Directorate of Distance Education

UNIVERSITY OF JAMMU

JAMMU

SELF LEARNING MATERIAL
M. COM SEMESTER - III

SUBJECT : Capital Market Analysis **Units I-IV**

COURSE No. : FC-312 **Lesson No. 1-20**

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Course Co-ordinator

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SYLLABUS
M.COM. IIIRD SEMESTER

Course : M.COM-FC312 **Max. Marks : 100 Marks**
Credit : 4 **External : 80 Marks**
TIme : 3.00 Hrs **Internal : 20 Marks**

(Syllabus for the examinations to be held in Dec 2020, 2021, 2022)

OBJECTIVE : To provide knowledge about economic and legal framework of capital market.

UNIT -I : ECONOMIC FRAMWORK OF CAPITAL MARKET (1-90)

Introduction : Contstituents of the financial system; financial assests; Financial intermediaries; Capital market: concept, functions of capital market, role of capital market in resource allocation, capital formation, stages of capital formation, role of capital market in capital formation; Capital market investment instituitons: National and State level institutions, qualified institutional buyers, anchor investors, private equity, venture capital, angel fund, pension fund, foreign protfolio investors, mutual fund, exchange traded funds, fund of funds, alternate investment fund, hedge funds; Resource mobilisation in International capital market.

UNIT - II : PRIMARY MARKET (91-158)

Introduction; types of issue; Offer for sale: meaning, process, difference between offer for sale professional and IPOs/FPOs, SEBI guidelines on offer for sale, filing of offer document, pre-issue management, post-issue management, co-ordination with intermediaries, underwriting, due diligence, basis of allotment, book building, green shoe option facility, rights issue, bonus issue, preferential issue, qualified institutions placement, placement document, pricing, institutional placement programme, appointment of merchant banker, offer document, listing agreement, event based and time based compliance under lsiting agreement.

UNIT - III : SECONDARY MARKET (159-228)

History of stock exchanges; Continuing compliance obligations and disclosures: Post-listing activities, Corporate Actions; Requirements for Continuing Lisitng; Corporate Governance Norms; Disclosures as per Listing Agreement; Price Sensitive Information, Material Changes, Quarterly results; Functioning of an Exchange: Margining, Trading, Clearing and Settlement, Trade Guarantee Fund, Trading

Software Arbitration Mechanism; Market instruments; Stock market indices; importance of indices, computation of stock index, difference between indices, SENSEX, BSE sectoral indices.

UNIT - IV : LEGAL FRAMEWORK (229-295)

Introduction; Issue and listing of securities; Regulatory framework relating to securities market interdeterminates; Misitry of finance- capital market division; Ministry of Corporate Affairs; Companies Act 2013; SEBI Act, 1992; Securities Contracts (Regulation) Act, 1956; Depositories Act, 2013; SEBI regulations and Guidelines:overview, SEBI (Prohibition of Insider Trading) regulations, 2011; Prevention of Money Laundering Act, 2002; Grievance Redressal Mechanism: Stock Exchange Invcestor Protection Fund, SEBI (SAT); Enforcement; economics offences wing, financial intelligence unit, central Bureau of investigation; Financial Action Task Force Securities Contract (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012.

BOOKS RECOMMENDED :

1. Indian Financial Systems- By M.Y. Khan, Tata McGraw Hill Education.
2. Capital Markets- By Dr. S. Gurusamy, Tata McGraw Hill Education.
3. Financial Institutions and Markets- By Shashi K. Gupta, Neeti Gupta, Nishja Aggarwal, Kalyani Publishers.
4. Guide to Indian Capital Market- By Sanjeev Aggarwal, Bharat law House.
5. SEBI- Law, Practice & Procedure- By S. Suryanarayanan & V. Varadaranjan, Commercial Law Publishers Pvt. Ltd.

NOTE FOR PAPER SETTING :

The paper consits of two sections. Each section will cover the whole of the syllabus without repeating the question in the entire paper.

Section A: It will consist of eight short answer questrions, selecting two from each unit. A candidate has to attempt any six and answer to each question shall be within 200 words. Each question carries four marks and total weightage to this section shall be 24 marks.

Section B: It will consist of six essay type questions with answer to each question within 800 words. One question will be set atleast from each unit and the candidate has to attempt four. Each question will carry 14 marks and total weightage shall be 56 marks.

MODEL QUESTION PAPER

CAPITAL MARKET ANALYSIS

Time: 3 Hours **Max. Marks: 80**

SECTION A

Attempt any six questions, each question carries four (4) marks. Answer to each question should be within 200 words.

Q1. Explain the role of capital market in resource allocation.

Q2. What is mutual fund?

Q3. Briefly explain the term underwriting.

Q4. What do you mean by Right issue?

Q5. What do you mean by stock exchange?

Q6. What is price sensitive information?

Q7. What is depository Act?

Q8. Explain the money laundering Act, 2002.

SECTION B

Attempt any four questions, each question carries fourteen (14) marks. Answer to each question should be within 800 words.

Q1. What is financial system? Briefly define the constituents of financial system.

Q2. What do you mean by Capital market investment institutions? Differentiate between national and state level institutions.

Q3. What is offer for sale? Explain the process for it.

Q4. Briefly define the functioning of stock exchange. Also explain about the SENSEX.

Q5. What is listing of securities? Explain in detail about the regulatory framework relating to security market intermediaries.

Q6. Briefly explain the amendments under companies Act 2013.

UNIT – 1 LESSON NO.1

ECONOMIC FRAMEWORK OF CAPITAL MARKET

STRUCTURE

1.1 INTRODUCTION

A financial system can be defined at the global, regional or firm-specific level. It is a set of implemented procedures that track financial activities of the company. On a regional scale, the financial system is the system that enables lenders and borrowers to exchange funds. A financial system is the system that covers financial transactions and the exchange of money between investor, lender and borrower. A Financial systems are made of intricate and complex models that portray financial services, institutions and markets that link depositors with investors.

On a regional scale, the financial system is the system that enables lenders and borrowers to exchange funds. The global financial system is basically a broader system that encompasses all financial institutions, borrowers and lenders who operate within the global economy.

Multiple components make up the financial system of different levels: Within **a firm,** the financial system encompasses all aspects of finances. For example, it would include accounting measures, revenue and expense schedules, wages and balance sheet verification. **Regional** financial systems would include banks and other financial institutions, financial markets, financial services. In a **global** view, financial systems would include the International Monetary Fund, central banks, World Bank and major banks that practice overseas lending.

1.1.1 Components of Financial System

Financial systems are strictly regulated because they directly influence financial markets. The stability of the financial markets plays a crucial role in the monetary protection of consumers. These financial systems are mostly handled by financial institutions which include commercial banks, central banks, public banks and cooperative banks. Cooperative banks and development banks managed by states are also listed under financial institutions that have heavily regulated financial systems.

Financial systems are not only evident in bank financial institutions. Some institutions have market brokering, investment and risk pooling services. However, these institutions are non-bank financial institutions that are not regulated by a bank regulation firm or agency. Examples of non-bank financial institutions are companies that offer mutual funds, insurance and financial loans. Companies with commodity traders are also considered to be non-bank financial institutions that have financial systems.

Another component of financial systems is financial markets that trade commodities, securities and other items that are traded according to general supply and demand. Financial markets include the primary markets and secondary markets. Primary markets provide avenues for buyers and sellers to buy and sell stocks and bonds. Secondary markets provide a venue for investors and traders to purchase instruments that have been previously bought.

Along with financial institutions and markets, financial systems are also evident in financial instruments. These financial instruments include cash instruments and derivative instruments. Cash instruments include loans, deposits and securities. Derivative instruments are financial instruments that are dependent on an underlying asset's performance.

1.2 OBJECTIVES

After reading this lesson you will be able to understand:

- The components of financial system
- Functions of financial market
- Different types of financial assets and financial intermediaries

1.3 CONSTITUENTS OF THE FINANCIAL SYSTEM

There are three main constituents of the financial system: (a) the financial assets, (b) the financial market and (c) the financial institutions.

1. 3.1 Financial Assets

The financial assets or near-money assets are the claims to money and perform some functions of money. They have high degree of liquidity but are not as liquid as money is. Financial assets are of two types: (a) primary or direct assets, and (b) secondary or indirect assets.

Primary assets are the financial claims against real-sector units created by real sector units as ultimate borrowers for raising funds to finance their deficit spending; they are the obligations of ultimate borrowers.

The examples of Primary assets are bills, bonds, equities, book debits, etc. Secondary assets are financial claims issued by financial institutions against themselves to raise funds from the public; these assets are the obligations of the financial institu-tions.

The examples of secondary assets are bank deposits, life insurance policies, Unit Trust of India units, etc.

1.3.2 Financial Markets

The financial system of a country works through the financial markets and the financial institutions. The financial markets deal with the financial assets of different types, currency deposits, cheque, bills, bonds, etc.

1.3.2.1 Financial markets perform the following functions

(a) They create and allocate credit

(b) They serve as intermediaries in the process of mobilisation of saving

(c) They provide convenience and benefits to the lender and borrowers

(d) They promote economic development through a balanced regional and sectoral allocation of investible funds.

Financial markets are credit markets which cater the credit needs of individuals, firms and institutions. Since credit is required and supplied for short period and long period, the financial markets are broadly divided into two types:

(a) Money market and

(b) Capital market.

Money market deals with the short-period borrowing and lending of funds; in the money market, the short term securities are exchanged. Capital market deals with the long period borrowing and lending of funds; in the capital market, long-term securities are exchanged.

Financial market may also be categorized into: (a) primary market, and (b) secondary market. Primary market is a market in which newly issued credit instruments are sold and purchased. Secondary market, on the other hand, is market in which previously issued credit instruments are bought and sold.

1.3.3 Financial Institutions

Financial institutions or financial intermediaries act as half- way houses between the primary lenders and the final borrowers. They borrow funds (or accept deposits) from those who are willing to give up their current purchasing power and lend to (or buy securities from) those who require the funds for meeting the current expenditures. Financial institutions are generally divided into two categories (a) banks, and (b) non-bank financial intermediaries. The main difference between banks and non bank financial intermediaries is that the former possess, while the latter do not possess the demand deposits or credit-creating power.

1.4 FINANCIAL ASSETS

Financial assets refer to assets that arise from contractual agreements on future cash flows or from owning equity instruments of another entity. Financial instruments refer to a contract that generates a financial asset to one of the parties involved, and an equity instrument or financial liability to the other entity. A key difference between financial assets and PP&E assets which typically include land, buildings, and machinery is the existence of counterparty. Financial assets can be categorized as either current or non-current assets on a company's balance sheet. A financial asset has a claim upon the real assets or tangible money generating assetsowned normally by a company. They are often traded and offered in a financial assetmarket like the S&P 500 or the Dow Jones. As a result, this means that the value of a financial asset can often change. The main contribution of financial assets is to fund companies or money generating entities. They are offered in the market so investors can put their savings to work, and companies can invest in a real asset like a manufacturing plant to make money.

1.4. 1 Types of Financial Assets

Common types of financial assets include certificates, bonds, stocks, and bank deposits.

- **Certificate of deposit (CD):** This is an agreement between an investor and a bank in which the investor agrees to keep a set amount of money deposited in the bank in exchange for a guaranteed interest rate. The bank may offer a higher amount of interest payment since the money is to remain untouched for a set period of time. If the investor withdraws the CD before the end of the contract terms, he or she will lose out on the interest payments and be subject to financial penalties.

- **Bonds:** Another popular type of financial assets is bonds, which are usually sold by companies or government in order to help fund short-term projects. A bond is a legal document that states how much money the investor has lent the borrower and when it needs to be paid back (plus interest) and the bond's maturity date.

- **Stocks:** Stocks are the only type of financial assets that do not have an agreed upon ending date. Investing in stocks gives to depositors a part ownership of a company and share in the company's profits and losses. Stocks can be kept for any period time until the shareholder decides to sell it to another investor.

1.4.2 Financial Assets

Some examples of Financial Assets include the following:

Stock – This is an investor's claim upon the ownership of a company.

Bonds – This is a claim upon interest payments and a principal payment in the future from a company. It is a liability to the company.

Loans – Treat this financial asset the same way as the bond above.

Insurance – This financial asset pays out if the terms of the contract are met. In other words if a person has car insurance. The money paid monthly goes toward a financial asset that will pay off if that person met with an accident.

1.4.3 Pros and Cons of Financial Assets

The key task of financial assets, which were discussed above, is the process of generating income. The ability to produce a steady income in the process of investment or operating activities is a key characteristic of the financial asset.

It is important to understand that the values that are in the process of use of assets, have a direct relationship to the factor of liquidity. We are talking about the principle that assets should be liquid. This means that you can convert them into cash at fair market value. This characteristic is very important because it ensures restructuring of enterprises under adverse conditions.

Such financial assets as checking accounts, savings accounts and money market accounts are easily turned into cash for paying bills and covering household financial needs, such as plumbing works. Ill-considered investments in illiquid assets may result into lack of cash and usage of a high-interest credit cards to cover bills, inevitably leading to debts increase and negatively affecting overall financial status of investor. In the case of stocks, to receive cash investor has to sell stock and wait for the settlement date and it's worth doing to have another financial asset available for emergency cases.

On the other hand, keeping money in savings accounts results in greater preservation of capital. All financial risks related with bank accounts in all financial institutions are typically covered by the Federal Deposit Insurance Corporation (FDIC) and insure deposits against loss. More investments in liquid assets give investor an opportunity to purchase aggressive assets such as real estate or trade in Forex market with greater confidence.Despite the fact that checking accounts and savings accounts refer to liquid assets, they have more limited return on investment. At the same time, CDs and money market accounts restrict withdrawals for months or years. When interest rates fall, callable CDs are often called, and investors face moving their money to potentially lower-income investments. Distributing portions of your money among different types of investments could benefit in case some of them don't measure up. Each type of investment has its own potential rewards and risks. By owning a mix of different investments, you vastly diversify your portfolio. It is worth doing to minimize the risks you'd assume by putting all of your money in a single type of investment

1.5 FINANCIAL INTERMEDIARIES

A financial intermediary is a firm or an institution that acts an intermediary between a provider of service and the consumer. It is the institution or individual that is in between two or more parties in a financial context. In theoretical terms, a financial intermediary channels savings into investments. Financial intermediaries exist for profit in the financial system and sometimes there is a need to regulate the activities of the same. Also, recent trends suggest that financial intermediaries role in savings and investment functions can be used for an efficient market system or like the sub-prime crisis shows, they can be a cause for concern as well.

Financial intermediaries work in the savings/investment cycle of an economy by serving as conduits to finance between the borrowers and the lenders. In the financial system, intermediaries like banks and insurance companies have a huge role to play given that it has been estimated that a major proportion of every dollar financed externally has been done by the banks. Financial intermediaries are an important source of external funding for corporate. Unlike the capital markets where investors contract directly with the corporate creating marketable securities, financial intermediaries borrow from lenders or consumers and lend to the companies that need investment.

1.5.1 Role of the Financial Intermediaries

The reason for the all-pervasive nature of the financial intermediaries like banks and insurance companies lies in their uniqueness. As outlined above, Banks often serve as the "intermediaries" between those who have the resources and those who want resources. Financial intermediaries like banks are asset based or fee based on the kind of service they provide along with the nature of the clientele they handle.

Asset based financial intermediaries are institutions like banks and insurance companies whereas fee based financial intermediaries provide portfolio management and syndication services.

1.5.2 Need for regulation of financial intermediaries

The very nature of the complex financial system that we have at this point in time makes the need for regulation that much more necessary and urgent. As the sub-prime crisis has shown, any financial institution cannot be made to hold the financial system hostage to its questionable business practices. As the manifestations of the crisis are being felt and it is now apparent that the asset backed derivatives and other “exotic” instruments are amounting to trillions, the role of the central bank or the monetary authorities in reining in the rogue financial institutions is necessary to prevent systemic collapse.

As capital becomes mobile and unfettered, it is the monetary authorities that have to step in and ensure that there are proper checks and balances in the system so as to prevent losses to investors and the economy in general.

1.5.3 Recent trends

Recent trends in the evolution of financial intermediaries, particularly in the developing world have shown that these institutions have a pivotal role to play in the elimination of poverty and other debt reduction programs. Some of the initiatives like micro-credit reaching out to the masses have increased the economic well being of hitherto neglected sectors of the population.

Further, the financial intermediaries like banks are now evolving into umbrella institutions that cater to the complete needs of investors and borrowers alike and are maturing into “financial hyper marts”.

As we have seen, financial intermediaries have a key role to play in the world economy today. They are the “lubricants” that keep the economy going. Due to the increased complexity of financial transactions, it becomes imperative for the financial intermediaries to keep re-inventing themselves and cater to the diverse portfolios and needs of the investors. The financial intermediaries have a significant responsibility towards the borrowers as well as the lenders. The very term intermediary would suggest that these institutions are pivotal to the working of the economy and they along with the monetary authorities have to ensure that credit reaches to the needy without jeopardizing the interests of the investors. This is one of the main challenges before them.

Financial intermediaries have a central role to play in a market economy where efficient allocation of resources is the responsibility of the market mechanism. In these days of increased complexity of the financial system, banks and other financial intermediaries have to come up with new and innovative products and services to cater to the diverse needs of the borrowers and lenders. It is the right mix of financial products along with the need for reducing systemic risk that determines the efficacy of a financial intermediary.

1.6 SUMMARY

Financial system is the mechanism that helps in the mobilisation and allocation of funds and savings in an economy. The financial systems are mostly handled by financial institutions which include commercial banks, central banks, public banks and cooperative banks. There are three main constituents of the financial system: (a) the financial assets, (b) the financial market and (c) the financial institutions. Financial assets refer to assets that arise from contractual agreements on future cash flows or from owning equity instruments of another entity. Some examples include the following: Stock , Bonds , Loans. A financial intermediary is a firm or an institution that acts an intermediary between a provider of service and the consumer. Recent trends in the evolution of financial intermediaries, particularly in the developing world have shown that these institutions have a pivotal role to play in the elimination of poverty and other debt reduction program.

1.7 GLOSSARY

- Derivative — the value of which is derived from the underlying assets
- Deficit — it is the situation of shortage
- Intermediaries — act as a middle man

- Counterparty an opposite party in a contract or financial transaction
- Stock the capital raised by a company or corporation through the issue and subscription of shares.
- Bonds an agreement with legal force

1.8 SELF-ASSESSMENT QUESTIONS

Q1. What do you understand by financial system?

Q2. Define the following terms:

(a) Financial assets

(b) The financial markets

(c) Financial institutions

1.9 LESSON END EXERCISE

Q1. What is financial system and what are its important components?

Q2. What are different types of financial assets give suitable examples?

Q3. Describe the role and importance of financial intermediaries?

1.10 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

M.Y. Khan : Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi – 110 002.

