Securities Laws & Compliances {Module-II- Paper 6}

Test Paper 04/2011

(This Test paper is based on Entire Study Material)

PART- A

Q.2(a) What is the difference between Depository and Custodian? Briefly explain the term "Establishment of Connectivity with NSDL & CDSL"?

Answer:- ***Depository*** means a body corporate which manages the shares of an Investor into electronic form and Provides the facility of easy transferability, Pledging of shares, Settlement of Securities/Account.

Custodian means an Intermediary, who Provides "Custodial services". Here "Custodial services" means Safe-keeping of Securities of a clients.

Hence following are the differences between Depository and Custodian:-

On the Basis of	***Depository***	***Custodian***
Function	Depository is a Part from keeping the shares in E-form, manages the shares on behalf of Investor.	Function of Custodian is merely 'safe-keeping' of shares. It handles Huge- Paper work.
Position	Depository is an institution or can be called as a organization itself.	Custodian is an In- term diary.
Act	Depository comes under a Separate Act, I.e. Depository Act-1956, a Part from SEBI (depot. & part.) Reg.-'96'.	Custodian is regulated by SEBI (Custodian of Securities) Reg. 1996 and there is no separate Act.

Establishment of Connectivity with NSDL & CDSL: - To enhance the efficiency of the stock-market, rolling settlement were introduced by SEBI. To facilitate the settlement, SEBI prescribed the compulsory dematerialized trading by companies through connectivity with both the depositories NSDL& CDSL.

The stock exchange may consider shifting the trading of Securities of the companies who have established connectivity with both the depositories to rolling Settlement subject to the following:

(a) At least 50% of non-promoter holdings as per clause 35 of the listing Agreement are in de-mat mode before shifting the trading in the Securities of the Company from trader for Trade Segment to Rolling Settlement.
For this purpose, the listed companies are required to obtain a certificate from its register and transfer Agent and submit the same to the Stock exchanges. However, if an issuer company does not have a separate Registrar and Transfer Agent. It may obtain a Certificate in this Regard from a Practicing Company Secretary/Chartered Accountant and submit the same to the Stock Exchanges.

(b) There are no other ground/reasons for Continuation of the trading in Trade for Trade Segment.

Q.2(b) What do you mean by Straight Through Processing (STP) ? State the various advantages of STP.

Answer:- ***Straight Through Processing (STP):-*** It is a mechanism, that automates the end to end processing of transactions of financial Instruments. It electronically captures & Process the transactions from. Order origination point the final Settlement. STP streamlines the process of trade execution and Settlement and avoids manual entry and re-entry of the details of the same trade by different market Intermediaries and Participants.

SEBI has mandated the use of STP System for all institutional trades w.e.f. July, 2004. In order to regulate the STP Services, it had also issued SEBI (STP Centralized Hub and STP Services Providers) Guidelines, 2004.

- ***Advantages of STP are as follows:-***
  - (i) Minimization in Human errors, while entering or re-entering the details, because it automate the Processing;
  - (ii) Facilitates movement towards shorter settlement cycles (T+1);
  - (iii) Greater transparency with clear audit trail;
  - (iv) Improved operational efficiency in handing larger volumes;
  - (v) Timely settlement of trades& Instructions;
  - (vi) Enables Increased cross border trading (FII Trade)
  - (vii) Messaging standards as per ISO 15022 Standards.
  - (viii) Increases Competitive advantage of our Markets.

Q.(3) Distinguish between any three of the following :-

(i) French Auction and Dutch Auction.

(ii) Open Ended Scheme and Close Ended Scheme.

(iii) Primary Market and secondary Market.

(IV) Leveraged funds and Hedge Funds.

Answer.(3)(i) French Auction and Dutch Auction:-

Both are two types of Auction for Treasury Bills.

French Auction:- When all the bids accepted at the cut off level it is known as French Auction. It is also known as Multiple Price Based Auction. This method is followed in the case of 364 days treasury bills and if valid only for competitive bidders. In this method the bidder has to obtain the treasury bills at the Price quoted by him.

