

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) *A merchant banker can advise investment in the shares of a particular company on a TV Channel.*
- (ii) *The securities market facilitates the internationalisation of an economy by linking it with the rest of the world.*
- (iii) *A company can issue sweat equity shares within 6 months of commencement of business.*
- (iv) *An appeal can be made to the Supreme Court if a person is aggrieved by an order of the Securities Appellate Tribunal.*
- (v) *A company may change the denomination (face value) of its already issued shares by splitting or consolidation. (2 marks each)*

(b) *Re-write the following sentences after filling-up the blank spaces with appropriate word(s)/figure(s) :*

- (i) _____ *is an unsecured money market instrument issued in the form of promissory note.*
- (ii) _____ *means an institution incorporated or established outside India which proposes to make investment in India in securities.*
- (iii) *Equity linked saving schemes offering tax rebate to the investors under tax laws have a lock-in-period of _____ years.*
- (iv) *The total underwriting obligations of an underwriter under all agreements should not exceed 20 times of his _____.*
- (v) *The primary responsibility of building the book in an issue is of the _____ . (1 mark each)*

(c) *Choose the most appropriate answer from the given options in respect of the following :*

- (i) *Securities audit can be conducted by the —*
 - (a) *Chartered Accountant in Practice*
 - (b) *Cost & Works Accountant in Practice*
 - (c) *Company Secretary in Whole-time Practice*
 - (d) *Certified Financial Analyst.*
- (ii) *Which of the following is not an investment strategy in derivatives trading—*
 - (a) *Strap*
 - (b) *Straddle*

- (c) *Swap*
- (d) *Strip.*
- (iii) *Provisions of the Securities Contract (Regulation) Act, 1956 do not apply to —*
 - (a) *Government companies*
 - (b) *Banking companies*
 - (c) *Financial institutions*
 - (d) *Corporations set up by an Act of Parliament.*
- (iv) *The credit rating methodology for non-banking financial companies is based on —*
 - (a) *Capital adequacy*
 - (b) *Asset quality*
 - (c) *Earning and liquidity*
 - (d) *All the above.*
- (v) *Zero coupon bonds are issued —*
 - (a) *At par*
 - (b) *At premium*
 - (c) *At discount*
 - (d) *Any of the above.*

(1 mark each)

Answer 1(a)

- (i) **True :** The Merchant Banker can render such an advice on TV provided he makes a disclosure of his interest in the said scrip including a long or short position as per code of conduct detailed in Schedule III to SEBI (Merchant Bankers) Regulations, 1992.
- (ii) **True :** The securities market facilitates the internationalization of economy by linking it with the rest of the world. This linkage assists through the inflow of capital in the form of portfolio investment. This implies that the domestic company is opened up to international competitive pressures, which help to raise efficiency. It is also very likely that existence of a domestic securities market will deter capital outflow by providing attractive investment opportunities within domestic economy.
- (iii) **False :** Sweat equity shares are permitted to be issued by specified Indian companies under section 79A of the Companies Act, 1956. According to this section a company cannot issue Sweat Equity Shares unless a period of one year has elapsed at the date of issue since the date on which the company was entitled to commence its business. As this company has not yet completed one year from the date of commencement of business, it cannot issue sweat equity.
- (iv) **True :** Section 15Z lays down that any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme

Court within 60 days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of fact or law arising out of such order. It also provides that the Supreme Court may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding 60 days.

- (v) **True :** The companies which have already issued shares in any 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 :
- (i) the shares shall not be issued in the denomination of decimal of a rupee;
 - (ii) the denomination of the existing shares shall not be altered to a denomination of decimal of a rupee.
 - (ii) at any given time there shall be only one denomination for the shares of the company;
 - (iv) the companies seeking to change the standard denomination may do so after amending the Memorandum and Articles of Association, if required.
 - (vi) The company shall adhere to the disclosure and accounting norms specified by SEBI from time to time.

