

Paper-6
Security Laws and Compliances
Solution June - 2013

Answer 1 (a)

- (i) **True:** Dematerialization of share is optional. An investor can hold shares in physical form but to sell them in the market, the share need to be dematerialised.
False: According to SEBI (ICDR) Regulations, 2009, a Company is required to make a public issue of shares in dematerialized form. Accordingly, a company has to issue shares in dematerialized form. At the request of the Shareholder, a company is required to convert the dematerialized shares into physical form.
- (ii) The securities market facilities the internationalization of an economy by thinking it with rest of the worlds through ADR/GDR/FCCB/FCEB and allowing them to issue IDR.
- (iii) **False:** Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note.
- (iv) **True:** The strap buyer feels the market may go either way, but is more likely to go up as he enters into two calls one put option.
- (v) **False:** The placement memorandum is issued for private circulation only.

Answer 1 (b)

- (i) Mutual Funds are regulated by **SEBI (Mutual Funds) Regulations, 1996.**
- (ii) Re- issue of existing government securities having pre-determined yields by the Reserve Bank of India is known as **On tap-issued/Dated Government Securities/ Treasury Bills.**
- (iii) The provisions relating to Corporate Governance are mostly found in clause **49** of the listing agreement.
- (iv) In the case of an IPO **Not less than 20%** of shares held by the promoters are locked-in for 3 years.
- (v) A listed company is required to appoint a **Compliance Officer** to liaise with SEBI and Stock Exchanges.

Answer 2 (a)

- (i) **‘Initial margin’ and ‘Maintenance margin’**
“Initial Margin” means the minimum amount, calculated as a percentage of the transaction value, to be placed by the client, with the broker, before the actual purchase. The broker may advance the balance amount to meet full settlement obligations.
“Maintenance margin” means the minimum amount, calculated as a percentage of market value of the securities, calculated with respect to last trading day’s closing price, to be maintained by client with the broker.

(ii) **'Public notice' and 'Public Announcement'**

Public notice is a notice given to the public or persons affected, usually by publishing in a news paper of general circulation. This notice is usually required, in matter of public concern. For Example: In terms of Regulations 47, 55 and 60 of SEBI (ICDR) Regulations, 2009, an issuer is required to issue public notices in all the newspapers in which the issuer has issued pre-issue advertisement for public issue or Right Issue.

On the other hand Announcement means any and every effort or enterprise and attempt made to make known a thing or the existence of a thing openly or publicly. In terms of Regulations 3 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, a public announcement is an announcement made in the newspapers by the acquirer primarily disclosing his intention to acquire shares of the target company from existing shareholders by means of an open offer.

(iii) **'Call option' and 'Put option'**

Call option contract conveys the right to the option buyer to buy specified quantity of underlying asset at specified rate (the strike price) for a limited length of time (until expiration). The buyer of call option expects that market will go upward direction.

Put option contract conveys the right to the option to sell specified quantity of underlying assets at specified rate (the strike price) for a limited length of time (until expiration). The buyer of put option expects that market will go downward direction. The buyer of option has unlimited profit but limited loss upto option premium.

(iv) **'Bullish trend' and 'Bearish trend'**

Bear market is a weak or falling market characterised by the dominance of sellers, whereas Bull market is a rising market with abundance of buyers and relatively few sellers. When the price of shares moves in a particular direction which persists for a period of time, a price line is regarded as established. When the movement is upward, the trend is called 'BULLISH' and when the movement is downward it is called 'BEARISH'

Answer 2 (b)

- (i) KYC – Know your Client
- (ii) HNI- High Networth Individual
- (iii) SWP – Systematic Withdrawal Plan

Answer 3

Composition of Audit Committee

As per clause 49 of listing agreement, a qualified and independent audit committee shall be set up giving the terms of reference subject to the following.

