

## **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**

*Write notes on any four of the following :*

- (i) Carrot and stick bond*
- (ii) Basket trading system*
- (iii) Employees stock option*
- (iv) Collective investment scheme*
- (v) Ombudsman in stock market*
- (vi) Exchange traded funds.*

*(5 marks each)*

#### **Answer 1(i)**

##### **Carrot and stick bond**

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 1(ii)**

##### **Basket trading system**

The Bombay Stock Exchange provides the investors as well as its member brokers a facility of Basket Trading System, with a view to provide investors the facility of creating sensex linked portfolio and also to create a linkage of market prices of the underlying securities of sensex in the cash segment and futures on sensex. In this system the investors through the member brokers of the exchange are able to buy or sell all 30 scrips of sensex in one go in the proportion of their respective weights in the sensex. The investors can also create their own baskets by deleting certain scripts from 30 scripts in the sensex.

#### **Answer 1(iii)**

##### **Employees stock option**

Employee Stock Option means the option given to the whole-time directors, officers or employees' of a Company which gives them the right to purchase or subscribe at a future date the securities offered by the company at a pre-determined price. Employee stock option plays vital role in rewarding and motivating employees in attracting and retaining the best talent in the company.

**Answer 1(iv)****Collective investment scheme**

Collective Investment Scheme (CIS) under SEBI (Collective Investment Schemes) Regulations, 1999 means any scheme or arrangement made or offered by any company under which :

- (a) the contributions, or payments made by the investors, by whatever name called, are pooled and utilized solely for the purposes of the scheme or arrangement;
- (b) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable from such scheme or arrangement.
- (c) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors; and
- (d) the investors do not have day-to-day control over the management and operation of the scheme or arrangement.

The CIS Regulations, however, excludes any scheme or arrangement made or offered by a co-operative society, deposits accepted by non-banking financial companies; contract of insurance; deposits accepted under Section 58A of the Companies Act, 1956 etc.

**Answer 1(v)****Ombudsman in stock market**

“Ombudsman” means any person appointed under regulation 3 of SEBI (Ombudsman) regulations, 2003 and unless the context otherwise requires, includes stipendiary Ombudsman. Regulation 2(n) of the Regulations defines stipendiary Ombudsman as a person appointed under Regulation 9 for purpose of acting as Ombudsman in respect of a specific matter or matters in a specific territorial jurisdiction and for which he may be paid such expenses, honorarium, sitting fees as may be determined by the Board from time to time.

An Ombudsman has crucial role to play in redressal of investors' grievances. Any person who has a grievance against a listed company or an intermediary relating to any of the matters specified in SEBI (Ombudsman) Regulations may himself or through his authorized representative or any investors association recognized by SEBI, make a complaint to the Ombudsman within whose jurisdiction the registered or corporate office of such listed company or intermediary is located. If SEBI has not notified any Ombudsman for a particular locality or territorial jurisdiction, the complainant may request the Ombudsman located at the Head Office of the SEBI for forwarding his complaint to competent jurisdiction. The powers and functions of ombudsman have also been defined under the said Regulations.

**Answer 1(vi)****Exchange Traded Funds**

Exchange Traded Funds (ETFs) represent a basket of securities that are traded on an exchange. They are similar to index mutual funds but are traded more like a stock.

They are a rapidly growing class of financial product and are typically organized as unit trusts. ETFs can be bought and sold throughout the trading day, allowing for intraday trading - which is rare with mutual funds. Unlike mutual funds, ETFs do not trade necessarily at the net asset values of their underlying holdings, meaning an ETF could potentially trade above or below the value of the underlying portfolios.