Answer 1(b)

- (i) **Commercial Paper** is an unsecured money market instrument issued in the form of promissory note.
- (ii) **Foreign Institutional Investors** means an institution incorporated or established outside India which proposes to make investment in India in securities.
- (iii) Equity linked saving schemes offering tax rebate to the investors under tax laws have a lock-in-period of **three** years.
- (iv) The total underwriting obligations of an underwriter under all agreements should not exceed 20 times of his **Networth** .
- (v) The primary responsibility of building the book in an issue is of the **Book Runner Lead Manager** .

Answer 1(c)

- (i) (c) Company Secretary in Whole-time Practice.
- (ii) (c) Swap.
- (iii) (d) Corporations set up by an Act of Parliament
- (iv) (d) All the above
- (v) (c) At discount.

Question 2

(a) Write short notes on any four of the following :

- (i) Reserve fund
- (ii) Clearing corporation
- (iii) Micro finance companies
- (iv) Internet trading
- (v) Placement memorandum.

(3 marks each)

(b) Expand the following :

- (i) DAC
- (ii) DFHI
- (iii) CDSL
- (iv) EDIFAR.

(1 mark each)

Answer 2(a)(i)**Reserve Fund**

This is a terminology used in the context of Non-banking Finance Companies. Section 45-IC of Reserve Bank of India Act, 1934 inter alia requires every NBFC to create a Reserve Fund and transfer thereto a sum not less than 20% of the net profit every year as disclosed in the Profit & Loss Account before any dividend is declared. Appropriations from the Reserve Fund can be made by NBFC only for those purposes specified by RBI and such appropriations when made shall be reported to RBI within 21 days thereof. In cases where the amount of Reserve Fund together with the amount in share premium account is not less than the paid-up capital of the company, RBI may by an order in writing declare that the provisions regarding Reserve Fund shall not be applicable to the NBFC for such period as may be specified in the order.

Answer 2(a)(ii)**Clearing Corporation**

Section 8A(1) of Securities Contract (Regulations) Act, 1956 provides that a recognized stock exchange may with the prior approval of SEBI transfer the duties and functions of a clearing house to a clearing corporation, being a company incorporated under the Companies Act, 1956 for the purpose of :

- (a) Periodical settlement of contracts and differences thereunder
- (b) Delivery of securities and payments thereof;
- (c) Any other matter incidental to, or connected with, such transfer.

Every Clearing Corporation may make bye laws for transacting its Business and submit the same to SEBI for approval. SEBI may if it is satisfied that it is in the interest of the trade and public to transfer the duties and functions of clearing house to a clearing corporation, grant approval to the bye laws submitted to it and approve transfer of duties and functions of the clearing house to it. The provisions of other section which apply to the clearing house shall also equally apply to such Corporations

Answer 2(a)(iii)**Micro Finance Companies**

Micro Finance Companies are non-banking financial companies which are engaged in micro financing activities, providing credit not exceeding Rs.50,000 for a business enterprise and Rs.1,25,000 for meeting the cost of a dwelling unit to any poor person for enabling him to raise his level of income and standard of living.

Answer 2(a)(iv)**Internet Trading**

Internet Trading refers to online trading through buying and selling securities via the Internet. Earlier investors used to place orders for buying or selling through the Trading Members either verbally i.e., personally or telephonically or in a written form, i.e., facsimile or a letter. In Internet trading, investors will place orders by accessing a Trading Member's website through the Internet.

In internet trading system broking accounts, bank accounts and demat accounts are linked electronically. Once the order is placed, the system automatically verifies the availability of the funds/ shares and credits/debits the accounts once the order is executed by the exchange.

Answer 2(a)(v)**Placement Memorandum**

The venture capital fund established as a trust before issuing any units file a placement memorandum with SEBI which should give details of the terms subject to which monies are proposed to be raised from investors. A venture capital fund established as a company should before making an offer inviting any subscriptions to its securities, file with SEBI a placement memorandum which shall give details of the terms subject to which monies are proposed to be raised from the investors.

