consist of bank guarantee in favour of the merchant banker or deposit of acceptable securities with the appropriate margin, with the merchant banker. The escrow account can also be maintained as a combination of the above. [Regulation 10(3)]. The discretion in respect of 'acceptable' securities and 'appropriate' margin shall be exercised by the merchant banker.

Where the escrow account opened by the company consists of bank guarantee, it should be in favour of the merchant banker and should remain valid for 30 days after the closure of the offer. [Regulation 10(5)]. The bank guarantee should not be returned by the merchant banker till the completion of all obligations under the Regulations. [Regulation 10(7)].

At the time of opening of the account, the company should deposit with the bank, in cash, a sum of at least 1% of the total consideration payable as security for fulfillment of obligations under the Regulations. [Regulation 10(8)].

Answer 8(c)

Listing of securities with stock exchange is a matter of great importance for companies and investors, because listing provides the liquidity to the securities in the market.

The prices at which the securities are traded in the stock exchange are published in the News Papers. Investors are able to know these price trends from such publications. Compared to listed securities the trading of unlisted securities is difficult. The price trends in respect of unlisted securities are seldom known to the investors and the contract between the seller and buyer takes places mostly on one to one basis.

Benefits of Listing to companies and investors

The following benefits are available when securities are listed by a company in the stock exchange—

- (1) Public image of the company is enhanced.
 - (2) The liquidity of the security is ensured making it easy to buy and sell the securities in the stock exchange.
 - (3) Tax concessions are made available both to the investors and the companies.
 - (4) Listing procedure compels company management to disclose important information to the investors enabling them to make crucial decisions with regard to keeping or disposing of such securities.
 - (5) Listed companies command better support such as loans and investments from Banks and FIs.
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