## Question 2

- (a) *“The financial markets have two major components — the money market and the capital market.” Discuss. (5 marks)*
- (b) *How the proceeds of external commercial borrowings (ECB) can be utilised as per norms ? (5 marks)*
- (c) *Organise Infotech Ltd., an existing listed company, wants to make a bonus issue of shares. The Chief Executive Officer (CEO) of your company wants to know about pre-requisites for bonus issue. As the Company Secretary, prepare a note on the SEBI guidelines applicable in this regard. (6 marks)*

## Answer 2(a)

The financial markets have two major components namely: Money Market and Capital Market. The money market refers to the market where borrowers and lenders exchange short-term funds to solve their liquidity needs. Money market instruments are generally financial claims that have low default risk, maturities under one year and high marketability. The Capital Market is a market for financial investments that are direct or indirect claims to capital. It is wider than the Securities Market and embraces all forms of lending and borrowing, whether or not evidenced by the creation of a negotiable financial instrument. The Capital Market comprises the complex of institutions and the mechanisms through which intermediate term funds and long term funds are pooled and made available to business, government and individuals. The Capital Market also encompasses the process by which securities already outstanding are transferred.

## Answer 2(b)

### Utilization of ECB Proceeds

ECB proceeds can be utilized for overseas direct investment in Joint Ventures (JV)/ Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/WOS abroad.

Utilisation of ECB proceeds is permitted in the first stage acquisition of shares in the disinvestments process and also in the mandatory second stage offer to the public under the Government's disinvestments programme of PSU shares.

However, utilization of ECB proceeds is not permitted for on-lending or investment in capital market by corporates.

Utilisation of ECB proceeds is also not permitted in real estate. The term 'real estate' excludes development of integrated township.

End-uses of ECB for working capital, general corporate purpose and repayment of existing Rupee loans are also not permitted.

**Answer 2(c)**

*From :  
XYZ Company Secretary*

*To: CEO  
Organise Infotech Limited*

**As desired, please find the note on the Requirements to be complied by Organise infotech Ltd while making a Bonus Issue**

- (1) The proposed bonus issue should not dilute the value or rights of the fully or partly convertible debentures.
- (2) If the conversion of Fully Convertible Debentures(FCD)/Partly Convertible Debenture(PCD) is pending, the reservation of shares out of bonus issue is to be made in proportion to the convertible part of FCD's or PCD's. The shares so reserved may be issued at the time of conversion of such debentures on the same terms on which the rights or bonus issues were made.
- (3) The bonus issue is to be made out of free reserves built out of the genuine profits or securities premium collected in cash only.
- (4) The reserves created by revaluation of fixed assets should not be capitalized.
- (5) Bonus issue should not be made in lieu of dividend.
- (6) If there are any partly paid-up shares, these shares should be made fully paid-up before the bonus issue is made.
- (7) The company should not have defaulted in the payment of any interest or principal in respect of its fixed deposits and interest on existing debentures or on redemption of debentures.
- (8) The company should not have defaulted in the payment of its statutory dues to the employees such as contribution to provident fund, gratuity, bonus.
- (9) The bonus issue should be made within a period of six months from the date of approval of the Board of Directors.
- (10) The Articles of Association of the Company should provide for capitalization of reserves and if there is no provision in the Articles of Association, a general body meeting of the company is to be held and a special resolution making provisions in the Articles of Association for capitalization should be passed.
- (11) If consequent upon the issue of bonus shares, the subscribed and paid-up capital of the company exceed the authorized share capital, a General Meeting of the company should be held to pass necessary resolution for increasing the authorized capital.
- (12) A certificate duly signed by the issuer company and countersigned by Statutory Auditor or Company Secretary in Practice to the effect that the guidelines in relation to bonus issues have been complied with, is required to be forwarded to SEBI.

Submitted please

XYZ  
Company Secretary

**Question 3**

- (a) *Describe the objectives of constituting SEBI and state the composition of the SEBI Board.*
  - (b) *State the requirements for monitoring of ratings by a credit rating agency.*
  - (c) *State the approvals required for issue of Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs).*
  - (d) *“Quality of Corporate Governance is a function of certain factors.” Explain.*
- (4 marks each)*

**Answer 3(a)**

The objective of constituting SEBI is to ensure effective regulation of the securities market. SEBI Act, 1992 was enacted to empower SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market and for matters connected therewith or incidental thereto. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market.

Section 4(1) of SEBI Act provides that SEBI Board shall consist of the following members, namely:

- (a) a Chairman;
- (b) two members from amongst the officials of the Ministry of the Central Government dealing with Finance and administration of the Companies Act, 1956;
- (c) one member from amongst the officials of the Reserve Bank;
- (d) five other members of whom at least three shall be the whole time members, to be appointed by the Central Government.