Answer 2(b)

- (i) DAC : Disciplinary Action Committee
- (ii) DFHI : Discount and Finance House of India
- (iii) CDSL : Central Depository (Services) Limited
- (iv) EDIFAR : Electronic Data Information Filing and Retrieval System.

Question 3

- (a) *What is 'margin trading facility' ? Discuss briefly the essential requirements in respect of providing margin trading facility.* (6 marks)
- (b) *"Treasury bills are an effective cash management product." Elucidate.* (5 marks)
- (c) *Explain the following credit rating symbols :*
 - (i) PL3

- (ii) *FAAA*
- (iii) *CR1*
- (iv) *FD*
- (v) *PA-1.*

(1 mark each)

Answer 3(a)

Margin trading facility is a leveraging mechanism of trading through borrowed funds in order to enable the investors to take exposure in the secondary market over and above their own resources. The trading member is required to obtain prior permission of the exchange before providing margin trading facility to its clients. Only corporate brokers with a net worth of at least 300 crores would be eligible to offer margin trading facility to their clients. The trading member/broker is required to enter into an agreement with each of its client for providing margin trading facility. Margin to be paid in the form of cash/fixed deposit/bank guarantee only. Total indebtedness for the purpose of margin trading must not exceed five times the net worth. Margin trading facility is available in capital market segment only. Exposure to any single client at any point of time should not exceed 10% of the lendable resources.

Answer 3(b)

Treasury Bills are very useful instruments to deploy short term surpluses depending upon the availability and requirement. Even funds which are kept in current accounts can be deployed in treasury bills to maximise returns. Banks do not pay any interest on fixed deposits of less than 15 days, or balances maintained in current accounts, whereas treasury bills can be purchased for any number of days depending on the requirements. This helps in deployment of idle funds for very short periods as well. Further, since every week there is a 91 days treasury bills maturing and every fortnight a 364 days treasury bills maturing, one can purchase treasury bills of different maturities as per requirements so as to match with the respective outflow of funds. At times when the liquidity in the economy is tight, the returns on treasury bills are much higher as compared to bank deposits even for longer term. Besides, better yields and availability for very short tenors, another important advantage of treasury bills over bank deposits is that the surplus cash can be invested depending upon the staggered requirements.

Answer 3(c)

- (i) **PL3** : Adequate capacity for repayment of interest and principal on the loan. Variability in earnings and profitability may result in significant changes in the level of debt servicing capability. The effect of industry characteristics may be more pronounced.
- (ii) **FAAA** : (F triple A) Highest safety indicates the degree of safety regarding timely payment of interest and principal is very strong.
- (iii) **CR1** : Very strong contract execution capacity – The prospects of timely completion of projects without cost overruns are best and the ability to pay liquidated damages for non-conformance with contract is highest.
- (iv) **FD** : Default - indicates the issuer is either in default or is expected to be in default upon maturity.

- (v) **PA-1** : Projects rated PA-1 indicate highest ability of the developer to specify and build to agreed quality levels and transfer clear title within stipulated time schedules.

Question 4

- (a) *Distinguish between any two of the following :*
- (i) *'Employee stock option scheme' and 'employee stock purchase scheme'.*
 - (ii) *'Organised money market' and 'unorganised money market'.*
 - (iii) *'Voluntary delisting' and 'Compulsory delisting'.* (3 marks each)
- (b) *Elaborate the following expressions/terms as defined under the SEBI (Prohibition of Insider Trading) Regulations, 1992 :*
- (i) *Price sensitive information*
 - (ii) *Close period*
 - (iii) *Insider.* (2 marks each)
- (c) *"Permanent Account Number (PAN) is the sole identification number for all transactions in the securities market." Elucidate.* (4 marks)

Answer 4(a)(i)

Employees Stock Options and Employees Stock Purchase Scheme

Employees Stock Options Scheme means a Scheme under which a Company grants options to its whole-time directors, officers or employees to apply shares of the company at a predetermined price. Option means the right but not the obligation to apply for the shares of the Company. The option granted are non transferable. Such options are generally used for rewarding and motivating employees; attracting and retaining the best talent; ensuring employees commitment and performance.