Shashi K Gupta : Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Nishja Aggarwal Ram Road, 24, Daryaganj, New Delhi - 110002 Neeti Gupta

Vishal Saraogi : Capital Markets and Securities Laws simplified, Lawpoint Publication, 6C, R.N. Mukherjee Road, Kolkata-700001

https://www.managementstudyguide.com/financial-intermediaries.htm

https://bbamantra.com/indian-financial-system-introduction

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https://corporatefinanceinstitute.com › Resources › Knowledge › Accounting

CAPITAL MARKET

STRUCTURE

2.1 INTRODUCTION

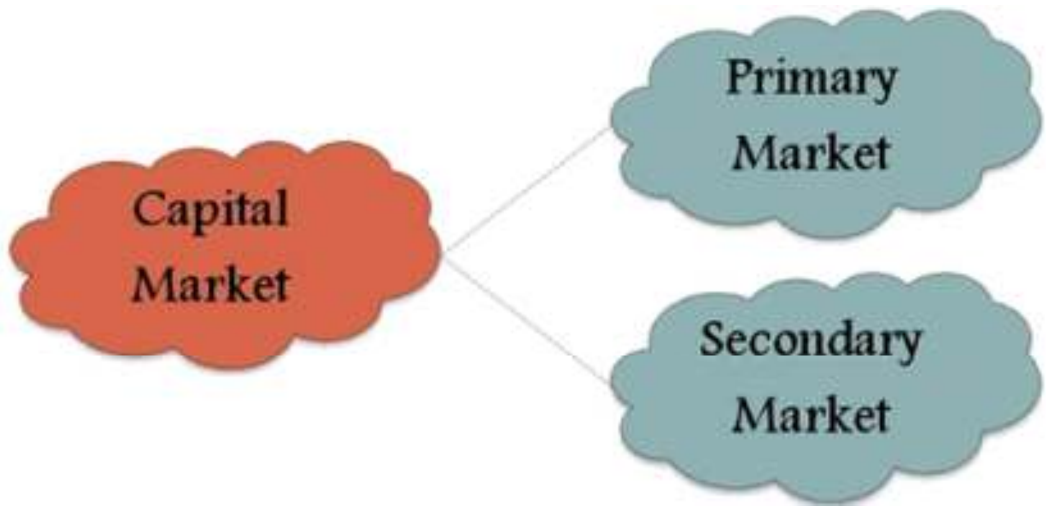
There are broadly two types of financial markets in an economy capital market and money market. Capital market deals in financial instruments and commodities that are long-term securities, whereas money market deals with the securities that have a maturity of less than one year. Capital markets perform the same functions as the money market. It provides a link between the savers/investors and the wealth creators. The funds will be used for productive purposes and create wealth in the economy in the long term. One of the important functions of the capital markets is to provide ease of transactions for both the investors and the companies. Both parties should be able to find each other with ease and the legal aspect of things should go smoothly. Now let us take a look at the two major types of capital markets.

2.1. Concept and Objectives of Capital Market

- In the first place, it is only an organised securities market (an integral part of capital market) which can provide sufficient marketability and price continuity for shares, so necessary for the needs of investors
- Secondly, it is only such a market that can provide a reasonable measure of safety and fair deal-ing in the buying and selling of securities.
- Thirdly, through the interplay of demand for and supply of securities, properly organised stock exchange assists in a reasonably correct evaluation of securities in terms of their real worth.
- Lastly, through such evaluation of securities the stock exchange helps in the orderly flow and distribution of savings as between different types of competitive investments

2.1.2 Types of Capital Market

The capital market is bifurcated in two segments, primary market and secondary market:



2.1.2.1 Primary Market

Called as New Issues Market, it is the market for the trading of new securities, for the first time. It embraces both initial public offering and further public offering. In the primary market, the mobilisation of funds takes place through prospectus, right issue and private placement of securities.

Capital market improves the quality of information available to the investor regarding the investment. Add to that, it plays a crucial role in encouraging the adoption of rules of corporate governance, which backs the trading environment. It includes all the processes that help in the transfer of already existing securities. The most important type of capital market is the primary market. It is what we call the new issue market. It exclusively deals with the issue of new securities, i.e. securities that are issued to investors for the very first time.

The main function of the primary market is capital formation for the likes of companies, governments, institutions etc. It helps investors invest their savings and extra funds in companies starting new projects or enterprises looking to expand their companies.

The companies raise money in the primary market through securities such as shares, debentures, loans and deposits, preference shares etc. Let us take a look the various methods of how new securities are floated in the primary market.

Methods of Raising Funds

1] Offer through Prospectus

This is a method of public issue. It is also the most used method in the primary market to raise funds. Here the company invites the investors (general members of the public) to invest in their company via an advertisement also known as a prospectus.

After a prospectus is issued, the public subscribes to shares, debentures etc. As per the response, shares are allotted to the public. If the subscriptions are very high, allotment will be done on lottery or pro-rata basis.

The company can sell the shares directly to the public, but it generally hires brokers and underwriters. Merchant banks are another option to help out with the process, especially Initial Public Offerings.

2] Private Placement

Public offers are an expensive affair. The incidental costs of IPO's tend to be very high. This is why some companies prefer not to go down this route. They offer investment opportunities to a select few individuals.

So the company will sell its shares to financial institutions, banks, insurance companies and some select individuals. This will help them raise the funds efficiently, quickly and economically. Such companies do not sell or offer their securities to the public at large.

3] Rights Issue

Generally, when a company is looking to expand or are in need of additional funds, they first turn to their current investors. So the current shareholders are given an opportunity to further invest in the company. They are given the "right" to buy new shares before the public is offered the chance.

This allotment of new shares is done on pro-rata basis. If the shareholder chooses to execute his right and buy the shares, he will be allotted the new shares. However, if the shareholder chooses to let go of his rights issue, then these shares can be offered to the public.

4] E-IPO

It stands for Electronic Initial Public Offer. When a company wants to offer its shares to the public it can now also do so online. An agreement is signed between the company and the relevant stock exchange known as the E-IPO.

This system was introduced in India some three years ago by the SEBI. This makes the process of the IPO speedy and efficient. The company will have to hire brokers to accept the applications received. And a registrar to the issue must also be appointed.

2.1.2.2 Secondary Market

Secondary Market is more commonly known as the stock market or the stock exchange. Here the securities (shares, debentures, bonds, bills etc) are bought and sold by the investors.

The main point of difference between the primary and the secondary market is that in the primary market only new securities were issued, whereas in the secondary market the trading is for already existing securities. There is no fresh issue in the secondary market.Secondary Market can be described as the market for old securities, in the sense that securities which are previously issued in the primary market are traded here. The trading takes place between investors, that follows the original issue in the primary market. It covers both stock exchange and over-the counter market.

The securities are traded in a highly regularised and legalized market within strict rules and regulations. This ensures that the investors can trade without the fear of being cheated. In the last decade or so due to the advancement of technology, the secondary capital market in India has seen a great boom.

2.2 OBJECTIVES

After reading this lesson you will be able to understand

- The capital market
- Functions of capital market
- Different types of capital market

2.3 FUNCTIONS OF CAPITAL MARKET

Capital Market is used to mean the market for long term investments that have explicit or implicit claims to capital. A long term investment refers to those investments whose lock-in period is greater than one year.

In the capital market, both equity and debt instruments, such as equity shares, preference shares, debentures, zero-coupon bonds, secured premium notes and the like are bought and sold, as well as it covers all forms of lending and borrowing.

Capital Market is composed of those institutions and mechanisms with the help of which medium and long term funds are combined and made available to individuals, businesses and government. Both private placement sources and organized market like securities exchange are included in it.

Functions : Following are the functions of capital market:

- Mobilization of savings to finance long term investments.
- Facilitates trading of securities.
- Minimization of transaction and information cost.
- Encourage wide range of ownership of productive assets.
- Quick valuation of financial instruments like shares and debentures.
- Facilitates transaction settlement, as per the definite time schedules.
- Offering insurance against market or price risk, through derivative trading.
- Improvement in the effectiveness of capital allocation, with the help of

competitive price mechanism.

Capital market is a measure of inherent strength of the economy. It is one of the best sources of finance, for the companies, and offers a spectrum of investment avenues to the investors, which in turn encourages capital creation in the economy.

2.4 ROLE OF CAPITAL MARKET IN RESOURCE ALLOCATION

The capital market plays an important role in mobilising savings and channel them into productive investments for the development of commerce and industry. As such, the capital market helps in capital formation and economic growth of the country. We discuss below the importance of capital market.

The capital market acts as an important link between savers and investors. The savers are lenders of funds while investors are borrowers of funds. The savers who do not spend all their income are called. "Surplus units" and the borrowers are known as "deficit units". The capital market is the transmission mechanism between surplus units and deficit units. It is a condut through which surplus units lend their surplus funds to deficit units.

Funds flow into the capital market from individuals and financial intermediaries which are absorbed by commerce, industry and government. It thus facilitates the movement of stream of capital to be used more productively and profitability to increases the national income.

Surplus units buy securities with their surplus funds and deficit units sells securities to raise the funds they need. Funds flow from lenders to borrowers either directly or indirectly through financial institutions such as banks, unit trusts, mutual funds, etc. The borrowers issue primary securities which are purchased by lenders either directly or indirectly through financial institutions.

The capital market provides incentives to savers in the form of interest or dividend and transfers funds to investors. Thus it leads to capital formation. In fact, the capital market provides a market mechanism for those who have savings and to those who need funds for productive investments. It diverts resources from wasteful and unproductive channels such as gold, jewellery, real estate, conspicuous consumption, etc. to productive investments.

A well-developed capital market comprising expert banking and non-banking intermediaries, that brings stability in the value of stocks and securities. It does so by providing capital to the needy at reasonable interest rates and helps in minimising speculative activities.

The capital market encourages economic growth. The various institutions which operate in the capital market give quantities and qualitative direction to the flow of funds and bring rational allocation of resources. They do so by converting financial assets into productive physical assets. This leads to the development of commerce and industry through the private and public sector, thereby inducing economic growth.

In an underdeveloped country where capital is scarce, the absence of a developed capital market is a greater hindrance to capital formation and economic growth. Even though the people are poor, yet they do not have any inducements to save. Others who save, they invest their savings in wasteful and unproductive channels, such as gold, jewellery, real estate, conspicuous consumption, etc.

2.5 SUMMARY

Financial markets comprises of capital market and money market. Capital market deals in financial instruments and commodities that are long-term securities, whereas money market deals with the securities that have a maturity of less than one year. In the capital market, both equity and debt instruments, such as equity shares, preference shares, debentures, zero-coupon bonds, secured premium notes and the like are bought and sold, as well as it covers all forms of lending and borrowing. The capital market acts as an important link between savers and investors. The savers are lenders of funds while investors are borrowers of funds. The savers who do not spend all their income are called. "Surplus units" and the borrowers are known as "deficit units".

2.6 GLOSSARY

- Equity shareholders real owners of the company
- Preference shares having a fixed claim of dividend

- Debentures — acknowledgement of debt, bearing fixed rate of interest
- Explicit — overt, external
- Implicit — covert, internal

2.7 SELF-ASSESSMENT QUESTIONS

Q1. What is a capital market?

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Q2. What is primary market?

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Q3. What is secondary market?

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2.8 LESSON END EXERCISE

Q1. What are the important components of capital market?

Q2. What are the different functions performed by the capital market?

Q3. Define the role of Capital Market in Resource Allocation?

2.9 SUGGESTED READINGS

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CAPITAL FORMATION

STRUCTURE

3.1 INTRODUCTION

Capital formation means increasing the stock of real capital in a country.In other words, capital formation involves making of more capital goods such as machines, tools, factories, transport equipment, materials, electricity, etc., which are all used for future production of goods.For making additions to the stock of Capital, saving and investment are essential.

3.1.1 Process of Capital Formation

In order to accumulate capital goods some current consumption has to be sacrificed. The greater the extent to which the people are willing to abstain from present consumption, the greater the extent that society will devote resources to new capital formation. If society consumes all that it produces and saves nothing, future productive capacity of the economy will fall as the present capital equipment wears out.

In other words, if whole of the current productive activity is used to produce consumer goods and no new capital goods are made, production of consumer goods in the future will greatly decline. To cut down some of the present consumption and wait for more consumption in the future require far-sightedness on the part of the people. There is an old Chinese proverb, "He who cannot see beyond the dawn will have much good wine to drink at noon, much green wine to cure his headache at dark, and only rain water to drink for the rest of his days."

Although saving is essential for capital formation, but in a monetized economy, saving may not directly and automatically result in the production of capital goods. Savings must be invested in order to have capital goods. In a modern economy, where saving and investment are done mainly by two different classes of people, there must be certain means or mechanism whereby the savings of the people are obtained and mobilized in order to give them to the businessmen or entrepreneurs to invest in capital.

3.2 OBJECTIVES

After reading this lesson you will be able to understand:

- The capital formation and its stages
- Role of capital formation
- Sources and importance of capital formation

3.3 STAGES OF CAPITAL FORMATION

In a modern free enterprise economy, the process of capital formation consists of the following three stages including:

a) **Creation of Savings**

An increase in the volume of real savings so that resources, that would have been devoted to the production of consumption goods, should be released for purposes of capital formation.

(b) Mobilization of Savings

A finance and credit mechanism, so that the available resources are obtained by private investors or government for capital formation.

(c) Investment of Savings

The act of investment itself so that resources are actually used for the production of capital goods.

Detailed explanation of these three stages:

a) Creation of Savings

Savings are done by individuals or households. They save by not spending all their incomes on consumer goods. When individuals or households save, they release resources from the production of consumer goods. Workers, natural resources, materials, etc., thus released are made available for the production of capital goods.

The level of savings in a country depends upon the power to save and the will to save. The power to save or saving capacity of an economy mainly depends upon the average level of income and the distribution of national income. The higher the level of income, the greater will be the amount of savings.

The countries having higher levels of income are able to save more. That is why the rate of savings in the U.S.A. and Western European countries is much higher than that in the under-developed and poor countries like India. Apart from the power to save, the total amount of savings depends upon the will to save. Various personal, family, and national considerations induce the people to save.

People save in order to provide against old age and unforeseen emergencies.

Some people desire to save a large sum to start new business or to expand the existing business. Moreover, people want to make provision for education, marriage and to give a good start in business for their children.

Further, it may be noted that savings may be either voluntary or forced. Voluntary savings are those savings which people do of their own free will. As explained above, voluntary savings depend upon the power to save and the will to save of the people. On the other hand, taxes by the Government represent forced savings.

Moreover, savings may be done not only by households but also by business enterprises" and government. Business enterprises save when they do not distribute the whole of their profits, but retain a part of them in the form of undistributed profits. They then use these undistributed profits for investment in real capital.

The third source of savings is government. The government savings constitute the money collected as taxes and the profits of public undertakings. The greater the amount of taxes collected and profits made, the greater will be the government savings. The savings so made can be used by the government for building up new capital goods like factories, machines, roads, etc., or it can lend them to private enterprise to invest in capital goods.

b) Mobilization of Savings

The next step in the process of capital formation is that the savings of the households must be mobilized and transferred to businessmen or entrepreneurs who require them for investment. In the capital market, funds are supplied by the individual investors (who may buy securities or shares issued by companies), banks, investment trusts, insurance companies, finance corporations, governments, etc.

If the rate of capital formation is required to be stepped up, the development of capital market is very necessary. A well- developed capital market will ensure that the savings of the society-will be mobilized and transferred to the entrepreneurs or businessmen who require them.

c) *Investment of Savings*

To convert the savings into Capital Formation, savings must be invested. In order to do so, there must be a good number of honest and dynamic entrepreneurs in the country who are able to take risks and bear uncertainty of production.

Given that a country has got a good number of venturesome and entrepreneurs, investment will be made by them only if there is sufficient inducement to invest. Inducement to invest depends on the marginal efficiency of capital (i.e., the prospective rate of profit) on the one hand and the rate of interest, on the other.

But of the two determinants of inducement to invest-the marginal efficiency of capital and the rate of interest—it is the former which is of greater importance. Marginal efficiency of capital depends upon the cost or supply prices of capital as well as the expectations of profits.

Fluctuations in investment are mainly due to changes in expectations regarding profits. But it is the size of the market which provides scope for profitable investment. Thus, the primary factor which determines the level of investment or capital formation, in any economy, is the size of the market for goods.

Capital formation in a country can also take place with the help of foreign capital, i.e., foreign savings.

Foreign capital can take the form of:

(a) Direct private investment by foreigners (FOI)

(b) Loans or grants by foreign governments,

(c) Loans by international agencies like the World Bank.

There are very few countries which have successfully marched on the road to economic development without making use of foreign capital in one form or the other. India is receiving a good amount of foreign capital from abroad for investment and capital formation under the Five-Year Plans.

3.4 ROLE OF CAPITAL MARKET IN CAPITAL FORMATION

Financial market deals about the raising of finance by various institutions through the issue of various securities. Every business concern requires two types of finance. They are **Short-term** or ***working capital*** requirements and ***long term or fixed capital*** requirements. The ***short-term or working capital*** requirements are raised or borrowed in the money market through the issue of different securities such as bills, promissory notes, etc

Government raises the short-term funds through the issue of treasury bills. Banks play a vital role in providing short-term funds. The long-term funds or fixed capital are raised by companies by the issue of shares, debentures and bonds in the capital market. The long-term funds or fixed capital are raised by companies by the issue of shares, debentures and bonds in the capital market.

3.4.1 Source of Capital Formation: following are the sources of capital formation

- ***Deficit Financing***

Deficit financing, i.e., newly-created money is another source of capital formation in a developing economy. Owing to very low standard of living of the people, the extent to which voluntary savings can be mobilised is very much limited. Also, taxation beyond limit becomes oppressive and, therefore, politically inexpedient. Deficit financing is, therefore, the method on which the government can fall back to obtain funds.

However, the danger inherent in this source of development financing is that it may lead to inflationary pressures in the economy. But a certain measure of deficit financing can be had without creating such pressures.

There is specially a good case for using deficit financing to utilise the existing under-employed labour in schemes which yield quick returns. In this way, the inflationary potential of deficit financing can be neutralized by an increase in the supply of output in the short-run.

- ***Disguised Unemployment***

Another source of capital formation is to mobilize the saving potential that exists in the form of disguised unemployment. Surplus agricultural workers can be transferred from the agricultural sector to the non-agricultural sector without diminishing agricultural output.

The objective is to mobilize these unproductive workers and employ them on various capital creating projects, such as roads, canals, building of schools, health centers and bunds for floods, in which they do not require much more capital to work with. In this way', the hitherto unemployed, labour can be utilised productively and turned into capital.

- ***Capital Formation in the Public Sector***

In these days, the role of government has greatly increased. In an under-developed country like India, government is very much concerned with the development of the economy. Government is building dams, steel plants, roads, machine-making factories and other forms of real capital in the country. Thus, capital formation takes place not only in the private sector by individual entrepreneurs but also in the public sector by government.

There are various ways in which a government can get resources for investment purposes or for capital formation. The government can increase the level of direct and indirect taxation and then can finance its various projects. Another way of obtaining the necessary resources is the borrowing by the Government from the public.

The government can also finance its development plans by deficit financing. Deficit financing means the creation of new money. By issuing more notes and exchanging them with the productive resources the government can build real capital. But the method of deficit financing, as a source of development finance, is dangerous because it often leads to inflationary pressures in the economy. A certain measure of deficit financing, however, can be had without creating such pressures.