**Answer 3(b)**

SEBI (Credit Rating Agencies) Regulations, 1999 requires that Credit rating agency should during the lifetime of securities rated by it continuously monitor the rating of such securities. It should also disseminate information regarding newly assigned ratings, and changes in earlier rating promptly through press releases and websites, and, in the case of securities issued by listed companies, such information should also be provided simultaneously to all the stock exchanges where the said securities are listed.

**Answer 3(c)**

The following approvals are required for issue of Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs)

- (1) A meeting of Board of Directors is required to be held for approving the proposal to raise money from Euro Capital market, through board resolution indicating therein specific purposes for which funds are required, quantum of the issue, country in which issue is to be launched, time of the issue etc.
- (2) A special resolution under Section 81(1A) of the Companies Act, 1956 is required

to be passed at a duly convened general meeting of the shareholders of the company.

- (3) Approval from Ministry of Finance is required for FCCB issues exceeding stipulated limit
- (4) The issuer company has to obtain approvals from Reserve Bank of India under circumstances specified under the guidelines issued by the concerned authorities from time to time.
- (5) The issuing company has to make a request to the domestic stock exchange for in-principle consent for listing of underlying shares which shall be lying in the custody of domestic custodian.
- (6) The company is required to obtain in principle consent of Financial Institutions on the broad terms of the proposed issue.

### Answer 3(d)

The corporate governance framework depends on the legal, regulatory and institutional environment, business ethics and awareness of the environment and societal interests of the constituencies in which it operates. The degree to which corporations observe basic principles of good corporate governance is an increasingly important factor for taking key investment decisions. Quality of governance primarily depends on following factors:

- (i) Integrity of the management;
- (ii) Ability of the board;
- (iii) Adequacy of the process;
- (iv) Commitment level of individual board members;
- (v) Quality of corporate reporting;
- (vi) Participation of stakeholders in the management.

### Question 4

(a) *Distinguish between any two of the following :*

- (i) *'Leverage funds' and 'hedge funds'.*
- (ii) *'Futures' and 'options'.*
- (iii) *'Income oriented schemes' and 'growth oriented schemes'. (4 marks each)*

(b) *Define the following authorities as per the Securities Appellate Tribunal (Procedure) Rules, 2000 :*

- (i) *Presiding officer*
- (ii) *Registrar*
- (iii) *Appellate tribunal*
- (iv) *Adjudicating officer.*

*(1 mark each)*

(c) *Expand any four of the following :*

- (i) *CBOE*
- (ii) *ESPS*
- (iii) *OMO*
- (iv) *SMILE*
- (v) *KYC*
- (vi) *CARE.*

(1 mark each)

**Answer 4(a)(i)**

**‘Leverage funds’ and ‘hedge funds’**

Leverage Funds also known as borrowed funds, increase the size and value of portfolio and offer benefits to members through excess of gains over cost of borrowed funds. They tend to indulge in a speculative trading and risky investments.

Hedge Funds employ their funds for speculative trading, i.e., for buying shares whose prices are likely to rise and for selling shares whose prices are likely to dip. Hedge funds use a wide variety of trading strategies involving position-taking in a range of markets. They employ as assortment of trading techniques and instruments, often including short-selling, derivatives and leverage.

**Answer 4(a)(ii)**

**‘Futures’ and ‘options’**

*Futures* : A contract obliging one signatory to buy and another to sell a standard quality of a financial instrument on a pre-determined price. Futures may be commodity futures or security futures.

*Options* : A contract which gives the holder the right to purchase (call) or sell (put) the underlying futures contract or security at a specified price within a specified period of time . Options may be Put or Call options.

**Answer 4(a)(iii)**

**‘Income oriented schemes’ and ‘growth oriented schemes’**

*Income oriented scheme* : This scheme primarily offer fixed income to investors. Naturally enough, the main securities in which investments are made by such funds are the fixed income yielding ones like bonds.