ESOS scheme is under the superintendence and direction of the compensation committee of the Board of Directors in which there would be majority of independent Directors.

The Employees Stock Purchase Scheme (ESPS), on the other hand is a scheme through which shares of a Company are offered to permanent employees of the company or the holding company, director of the company whether whole time or part time either in isolation or along with the IPO at a predetermined Price. The employee should neither be a promoter nor belong to the Promoter's group and the director should directly or indirectly not hold more than 10% of the outstanding equity shares of the Company. The Company is free to fix the issue price of such shares. But these shares shall be locked in for a period of one year if issued at a price different from the price of public issue.

Answer 4(a)(ii)

Organised Money Market and Unorganised Money Market

Money market refers to the market for short-term securities. It is a market where money and highly liquid marketable securities are bought and sold.

On the basis of the participants and their trading and practices money market may be classified into two groups' organized and unorganized money market. In organized segments, commercial banks, co-operative banks, mutual funds etc. are the players and their participation is in standardized form whereas the indigenous money lenders, chit funds, nidhi etc. are the participants of unorganized money market and trading is in haphazard manner.

Answer 4(a)(iii)**'Voluntary delisting' and 'Compulsory delisting'**

Voluntary delisting of securities is voluntary in nature and being sought by the promoters of the company. Promoters or acquirers of the company voluntarily seek to delist their securities from all or some of the stock exchange. Compulsory delisting of securities is the decision of the stock exchange on which the shares of the company are listed. The compulsory delisting may be for : non-payment of listing fees; non-compliance with listing requirement; unfair trading practices at the behest of the promoters/ management.; reduction in the number of public holders of securities.

Answer 4(b)(i)**Price Sensitive Information**

Price Sensitive Information means any information which relates directly or indirectly to a company and which if published is likely to materially effect the price of the securities of that company. The following are deemed to be price sensitive information :

- (i) Periodical Financial results of the Company
- (ii) Intended declaration of dividend—both interim and final
- (iii) Issue of Securities or buy back of securities
- (iv) 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

Answer 4(b)(ii)**Close Period**

Close Period means the prohibited period specified for trading and dealing in the securities of the company. During this period dealing in securities of the Listed Company is prohibited. This period should continue up to 24 hours after the price sensitive information is made public. It could commence from the time of announcement of the meeting of the Board of Directors of a company with respect to all price sensitive information and end 24 hours after the decision of the Board is made public. In case of matters which are not required to be dealt with in the board meeting, the close period should be from the time the preliminary discussions in respect of the matters commence and end 24 hours after the information is made public.

Answer 4(b)(iii)**Insider**

Insider means any person who is or was connected with the company or is deemed to have been connected with the company, and who is reasonably expected to have access to unpublished price sensitive information in respect of securities of a company, or who has received or has had access to such unpublished price sensitive information.

Answer 4(c)**Permanent Account Number (PAN)**

SEBI has made PAN mandatory for trading in the cash market and for operating demat accounts with effect from January 1, 2007. In order to strengthen the know your client (KYC) norms and identify every participant in the securities market with their respective PAN thereby ensuring sound audit trail of all the transactions. SEBI decided that PAN would be the sole identification number for all participants transacting in the securities market irrespective of the amount of transaction.

Question 5

- (a) *INQ Ltd. is listed with the National Stock Exchange of India Ltd. with capital of Rs.125 crore. The company desires to make a GDR issue of Rs.500 crore to augment its capital for a new titanium dioxide project being set-up in Tamil Nadu. As the Company Secretary of INQ Ltd., prepare a note informing the Board of directors about various approvals required to make such an issue.*
(6 marks)
- (b) *Highlight the provisions of clause 40A and 40B of the listing agreement pertaining to continued listing of shares and takeover offers.*
(6 marks)
- (c) *Explain briefly any one of the following terms with reference to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 1997 :*
- (i) *Person acting in concert*
- (ii) *Public announcement.*
(4 marks)

Answer 5(a)

From : Company Secretary
INQ Ltd.