Dutch Auction:- When all the bids accepted are equal to or above the cut off Price it is known as Dutch Auction. It is also known as Uniform Price based Auction. This method is applicable in the case of the 91 days treasury bills only. In this method the bidder obtains he treasury bills at the cut-off price and not the price quoted by him.

Answer (3)(ii) Open Ended Scheme and Close Ended Scheme :-

Mutual Fund can be categorized into different types like on structure basis, on investment objective basis etc. On the basis of structure, mutual fund scheme can be divided into two parts i.e. open-ended scheme and closed ended scheme.

(i) ***Open ended scheme:*** When, there is no fixed corpus or Units are available for subscription throughout the year, then it is called "Open-ended scheme", these units don't have fixed-maturity. Investment can conveniently buy & sell units at NAV related prices.

(ii) ***Close-ended scheme:-*** When there is fixed number of units resulting into fixed-corpus and units available for subscription, only during a specified-period, then it is called "Close ended scheme."

Difference between Open ended & Close ended scheme:

Basis of Difference	*Open-ended*	*Close-ended*

1. Name of corpus	In open-ended scheme, there is variable corpus, because there is no fixed number of units;	In Close-ended scheme, there is fixed corpus and no new units can be offered;
2. Listing	There is no listing of units in open ended scheme.	There is listing of units of stock exchange for buying & selling;
3. Number of values	There is only on price is available i.e. NAV;	There are the values available i.e. - NAV & - Market-Value
4. Liquidity	Highly liquid	Mostly-liquid

<u>Answer (3)(iii)</u> Primary Market and secondary Market:

Difference between Primary Market and secondary Market

Basis of Difference	***Primary Market***	***Secondary Market***
1. Meaning	It means a market where in resources are mobilized by a company through sale of new securities.	It means a market where existing shares are sold & bought by the investors.
2. Nature of securities	Here shares are first time sold, by the company directly to the investors.	Here existing shares are sold by one investor to another-investor.
3. Intermediary	In Primary Market there are Lot of intermediary like Merchant Banker, underwriter etc.	In secondary market there is stock-broker sub-broker as intermediary.
4. Regulate by	Primary market is mainly regulated by SEBI	It is regulated by securities contact (Reg.) Act-1956.

<u>Answer (3)(iv)</u> **Leveraged funds and Hedge Funds:**

Difference between Leveraged funds and Hedge Funds:

Basis of Difference	***Leveraged Funds***	***Hedge Funds***
1. Meaning	Leverage funds are also known as borrowed funds.	Hedge funds are not borrowed funds; they are used for speculative trading.
2. Increase in portfolio	Leverage funds increase the size of portfolio.	Hedge funds doesn't increases the portfolio size and value.
3. Risk factor	Leverage funds are less risky.	Hedge funds are more risky.
4. Trading	Leverage funds tend to indulge in speculative trading and risky investments	Hedge funds employ their funds for speculative trading. i.e. for buying shares, whose price are likely to rise and for selling shares whose prices

		are likely to fall.

Q.4.(a) Discuss the role of audit committee in the context of corporate governance.

Answer 4(a) The role of the audit committee shall include the following:

(a) 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.
(b) 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.
(c) Approval of payment of statutory auditors for any other services rendered by the statutory auditors.
(d) Revising, with the management, the annual financial statements before submission to the board for approval.
(e) Reviewing, with the management, the quarterly financial statements before submission to the board for approval.
(f) Reviewing, with the management, the statement of uses / applications of funds raised through an issue (public issue, rights issue, preferential issue, etc.) the document / prospectus/notice and the report submitted by the monitoring agency monitoring the utilization of proceeds of a public or rights issue, and making appropriate recommendations to the Boards to take up steps in this matter.
(g) Reviewing, with the management, performance of statutory and internal auditors, and adequacy of the internal control systems.
(h) Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official internal audit.
(i) Discussion with internal auditors any significant and follow up there on.
(j) 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.