*Growth oriented scheme* : These schemes offer growth potentialities associated with investment in capital market namely : (i) high source of income by way of dividend and (ii) rapid capital appreciation, both from holding of good quality scrips. These funds, with a view to satisfying the growth needs of investors, primarily concentrate on the low risk and high yielding spectrum of equity scrips for the corporate sector.

**Answer 4(b)**

- (i) “Presiding Officer” means the Presiding Officer of the Securities Appellate Tribunal appointed under Section 15L of the SEBI Act.

- (ii) “Registrar” means the Registrar of the Appellate Tribunal and includes an officer of such Appellate Tribunal who is authorized by the Presiding Officer to function as Registrar.
- (iii) “Appellate Tribunal” means the Securities Appellate Tribunal established under section 15K of the SEBI Act.
- (iv) “Adjudicating officer” means an officer appointed under sub-section (1) of section 15-I of the SEBI Act.

**Answer 4(c)**

- (i) CBOE : Chicago Board of Options Exchange
- (ii) ESPS : Employees Stock Purchase Scheme
- (iii) OMO : Open Market Operations
- (iv) SMILE : Securities Market Infrastructure Leveraging Expert
- (v) KYC : Know Your Clients
- (vi) CARE : Credit Analysis & Research Limited

**Question 5**

- (a) *Asian Mutual Fund is a mutual fund registered with SEBI. Its asset management company (AMC) conducted business through associated brokers in excess of limits prescribed under Regulation 25(7) of the SEBI (Mutual Fund) Regulations, 1996. SEBI initiated penal proceedings against the Asian Mutual Fund and it's AMC for the contravention.*

*While responding to charges given in the show cause notice, Asian Mutual Fund and it's AMC pleaded that there was no mens rea in the acts of the AMC and, hence, no penal action should be taken by SEBI. Adjudicating officer imposed a penalty of Rs. 25 lakh under Section 15E of the Securities and Exchange Board of India Act, 1992 for failure to comply with Regulation 25(7).*

*You are required to advise with the help of decided case law whether Asian Mutual Fund should file an appeal against the order passed by the adjudicating officer.* (8 marks)

- (b) *“Derivatives are contracts, which derive their values from the value of one or more of other assets.” Comment.* (4 marks)
- (c) *State major functions of the ‘central listing authority’.* (4 marks)

**Answer 5(a)**

The facts of the case are similar to those of *Shriram Mutual Fund v. SEBI* (2003), wherein Shriram Mutual Fund conducted business through brokers associated with its sponsors in excess of permissible limits prescribed under regulations 25(7)(a) of SEBI Regulations on 12 occasions.

The Adjudicating Officer, after hearing the parties, imposed penalty of Rs.5 lacs for failure to comply with Regulations 25(7) of SEBI (Mutual Funds) Regulations, 1996 and also imposed a penalty of Rs. 2 lacs for its failure to comply with the terms and conditions of Certificate of Registration granted to it.



Shriram Mutual Funds filed an appeal to Securities Appellate Tribunal(SAT) against the order of adjudicating officer contending that the transactions with the associate brokers were related to thinly traded securities, for which there were no ready markets available through normal stock exchange or were relating to securities which did not have any large volume or trade in the market. It was further contended that these securities were either thinly traded, or did not have any volumes.

SAT while setting aside the order of the Adjudicating Officer held that the penalty is warranted by the quantum which has to be decided by taking into consideration the factors stated in Section 15-J, of SEBI Act, 1992.

Aggrieved by the order of the Tribunal, SEBI filed an appeal to Supreme Court.

Important points of law considered by the Supreme Court was whether the Tribunal was justified in allowing the appeal and that whether once it is conclusively established that the Mutual Fund has violated the terms of the certificate of registration and the statutory regulations, the imposition of penalty become a *sine qua non* of the violation. In other words, the breach of a civil obligation which attracts penalty in the nature of fine under the provisions of the Act, and the Regulations would immediately attract the levy of penalty irrespective of the fact whether the contravention was made by the defaulter with any guilty intention or not.