To : Managing Director
INQ Ltd.

Subject : Approvals required for issuance of GDR

The various approvals are required for issuance of GDRs by our Company listed on the Bombay Stock Exchange. GDRs are reckoned as part of Foreign Direct Investment and as such issuance of these requires a number of approvals both internal and External. The details of these approvals are given below:

Approval of Board of Directors

A meeting of the Board of Directors is required to be held to approve the proposal to

raise money from GDRs. The resolution passed by the Board should give approvals as regards to :

- (i) The specific purpose for which the funds are required
- (ii) Quantum of issue
- (iii) Country in which issue is to be launched
- (iv) Time of the Issue
- (v) Formation of a director/subcommittee of the Board for seeking approvals in connection with the issue, signing of agreements with depository, organizing road show for fixation of the price of GDRs, to decide and approve the notice of extraordinary general meeting of shareholders at which special resolution is to be considered.

Approval of Shareholders

The proposal shall require the approval of shareholders. A Special Resolution under Section 81(1-A) of the Companies Act, 1956 to be passed at the duly convened general meeting of the shareholders of the company.

Approval from Ministry of Corporate Affairs

Approvals under Section 94, 16, and 31 of the Companies Act if required to be taken for enhancing the capital or for altering the Articles for bringing the issue.

Consent of Stock Exchange - Consent or approval of Domestic Stock exchange for listing of underlying shares which shall be lying in the custody of domestic Custodian. These shares when released by the custodian after Cancellation of GDR are traded on Indian Stock exchange like any other Equity share.

Approval of Financial Institutions

The consent of financial institutions from whom the Company has taken Term loans to be obtained if necessary under the terms of loan agreement

SD/-
Company Secretary
INQ Ltd.

Answer 5(b)

Clause 40A & 40B — Conditions for continued listing and Takeover offer

- (a) To maintain on a continuous basis, public shareholding of at least 25% of the total number of issued shares.
- (b) To maintain on a continuous basis, public shareholding of at least 10% where the company offers or has in the past offered a particular class or kind of its shares to the public to the extent of at least 10%.
- (c) To maintain on a continuous basis, public shareholding of at least 10% if the number of outstanding listed shares of any class or kind of the company are

two crore or more and the market capitalization of such company in respect of shares of such class or kind is Rs.1000 crores or more.

- (d) To increase public shareholding to 25% or 10%, as the case may be, within such period as may be approved by the Specified Stock Exchange (SSE) but not exceeding two year if the public shareholding is less than 25% or 10%, as the case may be.
- (e) Not to dilute in any way its public shareholding or not to make any allotment of its shares to its promoters or entities belonging to its promoter group except for supervening extraordinary events, including, but not limited to events specified below:
 - (i) Issuance or transfer of shares in compliance with directions of a regulatory or statutory authority or court or tribunal;
 - (ii) Issuance or transfer of shares in compliance with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997;
 - (iii) Re-organization of capital by way of a scheme of arrangement; and
 - (iv) Issuance or transfer of shares under a restructuring plan approved in compliance with the Corporate Debt Restructuring System laid down by the Reserve Bank of India,
- (f) Not to make any offer to buyback its shares or buy its shares for the purpose of making sponsored issuance of depository receipts or take any other step, including issuance of depository receipts, if it results in reducing the public shareholding below the minimum level of 25% or 10%, as the case may be.