Another source of capital formation in the public sector is the profits of public undertakings which can be used by the government for further investment. As stated above, government can also get loans from foreign countries and international agencies like World Bank. India is getting a substantial amount of foreign assistance for investment purposes under the Five-Year Plans

3.4.2 Importance of Capital Market: the following points define the importance of the capital market:

1. It is only with the help of capital market, long-term funds are raised by the business community.

2. It provides opportunity for the public to invest their savings in attractive securities which provide a higher return.

3. A well developed capital market is capable of attracting funds even from foreign country. Thus, foreign capital flows into the country through foreign investments.

4. Capital market provides an opportunity for the investing public to know the trend of different securities and the conditions prevailing in the economy.

5. It enables the country to achieve economic growth as capital formation is promoted through the capital market.

6. Existing companies, because of their performance will be able to expand their industries and also go in for diversification of business due to the capital market.

7. Capital market is the barometer of the economy by which you are able to study the economic conditions of the country and it enables the government to take suitable action.

8. Through the Press and different media, the public are informed about the prices of different securities. This enables the public to take necessary investment decisions.

9. Capital market provides opportunities for different institutions such as commercial banks, mutual funds, investment trust; etc., to earn a good return on the investing funds. They employ financial experts who are able to predict

the changes in the market and accordingly undertake suitable portfolio investments.

3.5 SUMMARY

Capital formation means increasing the stock of real capital in a country. The three stages of capital formation includes: a) Creation of Savings, (b) Mobilization of Savings and (c) Investment of Savings. Financial market deals about the raising of finance by various institutions through the issue of various securities

3.6 GLOSSARY

- Capital wealth — form of money or other assets owned by a person or organization or available for a purpose such as starting a company or investing.
- Savings — money one has saved, especially through a bank or official scheme.
- Portfolioa — range of investments held by a person or organization
- Commercial banks — bank that offers services to the general public and to companies
- Capital formation — term used to describe the net capital accumulation during an accounting period for a particular country.
- Capital market — the part of a financial system concerned with raising capital by dealing in shares, bonds, and other long-term investments

3.7 SELF- ASSESSMENT QUESTIONS

Q1. What do you understand by capital formation?

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Q2. What are the different stages of capital formation?

Q3. What are the main sources of capital formation?

3.8 LESSON END EXERCISE

Q1. Briefly explain the different stages of capital formation.

Q2. Describe the role of capital market in capital formation.

3.9 SUGGESTED READINGS

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CAPITAL MARKET INVESTMENT INSTITUTIONS

STRUCTURE

4.1 INTRODUCTION

There are a number of financial institutions which are directly involved with real investment in the economy. These institutions mobilize the saving from the people and channel funds for financing the development expenditure of the industry and government of a country.

The financial institutions take maximum care in investing funds in those projects where there is high degree of security and the income is certain. The main institutional sources of capital market are as follows:

(i) Insurance Companies : Insurance companies are financial intermediaries. They call money by providing protection from certain risks to individuals and firms. The insurance companies invest the funds in long term investments primarily mortgage loans and corporate bonds.

(ii) Pension Funds : The pension funds are provided by both employees and employers. These funds are now increasing utilized in the provision of long term loans for the industry and government.

(iii) Building Societies : The building societies are now activity engaged in providing funds for the construction, purchase of buildings for the industry and houses for the people.

(iv) Investment Trusts : The investment trust mobilize saving and meet the growing, need of corporate sector, The income of the investment trust depends upon the dividend it receives from shares invested in various companies.

(v) Unit Trust : The Unit Trust collects the small savings of the people by selling units of the trust. The holders of units can resell the units at the prevailing market value to the trust itself.

(vi) Saving Banks : The saving banks collect the savings of the people. The accumulated saving is invested in mortgage loans, corporate bonds.

(vii) Specialized Finance Corporation : The specialized finance corporations are being established to help and provide finance to the private industrial sector in the form of medium and long term loans or foreign currencies.

(viii) Commercial banks : The commercial banks are also now activity engaged in the provision of medium and long terms loans to the industrialists, agriculturists, specialist finance institutions, etc., etc.

(ix) Stock Exchange : The stock exchange is a market in existing securities (shares, debentures and securities issued by the public authorities). The stock exchange provides a place for those persons who wish to sell the shares and also wish to buy them. Stock exchange, thus helps in raising equity capital for the industry

4.1.1 Financial Institutions: Types

Financial institutions can be categorized into the following types, based on the services offered by them:

* **Commercial banks:** These institutions offer services such as insurance, mortgages, loans and credit banks.

* **Credit banks:** They are cooperative financial institutions, generally controlled by members who have accounts in the firm. These unions offer direct debits, direct deductions from payroll, cheaper insurance facilities and standing order facilities.

* **Savings and loan association:** These associations offer loans, mortgages, insurance, credit cards and interest to their clients.

* **Stock brokerage firms:** These firms help individuals and corporate invest in stock market. Stock brokerage firms also offer insurance, mortgages, credit cards, securities, loans, check writing and money market services to clients.

* **Insurance companies:** Insurance companies provide a cash cover in lieu of

premium to policyholders. Services such as insurance, securities, mortgages, loans, credit cards and check writing are offered by these firms.

* **Retailers:** They offer services such as insurance, securities, mortgages, loans, credit cards and cash management

4.2 OBJECTIVES

After reading this lesson you will be able to understand:

- The capital formation and its stages
- Role of capital formation
- Sources and importance of capital formation

4.3 NATIONAL AND STATE LEVEL INSTITUTIONS

Financial institutions are government regulated or private entities that offer financial services to their customers. These institutions control the flow of cash from an investor to a company and vice versa within and outside a country. Financial institutions cater to clients ranging from individuals to big organizations, depending on their size and the services offered. Broadly speaking, financial institutions deal in the sectors pertaining to mortgage, automobile, homeowner, personal business and corporate finance.

4.3.1 National Level Institutions

A wide variety of financial institutions have been set up at the national level. They cater to the diverse financial requirements of the entrepreneurs. They include all India development banks like IDBI, SIDBI, IFCI Ltd, IIBI; specialized financial institutions like IVCF, ICICI Venture Funds Ltd, TFCI; investment institutions like LIC, GIC, UTI; etc.

1. **All-India Development Banks (AIDBs):-** Includes those development banks which provide institutional credit to not only large and medium enterprises but also help in promotion and development of small scale industrial units.

- **Industrial Development Bank of India (IDBI):** IDBI was established in

July 1964 as an apex financial institution for industrial development in the country. It caters to the diversified needs of medium and large scale industries in the form of financial assistance, both direct and indirect. Direct assistance is provided by way of project loans, underwriting of and direct subscription to industrial securities, soft loans, technical refund loans, etc. While, indirect assistance is in the form of refinance facilities to industrial concerns.

- **Small Industries Development Bank of India (SIDBI):** It was set up by the Government of India in April 1990, as a wholly owned subsidiary of IDBI. It is the principal financial institution for promotion, financing and development of small scale industries in the economy. It aims to empower the Micro, Small and Medium Enterprises (MSME) sector with a view to contributing to the process of economic growth, employment generation and balanced regional development.

- **Industrial Bank of India corporation ltd**: It was set up in 1985 under the Industrial reconstruction Bank of India Act, 1984, as the principal credit and reconstruction agency for sick industrial units. It was converted into IIBI on March 17, 1997, as a full-fledged development financial institution. It assists industry mainly in medium and large sector through wide ranging products and services. Besides project finance, IIBI also provides short duration non-project asset-backed financing in the form of underwriting/direct subscription, deferred payment guarantees and working capital/other short-term loans to companies to meet their fund requirements.

2. **Specialized Financial Institutions (SFIs):** These are the institutions which have been set up to serve the increasing financial needs of commerce and trade in the area of venture capital, credit rating and leasing, etc.

- IFCI Venture Capital Funds Limited (IVCF): formerly known as Risk Capital & Technology Finance Corporation Ltd (RCTC), is a subsidiary of IFCI Ltd. It was promoted with the objective of broadening entrepreneurial base in the country by facilitating funding to ventures involving innovative product/ process/technology. Initially, it started providing financial assistance by way of soft loans to promoters under its 'Risk capital scheme'. Since 1988, it also started providing finance under 'Technology finance and Development scheme' to projects for commercialization of indigenous technology for new processes, products, market or services. Over the years, it has acquired great deal of experience in investing in technology-oriented projects.

- ICICI Venture Funds Ltd: formerly known as Technology Development & Information Company of India Limited (TDICI), was founded in 1988 as a joint venture with the Unit Trust of India. Subsequently, it became a fully owned subsidiary of ICICI. It is a technology venture finance company, set up to sanction project finance for new technology ventures. The industrial units assisted by it are in the fields of computer, chemicals/polymers, drugs, diagnostics and vaccines, biotechnology, environmental engineering, etc.

- Tourism Finance Corporation of India Ltd. (TFCI):- is a specialized financial institution set up by the Government of India for promotion and growth of tourist industry in the country. Apart from conventional tourism projects, it provides financial assistance for non-conventional tourism projects like amusement parks, ropeways, car rental services, ferries for inland water transport, etc.

3. **Investment Institutions:-** are the most popular form of financial intermediaries, which particularly catering to the needs of small savers and investors. They deploy their assets largely in marketable securities.

- Life Insurance Corporation of India (LIC): was established in 1956 as a wholly-owned corporation of the Government of India. It was formed by the Life insurance corporation act, 1956, with the objective of spreading life insurance much more widely and in particular to the rural area. It also extends assistance for development of infrastructure facilities like housing, rural electrification, water supply, sewerage, etc. In addition, it extends resource support to other financial institutions through subscription to their shares and bonds, etc. The Life Insurance Corporation of India also transacts business abroad and has offices in Fiji, Mauritius and United Kingdom. Besides the branch operations, the Corporation has established overseas subsidiaries jointly with reputed local partners in Bahrain, Nepal and Sri Lanka.

- Unit Trust of India (UTI): was set up as a body corporate under the UTI act, 1963, with a view to encourage savings and investment. It mobilizes savings of small investors through sale of units and channelizes them into corporate investments mainly by way of secondary capital market operations. Thus, its primary objective is to stimulate and pool the savings of the middle and low income groups and enable them to share the benefits of the rapidly growing industrialization in the country. In December 2002, the UTI Act, 1963 was repealed with the passage of UTI Act, 2002, paving the way for the bifurcation of UTI into 2 entities, UTI-I and UTI-II with effect from 1st February 2003.
- General Insurance Corporation of India (GIC): was formed in pursuance of the General insurance business act, 2002 for the purpose of superintending, controlling and carrying on the business of general insurance or non-life insurance. Initially, GIC had four subsidiary branches.

4.3.2 State Level Institutions

Several financial institutions have been set up at the State level which supplements the financial assistance provided by the all India institutions. They act as a catalyst for promotion of investment and industrial development in the respective States. They broadly consist of 'State financial corporations' and 'State industrial development corporations'.

1. **State Financial Corporation's (SFCs) :-** are the State-level financial institutions which play a crucial role in the development of small and medium enterprises in the concerned States. They provide financial assistance in the form of term loans, direct subscription to equity/debentures, guarantees, discounting of bills of exchange and seed/ special capital, etc

4.4 FINANCIAL INSTITUTIONS IN INDIA

The Financial Institutions in India mainly comprises of the Central Bank which is better known as the Reserve Bank of India, the commercial banks, the credit rating agencies, the securities and exchange board of India, insurance companies and the specialized financial institutions in India

4.4.1 Reserve Bank of India

The Reserve Bank of India was established in the year 1935 with a view to organize the financial frame work and facilitate fiscal stability in India. The bank acts as the regulatory authority with regard to the functioning of the various commercial bank and the other financial institutions in India. The bank formulates different rates and policies for the overall improvement of the banking sector. It issue currency notes and offers aids to the central and institutions governments.

4.4.2 Commercial Banks in India

The commercial banks in India are categorized into foreign banks, private banks and the public sector banks. The commercial banks indulge in varied activities such as acceptance of deposits, acting as trustees, offering loans for the different purposes and are even allowed to collect taxes on behalf of the institutions and central government.

4.4.3 Credit Rating Agencies in India

The credit rating agencies in India were mainly formed to assess the condition of the financial sector and to find out avenues for more improvement. The credit rating agencies offer various services as:

Operation Up gradation

Training to Employees

Scrutinize New Projects and find out the weak sections in it

Rate different sectors

The two most important credit rating agencies in India are:

1. Credit Rating Information services of India Limited (CRISIL)
2. Investment Information and Credit Rating Agency(ICRA)

4.4.4 Securities and Exchange Board of India

The securities and exchange board of India, also referred to as SEBI was founded in the year 1992 in order to protect the interests of the investors and to facilitate the functioning of the market intermediaries. They supervise market conditions, register institutions and indulge in risk management.

4.4.5 Specialised Financial Institutions in India

The specialized financial institutions in India are government undertakings that were set up to provide assistance to the different sectors and thereby cause overall development of the Indian economy. The significant institutions falling under this category includes:

Board for Industrial & Financial Reconstruction

Export-Import Bank of India

Small Industries Development Bank of India

National Housing Bank

4.5 IMPORTANT FACTORS IN BUILDING A STABLE FINANCIAL SYSTEM

Most generally, a stable financial system can be described as a financial system that is able to withstand shocks without giving way to cumulative processes which could impair the allocation of savings to investments and the processing of payments in the economy. How do we get there?

1. First, financial system architecture should be carefully planned. Different stages of financial development require adequate institutional processes to be in place. Here, one can refer to the sequencing laid out by IMF in recent years and to the European experience with opening and gradually liberalizing the financial sector during the 1980s and 1990s.
2. Second, a solid micro supervision of the financial sector and individual institutions should be in place.
3. Third, close co-operation and exchange of information between the central bank and supervisory authorities is warranted at all times and especially in periods of financial stress. I will refer to this more extensively in a moment.
4. Fourth, there are several, complementary public policies that are typically

needed to sustain or build up confidence in financial institutions.

- ***Fiscal policy*: ** Fiscal Policy is the means by which a government adjusts its spending levels and tax rates to monitor and influence a nation's economy in order to achieve the intended goals of economic growth, full employment, inconme equality and the stabilisation of the economy in its growth path. If fiscal authorities, as in the euro area, are restricted in their ability to run deficits or accumulate large debts, an important source of financial market stress and financial instability is removed.

- ***Monetary policy***: As is now widely accepted, monetary authorities should in the first place try to guarantee price stability, being the best possible contribution it can make to growth in the medium to long-term. Indirectly, this should also be conducive to supporting financial stability, as the economy will have less macro uncertainties to deal with, when allocating resources. However, it goes without saying that the central bank should take an active interest in monitoring financial sector developments, given the importance of the sector, also from a monetary policy (transmission) perspective, and given its importance in the economic system (intermediation between lenders and borrowers). In some cases, when financial stability is threatened, monetary policy may be used as a tool to support the financial sector. This support may come not only through interest rate policy, but also and most powerfully through the central bank's role as a lender of last resort, that is, in providing final liquidity when solvent commercial banks suffer liquidity strains.

4.6 QUALIFIED INSTITUTIONAL BUYERS (QIB)

Investment in today' world is made in several different methods. People invest in real estate, gold bonds, debentures, providential funds, fixed deposits, investing in companies through shares and stock and much more. Investing in an Indian company or a foreign company is one of the most common ways used. These investments are made by many kinds of investors in India who are governed by specified sets of rules and regulations in the form of statues like Companies Act, 2013, Company Act rules, and the Securities and Exchange Board of India rules. Due to some difficulties, individuals tend to invest indirectly through investment institutions instead of investing by them.

These investing institutions are mainly a collective group of people in who come together and collect the investible amount from various investors and invest them in the investment market. Even though individuals have limited control when they use these indirect methods to invest, they have an expert handling and recommending the investment which should be made in order to get high returns. These institutional purchasers of securities are deemed financially sophisticated and are legally recognised by exchange boards to need less protection from the issuing companies than most public investors who invest directly.

These groups of investors who follow certain regulations and rules formulated by the SEBI are collectively qualified to be known as "Qualified Institutional Buyer" (QIB). SEBI has defined a Qualified Institutional Buyer as follows: Qualified Institutional Buyers are those institutional investors who are generally perceived to possess expertise and the financial muscle to evaluate and invest in the capital markets. In terms of clause 2.2.2B (v) of DIP Guidelines, a 'Qualified Institutional Buyer' shall mean:

- Scheduled commercial banks;
- Mutual funds;
- Foreign institutional investor registered with SEBI;
- Multilateral and bilateral development financial institutions;
- Venture capital funds registered with SEBI.
- Foreign Venture capital investors registered with SEBI.
- State Industrial Development Corporations.
- Insurance Companies registered with the Insurance Regulatory and Development Authority (IRDA).
- Provident Funds with minimum corpus of Rs.25 crores
- Pension Funds with minimum corpus of Rs. 25 crores

- Public financial institution as defined in Companies Act, 2013;

4.6.1 Regulations

The institutions which fall under any of the above mentioned categories are qualified to be a QIB in India.

SEBI through Guidelines for "Qualified Institutions Placement"- Amendments to SEBI (Disclosure and Investor Protection) Guidelines, 2000 introduced additional mode for listed companies to raise funds from domestic markets in the form of Qualifies Institutions Placement.

The listed companies which are eligible to raise funds in domestic market by placing securities with QIBs are those whose equity shares are listed on a stock exchange nationwide and which are complying with the prescribed regulations of minimum public shareholding of the listed agreements. These guidelines are applicable to any kind of securities in the form of equity shares or any other form of securities other than warrants, which can be converted into or exchanged with equity shares at a later date at any time after allotment of security (but, within six months from the date of allotment). These kinds of shares are referred to as "specified securities" and are fully paid up when they are allotted.

The guidelines are also very specific regarding who can be the investors or allottees to these specified securities. It specifically mentions that they can be issued only to QIBs and such QIBs cannot be promoters or related to promoters of the issuer directly or indirectly. Each and every placement is done to the qualified institutional buyers will be on private placement basis.

The SEBI has also prescribed that the aggregate amount raised through QIBs by an issuers in a financial year cannot exceed five times of the net worth of the issuer at the end of its previous financial year. Regulating the pricing of the specified securities, the guidelines provide that the floor price of these securities shall be determined in a similar manner of that of the GDR/ FCCB issues and shall be subject to adjustment in cases of corporate actions such as bonus issue or the pre-emptive right given to the already existing shareholders of the issuer.

In every placement it is a mandate to allot 10% of the securities to Mutual Funds. It is also mandatory in each and every placement to have at least two allottees for an issue of size up to Rupees two fifty Crore and at least five when it exceeds the above specified amount. Further, the issuer is also not allowed to allot more that 50 % of the issue size to a single allottee. Another important provision in favour of the issuer and against the investors is that the investors cannot and are not allowed to withdraw their bids or applications after closure of the issue.