The Supreme Court while allowing the appeal observed that penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulation is established and hence the intention of the parties committing such violation becomes wholly irrelevant. A breach of civil obligation which attracts penalty in the nature of fine under the provisions of the Act and the Regulations would immediately attract the levy of penalty irrespective of the fact whether contravention have been made by the defaulter with guilty intention or not. It was held that unless the language of the statute indicates the need to establish the presence of *mens rea*, it is wholly unnecessary to ascertain whether such a violation was intentional or not. On a careful perusal of Section 15-E of the Act, the Supreme Court observed that there is nothing which requires that *mens rea* must be proved before penalty can be imposed under these provisions. Hence, once the contravention is established, penalty will follow. The order passed by SAT was set aside by Supreme Court.

In the light of the above, though Asian Mutual Fund can be advised to file an appeal to the SAT against the order of Adjudicating Officer on the grounds that the securities were either thinly traded or did not have any volumes, but in terms of the decision of Supreme Court in Shriram Mutual Fund case, the Asian Mutual Fund will not succeed, if SEBI prefers an appeal to Supreme Court against the order of SAT.

#### **Answer 5(b)**

Derivatives are contracts which derive values from the value of one or more of other assets, called underlying assets. The asset from which a derivative derive its value is called 'underlying asset'. It may be share, commodity or even a market index. Some of the most commonly traded derivatives are futures, forward, options and swaps.

Derivatives include a security derived from a debt instrument, shares, loans, whether secured or unsecured, risk instrument or contract for differences or any other form of

security. Derivatives is meant essentially to facilitate temporarily hedging of price risk of inventory holding or a financial/commercial transaction over a certain period. Every derivative contract has a fixed expiration date. Financial derivatives are financial contract whose value is based upon the value of other underlying financial assets such as shares, stocks, bonds and foreign exchange with the change in price of such assets, the value of derivatives will also change.

### Answer 5(c)

#### Functions of the Central Listing Authority

The Authority has been empowered to perform following functions:

- (i) to receive and process applications for letter precedent to listing from applicants and issue, if it deems fit, a letter precedent to listing to any such applicant;
- (ii) to make recommendations to SEBI on issues pertaining to the protection of the interest of the investors in securities and development and regulation of the securities market, including the listing agreements, listing conditions and disclosures to be made in offer documents; and,
- (iii) to undertake any other functions as may be delegated to it by SEBI from time to time.

However, the SEBI Central Listing Authority Regulations, 2003 were repealed with effect from 02 January, 2007.

### Question 6

- (a) *What is 'bailout takeover' ? State the procedure for bailout takeover as set out in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.* (4 marks)
- (b) *How would you fix the price in preferential issue of shares in a listed company ?* (4 marks)
- (c) *What do you understand by 'independent directors' in the context of corporate governance ?* (4 marks)
- (d) *What do you mean by the following money market instruments ? Describe any two :*
  - (i) *Certificates of deposits*
  - (ii) *Inter-corporate deposits*
  - (iii) *Gilt-edged securities.* (2 marks each)

### Answer 6(a)

#### Bailout takeovers

Bailout takeover means substantial acquisition of shares in a financially weak company not being a sick industrial company, in pursuance to a scheme of rehabilitation approved by a public financial institution or a scheduled bank. The lead institution is required to appraise the financially weak company taking into account the financial viability and assess the requirement of funds for revival and draw up the rehabilitation package on the principle of protection of interests of minority shareholders, good management, effective revival and transparency.

The rehabilitation scheme specifically provides for the details of any change in management. The scheme may also provide for outright purchase of shares, exchange of shares and combination of both.

Before giving effect to any scheme of rehabilitation the lead institution is required to invite offers for acquisition of shares from at least three parties.

After receipt of the offers, the lead institution selects one of the parties having regard to the managerial competence, adequacy of financial resources and technical capability of the person acquiring shares to rehabilitate the financially weak company.

The lead institution provides necessary information to any person intending to make an offer to acquire shares about the financially weak company and particularly in relation to its present management technology range of products manufactured, shareholding pattern, financial holding and performance and assets and liabilities of such company for a period covering five years from the date of the offer as also the minimum financial and other commitments expected of from the person acquiring shares for such rehabilitation.