Answer 5(c)(i)

SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 1997 defines person acting in concert' as under :

- (1) Persons who, for a common objective or purpose of substantial acquisition of shares or voting rights or gaining control over the target company, pursuant to an agreement or understanding (formal or informal), directly or indirectly co-operate by acquiring or agreeing to acquire shares or voting rights in the target company or control over the target company.
- (2) Without prejudice to the generality of this definition, the following persons will be deemed to be persons acting in concert with other persons in the same category, unless the contrary is established :
 - (i) A company, its holding company, or subsidiary of such company or company under the same management either individually or together with each other;
 - (ii) A company with any of its directors, or any person entrusted with the management of the funds of the company;
 - (iii) Directors of companies referred to in sub-clause (i) of clause (2) and their associates;
 - (iv) Mutual fund with sponsor or trustee or asset Management Company;

- (v) Foreign institutional investors with sub-account(s);
- (vi) Merchant bankers with their client(s) as acquirer;
- (vii) Portfolio managers with their client(s) as acquirer;
- (viii) Venture capital funds with sponsors;
- (ix) Banks with financial advisers, stock brokers of the acquirer or any company which is a holding company, subsidiary or relative of the acquirer;
- (x) Any investment company with any person who has an interest as director, fund manager, trustee, or as a shareholder having not less than 2 per cent of the paid-up capital of that company or with any other investment company in which such person or his associate holds not less than 2 per cent of the paid up capital of the latter company.

Answer 5(c)(ii)**Public announcement**

The public announcement to be made under Regulation 10 or 11 or 12 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 is required to be made in all editions of one English national daily with wide circulation, one Hindi national daily with wide circulation and a regional language daily with wide circulation at the place where the registered office of the target company is situated and at the place of the stock exchange where the shares of the target company are most frequently traded.

A copy of the public announcement is required to be submitted to the board through the merchant banker, sent to all the stock exchanges on which the shares of the company are listed for being notified on the notice board and sent to the target company at its registered office for being placed before the Board of Directors of the Company,

Question 6

- (a) *Briefly describe the provisions relating to anti-money laundering.* (4 marks)
- (b) *"Best protection is the self-protection." Elucidate this statement with emphasis on the checks that an investor should exercise before deciding to invest in securities.* (4 marks)
- (c) *State briefly the special features of any two of the following :*
 - (i) *Deep discount bonds*
 - (ii) *Floating rate notes*
 - (iii) *Sweat equity shares.* (2 marks each)
- (d) *Describe briefly the code of conduct for a portfolio manager as laid down by the SEBI.* (4 marks)

Answer 6(a)

The Prevention of Money Laundering Act, 2002 has been brought into force with effect from 1st July, 2005. Section 12 of The Prevention of Money Laundering Act, 2002 lays down following obligations on an intermediary :

As per the provisions of the Act every banking company, financial institution and

intermediary which includes stock broker, sub-broker, share transfer agent, underwriter, portfolio manager, investment advisor registered under Section 12 of the SEBI shall

- (i) maintain a record of all transactions, the nature and value of which may be prescribed, whether such transactions comprise of a single transaction or a series of transactions integrally connected to each other and where such series of transactions take place within a month;
- (ii) furnish information of transactions referred to in clause (a) to the Director within such time as may be prescribed.
- (iii) verify and maintain the records of the identity of all its clients, in such a manner as may be prescribed.

Answer 6(b)

It is said that the best protection is the self protection. But in order to protect one self against the risks involved in making investment in corporate, one is to understand the investment world and the hazards to which it is exposed. This requires investors to educate themselves continuously on the development in the law, regulations of different financial instruments, players in the market because if any thing goes wrong with the investment due to what so ever reason the investor can not take the plea that he was ignorant of the extant laws. As such the investors must understand the cardinal principles of investment, rules of safety, importance of liquidity and measure of profitability. They must keep their ears and eyes open to new developments in the market and make a proper Assessment of the types of instrument, organization and intermediaries they are dealing with before venturing in to an investment. Following are few of the checks highlighted by SEBI which an investor should exercise while making an investment :

- (i) Promoter's track record and experience in the chosen field as well as reputation and integrity
- (ii) The professional Management team appointed to run the Company.
- (iii) Objects of issue and Project details, Project Technology and assured market
- (iv) Projects Profits and Ratios
- (v) Risk factors and pending litigations
- (vii) Record of service by company to share holders and investors in the past
- (viii) Soliciting information from stock exchange, registrar of companies and investor's associations

Answer 6(c)(i)

Deep Discount Bonds : IDBI and SIDBI had issued this instrument. For a deep discount price of Rs.2700 in IDBI the Investor got a bond with the face value of Rs.1,00,00. The bond appreciates to its face value over the maturity period of 25 years. The deep discount bond is considered a safe solid and liquid instrument.