All the Qualified Institutional Placements are taken care of and managed by the merchant brokers who are registered with SEBI. They shall exercise due diligence and furnish and submit a due diligence certificate to Stock Exchange Board informing them that the issue is with compliance with all the provisions and requirements given and mentioned by the SEBI.

Between each placement in case of multiple placements of these kinds of specified securities, there shall be a minimum gap of six months between them. In order to obtain in-principle approval and final permission from the Stock Exchange for the listing of these specified securities the Issuers and Merchant Broker shall submit reports, documents and undertakings, if any as prescribed in this regard in the listing agreement. But, on the other hand it is not mandatory to file any offer document or notice to the Exchange board in case of preferential allotment and QIP. The issuing companies are further allowed to offer a discount of up to 5% on the prices of the QIPs, but this discount can be offered only subject to the shareholders' approval.

4.6.2 Conclusion

The Securities and Exchange Board of India (SEBI) introduced the concept of Qualified Institutional Buyer at the time when Indian corporate were looking for chances to enter into foreign investments overseas to expand their operations, mainly due to two reasons: one, easy availability of funds in those jurisdictions and second, less stringent regulatory environment compared to India.

This concept has become a common route for raising capital due to a two fold reasoning. Firstly, it is advantageous for the issuing company as one, the amount of time taken to complete a QIP is much more less than through public shareholder as there is no long wait for document approvals by SEBI and the whole process can be completed in a span of 4 to 5 days and second, it is cost effective as there is no need to employ a large team of bankers, solicitors, advocates and auditors to obtain approvals. Secondly, the Qualified Institutional Buyers have the ability and opportunity to buy large stakes in company with the advantage of being able to exit and sell their stocks at any point of time post its listing on the exchange unlike waiting for a minimum period of one year when it is investing in an IPO.

Although due to the above mentioned reasons, companies prefer QIP, there are a few negative sides to it too. As QIPs give the Institutional Buyers an opportunity to hold a large stake in the company, it dilutes the existing stakes of the shareholders. Due to this, the companies with a huge amount of promoter holding prefer this method over the companies in which there are significant numbers of promoters with low stakes, as a further dilution of stakes could mean risking the management control of the company.

So it is a kind of bootstrap where, while coming over from a particularly problematic situation company enters another possible problematic condition

4.7 ANCHOR INVESTORS

Anchoring is the use of irrelevant information, such as the purchase price of a security, as a reference for evaluating or estimating an unknown value of a financial instrument.

Anchoring is a behavioral bias in which the use of a psychological benchmark carries a disproportionately high weight in a market participant's decision-making process. The concept is part of the field of behavioral finance, which studies how emotions and other extraneous factors influence economic choices.

In the context of investing, one consequence of anchoring is that market participants with an anchoring bias tend to hold investments that have lost value because they have anchored their fair value estimate to the original price rather than to fundamentals. As a result, market participants assume greater risk by holding the investment in the hope the security will return to its purchase price. Market participants are often aware that their anchor is imperfect and attempt to make adjustments to reflect subsequent information and analysis. However, these adjustments often produce outcomes that reflect the bias of the original anchors.

4.7.1 Anchoring Bias

An anchoring bias can cause a financial market participant, such as a financial analyst or investor, to make an incorrect financial decision, such as buying an undervalued investment or selling an overvalued investment. Anchoring bias can be present anywhere in the financial decision-making process, from key forecast inputs, such as sales volumes and commodity prices, to final output like cash flow and security prices.

Historical values, such as acquisition prices or high-water marks, are common anchors. This holds for values necessary to accomplish a certain objective, such as achieving a target return or generating a particular amount of net proceeds. These values are unrelated to market pricing and cause market participants to reject rational decisions.

Anchoring can be present with relative metrics, such as valuation multiples. Market participants using a rule of thumb valuation multiple to evaluate securities prices demonstrate anchoring when they ignore evidence that one security has a greater potential for earnings growth.

Some anchors, such as absolute historical values and values necessary to accomplish an objective, can be harmful to investment objectives, and many analysts encourage investors to reject these types of anchors. Other anchors can be helpful as market participants deal with the complexity and uncertainty inherent in an environment of information overload. Market participants can counter anchoring bias by identifying the factors behind the anchor and replacing suppositions with quantifiable data.

Comprehensive research and assessment of factors affecting markets or a security's price is necessary to eliminate anchoring bias from decision-making in the investment process.

Key Takeaways

- *Anchoring is a behavioral finance term to describe an irrational bias towards a psychological benchmark.*
- *This benchmark generally takes the form of irrelevant information, such as an estimate or figure or event that skews decision-making regarding a security by market participants, such as analysts or investors.*

4.7.2 Examples of Anchoring Bias

It is easy to find examples of anchoring bias in everyday life. Customers for a product or service are typically anchored to a sales price based on the price marked by a shop or suggested by a salesperson. Any further negotiation for the product is in relation to that figure, regardless of its actual cost.

Within the investing world, anchoring bias can take on several forms.

In one instance, traders are typically anchored to the price at which they bought a security. For example, if a trader bought stock ABC for $100, then she will be psychologically fixated on that price for a sale or further purchases of the same stock, regardless of ABC's actual value based on an assessment of relevant factors affecting it.

In another, analysts may become anchored to the value of a given index at a certain level instead of considering historical figures. For example, if the S&P 500 is on a bull run and has a value of 10,000, then analyst propensity will be to predict values closer to that figure rather than considering standard deviation of values, which have a fairly wide range for that index.

4.8 PRIVATE EQUITY

Private equity is the money for investments made directly in private companies or in public companies that become private.

Although some private equity comes from private individuals, most private equity funding comes from private equity firms. These firms are often partnerships that obtain their investment funds from wealthy individuals, investment banks, endowments, pension funds, insurance companies, various financial institutions and even corporations wishing to foster new products, businesses or technologies. A private equity firm must raise the money it needs to make investments in businesses. This fund raising is typically done by circulating a prospectus to potential investors who then agree to commit money to the fund. Once the private equity firm has enough commitments, the firm may begin collecting or "calling" those commitments when it wants to make an investment. If and when the private equity firm invests all of its money, or if it simply wants to expand its investing activities, it may start another fund. Most funds have a fixed life, meaning they must make their investments within a certain period (usually about 10 years). Private equity firms may have several funds going at the same time.

Private equity firms are different than venture capital firms in that they generally invest only in private companies (or in public companies that want to go private). Whereas venture capital firms tend to concentrate their investments in new and young businesses, private equity firms often aren't afraid to invest in older companies. Private equity firms might also use debt in their financing structures, often when they are participating in leveraged buyouts.

The managers of many private equity firms receive an annual management fee (usually 2% of the invested capital) and a portion of the fund's net profits (typically 20%). These fees compensate the managers for their expertise and responsibility to help their investments become successful.

Typically, private equity firms decide which companies to invest in by reviewing hundreds of business plans, meeting entrepreneurs and company managers, and performing extensive due diligence on investment candidates. They are very selective because they are seeking opportunities in which their investments will grow and provide a successful exit within a certain time frame.

One of the most common and controversial characteristics of private equity funding is that private equity firms usually take active management roles and board seats in the companies they invest in. This often means that management gives some control over their businesses to the firms. However, private equity firms can also provide crucial managerial or technical expertise, particularly in areas where the management is less confident. This is especially the case when the private equity firm specializes in an industry or niche.

One of the most important parts of a private equity investment is the “exit” or the private equity firm’s plans for selling its investment in a company. Usually the exit, also known as the “harvest,” takes place anywhere from three to 10 years, often via an initial public offering or through the merger or sale of the company.

Private equity is an important and necessary form of investment because it fosters liquidity and entrepreneurship, and it creates shareholder value. This in turn promotes job creation and economic growth. At the investment level, private equity can be tremendously lucrative because it allows investors to invest in the world’s leading private companies.However, private equity is not without risk. In fact, it is one of the riskiest investments available because many new companies fail or underperform. Private equity firms anticipate this by diversifying their investments and hoping that their successful investments more than compensate for their losses. Nonetheless, private equity investors must be willing to take significant long-term risks for what can be very high returns.

4.9 VENTURE CAPITAL

It is a private or institutional investment made into early-stage / start-up companies (new ventures). As defined, ventures involve risk (having uncertain outcome) in the expectation of a sizeable gain. Venture Capital is money invested in businesses that are small or exist only as an initiative, but have huge potential to grow. The people who invest this money are called venture capitalists (VCs). The venture capital investment is made when a venture capitalist buys shares of such a company and becomes a financial partner in the business.

Venture Capital investment is also referred to risk capital or patient risk capital, as it includes the risk of losing the money if the venture doesn’t succeed and takes medium to long term period for the investments to fructify.

Venture Capital typically comes from institutional investors and high net worth individuals and is pooled together by dedicated investment firms.

It is the money provided by an outside investor to finance a new, growing, or troubled business. The venture capitalist provides the funding knowing that there's a significant risk associated with the company's future profits and cash flow. Capital is invested in exchange for an equity stake in the business rather than given as a loan.

Venture Capital is the most suitable option for funding a costly capital source for companies and most for businesses having large up-front capital requirements which have no other cheap alternatives. *Software and other intellectual property* are generally the most common cases whose value is unproven. That is why; Venture capital funding is most widespread in the fast-growing technology and biotechnology fields.

4.9.1 Features of Venture Capital investments

- High Risk
- Lack of Liquidity
- Long term horizon
- Equity participation and capital gains
- Venture capital investments are made in innovative projects
- Suppliers of venture capital participate in the management of the company

4.9.2 Methods of Venture capital financing

- Equity
- participating debentures
- conditional loan

4.9.3 Venture capital funding process

The venture capital funding process typically involves four phases in the company's development:

- Idea generation

- Start-up
- Ramp up
- Exit

The process of Venture Capital funding can be also described in the following manner :

Step 1: Idea generation and submission of the Business Plan

The initial step in approaching a Venture Capital is to submit a business plan. The plan should include the below points:

- There should be an executive summary of the business proposal
- Description of the opportunity and the market potential and size
- Review on the existing and expected competitive scenario
- Detailed financial projections
- Details of the management of the company

There is detailed analysis done of the submitted plan, by the Venture Capital to decide whether to take up the project or no.

Step 2: Introductory Meeting

Once the preliminary study is done by the VC and they find the project as per their preferences, there is a one-to-one meeting that is called for discussing the project in detail. After the meeting the VC finally decides whether or not to move forward to the due diligence stage of the process.

Step 3: Due Diligence

The due diligence phase varies depending upon the nature of the business proposal. This process involves solving of queries related to customer references, product and business strategy evaluations, management interviews, and other such exchanges of information during this time period.

Step 4: Term Sheets and Funding

If the due diligence phase is satisfactory, the VC offers a term sheet, which is a non-binding document explaining the basic terms and conditions of the investment agreement. The term sheet is generally negotiable and must be agreed upon by all parties, after which on completion of legal documents and legal due diligence, funds are made available.

4.9.4 Types of Venture Capital funding

The various types of venture capital are classified as per their applications at various stages of a business. The three principal types of venture capital are early stage financing, expansion financing and acquisition/buyout financing.

The venture capital funding procedure gets complete in six stages of financing corresponding to the periods of a company's development

- Seed money: Low level financing for proving and fructifying a new idea
- Start-up: New firms needing funds for expenses related with marketingand product development
- First-Round: Manufacturing and early sales funding
- Second-Round: Operational capital given for early stage companies which are selling products, but not returning a profit
- Third-Round: Also known as Mezzanine financing, this is the money for expanding a newly beneficial company
- Fourth-Round: Also called bridge financing, 4th round is proposed for financing the "going public" process

A) Early Stage Financing:

Early stage financing has three sub divisions seed financing, start up financing and first stage financing.

- Seed financing is defined as a small amount that an entrepreneur receives for the purpose of being eligible for a start up loan.

- Start up financing is given to companies for the purpose of finishing the development of products and services.
- First Stage financing: Companies that have spent all their starting capital and need finance for beginning business activities at the full-scale are the major beneficiaries of the First Stage Financing.

B) Expansion Financing:

Expansion financing may be categorized into second-stage financing, bridge financing and third stage financing or mezzanine financing.

Second-stage financing is provided to companies for the purpose of beginning their expansion. It is also known as mezzanine financing. It is provided for the purpose of assisting a particular company to expand in a major way. Bridge financing may be provided as a short term interest only finance option as well as a form of monetary assistance to companies that employ the Initial Public Offers as a major business strategy.

C) Acquisition or Buyout Financing:

Acquisition or buyout financing is categorized into acquisition finance and management or leveraged buyout financing. Acquisition financing assists a company to acquire certain parts or an entire company. Management or leveraged buyout financing helps a particular management group to obtain a particular product of another company.

4.9.5 Advantages of Venture Capital

- They bring wealth and expertise to the company
- Large sum of equity finance can be provided
- The business does not stand the obligation to repay the money
- In addition to capital, it provides valuable information, resources, technical assistance to make a business successful

4.9.6 Disadvantages of Venture Capital

- As the investors become part owners, the autonomy and control of the founder is lost

- It is a lengthy and complex process
- It is an uncertain form of financing
- Benefit from such financing can be realized in long run only

4.9.7 Exit route

There are various exit options for Venture Capital to cash out their investment:

- IPO
- Promoter buyback
- Mergers and Acquisitions
- Sale to other strategic investor

4.9.8 Examples of venture capital funding

- Kohlberg Kravis & Roberts (KKR), one of the top-tier alternative investment asset managers in the world, has entered into a definitive agreement to invest USD150 million (Rs 962crore) in Mumbai-based listed polyester maker JBF Industries Ltd. The firm will acquire 20% stake in JBF Industries and will also invest in zero-coupon compulsorily convertible preference shares with 14.5% voting rights in its Singapore-based wholly owned subsidiary JBF Global Pte Ltd. The funding provided by KKR will help JBF complete the ongoing projects.

- Pepperfry.com, India's largest furniture e-marketplace, has raised USD100 million in a fresh round of funding led by Goldman Sachs and Zodius Technology Fund. Pepperfry will use the funds to expand its footprint in Tier III and Tier IV cities by adding to its growing fleet of delivery vehicles. It will also open new distribution centres and expand its carpenter and assembly service network. This is the largest quantum of investment raised by a sector focused e-commerce player in India.

4.10 ANGEL FUND

The recent rule relaxation for Angel Funds has seen regulator SEBI turning a guardian angel to the nascent startup eco-system in India. SEBI recently amended its Alternative Investment Fund (AIF) regulations to give angel investors an easier passage.

Angel investors are a class of well-to-do investors, usually experienced industry folk who take equity stakes in startups. They take very early-stage businesses under their wing. Typically, institutional investors such as venture capital funds or private equity funds do not like to commit capital to tiny businesses. Nor do they like to bet their shirt on firms that are yet to prove themselves in the marketplace. Angel investors literally step in where others fear to tread.

Angel funds pool money from many individual 'angels' so that they can invest sizeable amounts into start-ups and enjoy better negotiating power while doing so. Angel Funds in India, are regulated by SEBI, which lumps them with venture capital funds, SME funds, social impact funds and sundry other funds, under the umbrella regulations for Alternative Investment Funds (AIFs).

SEBI's rule relaxation has untangled many complex rules that constrained Angel Funds and their investors. Angel Funds have been allowed to source money from as many as 200 investors, instead of 49. They can invest lower amounts (₹ 25 lakh) in each startup, with shorter lock-ins (one year, instead of three). Investments have been allowed in firms incorporated in the last five years (up from three years). This gives founders a long runway to seek funding before the clock runs out.

Every year, angels in the US invest about $25 billion in nearly 50,000 startups; VC funds invest about the same amount in 5,000 start-ups or so. In India, barely 1,000 angel investors invest $20 million per year. Of the 268 registered AIFs as of November 15, only five are Angel Funds. Clearly, the original idea failed to take off and angels cited the long list of rules on their investment choices as a constraining factor.

SEBI-appointed Narayana Murthy committee suggested that these rules be relaxed in its report early this year. SEBI has borrowed mainly from this report to free up Angel Funds. But not all changes have altruistic motives. A few were just to ensure that it gels well with other rules. For example, the original regulation limiting the number of investors in the fund to below 50 was in line with the Companies Act, 1956. The increase of this limit to 200 aligns it with the new Companies Act, 2013.

If you are a wannabe entrepreneur, the new changes may make your capital raising just a little easier. As more wealthy people in India take an interest in startup investments, the over dependence on foreign investors will ease. And given SEBI's high standards for individual angels — minimum net worth of ₹ 2 crore, prior experience in early-stage investments or serial entrepreneurship, or a ten-year stint in industry — founders need not worry about inexperienced investors. If you are a HNI with funds to spare, the changes, though not magical, are interesting.

Angel funds may not turn attractive overnight, but SEBI's changes will help them gain popularity.

4.11 PENSION FUND

A pension plan is a retirement plan that requires an employer to make contributions into a pool of funds set aside for a worker's future benefit. The pool of funds is invested on the employee's behalf, and the earnings on the investments generate income to the worker upon retirement. Typically, pensions are tax-deferred, meaning that the employee does not pay taxes on the funds in the pension until he/she begins making withdrawals.

In addition to an employer's required contributions, some pension plans have a voluntary investment component. A pension plan may allow a worker to contribute part of his current income from wages into an investment plan to help fund retirement. The employer may also match a portion of the worker's annual contributions, up to a specific percentage or dollar amount.

4.12 FOREIGN PORTFOLIO INVESTORS

A foreign portfolio investment is a grouping of assets such as stocks, bonds, and cash equivalents. Portfolio investments are held directly by an investor or managed by financial professionals. In economics, foreign portfolio investment is the entry of funds into a country where foreigners deposit money in a country's bank or make purchases in the country's stock and bond markets, sometimes for speculation.

Most foreign portfolio investments consist of securities and other foreign financial assets that are passively held by the foreign investor. This does not provide the foreign investor with direct ownership of the financial assets and can be relatively liquid depending on the volatility of the market that the investment takes place in. Foreign portfolio investments can be made by individuals, companies, or even governments in international countries. This type of investment is a way for investors to diversify their portfolio with an international advantage.

Foreign portfolio investment shows up in a country's capital account. It is also part of the balance of payments which measures the amount of money flowing in and out of a country over a given time period.

Foreign portfolio investment is similar, but differs from foreign direct investment. In foreign portfolio investment the investor purchases stocks, securities and other financial assets but does not actively manage the investments or the companies that are issuing the assets. So, in FPI the investor does not have direct control over the securities or businesses. This means that FPI tends to be more liquid and less risky than FDI. The relatively high liquidity of FPI's makes them much easier to sell than FDI's. Foreign portfolio investments also tend to have a shorter time frame for returns than foreign direct investments.

Some benefits that come to investors from utilizing foreign portfolio investments include:[4]

- **Portfolio diversification:** FPI gives investors a fairly simple way to diversify their portfolio internationally.
- **International Credit:** FPI gives investors a larger credit base because they are able to access credit in the foreign countries that they have large amounts of investment in.
- **Benefits from the Exchange rates:** If an investor has an FPI in a foreign

country with a stronger currency than their own country the difference in exchange rates between the two countries can benefit the investor

- **Access to a larger market:** Often time's markets may be larger and less competitive outside of one's home country. For example, the market is much more competitive in the United States of America than in other less developed economies. Investors can take advantage of the less competitive markets internationally by using these foreign portfolio investments.