Q. 4(b) What is Self-Regulatory Organizations? What are its obligations?

Answer 4(b) Self Regulatory Organization **:** As per Regulation 2 (1) (k) of SEBI (Self-Regulatory Organizations) Regulation 2004, "Self-Regulatory organizations" means an organizations of intermediaries which is representing a particular segment of securities market and which is duty 7 recognized by the Board under these regulations, but excludes a stock exchange.

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

(a) It shall always abide by the directions of the Board.

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

Q.5.(a) Evaluate the role of SEBI in regulating financial Markets in India.

Answer 5(a): - Role of SEBI: Securities Exchange Board of India (in brief SEBI) was constituted as per the Provisions of SEBI Act, 1992. SEBI enjoys statutory powers for:

(a) Protecting the interest of investors in securities,
(b) Promoting the development of the securities market:
(c) Regulating the securities market.

Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to al intermediaries and person associated with securities market. SEBI can conduct enquiries, audit and inspection of all concerned and adjudicate offences under the Act. It has power to register and regulate all market intermediaries and also a penalize them in case of violations of the provisions of the Act, Rules and regulations made there under SEBI has full authority and autonomy to regulate and develop an orderly securities market.

Q.5.(b) What is Debenture Trustee? Describe briefly its responsibilities and obligations.

Answer 5(b): - ***''Debenture Trustee''*** *means a trustee of a trust deed for securing any issue of debenture of a body corporate*. These are the persons or agencies as trusted on behalf of debenture holders to project debenture holders' interests and keep assets by the company charged against debenture under trust.

SEBI (Debenture Trustees) Regulations, 1993 issued by the SEBI to regulate Debenture trustee.

Chapter I contains preliminary matters and definitions.

Chapter II consisting Regulations 3 to 12 deals with the procedure for registration of debenture trustees.

Chapter III containing Regulations 13 to 18 deals with the Responsibilities and obligations of Debenture Trustees.

Responsibilities and obligations of Debenture Trustees : - Regulations 13 lays down that no debenture trustee who has been granted a certificate by SEBI shall act as debenture trustee unless he enters into a written agreement the body corporate before the opening of the subscription list for issue of debenture and the agreement *inter alia* contains that debenture trustee has agreed to act as such under the trust deed for securing as issue of debenture for the body corporate and the time limit within which the security for the debenture shall be created.

Regulation, 13A stipulates that no debenture trustee shall act as such of any issue of debenture in case;

(a) It is an associate of the body corporate: or

(b) It has lent and the loan is not yet fully repaid or is proposing to lend money to the body corporate.

However, the requirement shall not be applicable in respect of debenture issued prior to the commencement of Companies (Amendment) Act, 2000 where-(i) recovery proceedings in respect of the assets charged against security has been initiated or the body corporate has been referred to Board for Industrial and Financial Reconstruction under Sick Industrial Companies (Special Provisions) Act, 1985 prior to commencement of SEBI (Debenture Trustee) Regulations, 2003.

Regulations 14 provides that every debenture trustee shall amongst other matters accept the trust deed which contains the matters specified in Schedule IV to the Regulations.

Q.5.(C) What are the restrictions on buy back of securities ?

Answer 5(c) :- ***These are the restrictions on buy-back of securities :***

(i) A company should not buy-back its securities if default subsists in repayment of deposits or interest payable thereon, or in redemption of debentures or preference shares or repayment of any term loan or interest payable thereon to any financial institution or bank. [Section 77B(1)(c)].

(ii) Buy-back should not be made if a company has defaulted in relation to preparation and filing of its annual return. [Section 77B(2)]. However, such a company may buy-back its securities after the default has been rectified.

(iii) Buy-back should not be made in the event of any default in relation to payment of dividend to any equity or preference shareholder. [Section 77B(2)].