Answer 6(c)(ii)

Floating Rate Notes : In case of floating rate notes, interest is not fixed and is allowed to float depending upon market conditions. This instrument is used by the issuers to hedge themselves against the volatility in interest rates.

Answer 6(c)(iii)

Sweat Equity Shares : Sweat Equity Shares are allotted to employees of companies, as rewards, free of cost or at a price which is considerably below the ruling market price. It is given as a reward for performance to further encourage them to put in their best in the organization. Under The Companies Act, 1956 sweat equity shares means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know how or making available rights in the nature of intellectual property rights.

Answer 6(d)**Code of Conduct for Portfolio Manager**

Regulation 13 lays down that every portfolio manager shall abide by the code of conduct as specified in Schedule III to the Regulations which is as follows :

- (i) A portfolio manager shall in the conduct of his business, observe high standards of integrity and fairness in all his dealings with his clients and other portfolio managers;
- (ii) The money received by a portfolio manager from a client for an investment purpose should be deployed by the portfolio manager as soon as possible for that purpose.
- (iii) A portfolio manager shall render at all times high standard of service, exercise due diligence, ensure proper care and exercise independent professional judgement.
- (iv) A portfolio manager shall not make any exaggerated statement, whether oral or written to the clients.
- (v) A portfolio manager shall not disclose to any clients or pass any confidential information about his client, which has come to his knowledge.
- (vi) Ensure that the investors are provided with true and adequate information without making any misguiding or exaggerated claims and are made aware of attendant risks before any investment decision is taken by them.
- (vii) The portfolio manager shall abide by the Act and the Rules, Regulations made thereunder and the Guidelines/Schemes issued by the Board.

Question 7

(a) Give your considered advice on the following proposals :

- (i) A company proposes to issue irredeemable preference shares.
- (ii) A portfolio manager wants to file a defamation suit against the Chairman, SEBI for imposing penalty on him.
- (iii) A mutual fund manager wants to park funds of a scheme in the fixed deposit of a bank.
- (iv) A listed company wants to issue fully convertible debentures with conversion period of 36 months. (2 marks each)

- (b) *What do you mean by 'exchange traded funds' ? Explain their advantages and disadvantages.* (4 marks)
- (c) *Define 'registered transfer agent' (RTA). Describe the role played by RTA both in the primary and secondary market.* (4 marks)

Answer 7(a)

- (i) The issuance of irredeemable preference shares was permitted till 14th June, 1988 and has since been stopped with the introduction of Section 80A in the Companies Act, 1956. The Company therefore cannot issue such shares.
- (ii) The SEBI Chairman must have inflicted penalty on the Portfolio Manager while acting or purporting to act in pursuance of any of the provisions of SEBI Act, 1992. Section 23 of this Act specifically states that no suit, prosecution or other legal proceedings shall lie against any employee or officer of SEB for anything done in good faith under this Act or Rules made thereunder. In view of this the suit filed by the Portfolio Manager shall not stand in the Court.
- (iii) As per Seventh Schedule to SEBI (Mutual Funds) Regulation, 1996. A fund manager can invest the funds of a scheme in short-term deposits of a bank pending its deployment in securities in terms of investment objectives of the scheme. But it should be ensured that the Bank is a scheduled commercial bank and deposits are short-term. Regulation 43 also provides the instruments in which Mutual fund may invest.
- (iv) The company can issue fully convertible debentures for a period of more than 36 months as per SEBI (Disclosure and Investor Protection) Guidelines, 2000. Earlier prior to 2007, there was a condition that a company can issue fully convertible debentures for a period of more than 36 months provided the conversion is made optional with 'put' and 'call' option. However at present there is no such condition.