Portfolio investments typically involve transactions in securities that are highly liquid, i.e. they can be bought and sold very quickly. A portfolio investment is an investment made by an investor who is not involved in the management of a company. This is in contrast to direct investment, which allows an investor to exercise a certain degree of managerial control over a company. Equity investments where the owner holds less than 10% of a company's shares are classified as portfolio investment. These transactions are also referred to as "portfolio flows" and are recorded in the financial account of a country's balance of payments.

Portfolio flows arise through the transfer of ownership of securities from one country to another.[6] Foreign portfolio investment is positively influenced by high rates of return and reduction of risk through geographic diversification. The return on foreign portfolio investment is normally in the form of interest payments or non-voting dividends.

4.13 MUTUAL FUND

A mutual fund is a type of financial vehicle made up of a pool of money collected from many investors to invest in securities such as stocks, bonds, money market instruments, and other assets. Mutual funds are operated by professional money managers, who allocate the fund's assets and attempt to produce capital gains or income for the fund's investors. A mutual fund's portfolio is structured and maintained to match the investment objectives stated in its prospectus.

Mutual funds give small or individual investors access to professionally managed portfolios of equities, bonds and other securities. Each shareholder, therefore, participates proportionally in the gains or losses of the fund. Mutual funds invest in a vast number of securities, and performance is usually tracked as the change in the total market cap of the fund—derived by the aggregating performance of the underlying investments.

The Basics of a Mutual Fund

Mutual funds pool money from the investing public and use that money to buy other securities, usually stocks and bonds. The value of the mutual fund company depends on the performance of the securities it decides to buy. So, when you buy a unit or share of a mutual fund, you are buying the performance of its portfolio or more precisely, a part of the portfolio's value. Investing in a share of a mutual fund is different from investing in shares of stock. Unlike stock, mutual fund shares do not give its holders any voting rights. A share of a mutual fund represents investments in many different stocks (or other securities) instead of just one holding.

That's why the price of a mutual fund share is referred to as the net asset value (NAV) per share, sometimes expressed as NAVPS. A fund's NAV is derived by dividing the total value of the securities in the portfolio by the total amount of shares outstanding. Outstanding shares are those held by all shareholders, institutional investors, and company officers or insiders. Mutual fund shares can typically be purchased or redeemed as needed at the fund's current NAV, which unlike a stock price doesn't fluctuate during market hours, but is settled at the end of each trading day.

The average mutual fund holds hundreds of different securities, which mean mutual fund shareholders, gain important diversification at a low price. Consider an investor who buys only Google stock before the company has a bad quarter. He stands to lose a great deal of value because all of his dollars are tied to one company. On the other hand, a different investor may buy shares of a mutual fund that happens to own some Google stock. When Google has a bad quarter, she only loses a fraction as much because Google is just a small part of the fund's portfolio.

4.13.1 How Mutual Funds Work

A mutual fund is both an investment and an actual company. This dual nature may seem strange, but it is no different from how a share of AAPL is a representation of Apple, Inc. When an investor buys Apple stock, he is buying part ownership of the company and its assets. Similarly, a mutual fund investor is buying part ownership of the mutual fund company and its assets. The difference is that Apple is in the business of making smartphones and tablets, while a mutual fund company is in the business of making investments.

Investors typically earn a return from a mutual fund in three ways:

1. Income is earned from dividends on stocks and interest on bonds held in the fund's portfolio. A fund pays out nearly all of the income it receives over the year to fund owners in the form of a distribution. Funds often give investors a choice either to receive a check for distributions or to reinvest the earnings and get more shares

2. If the fund sells securities that have increased in price, the fund has a capital gain. Most funds also pass on these gains to investors in a distribution.

3. If fund holdings increase in price but are not sold by the fund manager, the fund's shares increase in price. You can then sell your mutual fund shares for a profit in the market.

If a mutual fund is constructed as a virtual company, its CEO is the fund manager, sometimes called its investment adviser. The fund manager is hired by a board of directors and is legally obligated to work in the best interest of mutual fund shareholders. Most fund managers are also owners of the fund. There are very few other employees in a mutual fund company. The investment adviser or fund manager may employ some analysts to help pick investments or perform market research. A fund accountant is kept on staff to calculate the fund's NAV, the daily value of the portfolio that determines if share prices go up or down. Mutual funds need to have a compliance officer or two, and probably an attorney, to keep up with government regulations.

Most mutual funds are part of a much larger investment company; the biggest have hundreds of separate mutual funds. Some of these fund companies are names familiar to the general public, such as Fidelity Investments, the Vanguard Group, T. Rowe Price, and Oppenheimer Funds.

4.13.2 Types of Mutual Funds

Mutual funds are divided into several kinds of categories, representing the kinds of securities they have targeted for their portfolios and the type of returns they seek. There is a fund for nearly every type of investor or investment approach. Other common types of mutual funds include money market funds, sector funds, alternative funds, smart-beta funds, target-date funds, and even funds-of-funds, or mutual funds that buy shares of other mutual funds.

1. Equity Funds

The largest category is that of equity or stock funds. As the name implies, this sort of fund invests principally in stocks. Within this group is various sub-categories. Some equity funds are named for the size of the companies they invest in small-, mid- or large-cap. Others are named by their investment approach: aggressive growth, income-oriented, value, and others. Equity funds are also categorized by whether they invest in domestic (U.S.) stocks or foreign equities. There are so many different types of equity funds because there are many different types of equities. A great way to understand the universe of equity funds is to use a style box, an example of which is below.

The idea here is to classify funds based on both the size of the companies invested in (their market caps) and the growth prospects of the invested stocks. The term value fund refers to a style of investing that looks for high quality, low growth companies that are out of favor with the market. These companies are characterized by low price-to-earnings (P/E), low price-to-book (P/B) ratios, and high dividend yields. On the other side of the style, spectrum are growth funds, which look to companies that have had (and are expected to have) strong growth in earnings, sales, and cash flows. These companies typically have high P/E ratios and do not pay dividends. A compromise between strict value and growth investment is a “blend,” which simply refers to companies that are neither value nor growth stocks and are classified as being somewhere in the middle.

The other dimension of the style box has to do with the size of the companies that a mutual fund invests in. Large-cap companies have high market capitalizations, with values over $5 billion. Market cap is derived by multiplying the share price by the number of shares outstanding. Large-cap stocks are typically blue chip firms that are often recognizable by name. Small-cap stocks refer to those stocks with a market cap ranging from $200 million to $2 billion. These smaller companies tend to be newer, riskier investments. Mid-cap stocks fill in the gap between small- and large-cap.

A mutual fund may blend its strategy between investment style and company size. For example, a large-cap value fund would look to large-cap companies that are in strong financial shape but have recently seen their share prices fall and would be placed in the upper left quadrant of the style box (large and value). The opposite of this would be a fund that invests in startup technology companies with excellent growth prospects: small-cap growth. Such a mutual fund would reside in the bottom right quadrant (small and growth).

2. Fixed-Income Funds

Another big group is the fixed income category. A fixed income mutual fund focuses on investments that pay a set rate of return, such as government bonds, corporate bonds, or other debt instruments. The idea is that the fund portfolio generates interest income, which then passes on to shareholders.

Sometimes referred to as bond funds, these funds are often actively managed and seek to buy relatively undervalued bonds in order to sell them at a profit. These mutual funds are likely to pay higher returns than certificates of deposit and money market investments, but bond funds aren't without risk. Because there are many different types of bonds, bond funds can vary dramatically depending on where they invest. For example, a fund specializing in high-yield junk bonds is much riskier than a fund that invests in government securities. Furthermore, nearly all bond funds are subject to interest rate risk, which means that if rates go up the value of the fund goes down.

3. Index Funds

Another group, which has become extremely popular in the last few years, falls under the moniker "index funds." Their investment strategy is based on the belief that it is very hard, and often expensive, to try to beat the market consistently. So, the index fund manager buys stocks that correspond with a major market index such as the S&P 500 or the Dow Jones Industrial Average (DJIA). This strategy requires less research from analysts and advisors, so there are fewer expenses to eat up returns before they are passed on to shareholders. These funds are often designed with cost-sensitive investors in mind.

4. Balanced Funds

Balanced funds invest in both stocks and bonds to reduce the risk of exposure to one asset class or another. Another name for this type of mutual fund is "asset allocation fund." An investor may expect to find the allocation of these funds among asset classes relatively unchanging, though it will differ among funds. This fund's goal is asset appreciation with lower risk. However, these funds carry the same risk and can be as subject to fluctuation as other classifications of funds.

A similar type of fund is known as an asset allocation fund. Objectives are similar to those of a balanced fund, but these kinds of funds typically do not have to hold a specified percentage of any asset class. The portfolio manager is therefore given freedom to switch the ratio of asset classes as the economy moves through the business cycle.

5. Money Market Funds

The money market consists of safe (risk-free) short-term debt instruments, mostly government Treasury bills. This is a safe place to park your money. You won't get substantial returns, but you won't have to worry about losing your principal. A typical return is a little more than the amount you would earn in a regular checking or savings account and a little less than the average certificate of deposit (CD). While money market funds invest in ultra-safe assets, during the 2008 financial crisis, some money market funds did experience losses after the share price of these funds, typically pegged at $1, fell below that level and broke the buck.

6. Income Funds

Income funds are named for their purpose: to provide current income on a steady basis. These funds invest primarily in government and high-quality corporate debt, holding these bonds until maturity in order to provide interest streams. While fund holdings may appreciate in value, the primary objective of these funds is to provide steady cash flow to investors. As such, the audience for these funds consists of conservative investors and retirees. Because they produce regular income, tax-conscious investors may want to avoid these funds.

7. Global/International Funds

An international fund (or foreign fund) invests only in assets located outside your home country. Global funds, meanwhile, can invest anywhere around the world, including within your home country. It's tough to classify these funds as either riskier or safer than domestic investments, but they have tended to be more volatile and have a unique country and political risks. On the flip side, they can, as part of a well-balanced portfolio, actually reduce risk by increasing diversification since the returns in foreign countries may be uncorrelated with returns at home. Although the world's economies are becoming more interrelated, it is still likely that another economy somewhere is outperforming the economy of your home country.

8. Specialty Funds

This classification of mutual funds is more of an all-encompassing category that consists of funds that have proved to be popular but don't necessarily belong to the more rigid categories we've described so far. These types of mutual funds forgo broad diversification to concentrate on a certain segment of the economy or a targeted strategy. Sector funds are targeted strategy funds aimed at specific sectors of the economy such as financial, technology, health, and so on. Sector funds can, therefore, be extremely volatile since the stocks in a given sector tend to be highly correlated with each other. There is a greater possibility for large gains, but also a sector may collapse (for example the financial sector in 2008 and 2009).

Regional funds make it easier to focus on a specific geographic area of the world. This can mean focusing on a broader region (say Latin America) or an individual country (for example, only Brazil). An advantage of these funds is that they make it easier to buy stock in foreign countries, which can otherwise be difficult and expensive. Just like for sector funds, you have to accept the high risk of loss, which occurs if the region goes into a bad recession.

Socially-responsible funds (or ethical funds) invest only in companies that meet the criteria of certain guidelines or beliefs. For example, some socially responsible funds do not invest in "sin" industries such as tobacco, alcoholic beverages, weapons or nuclear power. The idea is to get competitive performance while still maintaining a healthy conscience. Other such funds invest primarily in green technology such as solar and wind power or recycling.

9. Exchange Traded Funds (ETFs)

A twist on the mutual fund is the exchange traded fund (ETF). These ever more popular investment vehicles pool investments and employ strategies consistent with mutual funds, but they are structured as investment trusts that are traded on stock exchanges and have the added benefits of the features of stocks. For example, ETFs can be bought and sold at any point throughout the trading day. ETFs can also be sold short or purchased on margin. ETFs also typically carry lower fees than the equivalent mutual fund. Many ETFs also benefit from active options markets where investors can hedge or leverage their positions. ETFs also enjoy tax advantages from mutual funds. The popularity of ETFs speaks to their versatility and convenience.

4.13.3 Mutual Fund Fees

A mutual fund will classify expenses into either annual operating fees or shareholder fees. Annual fund operating fees are an annual percentage of the funds under management, usually ranging from 1-3%. Annual operating fees are collectively known as the expense ratio. A fund's expense ratio is the summation of the advisory or management fee and its administrative costs.

Shareholder fees, which come in the form of sales charges, commissions and redemption fees, are paid directly by investors when purchasing or selling the funds. Sales charges or commissions are known as "the load" of a mutual fund. When a mutual fund has a front-end load, fees are assessed when shares are purchased. For a back-end load, mutual fund fees are assessed when an investor sells his shares.

Sometimes, however, an investment company offers a no-load mutual fund, which doesn't carry any commission or sales charge. These funds are distributed directly by an investment company rather than through a secondary party.

Some funds also charge fees and penalties for early withdrawals or selling the holding before a specific time has elapsed. Also, the rise of exchange-traded funds, which have much lower fees thanks to their passive management structure, have been giving mutual funds considerable competition for investors' dollars. Articles in the financial media about how fund expense ratios and loads can eat into rates of return have also stirred negative feelings about mutual funds.

4.13.4 Classes of Mutual Fund Shares

Mutual fund shares come in several classes. Their differences reflect the number and size of fees associated with them.

Currently, most individual investors purchase mutual funds with A shares through a broker. This purchase includes a front-end load of up to 5% or more, plus management fees and ongoing fees for distributions, also known as 12b-1 fees. To top it off, loads on A shares vary quite a bit, which can create a conflict of interest. Financial advisors selling these products may encourage clients to buy higher-load offerings to bring in bigger commissions for themselves. With front-end funds, the investor pays these expenses as they buy into the fund.

To remedy these problems and meet fiduciary-rule standards investment companies have started designating new share classes, including "level load" C shares, which generally don't have a front-end load but carry a 1% 12b-1 annual distribution fee.

Funds that charge management and other fees when an investor sell their holdings are classified as Class B shares.

A New Class of Fund Shares

The newest share class, developed in 2016, consists of clean shares. Clean shares do not have front-end sales loads or annual 12b-1 fees for fund services. American Funds, Janus and MFS, are all fund companies currently offering clean shares.

By standardizing fees and loads, the new classes enhance transparency for mutual fund investors and, of course, save them money. For example, an investor who rolls \$10,000 into an individual retirement account (IRA) with a clean-share fund could earn nearly \$1,800 more over a 30-year period as compared to an average A-share fund, according to an April 2017 Morningstar report, co-written by Aron Szapiro, Morningstar director of policy research, and Paul Ellenbogen, head of global regulatory solutions.

4.13.5 Advantages of Mutual Funds

There are a variety of reasons that mutual funds have been the retail investor's vehicle of choice for decades. The overwhelming majority of money in employer-sponsored retirement plans goes into mutual funds.

1. Diversification

Diversification, or the mixing of investments and assets within a portfolio to reduce risk, is one of the advantages of investing in mutual funds. Experts advocate diversification as a way of enhancing portfolio return while reducing its risk. Buying individual company stocks and offsetting them with industrial sector stocks, for example, offers some diversification. However, a truly diversified portfolio has securities with different capitalizations and industries and bonds with varying maturities and issuers. Buying a mutual fund can achieve diversification cheaper and faster than by buying individual securities. Large mutual funds typically own hundreds of different stocks in many different industries. It wouldn't be practical for an investor to build this kind of a portfolio with a small amount of money.

2. Easy Access

Trading on the major stock exchanges, mutual funds can be bought and sold with relative ease, making them highly liquid investments. Also, when it comes to certain types of assets, like foreign equities or exotic commodities, mutual funds are often the most feasible way in fact, sometimes the only way for individual investors to participate.

3. Economies of Scale

Mutual funds also provide economies of scale. Buying one spares the investor of the numerous commission charges needed to create a diversified portfolio. Buying only one security at a time leads to large transaction fees, which will eat up a good chunk of the investment. Also, the $100 to $200 an individual investor might be able to afford is usually not enough to buy a round lot of the stock, but it will purchase many mutual fund shares. The smaller denominations of mutual funds allow investors to take advantage of dollar cost averaging.

Because a mutual fund buys and sells large amounts of securities at a time, its transaction costs are lower than what an individual would pay for securities transactions. Moreover, a mutual fund, since it pools money from many smaller investors can invest in certain assets or take larger positions than a smaller investor could. For example, the fund may have access to IPO placements or certain structured products only available to institutional investors.

4. Professional Management

A primary advantage of mutual funds does not have to pick stocks and manage investments. Instead, a professional investment manager takes care of all of this using careful research and skillful trading. Investors purchase funds because they often do not have the time or the expertise to manage their own portfolios, or they don't have access to the same kind of information that a professional fund has. A mutual fund is a relatively inexpensive way for a small investor to get a full-time manager to make and monitor investments. Most private, non-institutional money managers deal only with high-net-worth individuals people with at least six figures to invest. However, mutual funds, as noted above, require much lower investment minimums. So, these funds provide a low-cost way for individual investors to experience and hopefully benefit from professional money management.

5. Variety and Freedom of Choice

Investors have the freedom to research and select from managers with a variety of styles and management goals. For instance, a fund manager may focus on value investing, growth investing, developed markets, emerging markets, income or macroeconomic investing, among many other styles. One manager may also oversee funds that employ several different styles. This variety allows investors to gain exposure to not only stocks and bonds but also commodities, foreign assets, and real estate through specialized mutual funds. Some mutual funds are even structured to profit from a falling market (known as bear funds). Mutual funds provide opportunities for foreign and domestic investment that may not otherwise be directly accessible to ordinary investors.

6. Transparency

Mutual funds are subject to industry regulation that ensures accountability and fairness to investors.

Pros

- Liquidity
- Diversification
- Minimal investment requirements
- Professional management
- Variety of offerings

Cons

- High fees, commissions, other expenses
- Large cash presence in portfolios
- No FDIC coverage
- Difficulty in comparing funds
- Lack of transparency in holdings

4.13.6 Disadvantages of Mutual Funds

Liquidity, diversification, and professional management, all these factors make mutual funds attractive options for a younger, novice, and other individual investors who don't want to actively manage their money. However, no asset is perfect, and mutual funds have drawbacks too.

1. Fluctuating Returns

Like many other investments without a guaranteed return, there is always the possibility that the value of your mutual fund will depreciate. Equity mutual funds experience price fluctuations, along with the stocks that make up the fund. The Federal Deposit Insurance Corporation (FDIC) does not back up mutual fund investments, and there is no guarantee of performance with any fund. Of course, almost every investment carries risk. It is especially important for investors in money market funds to know that, unlike their bank counterparts, these will not be insured by the FDIC.