- (i) Audit Committee shall have minimum three directors as members.
- (ii) 2/3rd of the members of Audit Committee shall be independent directors.
- (iii) All members of Committee shall be financially literate and atleast one member shall have according or related financial management expertise.
- (iv) Chairman of the Audit committee shall be an independent director.

Role and Responsibilities of Audit Committee

The role and responsibilities of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
4. Reviewing, with the management, the annual financial statements before submission to the board for approval. With particular reference to:
 - (a) Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (2AA) of Section 217 of the Companies Act, 1956.
 - (b) Changes, if any, in accounting policies and practices and reasons for the same.
 - (b) Major accounting entries involving estimates based on the exercise of judgment by management.
 - (d) Signification adjustment made in the financial statements arising out of audit findings.
 - (e) Compliance with listing and other legal requirements relating to financial statement.
 - (f) Disclosure of any related party transactions.
 - (g) Qualifications in the draft audit report.
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval.
6. Reviewing, with the management, the statement of uses/ application of funds raised through an issue (public issue, rights issue, preferential issue, etc), the statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice and the report submitted by the monitoring agency mentoring the utilization of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter.
7. Reviewing, with the management, performance of statutory and internal auditors, and adequacy of the internal control systems.
8. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
9. Discussion with internal auditors any significant findings and follow up there on.
10. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a

failure of internal control systems of a material nature and reporting the matter to the board.

11. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
12. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
13. To review the functioning of the Whistle Blower mechanism, in case the same is existing.
14. Approval of appointment of CFO (i.e., the whole-time Finance Director or any other person heading the finance function or discharging that function) after assessing the qualifications, experience & background, etc. of the candidates.
15. Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

Answer 3 (b)

Every credit rating agency develops its own rating parameters/ model/ weightages for rating respective instruments. Some of the common factors that may be taken into consideration for credit rating are –

- Issuer Company's operational efficiency
- Level of technological development
- Financials
- Competence and effectiveness of management
- Past record of debt servicing
- Capital structure
- Working capital etc.

Answer 4

Rule 3 of Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001, enables companies limited by shares to issue shares with differential rights as to dividend, voting or otherwise, subject to fulfillment of the following conditions:-

- (i) The company has distributed profits in terms of section 205 of the Companies Act, 1956 for preceding 3 financial years preceding the year in which it was decided to issue such shares.
- (ii) The company has not failed to repay its deposits or interest thereon due date or redeems its debentures on due date or pay dividend.
- (iii) The company has not defaulted in meeting investors grievances.
- (iv) The company has obtained the approval of shareholders in general meeting by passing resolution as required.
- (v) The company has not been convicted of any offence arising under SEBI Act 1992, FEMA, 1999, SCRA, 1956.
- (vi) The holder of the equity shares with differential voting rights shall enjoy all other rights to which the holder is entitled to except the differential rights.
- (vii) The Share with differential voting rights shall not exceed 25% of the total share

capital issued.

Answer 4 (b)

(i) Tracking Stocks

A Tracking stock is 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. As a result, if the unit or division performs well, the value of the tracking stocks may increase, even if the company’s performance as a whole is not up to mark or satisfactory. Tracking stock carries dividend rights tied to the performance of a targeted division without transferring ownership or control over divisional assets.

(iii) Multiple Listing

SEBI (ICDR) Regulations, 2009 provides that in case of an initial public offer, the company is required to make an application for listening of the specified securities in at least one recognized stock exchange having nationwide trading terminals. Further, it can make an application to one or more recognized stock exchanges for listening of specified securities on such stock exchanges and choose one of them as the designated stock exchange. Thus, a company can list its securities on more than one stock exchange. This is multiple listing.

(iii) Clearing

Clearing is the process that happens between execution and settlement. The clearing process involves determination of what counter-parties owe, and which counter-parties are due to receive on the settlement date, thereafter the obligations are discharged by settlement. Several entities, like the clearing corporation, clearing members, custodians, clearing banks, depositors are involved in the process of clearing. NSCCL and ICCL are the clearing corporations of NSE and BSE respectively.