(iv) Where a dividend has been declared by a company but has not been paid in accordance with the provisions of the Act, the company may buy-back its securities only after payment of dividend and interest thereon as per the provisions of the Act.

(v) Buy-back should not be made in the event of default in preparation of the annual accounts. [Section 77B(2)].

(vi) Where the report of the statutory auditors of the company contains a qualification that annual accounts are not prepared as per the accounting standards or otherwise are not in accordance with the provisions of Section 211, the company cannot proceed to buy-back its securities. However, compounding of the aforementioned defaults or subsequent curing of the default may qualify as an enabling provision for buy-back.

(vii) Buy-back should not be made by a company :

i. through any subsidiary company including its own subsidiary companies;
ii. through any investment company or group of investment companies. [Section 77B(1)(a) and (b)].

Q.6(a) Differentiate between Fixed Price Process and Book Building Process ?

Answer 6(a) :

Difference between Fixed Process and Book Building Process

Features	***Fixed process***	***Book Building process***
Pricing	Price at which the securities are offered/allotted is known in advance to the investor.	Price at which securities will be offered/allotted is not known in advance to the investor . Only an indicative price range is known.
Demand	Demand for the securities offered is known only after the closure of the issue.	Demand for the securities offered can be known everyday a the book is built.
Payment	Payment if make at the time of subscription where in refund is given allocation.	Payment only after allocation.

Q.6(b) Briefly explain the following with reference to SEBI (ICDR) Regulations, 2009 :

(i) Qualified Institutional Buyers.
(ii) Green shoe option
(iii) Promoter's Contribution

<u>Answer 6(b) (i)</u> Qualified Institutional Buyers:

As per SEBI (DIP) Guidelines,2000," Qualified Institutional Buyer" means:

i. PFI(Public Financial-Institution as definer u/s 4 A of companies Act-1956;
ii. Scheduled Commercial Bank
iii. Mutual funds Foreign institutional investors registered with SEBI;
iv. Multilateral & Bilateral development Financial institution;
v. Venture capital fund registered with SEBI;
vi. Foreign venture capital investors registered with SEBI;
vii. State industrial development corporations;
viii. Insurance companies regd. With IRDA
ix. Provident funds/Pension funds with minimum corpus of Rs.25 crore:

***Significance of QIBs*:** If an unlisted Co. fails to comply with eligibility norms as per Initial- Public offer, it can alternatively make issue through book- building process, subject to minimum 50% of net-offer to being allotted to QIBs.

<u>Answer 6(b) (ii)</u> Green shoe option: It means an opting in which an issuer company allocates excess shares than included in the public-issue, through a stabilizing Agent simply, GSO, is used when there is oversubscription of shares, and company is permitted to allot additional shares (permitted upto 15%)

There scheme of GSO, is regulated by chapter VII-A Of SEBI Guidelines. For availing this facility, company has to :

- Pass special-resolution in the general meeting of the company
- Appoint; any merchant banker as a "stabilizing- Agent"

***Significance of GSO*:** The basic purpose of GSO is not to make available additional share capital to company, but to Act as stabilizing force, if issue is over subscribed. It prevents the volatility, in the market- price of shares.

<u>Answer 6(b) (iii)</u> Promoter's Contribution :

In case of Listed Company: Promoters in the listed company participate either at least of 20% of proposed issue or holding the post-shares to the extent of 20% of the post-issue capital. In this the participation of the promoter is done when the issue is being passed publicly.

In case of Unlisted Company: Promoters in the unlisted companies contribute at most 20% of post-issue capital. Promoters also help in shareholding which offers for sale and it shouldn't be less than 20%. In the unlisted companies also securities which are issued to promoters at a low price which is lower than the equity gets offered to public and it doesn't remain eligible for promoter's contribution. Contribution of the promoters is considered by post-issue capital where the promoter contributes through some optional convertible security and it is also been there to public.