2. Cash Drag

Mutual funds pool money from thousands of investors, so every day people are putting money into the fund as well as withdrawing it. To maintain the capacity to accommodate withdrawals funds typically have to keep a large portion of their portfolios in cash. Having ample cash is excellent for liquidity, but money is sitting around as cash and not working for you and thus is not very advantageous. Mutual funds require a significant amount of their portfolios to be held in cash in order to satisfy share redemptions each day. To maintain liquidity and the capacity to accommodate withdrawals, funds typically have to keep a larger portion of their portfolio as cash than a typical investor might. Because cash earns no return, it is often referred to as a "cash drag."

3. High Costs

Mutual funds provide investors with professional management, but it comes at a cost, those expense ratios mentioned earlier. These fees reduce the fund's overall payout, and they're assessed to mutual fund investors regardless of the performance of the fund. As you can imagine, in years when the fund doesn't make money, these fees only magnify losses. Creating, distributing, and running a mutual fund is an expensive undertaking. Everything from the portfolio manager's salary to the investors' quarterly statements cost money. Those expenses are passed on to the investors. Since fees vary widely from fund to fund, failing to pay attention to the fees can have negative long-term consequences. Actively managed funds incur transaction costs that accumulate over each year. Remember, every dollar spent on fees is a dollar that is not invested to grow over time.

4. 'Diversification' and Dilution

'Diversification' a play on words is an investment or portfolio strategy that implies too much complexity can lead to worse results. Many mutual fund investors tend to overcomplicate matters. That is, they acquire too many funds that are highly related and, as a result, don't get the risk-reducing benefits of diversification. These investors may have made their portfolio more exposed; a syndrome called diversification. At the other extreme, just because you own mutual funds doesn't mean you are automatically diversified. For example, a fund that invests only in a particular industry sector or region is still relatively risky.

In other words, it's possible to have poor returns due to too much diversification. Because mutual funds can have small holdings in many different companies, high returns from a few investments often don't make much difference on the overall return. Dilution is also the result of a successful fund growing too big. When new money pours into funds that have had strong track records, the manager often has trouble finding suitable investments for all the new capital to be put to good use.

One thing that can lead to diversification is the fact that a fund's purpose or makeup isn't always clear. Fund advertisements can guide investors down the wrong path. The Securities and Exchange Commission (SEC) requires that funds have at least 80% of assets in the particular type of investment implied in their names. How the remaining assets are invested is up to the fund manager. However, the different categories that qualify for the required 80% of the assets may be vague and wide-ranging. A fund can, therefore, manipulate prospective investors via its title. A fund that focuses narrowly on Congolese stocks, for example, could be sold with a far-ranging title "International High-Tech Fund."

5. Active Fund Management

Many investors debate whether or not the professionals are any better than you or I at picking stocks. Management is by no means infallible, and, even if the fund loses money, the manager still gets paid. Actively managed funds incur higher fees, but increasingly passive index funds have gained popularity. These funds track an index such as the S&P 500 and are much less costly to hold. Actively managed funds over several time periods have failed to outperform their benchmark indices, especially after accounting for taxes and fees.

6. *Lack of Liquidity*

A mutual fund allows you to request that your shares be converted into cash at any time, however, unlike stock that trades throughout the day, many mutual fund redemptions take place only at the end of each trading day.

7. *Taxes*

When a fund manager sells a security, a capital-gains tax is triggered. Investors who are concerned about the impact of taxes need to keep those concerns in mind when investing in mutual funds. Taxes can be mitigated by investing in tax-sensitive funds or by holding non-tax sensitive mutual fund in a tax-deferred account, such as a 401(k) or IRA.

8. *Evaluating Funds*

Researching and comparing funds can be difficult. Unlike stocks, mutual funds do not offer investors the opportunity to juxtapose the price to earnings (P/E) ratio, sales growth, earnings per share (EPS), or other important data. A mutual fund's net asset value can offer some basis for comparison, but given the diversity of portfolios, comparing the proverbial apples to apples can be difficult, even among funds with similar names or stated objectives. Only index funds tracking the same markets tend to be genuinely comparable.

Example of a Mutual Fund

1. One of the most famous mutual funds in the investment universe is Fidelity Investments' Magellan Fund (FMAGX). Established in 1963 the fund had an investment objective of capital appreciation via investment in common stocks. Fidelity founder Edward Johnson originally managed it. The fund's glory days were between 1977 and 1990 when Peter Lynch served as its portfolio manager. Under Lynch's tenure, Magellan regularly posted 29% annual returns, almost double that of the S&P 500. Both the fund and Lynch became household words.

   Even after Lynch left, Fidelity's performance continued strong, and assets under management (AUM) grew to nearly $110 billion in 2000, making it the largest fund in the world. By 1997, the fund had become so large that Fidelity closed it to new investors, and would not reopen it until 2008.

As of April 2019, Fidelity Magellan has over US$16 billion in assets and is managed by Jeffrey Feingold since 2011. The fund's performance has pretty much tracked or slightly surpassed that of the S&P 500.

4.14 SUMMARY

Capital market mobilises the saving from the people and channelise their funds for financing the development expenditure of the industry and government of a country. Financial institutions are government regulated or private entities that offer financial services to their customers. These institutions control the flow of cash from an investor to a company and vice versa within and outside a country

Venture Capital typically comes from institutional investors and high net worth individuals and is pooled together by dedicated investment firms. Venture Capital investment is also referred to risk capital or patient risk capital, as it includes the risk of losing the money if the venture doesn't succeed and takes medium to long term period for the investments to fructify.

4.15 GLOSSARY

- Financial institutions — An enterprise such as a bank whose primary business and function is to collect money from the public and invest it in financial assets such as stocks and bonds, loans and mortgages, leases, and insurance policies.
- Institutional buyers — a corporation that is deemed to be an accredited investor as defined in the Securities and Exchange Commission's
- Fund — a sum of money saved or made available for a particular purpose
- Venture — a risky or daring journey or undertaking.
- Pension — a regular payment made by the state to people of or above the Official retirement age and to some widows and disabled people.

4.16 SELF-ASSESSMENT QUESTIONS

Q1. Define the term financial institutions.

Q2. What are national level institutions?

Q3. Who are Qualified Institutional Buyers?

Q4. What is venture capital fund?

Q5. What is pension fund?

4.16 LESSON END EXERCISE

Q1. Define the various state and national level financial institutions.

Q2. What are the different functions performed by the financial institutions?

Q3. Who are Anchor investors? Give some examples.

Q4. What are features of venture capital financing?

Q5. Who are Qualified Institutional Buyers and what are the regulations they need to follow?

4.17 SUGGESTED READINGS

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EXCHANGE TRADED FUNDS

STRUCTURE

5.1 INTRODUCTION

The Government has latched upon the Exchange Traded Funds (ETFs) route to disinvest its holdings in public sector companies rather than sell them on a piecemeal basis in the market. The latest such vehicle is the Bharat 22 ETF, a fund which houses 22 public sector companies, which is going to hit the market on Wednesday.

While ETFs originally tracked only the market bellwethers, they have evolved in recent years to track different asset classes. Many popular ETFs nowadays track custom-made indices as well. Apart from their returns, the efficacy of ETFs is measured through the Tracking Error, which measures how closely an ETF tracks its chosen index.

5.1.1 Exchange Traded Fund

Exchange Traded Funds (ETFs) are mutual funds listed and traded on stock exchanges like shares. Index ETFs are created by institutional investors swapping shares in an index basket, for units in the fund. Usually, ETFs are passive funds where the fund manager doesn't select stocks on your behalf. Instead, the ETF simply copies an index and endeavours to accurately reflect its performance. In an ETF, one can buy and sell units at prevailing market price on a real time basis during market hours.

The Bharat 22 ETF to be offered now allows the Government to park its holdings in selected PSUs in an ETF and raise disinvestment money from investors at one go. It tracks the specially made S&P BSE Bharat 22 Index, managed by Asia Index Private Limited. This index is made up of 22 PSU stocks and with a few private sector companies.

5.1.1 Importance of ETF

ETFs are cost efficient. Given that they don't make any stock (or security choices), they don't use services of star fund managers. In India, Nifty 50 and Sensex 30 ETFs charge annual expenses of 0.05 to 1 per cent of their Net Asset Value (NAV). But actively managed funds charge 2.5-3.25 per cent a year. Open-end index funds levy 0.20-2 per cent a year. The Bharat 22 ETF is quite a bargain too at an expense ratio of 0.0095 per cent, for three years from listing.

Costs apart, there are three reasons why ETFs are currently the rage among global investors. One, ETFs allow investors to avoid the risk of poor security selection by the fund manager, while offering a diversified investment portfolio. Two, the stocks in the indices are carefully selected by index providers and are rebalanced periodically. Three, ETFs offer anytime liquidity through the exchanges. Globally, ETFs have raced ahead of active funds in popularity thanks to their low fees and simple structure. If you are a newbie to equity markets, ETFs tracking indices such as Nifty 50 index or Sensex index can help you test the waters. This is indeed why the EPFO has chosen to route its maiden equity foray through a Sensex and Nifty ETF.

The Indian ETF universe is expanding. There are four types of ETFs already available i.e. Equity ETFs, Debt ETFs, Commodity ETFs and Overseas Equity ETFs. Indian equity ETFs track the Nifty50, Nifty Next 50, Sensex 30, Nifty 100 and BSE 100, with select ETFs tracking mid-sized companies.

Thematic ETFs mimic indices that reflect a particular theme or sector. For instance, the Reliance ETF Shariah BeES tracks the Nifty 50 Shariah index — an index of companies compliant with the Islamic law. Debt ETFs track liquid fund returns and returns on the 10-year government security. Under commodity ETFs, Gold ETFs are the key category.

5.2 OBJECTIVES

After reading this lesson you will be able to understand:

- the concept ETF, hedge fund and fund of funds
- Features of ETF, hedge fund and fund of funds
- Resource mobilisation in international market

5.3 FUND OF FUNDS

A Fund of Funds (FOF) scheme is a mutual funds scheme that invests in other mutual funds schemes rather than in securities.

In other words, A "fund of funds" (FoF) is an investment fund that uses an investment strategy of holding a portfolio of other investment funds rather than investing directly in shares, bonds or other securities. This type of investing is often referred to as multi-manager investment.

Advantages : Investing in a fund of funds arrangement will achieve even greater diversification than traditional mutual funds.

Disadvantages : On the downside, expense fees on fund of funds are typically higher than those on regular funds .

5.4 ALTERNATE INVESTMENT FUND

In India alternative investment funds (AIFs) are a relatively new concept and they have been described in detail in Regulation 2 (1) (b) SEBI (Alternative Investment Funds) Regulation, 2012. As per the current definition, AIFs are a privately held and managed pool of investment fund of either domestic or foreign origin. AIFs, as per current regulations, are investments that are organised in the form of an LLP (limited liability partnership), corporate body, company or trust.

For all intents and purposes, SEBI currently recognizes AIFs as private investment funds which are not covered by the current jurisdiction of any regulatory body currently operating in India. Being a private investment fund, AIFs are not available through IPOs or other forms of public issue which are applicable to Collective Investment Schemes and Mutual Funds that are registered with SEBI. Thus AIF regulations are completely separate from other fund management regulations including but not limited to SEBI (Mutual Funds) Regulations, 1996 and SEBI (Collective Investment Schemes) Regulations, 1999. As per existing AIF regulations, these private investment funds have been divided into 3 unique categories – Category I, Category II and Category III and the minimum qualifying amount for these schemes is Rs. 20 crores. The only exception to this rule is angel funds that have lower qualifying criteria in terms of fund corpus.

5.4.1 Types of alternative investment funds in India

Category I Alternative Investment Funds

Category I AIFs are specifically targeted at making investments in SMEs, early stage ventures, social ventures as well as start-up ventures in key sectors as they are considered to be economically or socially desirable according to the government. Being socially desirable initiatives, profit may or may not be a motive of Category I AIFs. Examples of Category I AIFs include angel funds, infrastructure funds, social venture funds, SME funds and venture capital funds.

Category II Alternative Investment Funds

According to the present form of the SEBI (Alternative Investment Funds) Regulation, 2012, any AIFs that are not covered under Category I and Category III definitions are classified as Category II AIFs. Unlike Category III AIFs, Category II AIFs are close ended in nature and not allowed to utilise leverage or borrowing mechanisms to generate capital for making investments capable of generating future returns/profits. However a Category II AIF is allowed to borrow or use leverage strategies to meet financial obligations for day to day operations

Category III Alternative Investment Funds

Category III AIFs are a unique class of private pooled funds that employ a range of complicated trading strategies including but not limited to arbitrage, margin trading, futures and derivatives trading, etc. to generate returns. This category of AIF is also allowed to utilise leverage in order to make investments in both unlisted and listed derivatives as specified by SEBI (Alternative Investment Funds) Regulation, 2012. Leading examples under this alternative investment fund category include PIPE Funds and Hedge Funds.

5.5 HEDGE FUNDS

To hedge means to safeguard, and in the context of investing, it means to safeguard against risks. A hedge fund uses the funds collected from accredited investors like banks, insurance firms, High Net-Worth individuals (HNIs) & families, and endowments and pension funds. This is the reason why these funds often function as overseas investment corporations or private investment partnerships. They do not need to be registered with SEBI, nor do they need to disclose their NAV periodically like other mutual funds.

A hedge fund portfolio consists of asset classes like derivatives, equities, bonds, currencies and convertible securities. Hence, they are also called as alternative investments. As a collection of assets that strives to 'hedge' risks to investor's money against market ups and downs, they need aggressive management. Unlike the typical equity mutual fund, they tend to employ substantial leverage. They hold both long and short positions, including positions in listed and unlisted derivatives.

5.5.1 Who can invest in Hedge Funds?

Hedge funds are mutual funds that are privately managed by experts. For this reason, they tend to be a bit on the costlier side. Hence, they are affordable and feasible only for the financially well-off. You not only have to be someone with surplus funds, but also an aggressive risk-seeker. This is because the manager buys and sells assets at a dizzying speed to keep up with the market movements.

As you know, higher the structural complexity, more the risks. Hence, the expense ratio (fee to the fund manager) is way more for hedge funds than regular mutual funds. It can range from 15% to 20% of your returns. So, we recommend first-time depositors to steer clear from these funds until you gain considerable experience in the field. Even then, it all depends on the fund manager. Therefore, unless you have full faith in your fund manager, investing in hedge funds can give you sleepless nights

5.5.2 Features & Benefits of Hedge Funds

Hedge fund industry in India is relatively young and it got a green flag in 2012 when Securities and Exchange Board of India (SEBI) allowed alternative investments funds (AIF). They have following features:

a. High Net-Worth Investors

Only qualified or accredited investors can invest in hedge funds. They are mainly high net worth individuals (HNIs), banks, insurance companies, endowments and pension funds. The minimum ticket size for investors putting money in these funds is Rs 1 crore.

b. Diverse Portfolio

Hedge funds have a wide portfolio of investments ranging from investments in currencies, derivatives, stocks, real estates, equities, and bonds. Yes, they essentially cover all the asset classes only limited by the mandate.

c. Higher Fees

They work on the concept of both expense ratio and management fee. Globally, it is 'Two and Twenty', meaning there is a 2% fixed fee and 20% of profits. As for hedge funds in India, the management fee can well below 2% to below 1%. And the profit sharing varies between 10% to 15% generally.

d. Higher Risks

Hedge funds investment strategy can expose funds to huge losses. Lock-in period generally for investment is relatively long. Leverage used by these funds can turn investments into a significant loss.

e. Taxation

The Category III AIF (hedge funds) is still not given pass-through status on tax. This implies that income from these funds is taxable at the investment fund level. Hence, the tax obligation will not pass through to the unit holders. This is a disadvantage for this industry as they are not on a level playing ground with other mutual funds.

f. Regulations

It is not required that Hedge funds be registered with the securities markets regulator and have no reporting requirements including regular disclosure of Net Asset Values (NAV).

5.5.3 Functioning of Hedge Funds

Returns from hedge funds actually stand testimony to the fund manager's skill, rather than the market conditions. Asset managers here do their best to reduce/ remove market exposure and generate good returns despite the market movement. They function in small market sectors to reduce risks by more diversification. Some of the strategies that hedge fund managers use are:

a. Sell short:

Here, the manager, hoping for the prices to drop, can sell shares to buy-back in future at a lesser price.

b. Use arbitrage:

Sometimes the securities may have contradictory or inefficient pricing. Managers use this to their advantage.

c. Invest towards an upcoming event:

For instance, some major market events like acquisitions, mergers, and spin-offs among others can influence manager's investment decisions.

d. Invest in securities with high discounts:

Some companies facing financial stress or even insolvency will sell their securities at an unbelievably low price. The manager may decide to buy after weighing the possibilities.

5. 5.4 Comparison between Hedge Funds & Mutual Funds

a. Investment Stance

Hedge funds generally have an aggressive stance on their investments and seek higher returns using speculative positions and trading in derivatives and options. They can take short positions (Short Sell) in the markets, while mutual funds cannot. Short selling allows these funds to benefit even in the falling markets, which is not so for mutual funds.

b. Leverage

Mutual funds are safer as they don't have much leverage, whereas hedge funds have a huge amount of leverage and thus higher risk.

c. Investors

Hedge funds are available only to High net worth investors. Whereas Mutual funds are accessible to the large group of people. In fact, you can start a SIP with the amount as low as Rs. 500.

In short, hedge funds are comparatively high-risk funds that aim higher returns compared to mutual funds. However, choose wisely and check if the manager's strategy works for you. A hedge fund is only one of the investment avenues, and it takes an in-depth study to assess different options. This is where Clear Tax Invest makes it convenient for you. We have done the research for you and hand-picked the best performing funds from the top AMCs.

5.6 RESOURCES MOBILIZATION IN INTERNATIONAL CAPITAL MARKET

Funds can be raised in the primary market from the domestic market as well as from international markets. After the reforms were initiated in 1991, one of the major policy changes was allowing Indian companies to raise resources by way of equity issues in the international markets. Earlier, only debt was allowed to be raised from international markets. In the early 1990s foreign exchange reserves had depleted and the country's rating had been downgraded. This resulted in a foreign exchange crunch and the government was unable to meet the import requirement of Indian companies. Hence allowing companies to tap the equity and bond market In Europe seemed a more sensible option. This permission encourages Indian companies to become global.

India companies have raised resources from international capital markets through Global depository receipts (GDRs) / American Depository Receipts (ADRs), Foreign Currency Convertible Bonds (PCCBs) and External Commercial Borrowings (ECBs). The last are used as a residual source after exhausting external equity as a main source of finance for large value projects.

- Global Depository Receipts (GDRs): GDRs essentially equity instruments issued abroad by authorized overseas corporate bodies against the shares/bonds of Indian companies held with nominated domestic custodian banks. The issue of GDR creates equity shares of the issuing company which are kept with a designated bank. GDRs are freely transferable outside India and divided in respect of the share represented by the GDR is paid in Indian rupees only. They are listed and traded on a foreign stock exchange. Trading takes place between professional market makers on an OTC (over the counter) basis. A GDR may represent one or more shares of the issuing company. The shares correspond to other GDR in a fixed ratio. A holder of a GDR can, at any time, convert it into the number of shares that it represents. Till conversion, the GDRs do not carry any voting rights and once conversion takes place the underlying shares are listed and traded on the domestic exchange. Most of the Indian companies have their GDR issues listed on the Luxembourg Stock Exchange and the London Stock Exchange. Indian GDRs are primarily sold to institutional investors and the major demand is in the UK, US, Hong Kong, Singapore, France and Switzerland. Rule 144 A of the Securities and Exchange Commissions (SEC) of the US permits companies from outside the US to offer their GDRs to qualified institutional buyers.