(iv) Circuit Breaker :

Circuit Breakers or price limits are imposed to control volatility in the price movements’ vis-a-vis prescribed daily and weekly limit for every stock. The daily price limit is checked against the stock closing price in the previous trading session. The weekly price limit of stock depends on its closing price on the last trading day in the previous week. The circuit breakers are applicable at three stages of the index movement either way at 10%, 15% and 20%. The market wide circuit breakers can be triggered by movement of either BSE SENSEX or the NSE NIFTY, whichever is breached earlier.

Answer 5

(a) The procedure followed by the Depository Particulars with respect to issuance of Deliver Instruction Slip (DIS):

- (a) Issuance of DIS booklets including loose slips.
- (b) Existence of controls on DIS issued to Clients including pre-stamping of Client ID and unique printed serial numbers.
- (c) Record maintenance for issuance of DIS booklets (including loose slips) in the back office.

The procedure followed by the Depository Participants with respect to verification of DIS:

- (a) Date and time stamping (including late stamping) on instruction slips.
 - (b) Blocking of used/ reported lost/ stolen instruction slips in back office system/ manual record.
 - (c) Two step verification for a transaction for more than Rs. 5 lakh, especially in case of off-market transaction.
 - (d) Instructions received from dormant accounts.
- (b) Insider trading generally means trading in the share of a company by the person who are in the management of the company or are close to them on the basis of undisclosed price sensitive information regarding the working of a company, which they process but which is not available to others.
- Section 15 G of SEBI Act, 1992 lays down that if any insider–
- (i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price sensitive information; or
 - (ii) communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or
 - (iii) counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price sensitive information.
- He shall be liable to a penalty of twenty five crore rupees or three times the amount of profits made out of insiders trading, whichever is higher.
- (c) A company may buy- back its shares or other specified securities by any one of the following methods under the SEBI (Buy- back of Securities) Regulations, 1998:-
- (a) from the existing security – holders on a proportionate basis through the tender offer;
 - (b) from the open market through –
 - (i) book- building process
 - (ii) stock exchange;
 - (c) from odd-lot holders.

PART B

Answer 6

- (i) **Green shoe option:** Green shoe option (GSO) means an option of allocating shares in excess of the shares included in the public issue and operating a post-listing price stabilizing mechanism in accordance with the provisions of SEBI (ICDR) Regulation, 2009.
- The GSO process involves the appointment of a merchant bank as a stabilising agent (SA) by the issuer company; agreement with promoters or other pre-issue shareholders to 'borrow' a certain number of shares from shares in restricted to 15% of the issue size. The issuer company is required to pass a shareholder resolution for appointing a stabilizing agent and SA is required to open a GSO bank account and a GSO demat account.