Q. 7(a) Discuss about the intermediaries involve In-debt market?

Answer 7(a): Debt markets are markets for the issuance, trading and settlement in fixed income securities of various types and features. Fixed income securities can be issued by almost any legal entity like central and state governments, public bodies, statutory corporations, banks and institutions and corporate bodies.

These are the intermediaries involve in-debt market :

Primary Dealers: Primary dealers (PDs) are important intermediaries in the government securities markets. They act as underwriters in the primary market, and as market makers in the secondary market. PDs underwrite a portion of the issue of government's security that is floated for a predetermined amount. The underwriting commitment of each PD is broadly decided on the basis of its size in terms of its net owned funds, its holding strength, the committed amount of bids and the volume of turnover in securities.

Brokers : Brokers play an important role in secondary debt market by bringing together counterparties and negotiating terms of the trade. It is through them the trades are entered on the stock exchange. The brokers are regulated by the stock exchange and also by SEBI.

Q.7(b) Distinguish between 'Pass though Certificates' and 'Inflation linked Bonds'?

Answer 7(b): Pass Through Certificates: When mortgages are pooled together and undivided interests in the pool are sold, pass-through securities are created. The Pass-through securities promise that the cash flow from the underlying mortgages would be passed through to the holders of the securities in the form of monthly payments of interest and principal.

Inflation linked bonds: A bond is considered indexed for inflation if the payments on the instrument are indexed by reference to the change in the value of a general price or wage index over the term of the instrument. The options are that either the interest payments are adjusted for inflation or the principal repayment or both.

Q.7(c) Discuss the role of Ombudsman in redressal of investor grievances?

Answer 7(c): ***Meaning of Ombudsman:*** In general Ombudsman means a person appointed to hear and act upon utilization complaint about government services.

SEBI issued SEBI (Ombudsman) regulations 2003, Regulation 2 (1) defines Ombudsman means any person appointed under regulation 3 of these regulations and unless the content otherwise requires, includes stipendiary Ombudsman. Thus, Ombudsman is a person who attends the complaints of their costumes.

The Ombudsman has the following functions:

(i) To receive complaints specified under SEBI (Ombudsman) Regulations against any intermediary or a listed company of both:

(ii) To consider such complaints and facilities resolution thereof by amicable settlement;

(iii) To approve a friendly or amicable settlement of the dispute between the parties;

(iv) To adjudicate such complaints in the event of failure of settlement thereof by friendly or amicable settlement.

Q.7 (d) What are the conditions for conversion of ECB into equity?

Answer 7(d): ***Condition for Conversion of ECB into Equity :***

(i) Conversion of ECB into equity is permitted subject to the following conditions;

- The activity of the company is covered under the Automatic Route for Foreign Direct Investment or Government approval for foreign equity participation has been obtained by the company, wherever applicable,
- The foreign equity holding after such conversion of debt into equity is within the sectorial cap, if any,
- Pricing of shares is as per the SEBI and erstwhile CCI guidelines/regulations in the case of listed/unlisted companies as the case may be.

(ii) Conversion of ECB into equity may be reported in the form FC-GPR to the Regional Office concerned of the Reverse Bank as well as in form ECB-2 Submitted to Reserve Bank of India within seven working days from the close of month to which it relates. Once reported, filling of ECB-2 in the subsequent months in not necessary.

Q.8 (a) Describe briefly the variations of terms of ESOS?

Answer 8(a): SEBI has issued SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 according to which Employee Stock Option Scheme means a scheme under which the company grants option to its employees 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.

Variations of terms of ESOS

(a) The company should not vary the terms of the Scheme in any manner which may be detrimental to the interests of the employees.
(b) However, if such variations are not prejudicial to interests of the option holders, the company is required to pass a special resolution in a general meeting to vary the terms of scheme.
(c) The provisions of clause 3(iii) as above shall apply to such variations of terms as the apply to the original grant of option.
(d) The notice for passing special resolution for variation of terms of ESOSis required to be sent.
(e) The notice should disclose full details of the variation, the rationale therefore and the details of the employees who are beneficiary of such variation.
(f) The companies should be given an option to re-price the options which are not exercised if ESOS's were rendered unattractive due to fall in the price of shares in the market. The company must ensure that such re-price should not be detrimental to the interest of employees and approval of shareholders in General Meeting has been obtained for such pricing.