- American Depository Receipts (ADRs): ADRs are negotiable instruments denominated in dollars, and issued by the US Depository Bank. A non-US company that seeks to list in the US, deposits its shares with a bank and receives receipts which enable the company to issue American Depository Shares (ADSs). These ADS's serve as stock certificates and are used interchangeably with ADRs which represent ownership of deposited shares. There is no legal or technical difference between an ADR and a GDR. As they are listed on the New York Stock Exchange (NYSE) and NASDAQ (National Association of Securities Dealers Automated Association), ADR issued offer access to the US institutional and retail markets while GDR issues offer access only to the US institutional market. GDR listing requires comprehensive disclosures and greater transparency as compared to GDR listing.

  GDRs can be converted into ADRs by surrendering the existing GDRs and depositing the underlying equity shares with the ADR depository in exchange for ADRs. The company has to comply with the Securities and Exchange Commission requirements to materialize this exchange offer process. However, the company does not get any funds by this conversion. The trend is towards the conversion of GDRs into ADRs as ADRs are more liquid and cover a wider market. Besides these, many European investors have been disappointed by poor performance of Indian GDRs in traditional industries and are unwilling to provide more capital.

  Foreign Currency Convertible Bonds (FCCBs): FCCBs are bonds subscribed by a non-resident in a foreign currency. They carry a fixed interest coupon rate and are convertible to a certain number of ordinary shares at a preferred price. These bonds are listed and traded abroad.

- External Commercial Borrowings (ECBs): Indian corporate companies are allowed to raise foreign loans for financing infrastructure projects.

5.7 SUMMARY

Exchange Traded Funds (ETFs) are mutual funds listed and traded on stock exchanges like shares. A Fund of Funds (FOF) scheme is a mutual funds scheme that invests in other mutual funds schemes rather than in securities. Funds can be raised in the primary market from the domestic market as well as from international markets

5.8 GLOSSARY

- Sensex — a figure indicating the relative prices of shares on the Mumbai (Bombay) Stock Exchange
- Nifty — It comprises of 50 stocks in its Index. Computation of Nifty: The base year of Nifty is taken as 1978-79 and the base Value is 100. Nifty is calculated by "Free-float market capitalization"
- Alternative investment — An alternative investment is an asset that is not one of the conventional investment types, such as stocks, bonds and cash. Alternative investments include private equity, hedge funds, managed futures, real estate, commodities and derivatives contracts.

5.9 SELF-ASSESSMENT QUESTIONS

Q1. What are ADRs?

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Q2. What are GDRs?

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Q3. What is fund of funds?

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Q4. What is alternate investment fund?

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Q5. What is Hedge Fund?

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5.10 LESSON END EXERCISE

Q1. What are the different means of raising capital in an international market?

Q2. What is ETF and what is their importance?

Q3. What is alternate investment fund and define the different types of alternative investment funds in India?

Q4. Who can invest in Hedge Funds? Define its Features & Benefits.

Q5. What is the difference between Hedge Funds & Mutual Funds?

5.11 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

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PRIMARY MARKET

STRUCTURE

6.1 INTRODUCTION

Primary Market also called the New Issue market, i.e. the market for issuing new securities. The main players of these markets are the private and public companies that offer equity or debt based securities such as stocks and bonds in order to raise money for their operations such as business expansion, modernization and so on. They sell their securities to the public through an Initial Public Offering (IPO). The securities can be directly bought from the shareholders, which is not the case for the secondary market. The primary market is a market for new capital that will be traded over a longer period. Here the securities are issued on an exchange basis.

A primary market is not inclusive of sources, from where companies can generate external finance over a long term, such as loans provided by financial organizations. Through these markets, companies can also go public, which means changing private capital to public capital.

Many companies have entered the primary market to earn profit by converting their capital, which is basically a private capital, into a public one, releasing securities to the public. This phenomena is known as "public issue" or "going public".

6.1.1 Primary Market Underwriters

Investment banks are the main underwriters in the primary markets and thus are the major facilitators of these types of markets. They normally decide the base price of the securities on sale and then administer the entire process of its sale to the investors.

The underwriters also play the important role of safeguarding the issue related risks for the companies that are offering the shares for sale.

6.1.2 Primary Market Processes

Primary markets are basically the platform where an investor gets the first opportunity to purchase a new security. The group or company that issues the security gets the money by selling a certain amount of securities.

Normally, the entire process of buying a primary market security involves several rules and regulations that have to be properly adhered to before a security can change hands.

IPO or Initial Public Offering is one of the integral procedures of the primary markets. Through an IPO an organization announces the sale of its securities at a certain starting price.

Investors can obtain news of upcoming shares only in the primary market. The issuing firm collects money, which is then used to finance its operations or expand business, by selling its shares. Before selling a security on the primary market, the firm must fulfill all the requirements regarding the exchange.

After trading in the primary market, the security will then enter the secondary market, where numerous trades happen every day. The primary market accelerates the process of capital formation in a country's economy.

Experts have said that various operations in a primary market such as advices given to issuers and underwriting are similar to mergers and acquisitions. They also opine that a primary market is an important source of revenue generation for investment banks.

6.1.3 Methods of Issuing Securities in the Primary Market

There are three methods through which securities can be issued in the primary market:

- Rights Issue,
- Initial Public Offer (IPO), and
- Preferential issue.

A company's new offering is placed on the primary market through an initial public offer.

Primary Market Volatility: Unpredictability is one of the major features of a primary market. They are normally more unstable compared to the secondary markets, which see majority of the trades in an exchange. The major reason behind this is the fact that it is difficult to precisely assess the levels of demand among investors for a security before a couple of days of trading.

Primary Market vs. Secondary Market: The basic difference between secondary and primary markets is that in case of the latter, an investor buys the securities directly from the organization that is providing them.

Primary Markets Sales: There are several ways in which sales operations are conducted at the primary markets. Companies can provide their shares at face value or they can also be sold at discounted prices. Securities can be sold in both international and domestic markets. When a transaction is completed in a primary market, the issuing organization provides the investors new security certificates.

6.2 OBJECTIVES

After reading this lesson you will be able to understand:

- primary market underwriting and its process
- Types of issues
- Advantages and disadvantages of primary market

6.3 TYPES OF ISSUES

Primary market is the part of capital market where issue of new securities takes place. Public sector institutions, companies and governments obtain funds for further growth of the company after the sale of their securities or bonds in primary market. The selling process of new issues in primary market is called as Underwriting and this process is done by a group of people called underwriters or security dealers. From a retail investor's point of view, investing in the primary market is the first step towards trading in stocks and shares.

Public issues can be classified into 3 types:

1. **Initial Public Offering (IPO) –** Fresh issue of shares or selling existing securities by an unlisted company for the first time is known as IPO. Listing and trading of securities of a company takes place in IPO.

2. **Rights Issue –** Rights issue is when the listed company issues new securities and provides special rights to its existing shareholders for buying the securities before issuing it to public. The rights are issued on particular ratio based on the number of

securities currently held by the share holder.

3. **Preferential Issue** – It is the fresh issue of securities and shares by listed company. It is called as preferential as the shareholders with preferential shares get the preference when it comes to dividend disbursement.

6.3.1 Functions of Primary Market: The following are some of the important functions of the primary market:

- **Capital formation** - It provides attractive issue to the potential investors and with this company can raise capital at lower costs.
- **Liquidity** - As the securities issued in primary market can be immediately sold in secondary market the rate of liquidity is higher.
- **Diversification** - Many financial intermediaries invest in primary market; therefore there is less risk if there is failure in investment as the company does not depend on a single investor. The diversification of investment reduces the overall risk.
- **Reduction in cost** - Prospectus containing all details about the securities are given to the investors hence reducing the cost is searching and assessing the individual securities.

6.3.2 Role of Primary Market: It is the new issue market for the new long term capital.

- Here the securities are issued by company directly to the investors and not through any intermediaries.
- On receiving the money from the new issues, the company will issue the security certificates to the investors.
- The amount obtained by the company after the new issues are utilized for expansion of the present business or for setting up new ventures.
- External finance for longer term such as loans from financial institutions is not included in primary market. There is an option called 'going public' in which the borrowers in new issue market raise capital for converting private

capital into public capital.

6.3.3 Prerequisites for Investor to Participate in Primary market Activities:

- PAN Number
- Bank Account
- Demat Account

6.3.4 Advantages- the following are some of the advantages of primary market:

- Price manipulation is very less in primary market compared to secondary market.
- There is no payment of brokerage, transaction fees, and stamp duty or service tax.
- Investors get the shares at same prices so market fluctuations do not affect it.

6.3.5 Disadvantages- the following are some of the disadvantages of primary market:

- The shares are allotted proportionately if there is over subscription which means, the small investors may not get any allotment.
- Money is locked in for longer time, as it is a long term investment.
- The shares allotment for the investor takes few days in primary market compared to secondary market where it takes only 3 days to allot the shares.

6.4 SUMMARY

Primary Market also called the New Issue market. The main players of these markets are the private and public companies that offer equity or debt based securities such as stocks and bonds in order to raise money for their operations such as business expansion, modernization and so on. Primary market is the part of capital market where issue of new securities takes place. Public sector institutions, companies and governments obtain funds for further growth of the company after the sale of their securities or bonds in primary market.

6.5 GLOSSARY

- Initial Public Offering — an act of offering the stock of a company on a public stock exchange for the first time
- Primary market — the primary market is the part of the capital market that deals with the issuance and sale of equity-backed securities to investors directly by the issuer. Investors buy securities that were never traded before
- Right Issue — an issue of shares offered at a special price by a company to its existing shareholders in proportion to their holding of old shares
- Preferential issue — A preferential issue is an issue of shares or of convertible securities by listed companies to a select group of persons under Section 81 of the Companies Act, 1956 which is neither a right issue nor a public issue. This is a faster way for a company to raise equity capital.

6.6 SELF-ASSESSMENT QUESTIONS

Q1. What is primary market?

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Q2. What are advantages and disadvantages of primary market?

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Q3. What are the Prerequisites for Investor to Participate in Primary market Activities?

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6.7 LESSON END EXERCISE

Q1. Briefly explain the process of money market.

Q2. What are the various methods of issuing securities in the market?

Q3. What are different types of issue?

6.8 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

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OFFERS FOR SALE

STRUCTURE

7.1 INTRODUCTION

Unlike a follow-on public offering (FPO), where companies can raise funds by issuing fresh shares or promoters can sell their existing stakes, or both, the OFS mechanism is used only when existing shares are put on the block. Only promoters or shareholders holding more than 10 per cent of the share capital in a company can come up with such an issue.

The mechanism is available to 200 top companies in terms of market capitalisation. In an OFS, a minimum of 25 per cent of the shares offered, are reserved for mutual funds (MFs) and insurance companies. At any point, no single bidder other than these two institutional categories is allocated more than 25 per cent of the size of the offering.

A minimum of 10 per cent of the offer size is reserved for retail investors. A seller can offer a discount to retail investors either on the bid price or on the final allotment price. The OFS window is open only for a single day. It is mandatory for the company to inform the stock exchanges two banking days prior to the OFS about its intention.

7.1.1 Meaning of Offers For Sale

Offer for sale (OFS) is a simpler method of share sale through the exchange platform for listed companies. The mechanism was first introduced by India's securities market regulator Sebi, in 2012, to make it easier for promoters of publicly-traded companies to cut their holdings and comply with the minimum public shareholding norms by June 2013. The method was largely adopted by listed companies, both state-run and private, to adhere to the SEBI order. Later, the government started using this route to divest its shareholding in public sector enterprises.

This has a key advantage over follow-on public offer (FPO), which stays open for three to 10 days, and takes considerable time, as it requires filing of draft papers and obtaining necessary approvals from SEBI. In OFS, the entire retail bid amount is backed by 100 per cent margins in the form of cash and cash-equivalent. The process is quick and any excess fund, due to non-allotment or partial allotment, is refunded to the trading member on the same day, after 6 pm.

Bids backed by 100 per cent margins are allowed to be modified anytime during the OFS hours. Nonetheless, those with zero per cent margin can only be modified upwards, for revision in price and quantity. No cancellation is permitted in such bids. Bids below the floor price are rejected. The allocation remains subject to final price discovery. An FPO, on the other hand, defines a price band within which bids are placed. The floor price is generally set at a discount to the prevailing price. But sometimes things go overboard. Take the example of MMTC. In June 2013, the OFS was offered at a steep discount of 72 per cent, thanks to low free-float shares (and hence low volumes) and premium valuations on lack of efficient price discovery mechanism. The stock crashed and now trades way below its pre-OFS price

7.2 OBJECTIVES

After reading this lesson you will be able to understand:

- the concept offer for sale
- Process of offer for sale
- SEBI guidelines for offer for sale

7.3 OFS PROCESS

First of all, very basic, investor need to compulsorily have a demat/trading account(s) and permanent account number (PAN) to participate in an Offer for Sale. The sellers are required to deposit the offered shares with the exchange before 11.00 a.m. on 1 day, where is the day of OFS.

Once the OFS starts, you can participate in the process yourself using your online trading accounts like ICICI Direct, Kotak Securities etc. by placing your bids under the â€˜OFSâ€™ section of their respective broking websites.

Investors, who do not have online trading accounts, can place their bids by directing the dealer of their broking company to do it on their behalf. You can modify or cancel your bids during the offer timings except in the last 60 minutes i.e. till 2:30 p.m.

The exchange will announce only during the last 60 minutes of the OFS. Indicative Price is the volume weighted average price of all the valid/confirmed bids. e.g., there are total 1000 shares in an offer for sale with Rs. 200 as the floor price. If the investors bid for 200 shares at Rs. 210 and 800 shares at Rs. 200, the indicative price for the offer would be [(200*210)+(800*200)]/1000 = Rs. 202.

No leverage is provided to the investors against the stock margin available in the trading accounts and thus, they are required to deposit 100% of the order value in cash to bid for it. Also, the funds allocated for OFS cannot be utilised for other investment purposes or against any other obligation of the trading member.

Once the bidding gets over, allotment price is fixed and allocation is done. The successful bidders will be allotted shares directly into their demat account on T+1 basis the very next day. In case of partial allotment or no allotment, the refunds will be made on the same day itself. This makes the OFS process really fast, just like buying shares of the company from the open market.

During the offer timings or once the offer gets completed, you can monitor the quantity and price of bids received etc. from the link of NSE.

7.3.1 Allocation Methodology and Contract Notes

The companies can adopt one of the two methodologies for allocating the shares on offer i.e. either on a price priority basis at multiple clearing prices or on a proportionate basis at a single clearing price.

Like you get the contract notes by the evening of the trading day on which you buy shares of a company, you will get a contract note in the same format when you buy shares in an OFS. Contract note will have the details of your bid price and the quantity allotted in the specified format.

7.4 DIFFERENCE BETWEEN OFFER FOR SALE (OFS) AND IPOS/ FPOS

- **Physical Application:** Unlike IPOs/FPOs, no physical application forms are issued to apply for shares in the OFS process. OFS process is completely platform based.
- **Time Period:** While IPOs/FPOs remain open for 3-4 days, OFS gets over in a single trading day as the markets gets closed for trading at 3:30 p.m.
- **Price Band:** Under IPOs/FPOs, there is a price band in which the investors need to bid for the shares or simply give their consent to buy the shares at the Cut-Off price. With OFS, there is a Floor Price. As the name suggests, it is the minimum price at which you can bid for the shares under OFS. You will not be able to place an order below the floor price as it will not be accepted by the system.

  Though it is not mandatory to disclose the floor price before the issue opens, the promoters usually disclose it prior to the share sale in almost all of the issues. Alternatively, the promoters can submit the floor price in a sealed envelope to the exchange which will be disclosed post closure of the offer. In case the floor price is not disclosed to the public, the investors can place their bids at any price they want.

An IPO is the first time any privately-owned company, issues its shares to public and enters the stock market.OFS is opted by companies when the funding raised through IPO are not enough to meet their requirements. In an OFS, a promoter of the company sells their shares directly to the public on an exchange platform.

Comparison Chart

BASIS FOR COMPARISON	IPO	FPO
Meaning	Initial Public Offering (IPO) refers to an offer of securities made to the public for subscription, by the company.	Follow-on Public Offering (FPO) means an offer of securities for subscription to public, by any publicly traded enterprise.
What is it?	First public issue	Second or third public issue
Issuer	Unlisted Company	Listed Company
Objective	Raising capital through public investment.	Subsequent public investment.
Risk	High	Comparatively low

7.5 SEBI GUIDELINES ON OFFER FOR SALE

Comprehensive guidelines on Offer For Sale (OFS) of Shares by Promoters through the Stock Exchange Mechanism

1. Comprehensive guidelines on sale of shares through OFS mechanism were issued vide circular no CIR/MRD/DP/18/2012 dated July 18, 2012. Based on past experience of sale of shares through OFS, the mechanism of OFS has been found to be useful by market participants and popular for offloading shares of promoters in

listed companies in order to achieve minimum public shareholding. With the deadline of June 2013 to achieve minimum public shareholding approaching, to encourage promoters to offload their shares through OFS route and based on market feedback, it has been decided to modify the OFS framework to make it more economical, efficient and transparent.

2. The aforesaid circular is amended as under:

2.1. Para 1 (b) (ii) shall be replaced by the following: All promoters/promoter group entities of top 100 companies by market capitalisation in any of the last four completed quarters, market capitalisation being calculated as average market capitalisation in a quarter.

2.2. Para 2(c) shall be replaced by the following: Indicative Price is the volume weighted average price of all the valid bids.

2.3. Para 5(d) (ii) shall be replaced by the following: Orders shall be placed during trading hours.

2.4. Para 5 (d) (iii) shall be omitted.

2.5. Para 5(e) (i) shall be replaced by the following: A separate window for the purpose of sale of shares through OFS shall be created. The following orders shall be valid in the OFS window:

A. Orders with 100% of margin paid upfront by institutional investors and non-institutional investors. Such orders can be modified or canceled at any time during the trading hours.

B. Orders without paying upfront margin by institutional investors only. Such orders cannot be modified or cancelled by the investors or stock brokers, except for making upward revision in the price or quantity.

2.6. Para 5 (e) (ii) shall be replaced by the following: Cumulative bid quantity shall be made available online to the market throughout the trading session at specific intervals in respect of orders with 100% upfront margin and separately in respect of orders placed without any upfront margin. Indicative price shall be disclosed to market throughout the trading session. The indicative price shall be calculated based on all valid bids/orders.

2.7. Para 6 (a) shall be replaced by the following: Clearing Corporation shall collect 100% margin in cash from non-institutional investors. In case of institutional investors who place orders/bids with 100% of margin upfront, custodian confirmation shall be within trading hours. In case of institutional investors who place orders without upfront margin, custodian confirmation shall be as per the existing rules for secondary market transactions. The funds collected shall neither be utilized against any other obligation of the trading member nor co-mingled with other segments.