- (ii) **Employee stock Option:** According to the Companies Act, 1956, the term 'Employee Stock Option' (ESOP) means the option given to the whole time directors, officers or employees of a company, which gives such directors, officers or employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a predetermined price. SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999, provides that Employee Stock Option Scheme means a scheme under which the company grants option to its employee and option means a right but not an obligation granted to an employee in pursuance of ESOS to apply for shares of the company at a pre-determined price.
- (iii) **Voluntary delisting of securities:** According to SEBI (Delisting of Equity Shares) Regulations, 2009, a company can voluntarily apply to the concerned stock exchange(s) for delisting. Public notice and all announcements are required to be given by the Promoters of the company. The Company seeking voluntary delisting shall take the approval of the concerned stock exchange(s) and also of public shareholders. Shareholders resolution is required to be passed through Postal ballot. The complete process is monitored by the Merchant Bankers. The price should be determined on the basis of the past trading data or book values of the company by the promoters in consultation by the Merchant Bankers. The price by the promoters in consultation by the Merchant Banker. The company cannot relist its securities for a period of 5 years.
- (iv) **Compliance Officer:** In terms of Clause 47 of the listing Agreement of Stock Exchange, Compliance Officer shall be the Company Secretary of the company. The Compliance Officer shall directly liaise with SEBI with regard to compliance with various laws, rules regulations, and other directives issued by SEBI and investor complaints related matters. He/She is also required to co-ordinate with regulatory authorities in various matters and provide necessary guidance, so as to ensure compliance internally and ensure that observations made/ deficiency pointed out the SEBI do not recur. The Compliance Officer shall be responsible for ensuring the correctness, authenticity and comprehensiveness of the information, statements, reports etc. filled under corporate filing and dissemination system as specified Clauses 52(1)(b) the equity listing agreement.
- (v) **IPO Grading:** IPO Grading (Initial Public Offering Grading) is a service aimed at facilitating the assessment of equity issues offered to public. The grade assigned to any individual issue represents a relative assessment of the "fundamentals". It can be assigned by a registered credit rating agency. Such grading is assigned on a five-point scale with a higher score indicating stronger fundamentals as below:
- | | | |
|-------------|---|----------------------------|
| IPO grade 1 | = | Poor fundamentals |
| IPO grade 2 | = | Below average fundamentals |
| IPO grade 3 | = | Average fundamentals |
| IPO grade 4 | = | Above average fundamental |
| IPO grade 5 | = | Strong fundamentals |

According to SEBI ICDR Regulations 2009, IPO grading is mandatory for making an IPO.

Answer 7

- (a) The non-convertible portion of partly convertible debt instruments issued by a listed issuer, the value of which exceeds fifty lakh rupees can be rolled over without change in the interest rate, subject to the compliance with the provisions of Section 121 of the Companies Act, 1956 and the following conditions with respect to SEBI (ICDR) Regulation, 2009;
- (i) 75% of the holders of the convertible debt instruments of the issuer have, through a resolution, approved the rollover through postal ballot.
 - (ii) The issuer has along with the notice for passing the resolution, sent to all holders of the convertible debt instruments, an auditor's certificate on the cash flow of the issuer and with comments on the liquidity position of the issuer.
 - (iii) The issuer has undertaken to redeem the non- convertible portion of the partly convertible debt instruments of all holders of the convertible debt instrument who have not agreed to the resolution.
 - (iv) Credit rating has been obtained from at least one credit rating agency registered with the Board within a period of six months prior to the due date of redemption and has communicated to the holders of the convertible debt instruments, before the rollover.
- (b) Listed companies satisfying specified requirement are eligible to make fast track issue in terms of SEBI (ICDR) Regulations, 2009. Fast track issue is exempted from certain norms relating to filing of draft offer document with SEBI and Stock Exchange subject to compliance of certain condition, which are as under:
- (i) The shares of the company have been listed on any stock exchange having nationwide terminals for a period of at least three years immediately preceding the reference date.
 - (ii) The average market capitalization of public shareholding of the company is at least ₹ 3,000 crores for a period of one year.
 - (iii) The annualized trading turnover of the shares of the company during six calendar months immediately preceding the month of the reference date has been at least 2% of the weighted average number of shares listed during the said six months period.
 - (iv) The company has redressed at least 95% of the total shareholder/ investor grievances or complains.
 - (v) The company has complied with the listing agreement for a period of at least three years immediately preceding the reference date.
 - (vi) The impact of auditors' qualifications if any on the audited accounts of the company in respect of the financial years for which such accounts are disclosed in the offer document does not exceed 5% of the net profit/ loss after tax of the company for the respective years.