Answer 7(b)

Exchange Traded Funds

Exchange traded funds are a new variety of mutual fund that first became available in 1993. ETFs have grown rapidly and now hold nearly \$80 billion assets. ETFs are sometimes described as more tax efficient than traditional equity mutual funds. Exchange Traded Funds are rapidly growing class of financial products. These are typically organized as unit trusts.

Advantages : ETFs offer more flexibility than other funds. There can be bought and sold throughout the trading day. Traders have the ability to short or buy ETFs on margin. Low annual expenditures rival the cheapest mutual funds.

Disadvantages : ETFs have also some negatives. Commissions-like stocks trading exchange traded funds will cost the investors. Only institutions and extremely wealthy can deal directly with the ETFs.

Answer 7(c)

The Registrars to an Issue constitute an important category of intermediaries in the primary market. They render very useful services in mobilizing new capital and facilitating

proper records of the details of the investors, so that the basis for allotment could be decided and allotment is ensured as per SEBI Guidelines.

They also render service to the existing companies in servicing the share capital contributed by the investors. The system of share transfers gives liquidity to the investment and helps the investors to easily acquire or dispose off shares in the secondary market. The share transfer agents who have the necessary expertise, trained staff, reliable infrastructure and SEBI licence render service to the corporates by undertaking and executing the transfer and transmission work relating to the company's shares and securities. Thus they have a role to play both in the primary and the secondary markets.

Question 8

- (a) Explain any two of the following terms related to capital market :
 - (i) Hybrid scheme
 - (ii) Top down investing
 - (iii) Inter-corporate deposit
 - (iv) Gilt-edged securities. (2 marks each)
- (b) Explain briefly the SEBI guidelines on pricing of equity shares by an issuer company. (4 marks)
- (c) Critically examine the role of SEBI in the regulation of capital market in India. (4 marks)
- (d) Define 'listed securities' and 'permitted securities' and distinguish between them. (4 marks)

Answer 8(a)(i)

Hybrid Scheme : In such type of Schemes both fixed income as well as growth orientation needs are satisfied. Mutual Funds fix judicious mix of securities; bonds, debentures and sound equities. The funds are therefore, also known as 'Balanced Funds'.

Answer 8(a)(ii)

Top down investing : This is an investment strategy which first takes a view on the economy and then looks at the industry scenario to assess the potential performance of a company. This is opposite to Bottom up Investing Technique.

Answer 8(a)(iii)

Inter-corporate deposit : 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 corporate 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 8(a)(iv)

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 Board, 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.

Answer 8(b)

Pricing of equity shares

- (a) A listed company and an unlisted company eligible to make a public issue and desirous of getting its securities listed on a recognized stock exchange, may freely price its equity shares or any securities convertible at a later date into equity shares.
- (b) An eligible infrastructure company shall be free to price its equity shares subject to the compliance with the disclosure norms as specified by SEBI from time to time.
- (c) The banks may freely price their issue of equity shares or any securities convertible at a later date into equity share subject to approval by the Reserve Bank of India.

Answer 8(c)

According to Preamble of the SEBI Act, 1992 the objective of setting up of SEBI is to protect the interests of investors in securities and to promote the development and to regulate the securities market. During the last eighteen years, it has sought to balance the two objectives by 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 institutions 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.

Answer 8(d)

‘Listed securities’ and ‘permitted securities’

Securities traded on a stock exchange can be broadly classified as listed cleared securities and permitted securities.

Securities which are listed on any recognized stock exchange are known as Listed Securities.

The Securities listed on some of recognized stock exchanges, when permitted to be traded by those stock exchanges where they are not listed are called permitted securities. Such permission is given if suitable provision exists in the regulations of the concerned stock exchanges.