#### **Answer 6(b)**

Offer prices of shares issued on preferential basis should not be less than the higher of the average of the weekly high and low of the closing price of related shares quoted on the stock exchange during the six months or two weeks preceding the relevant date. The relevant date for the purpose means a date 30 days prior to the date of annual general meeting convened in terms of Section 81(1A) of Companies Act, 1956 to consider the proposed issue.

In case of issue of warrants on preferential basis with an option to apply and get shares allotted, the price of resultant shares will also be determined in the above manner. However the issuer may adopt relevant date as mentioned above or a date thirty days prior to the date on which the warrant holders become entitled to apply for the shares.

#### **Answer 6(c)**

As per Clause 49 of the Listing agreement, which is pertaining Corporate Government. 'Independent director' shall mean non-executive director of the company who –

- (a) apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect the independence of the director;
- (b) is not related to promoters or persons occupying management positions at the board level or at one level below the board;
- (c) has not been an executive of the company in the immediately preceding three financial years;
- (d) is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:
  - (i) the statutory audit firm or the internal audit firm that is associated with the company;

- (ii) the legal firm(s) and consulting firm(s) that have a material association with the company.
- (e) is not a material supplier, service provider or customer or a lessor or lessee of the company which may effect the independence of the director; and
- (f) is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares.

Independent directors are known to bring an objective view in Board deliberations. They act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict. They bring a valuable outside perspective to the deliberations.

#### **Answer 6(d)(i)**

##### **Certificates of Deposits**

Certificates of Deposit (CDs) is a negotiable money market instrument and issued in dematerialised form or as a Usance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period. Guidelines for issue of CDs are presently governed by various directives issued by the Reserve Bank of India, as amended from time to time.

#### **Answer 6(d)(ii)**

##### **Inter-Corporate Deposits**

Inter Corporate Deposit is an unsecured loan extended by one corporate to another. Existing mainly as a refuge for low rated corporates, this instrument allows funds surplus corporates to lend to other corporates. Also the better-rated corporates can borrow from the banking system and lend in this market. As the cost of funds for a corporate is much higher than a bank, the rates in this market are higher than those in the other markets. ICDs are unsecured, and hence the risk inherent is high.

#### **Answer 6(d)(iii)**

##### **Gilt-edged securities**

These securities are issued by Governments such as Central and State Governments, Semi-Government Authorities, City Corporations, Municipalities, Port Trust, State Electricity Boards, Metropolitan Authorities, Housing Boards and Large Financial Institutions. They are held by RBI and are eligible to be reckoned for the purpose of Statutory Lending Rate of the Banks. Though they are long dated securities, they are in great demand as banks have to buy/sell them for maintaining the level of Net Demand and Time Liabilities (NDTL). Being a security issued by the sovereign government, they are considered the most secured financial instruments which guarantees both safety of the capital and the income.

#### **Question 7**

- (a) *You are the Company Secretary of Golden Biotech Ltd. The Board of directors of the company is contemplating buy-back of securities of the company through purchase in open market at stock exchange. State the law and procedure for buy-back as laid down under the SEBI Regulations. (8 marks)*

- (b) *Explain the term 'price sensitive information'. Which information is considered to be price sensitive ?* (4 marks)
- (c) *When does a stock broker become liable for prosecution by SEBI ? Explain with relevant provisions in the Securities and Exchange Board of India Act, 1992 and the Regulations made thereunder.* (4 marks)

### **Answer 7(a)**

Regulation 14(2)(a) of SEBI (Buy back of Securities Regulations), 1998, enables a company to buy back its securities from the open market through stock exchanges. The Procedure for buy back through purchase in open market at stock exchange is as follows:

- (1) In the special resolution or Board resolution passed for buy-back through stock exchange, the maximum price at which the buy-back shall be made should be specified.
- (2) Promoters or persons in control are not permitted to offer their securities when buy-back is made through stock exchanges
- (3) The company should appoint a merchant banker and make a public announcement containing necessary disclosures, at least 7 days prior to the commencement of buy-back. A copy of the same should be filed with SEBI within 2 days of such announcement along with the required fees
- (4) The buy-back shall be made only on stock exchanges having nationwide trading terminals.
- (5) The buyback of shares or other specified securities shall be made only through order matching mechanism except 'all or none' order matching system.
- (6) Buy-back be made only through stock exchanges which have electronic trading facility.
- (7) The company and the merchant banker is required to submit the information regarding the shares or other specified securities bought- back to the stock exchange on a daily basis and publish the said information in a national daily on a fortnightly basis and every time when an additional five per cent of the buy back has been completed. However where there is no buy back during a particular period the company and the Merchant Banker is not required publishing the details in a national daily.
- (8) The identity of the Company as a purchaser shall appear on the electronic screen when the order is placed.

### **Answer 7(b)**

As per 2(ha) of SEBI (Prohibition of Insider Trading) Regulations, 1992, 'Price sensitive information' means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company.

The following information shall be deemed to be price sensitive:

- (i) periodical financial results of the company;
- (ii) intended declaration of dividends (both interim and final);
- (iii) issue of securities or buy-back of securities;

- (iv) any major expansion plans or execution of new projects;
- (v) amalgamation, mergers or takeovers;
- (vi) disposal of the whole or substantial part of the undertaking;
- (vii) any significant changes in policies, plans or operations of the company.

Further listing agreement requires listed companies to immediately inform certain information which are considered to be the price sensitive, such as change in general character or nature of business; information having bearing on operation/payment of the company.

### **Answer 7(c)**

#### **Liability for prosecution**

A stock broker or a sub-broker shall be liable for prosecution under Section 24 of the Act for any of the following violations, namely—

- (i) Dealing in securities without obtaining certificate of registration from the Board as a stock broker or a sub-broker.
- (ii) Dealing in securities or providing trading floor or assisting in trading outside the recognized stock exchange in violation of provisions of the Securities Contract (Regulation) Act, 1956 or rules made or notifications issued thereunder.
- (iii) Market manipulation of securities or index.
- (iv) Indulging in insider trading in violation of Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992.
- (v) Violating the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003.
- (vi) Failure without reasonable cause—
  - (a) to produce to the investigating authority or any person authorized by him in this behalf, any books, registers, records or other documents which are in his custody or power; or
  - (b) to appear before the investigating authority personally or to answer any question which is put to him by the investigating authority; or
  - (c) to sign the notes of any examination taken down by the investigating authority.
- (vii) Failure to pay penalty imposed by the adjudicating officer or failure to comply with any of his directions or orders.

#### **Question 8**

- (a) *What are the rights and responsibilities of the members of a company as per the SEBI's Investors Education Guide ?*
- (b) *What are the provisions in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 regarding minimum number of shares to be acquired under the takeover offer ?*
- (c) *State briefly the requirements for bidding process related to public issue of equity shares.*

(d) Outline the main legislations governing securities market in India.

(4 marks each)

**Answer 8(a)**

**Rights of Members as per SEBI's Investor Education Guide**

- (i) To receive share certificates on allotment or transfer, as the case may be, in due time.
- (ii) To receive copies of notices for various general meetings and attend them either personally or through proxies and to participate and vote.
- (iii) To receive copies of abridged annual report, balance sheet, profit and loss account and auditor's report.
- (iv) To receive dividends declared (including interim dividends) in time.
- (v) To receive other corporate benefits such as rights issues, bonus issues as and when approved.
- (vi) To apply to the Company Law Board to call or direct the calling of annual general meeting of the company.
- (vii) To inspect minute books of the general meetings and to take copies thereof.
- (viii) To proceed against the company by way of civil or criminal proceedings wherever justified.
- (ix) To apply for the winding up of the company.
- (x) To receive the residual proceeds on winding up.

Besides the above rights enjoyed as individual shareholder, the following rights can also be claimed as a group:

- (i) To requisition an extraordinary general meeting.
- (ii) To demand a poll on any resolution.
- (iii) To apply to Company Law Board to investigate the affairs of the company.
- (iv) To apply to Company Law Board for relief in cases of oppression and mismanagement.