- (vii) No prosecution proceedings or show cause notices has been issued by SEBI.
- (viii) The entire shareholding of the promoter group is held in dematerialized form as on the reference date.
- (c) **Qualified Institution Placement (QIP)** means allotment of eligible securities by a listed issuer to qualified institutional buyers on private placement basis in terms of ICDR Regulations. QIP is different from offer of securities to qualified Institutional Buyers in an IPO. QIP is required to be made on the basis of a placement document which contains all material information including those specified in ICDR Regulations. SEBI (ICDR) Regulations, 2009 provides that for making a QIP, special resolution approving the issue shall be passed by its shareholders. The QIP should be in compliance with requirement of minimum public shareholding specified in the listing agreement.
- (d) As per SEBI (ICDR) Regulations, 2009, a listed company cannot make any issue of security through a rights issue where the aggregate value of securities including premium exceeds ₹ 50 lacs, unless it has filed a draft letter of offer with SEBI through a Merchant Banker at least 30 days prior to the filing of prospectus with the designated stock exchange. Rights issue is required to be kept open for at least 15 days and not more than 30 days. The issuer is required to comply with various requirements such as –
 - issue of securities in dematerialized form
 - partly paid-up shares to be made fully paid up
 - firm arrangements of finance through verifiable means
 - pricing norms
 - Inter-se-allocation of responsibilities of merchant Bankers
 - Competence and Appointment of Intermediaries
 Application to the Stock Exchange(s) where the company's shares are listed for permission of listing of new shares.

Answer 8

- (i) **Subscription List:** SEBI (ICDR) Regulations 2009, provides that a public issue shall be kept open for at least three working days but not more than ten working days including the days for which the issue is kept open in case of revision in price band. In case of book building process the price band is revised, the bidding (issue) period disclosed in the red herring prospectus shall be extended for a minimum of three working days provided that the total bidding period shall not exceed ten working days.
- (ii) **Issue Opening Date:** SEBI (ICDR) Regulations, 2009 provides that a public issue may be opened within 12 months from the date of insurance of the observation letter by SEBI, if any or within 3 months of expiry from 31st day from the date of filing of draft offer document with SEBI, if no observation letter is issued. An issue shall be opened after atleast 3 working days from the date of registering the red herring prospectus with Registrar of Companies.
- (iii) **Differential pricing:** Pricing of an issue where one category is offered shares

at a price different from the other category is called differential pricing. A company can offer specified securities at different prices to retail individual investors or retail individual shareholders or employees entitled for reservation, anchor investor etc. A company making public issue of the securities has to comply with the provisions as laid down in SEBI (IDR) Regulations, 2008 relating pricing in these regulations, SEBI has prescribed certain criteria for making differential pricing for different categories of investors.

- (iv) **Lock-in-period:** A lock in period is a predetermined time phase during which the holders of securities are not allowed to sell those shares. According to SEBI (ICDR) Regulation, 2009, the promoters contribution is subject to lock-in-period of 3 years from the date of commencement of commercial production or the date of allotment in the public issue whichever is later; any contribution made by promoters over and above the minimum contribution shall be subject to a lock-in-period of 1 year. If the shares are held by promoters and lent to the stabilizing agent then such shares are exempted from lock-in-period requirements from the date of such lending.
- (v) **Price Band:** The Price band is a band of price within which investors can bid. SEBI (ICDR) Regulation, 2009 provides that the spread between the floor and the cap of the price band shall not be more than 20%. The price band can be revised. If revised, the bidding period shall be standard for a further period of three days, subject to the total bidding period not exceeding ten days. The issuer can mention floor price or price band in the red herring prospectus in case of a book built issue and determine the price at a later date before registering the prospectus with the Registrar of Companies.
- (vi) **Red-herring prospectus:** Red-herring prospectus (RHP) is a prospectus, which does not have details of either price or number of shares being offered, or the amount of issue. A RHP for a Further Public Offer (FPO) can be filed with the ROC without the price band and the issuer, in such a case will notify the floor price or a price band by way of an advertisement. In the case of book-built issues, it is a process of price discovery and the price cannot be determined until the bidding process is completed. Hence, such details are not shown in the Red Herring Prospectus filed with ROC in terms of the provisions of the Companies Act. Only on completion of the bidding process, the details of the final price are included in the offer document. The offer document thereafter with ROC is called a prospectus.