Q.8 (b) What are the approvals required for Issuance of GDRS?

Answer 8(b): Indian company, can raise funds from abroad by issue of GDR or FCCB (also collectively referred as Euro-Issue) by obtaining following approvals:-

(i) ***Approval of Board of Directors***: The Indian company will hold its Board Meeting and pass resolutions for approving:

- Fund requirements.

- Quantum of Euro-Issue,&
- Country, in which issue to be made etc.

(ii) ***Shareholders Approvals*:** For Euro-Issue, company has to obtain shareholders' approval by passing special-resolution, for compliance of various sections of companies Act-1956

(iii) ***Approval of Ministry of Finance*:** At present no approval is requied for issue of global depository Receipts (GDR) and American Depository Receipt (ADR), from Ministry of Finance.
However, in case of issue of FCCB for an amount exceeding US $100million, the approval is required.

(iv) ***Approval of Department of Companies Affairs*:** This approval is required only when the issuer company is issuing FCCB.

(v) ***Approval of RBI*:** Since rising of funds involves offering of rupee denominate shares against foreign – currency, so necessary approval is required from RBI.

(vi) ***In-Principal Consent of Domestic Stock Exchange*:** The ordinary share; against which GDR/ADR etc. are issued must be listed on stock- Exchange and for this Indian company has to obtain approval of consent.

(vii) ***In- Principal Consent of Financial- Institutions*:** This approval is required only when, the issuer company has obtained termed loan from any financial-Institutions.

Q.8(c) Briefly explain the conditions required to be fulfilled for issuing IDRS in accordance with SEBI (ICCR) Regulations, 2009?(5 Marks)

<u>Answer 8(c):</u> Conditions for issue of IDR

An issue of IDR shall be subject to the following conditions:

(a) Issue size shall not be less than fifty crore rupees;
(b) Procedure to be followed by each class of applicant for applying shall be mentioned in the prospectus;
(c) Minimum application amount shall be twenty thousand rupees;
(d) At least fifty percent of the IDR issued shall be allotted to qualified institutional buyers on proportionate basis;
(e) The balance fifty percent may be allocated among the categories of no-institutional investors and retail individual investors including employees at the discretion of the issuer and the manner of allocation shall be disclosed in the prospectus. Allotment to investors within a category shall be in proportionate basis;

However, at least thirty percent of IDR's is offered in the public issue shall be available for allocation to retail individual investors and in case of under subscription in retail individual investor category. Spillover to the other categories to the extent of under subscription can be permitted.

(f) At any given time, there shall be only one denomination of IDR of the issuing company.

Q.8 (d) Briefly explain ASBA Process with regard to public issue of securities?

Answer 8(d): ***Applications Supported by Block Amount (ASBA):*** It is an application for subscribing to an issue, containing an authorizations to block the application money in a bank account.

ASBA Process: An ASBA investor submits an ASBA physically or electronically through the internet banking facility, to the Self Certified Syndicate Bank (SCCB) with whom the bank account to be blocked, is maintained. The SCCB then blocks the authorization to this effect given by the account holder in the ASBA. The application money remains blocked in the bank account till finalization of the basis of allotment in the issue or till withdrawal/failure of the issue or till withdrawal/rejection of the application, as the case may be. The application data shall thereafter be uploaded by the SCSB in the electronic bidding system through a web enabled interface provided by the Stock Exchange. Once the basis of allotment is finalized, the Registrar to the issue sends an appropriate request to the SCSB for unblocking the relevant bank accounts and for transferring the requisite amount the insurer's account. In case of withdrawal/ failure of the issue, the amount shall by unblocked by the SCSB on receipt of information from the pre-merchant bankers.

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