**Responsibilities of Members**

Besides the above rights members also have certain responsibilities to be discharged. They are:

- (a) To remain informed.
- (b) To be vigilant.
  - To participate and vote in general meetings.
  - To exercise rights as an individual and also as a group.

**Answer 8(b)**

**Minimum Number of Shares to be Acquired**

Regulation 21 prescribes the following criteria in regard to minimum number of shares

which are to be acquired by the offeror for giving effect to the takeover of a company or substantial acquisition of its shares:

- (1) The public offer made by acquirer to the shareholders of the target company should be for a minimum of 20% of the voting capital of the company.
- (2) If the acquisition made in pursuance of a public offer results in the public shareholding in the target company being reduced below the minimum level required as per the Listing Agreement, the acquirer shall take necessary steps to facilitate compliance of the target company with the relevant provisions thereof, within the time period mentioned therein.
- (3) Where the public offer is made under sub-regulation (2A) of regulation 11 the minimum size of the public offer shall be the lesser of the following –
  - (a) twenty per cent of the voting capital of the company; or
  - (b) such other lesser percentage of the voting capital of the company as would, assuming full subscription to the offer, enable the acquirer, together with the persons acting in concert with him, to increase his holding to the maximum level possible, which is consistent with the target company meeting the requirements of minimum public shareholding laid down in the Listing Agreement.
- (4) Where the number of shares offered for sale by shareholders are more than the shares agreed to be acquired by the person making the offer, such person is required to, accept the offers on a proportional basis in consultation with merchant banker taking care that the basis of acceptance is decided in a fair and equitable manner and does not result in non-marketable lots.
- (5) The acquisition of shares from a shareholder should not be less than marketable lots or the entire holding if it is less than the marketable lot.
- (6) For the purpose of computing percentage, the voting rights as at the expiration of 15 days after the closure of the public offer is reckoned.

**Answer 8(c)**

The method and process of bidding should be in compliance of the following requirements:

- (i) Bid shall be open for atleast three days and not more than seven working days, which may be extended to a maximum of ten working days in case the price band is revised in accordance with the guidelines
- (ii) The advertisement made should contain the date of opening and closing of the bidding(not less than 5 days), the names and addresses of the syndicate members as well as the bidding terminals for accepting the bids and the method and process of bidding.
- (iii) Bidding shall be permitted only if an electronically linked transparent facility is used.
- (iv) The 'syndicate members' shall be present at the bidding centres so that at least one electronically linked computer terminal at all the bidding centres is available for the purpose of bidding.



- (v) The number of bidding centres, in case 75% of the net offer to the public is offered through the book building, process shall not be less than the number of mandatory collection centres as specified in these regulations. In case 100% of the net offer to the public is made through book building process, the bidding centres shall be at all the places, where the recognized stock exchanges are situated. The same norms as applicable for collection centres shall be applicable for the bidding centres also.
- (vi) Individual as well as qualified institutional buyers shall place their bids only through the 'brokers' who shall have the right to vet the bids. The applicant shall enclose the proof of DP ID and Client ID along with the application, while making bid
- (vii) During the period the issue is open to the public for bidding, the applicants may approach the brokers of the stock exchange/s through which the securities are offered under on-line system, to place an order for bidding to the securities.
- (viii) Every broker shall accept orders from all clients/investors who place orders through him. The investors shall have the right to revise their bids provided that Qualified Institutional Buyers shall not be allowed to withdraw their bids after the closure of the bidding.
- (ix) There shall be a standard bidding form to ensure uniformity in bidding and accuracy.
- (x) At the end of each day of the bidding period the demand shall be shown graphically on the terminals for information of the syndicate members as well as the investors. The identities of the Qualified Institutional Buyers making the bidding, would however not be made public.

The stock exchanges shall display data pertaining to book built issues in a uniform format, inter alia giving category wise details of bids received. The data pertaining to an issue shall be displayed on the site for a period of atleast three days after closure of bids.

#### **Answer 8(d)**

#### **Main legislations governing securities market in India**

The four main legislations governing the securities market are : (a) The SEBI Act, 1992 which establishes SEBI to protect investors and develop and regulate securities market; (b) The Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; (c) The Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges; and (d) The Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities.

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