2.8. Para 6 (b) shall be replaced by the following: In case of order/bid modification or cancellation, such funds shall be released/ collected on a real time basis by clearing corporation.

2.9. Para 8 (i) (b) shall be replaced by the following: Settlement shall take place on trade for trade basis. For non-institutional orders/bids and for institutional orders with 100% margin, settlement shall take place on T+1 day. In case of orders/bids of institutional investors with no margin, settlement shall be as per the existing rules for secondary market.

2.10. Para 8 (ii) (a) shall be replaced by the following: In case of default in pay-in by any investor, 10% of the order value shall be charged as penalty from the investor and collected from the broker. This amount shall be credited to the Investor Protection Fund of the stock exchange.

3. All other conditions for sale of shares through OFS framework shall be as per SEBI circular CIR/MRD/DP/18/2012 dated July 18, 2012.

4. Stock Exchanges are directed to:

   4.1. Take necessary steps and put in place necessary systems for implementation of the above.

   4.2. Make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of the above decision.

   4.3. Bring the provisions of this circular to the notice of the member brokers of the stock exchange to also to disseminate the same on their website.

5. This circular is being issued in exercise of powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

7.6 SUMMARY

Offer for sale (OFS) is a simpler method of share sale through the exchange platform for listed companies. The mechanism was first introduced by India's securities market regulator SEBI, in 2012, to make it easier for promoters of publicly traded companies to cut their holdings and comply with the minimum public shareholding norms by June 2013. Investor need to compulsorily have a demat/ trading account(s) and permanent account number (PAN) to participate in an Offer for Sale(OFS). Comprehensive guidelines on Offer For Sale (OFS) of Shares by Promoters through the Stock Exchange Mechanism had been issued by SEBI.

7.7 GLOSSARY

- Public offering — an act of offering the stock of a particular company on a public stock exchange
- SEBI — regulatory body of the securities market in the Republic of India.
- Stock Exchanges — a market in which securities are bought and sold.
- Public Share holding — Public Share holding Company is a company whose capital is Divided into shares of equal value, which

  are transferable. Shareholders of a Public Shareholding Company are not liable for the company's obligations except for the amount of the nominal value of the shares for which they subscribe.

7.8 SELF-ASSESSMENT QUESTIONS

Q1. What do you understand by offer of sale?

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Q2. What is the process of offer for sale?

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Q3. What is an Initial Public Offer (IPO)?

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7.9 LESSON END EXERCISE

Q1. What is the difference between Offer For Sale and Initial Public Offer?

Q2. What are the guidelines issued by SEBI regarding OFS?

Q3. Briefly describe the process of OFS.

7.10 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

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FILLING OF OFFER DOCUMENT

STRUCTURE

8.1 INTRODUCTION

Offer document means Prospectus in case of a public issue or offer for sale and Letter of offer in case of a rights issue, which is filed with the Registrar of Companies (ROC) and Stock Exchanges. An offer document covers all the relevant information to help an investor to make his/her investment decision.

8.1.1 Filling of Offer Documents

(1) No issuer shall make,

(*a*)	a public issue; or
(*b*)	a rights issue, where the aggregate value of the specified securities offered is fifty lakh rupees or more,

unless a draft offer document, along with fees as specified in Schedule IV, has been filed with the Board through the lead merchant banker, at least thirty days prior to registering the prospectus, red herring prospectus or shelf prospectus with the Registrar of Companies or filing the letter of offer with the designated stock exchange, as the case may be.

(2) The Board may specify changes or issue observations, if any, on the draft offer document within thirty days from the later of the following dates:

(*a*)	the date of receipt of the draft offer document under sub-regulation (1); or
(*b*)	the date of receipt of satisfactory reply from the lead merchant bankers, where the Board has sought any clarification or additional information from them; or
(*c*)	the date of receipt of clarification or information from any regulator or agency, where the Board has sought any clarification or information from such regulator or agency; or
(*d*)	the date of receipt of a copy of in-principle approval letter issued by the recognised stock exchanges.

(3) If the Board specifies changes or issues observations on the draft offer document, the issuer and lead merchant banker shall carry out such changes in the draft offer document and comply with the observations issued by the Board before registering the prospectus, red herring prospectus or shelf prospectus, as the case may be, with the Registrar of Companies or filing the letter of offer with the designated stock exchange.

(4) The issuer shall, simultaneously while registering the prospectus, red herring prospectus or shelf prospectus with the Registrar of Companies or filing the letter of offer with the designated stock exchange or before the opening of the issue, file a copy thereof with the Board through the lead merchant banker.

(5) The lead merchant banker shall, while filing the offer document with the Board in terms of sub-regulation (1) and sub-regulation (4), file a copy of such document with the recognised stock exchanges where the specified securities are proposed to be listed.

(6) The offer document filed with the Board under this regulation shall also be furnished to the Board in a soft copy in the manner specified in Schedule V

8.2 OBJECTIVES

After reading this lesson you will be able to understand the concept of:

- offer document
- Pre issue and post issue management
- Underwriting
- book building

8.3 PRE ISSUE MANAGEMENT

Pre issue management is time bound programme and concerned with following:

1. Issue of shares
2. Marketing, Coordination and underwriting of the issue.
3. Pricing of issues

8.4 POST ISSUES MANAGEMENT

Post issue management is concerned with following:

1. Collection of application forms and amount received
2. Scrutinizing application
3. Deciding allotment procedure
4. Mailing of share certificates/refund or allotment orders

8.5 CO-ORDINATION WITH INTERMEDIARIES

(1) The post-issue merchant banker shall maintain close co-ordination with the registrars to the issue and arrange to depute its officers to the offices of various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from collecting bank branches and/or Self Certified Syndicate Banks, processing of the applications including application form for ASBA and other matters till the basis of allotment is finalised, despatch

of security certificates and refund orders are completed and securities are listed.

(2) Any act of omission or commission on the part of any of the intermediaries noticed during such visits shall be duly reported to the Board.

(3) In case there is a devolvement on underwriters, the merchant banker shall ensure that the notice for devolvement containing the obligation of the underwriters is issued within a period of ten days from the date of closure of the issue.

(4) In case of undersubscribed issues, the merchant banker shall furnish information in respect of underwriters who have failed to meet their underwriting devolvement to the Board in the format specified in Schedule XVII.

(5) The post-issue merchant banker shall confirm to the bankers to the issue by way of copies of listing and trading approvals that all formalities in connection with the issue have been completed and that the banker is free to release the money to the issuer or release the money for refund in case of failure of the issue

8.6 UNDERWRITING

Underwriting mean insuring. An insurance company underwrites policy when it agrees to take the risk of insuring your life or covering your medical expenses in exchange for the premium to be paid.

An investment bank underwrites an initial public offering (IPO) or a bond issue when it buys the shares or bonds from the issuer and takes the risk of having to sell them to individual or institutional investors to recover its investment.

The acceptance by a financial institution of the financial risks involved in a particular transaction for an agreed fee. For example, insurance companies underwrite insurance risks such as damage to property paying out money to policyholders wholly or in part to cover bonafide claims for compensation, merchant banks underwrite new share issues, guaranteeing to buy up any shares that are not sold in the open market, and bills of exchange.

Underwriting is the process that a lender or other financial service uses to assess the creditworthiness or risk of a potential customer. It also refers to an investment banker's process of packaging and selling a security on behalf of a client.

The Process of Underwriting works is the following manner:

Underwriting refers to the structured process used by financial service companies, such as banks, investors, or insurers, to determine and price the risk from a potential client. The underwriting process is a detailed and systematic analysis of a potential borrower's credit-worthiness, including employment history, salary, financial statements and performance, publicly available information, and independent credit reports. The underwriting process is intended to determine the credit needs, the quality of the collateral assets to be used to support the borrowing, and the borrower's ability to repay the debt. Upon completion of a formal underwriting process and a summary presented to a credit committee within the lender, the lender will either approve or reject the request for a loan.

Similarly, an insurance company will evaluate the risks of a potential candidate for insurance, based on a variety of actuarial factors. The bottom line from such an underwriting process is to price the insurance in accordance with its associated risk.

In securities trading, underwriting also includes assessing the risk and pricing the security accordingly. However, the formal underwriting process also involves agreeing to buy the security (by the underwriter) and then selling the security for a profit. The underwriter effectively takes a risk by agreeing to buy the security at the established price. In most instances, underwriters will line up buyers for the securities before they take on the security, so that it can "flip" the security to the buyer immediately.

Underwriting is a critical step in the credit analysis and risk pricing process for almost all financial service companies. For companies, understanding the underwriting process and the requirements at each stage of the process will allow a company to prepare and present itself accordingly. For investors, the information contained in an underwriting is crucial to understanding the risks and potential rewards from a security's underlying asset.

8.7 DUE DILIGENCE

The investigation of an asset, investment, or anything else to ensure that everything is as it seems. Due diligence helps a buyer or investors makes sure that there are no unexpected problems with the asset or investment and that he/she does not overpay. Due diligence can be a complex and formalized process in the acquisition of a company. Even when buying a house. For example, due diligence is time consuming and at times expensive endeavors, like a home inspection. However, due diligence is seen as a necessary part of doing business or buying an asset.

The process of investigating all facts, conditions, rules, laws, regulations, financial considerations, or any other such matters as would affect one's decision to purchase property. The various types of investigations as would comprise due diligence will vary from property to property. With the purchase of a home, it might include nothing more than a home inspection and a review of any restrictive covenants. When purchasing raw land for development, it could include zoning issues, possible environmental contamination, surveys, soil compaction studies, analysis of cost to develop versus value when completed and so on as far as the imagination can go.

1. **General:** Measure of prudence, responsibility, and diligence that is expected from, and ordinarily exercised by, a reasonable and prudent person under the circumstances.
2. **Business:** Duty of a firm's directors and officers to act prudently in evaluating associated risks in all transactions.
3. **Investing:** Duty of the investor to gather necessary information on actual or potential risks involved in an investment.
4. **Negotiating:** Duty of each party to confirm each other's expectations and understandings, and to independently verify the abilities of the other to fulfill the conditions and requirements of the agreement. Read more: http://www.businessdictionary.com/definition/due-diligence.html

8.8 BASIS OF ALLOTMENT

After the closures of the issue, the bids received are aggregated under different categories i.e., firm allotment, Qualified Institutional Buyers (QIBs), Non-Institutional Buyers (NIBs), Retail, etc. The over subscription ratios are then calculated for each of the categories as against the shares reserved for each of the categories in the offer document. Within each of these categories, the bids are then segregated into different buckets based on the number of shares applied for. The over subscription ratio is then applied to the number of shares applied for and the number of shares to be allotted for applicants in each of the buckets is determined. Then, the number of successful allottees is determined. This process is followed in case of proportionate allotment. In case of allotment for QIBs, it is subject to the discretion of the post issue lead manager.

8.9 BOOK BUILDING

Every business organisation needs funds for its business activities. It can raise funds either externally or through internal sources. When the companies want to go for the external sources, they use various means for the same. Two of the most popular means to raise money are Initial Public Offer (IPO) and Follow on Public Offer (FPO).

During the IPO or FPO, the company offers its shares to the public either at fixed price or offers a price range, so that the investors can decide on the right price. The method of offering shares by providing a price range is called book building method. This method provides an opportunity to the market to discover price for the securities which are on offer

Book Building may be defined as a process used by companies raising capital through Public Offerings-both Initial Public Offers (IPOs) and Follow-on Public Offers (FPOs) to aid price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional investors as well as the retail investors. The issue price is determined after the bid closure based on the demand generated in the process.

8.9.1 Book Building vs. Fixed Price Method

The main difference between the book building method and the fixed price method is that in the former, the issue price not decided initially. The investors have to bid for the shares within the price range given. The issue price is fixed on the basis of demand and supply of the shares.

On the other hand, in the fixed price method, the price is decided right at the start. Investors cannot choose the price. They have to buy the shares at the price decided by the company. In the book building method, the demand is known every day during the offer period, but in fixed price method, the demand is known only after the issue closes.

Book Building may be defined as a process used by companies raising capital through Public Offerings-both Initial Public Offers (IPOs) and Follow-on Public Offers (FPOs) to aid price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional investors as well as the retail investors. The issue price is determined after the bid closure based on the demand generated in the process.

8.9.2 Book Building in India

The introduction of book building in India was done in 1995 following the recommendations of an expert committee appointed by SEBI under Y.H. Malegam. The committee recommended and SEBI accepted in November 1995 that the book-building route should be open to issuer companies, subject to certain terms and conditions. In January 2000, SEBI came out with a compendium of guidelines, circulars and instructions to merchant bankers relating to issue of capital, including those on the book-building mechanism.

The principal intermediaries involved in a book building process are the companies, Book Running Lead Manager (BRLM) and syndicate members are the intermediaries registered with SEBI and eligible to act as underwriters. Syndicate members are appointed by the BRLM. The book building process is undertaken basically to determine investor appetite for a share at a particular price. It is undertaken before making a public offer and it helps determine the issue price and the number of shares to be issued.

8.9.3 Important Points in Book Building Process: the following are some of the important points:

1. The Issuer who is planning an offer nominates lead merchant banker(s) as 'book runners'.
2. The Issuer specifies the number of securities to be issued and the price band for the bids.
3. The Issuer also appoints syndicate members with whom orders are to be placed by the investors.
4. The syndicate members put the orders into an 'electronic book'. This process is called 'bidding' and is similar to open auction.
5. The book normally remains open for a period of 5 days.
6. Bids have to be entered within the specified price band.
7. Bids can be revised by the bidders before the book closes.
8. On the close of the book building period, the book runners evaluate the bids on the basis of the demand at various price levels.
9. The book runners and the Issuer decide the final price at which the securities shall be issued.
10. Generally, the number of shares is fixed; the issue size gets frozen based on the final price per share.
11. Allocation of securities is made to the successful bidders. The rest bidders get refund orders.

8.9.4 How is the Price Fixed?

All the applications received till the last dates are analyzed and a final offer price, known as the cut-off price is arrived at. The final price is the equilibrium price or the highest price at which all the shares on offer can be sold smoothly. If the price quoted by an investor is less than the final price, he will not get allotment.

If price quoted by an investor is higher than the final price, the amount in excess of the final price is refunded if he gets allotment. If the allotment is not made, full money is refunded within 15 days after the final allotment is made. If the investor does not get money or allotment in a month's time, he can demand interest at 15 per cent per annum on the money due.

8.10 GREEN SHOE OPTION FACILITY

A green shoe option is a clause contained in the underwriting agreement of an initial public offering (IPO). Also known as an over-allotment provision, it allows the underwriting syndicate to buy up to an additional 15% of the shares at the offering price if public demand for the shares exceeds expectations and the stock trades above its offering price.

(Example):

As the underwriter has the ability to increase supply if demand is higher than expected, a green shoe option can create price stability during an IPO.

Some IPO agreements do not include green shoe options in their underwriting agreements. This is usually the case when the issuer wants to fund a specific project at a pre-determined cost and does not want to be responsible for more capital than it originally sought.

A green shoe option can create greater profits for both the issuer and the underwriting company if demand is greater than expected. It also facilitates price stability.

The Green Shoe Company, now called Stride Rite Corp., was the first issuer to allow the over-allotment option to its underwriters, hence the name.

8.11 RIGHTS ISSUE

Rights offering is a group of rights offered to existing shareholders to purchase additional stock shares, known as subscription warrants, in proportion to their existing holdings. In a rights offering, the subscription price at which each share may be purchased is generally discounted relative to the current market price. Rights are often transferable, allowing the holder to sell them in the open market

In a rights offering, each shareholder receives the right to purchase a pro rata allocation of additional shares at a specific price and within a specific period (usually 16 to 30 days). Shareholders are not obligated to exercise this right.

8.11.1 Types of Rights Offerings

There are two general types of rights offerings: direct rights offerings and insured/standby rights offerings. In direct rights offerings, there are no standby/ backstop purchasers (purchasers willing to purchase unexercised rights) as the issuer only sells the number of exercised shares. If not subscribed properly, the issuer may be undercapitalized. Insured/standby rights offerings, usually the more expensive type, allow third-parties/backstop purchasers (e.g. investment banks) to purchase unexercised rights. The backstop purchasers agree to the purchase prior to the rights offering. This type of agreement ensures the issuing company that their capital requirements will be met.

8.11.2 Right Offering Advantages

Companies generally offer rights when they need to raise money. Examples include when there is a need to pay off debt, purchase equipment, or acquire another company. In some cases, a company may use a rights offering to raise money when there are no other viable financing alternatives. Other significant benefits of a rights offering are that the issuing company can bypass underwriting fees, there is no shareholder approval needed, and market interest in the issuer's common stock generally peaks. For existing shareholders, rights offerings present the opportunity to purchase additional shares at a discount.

8.11.3 Right Offering Disadvantages

Sometimes, rights offerings present disadvantages to the issuing company and existing shareholders. Shareholders may disapprove because of their concern with dilution. The offering may result in more concentrated investor positions. The issuing company, in an attempt to raise capital, may find that additional required filings and procedures associated with the rights offering are too costly and time-consuming; the costs of the rights offering may outweigh the benefits (cost-benefit principle).

8.12 BONUS ISSUE

A bonus issue, also known as a scrip issue or a capitalization issue, is an offer of free additional shares to existing shareholders. A company may decide to distribute further shares as an alternative to increasing the dividend payout. For example, a company may give one bonus share for every five shares held.

Bonus issues are given to shareholders when companies are short of cash and shareholders expect a regular income. Shareholders may sell the bonus shares and meet their liquidity needs. Bonus shares may also be issued to restructure company reserves. Issuing bonus shares does not involve cash flow. It increases the company's share capital but not its net assets.

Bonus shares are issued according to each shareholder's stake in the company. For example, a three-for-two bonus issue entitles each shareholder three shares for every two they hold before the issue. A shareholder with 1,000 shares receives 1,500 bonus shares (1000 x 3 / 2 = 1500).

8.12.1 Advantages and Disadvantages of Issuing Bonus Shares

Companies low on cash may issue bonus shares rather than cash dividends as a method of providing income to shareholders. Because issuing bonus shares increases the issued share capital of the company, the company is perceived as being bigger than it really is, making it more attractive to investors. In addition, increasing the number of outstanding shares decreases the stock price, making the stock more affordable for retail investors.

However, issuing bonus shares takes more money from the cash reserve than issuing dividends does. Also, because issuing bonus shares does not generate cash for the company, it could result in a decline in the dividends per share in the future, which shareholders may not view favorably. In addition, shareholders selling bonus shares to meet liquidity needs lowers shareholders' percentage stake in the company, giving them less control over how the company is managed.

8.12.2 Stock Splits and Bonus Shares

Stock splits and bonus shares have many similarities and differences. When a company declares a stock split, the number of shares increases, but the investment value remains the same. Companies typically declare a stock split as a method of infusing additional liquidity into shares, increasing the number of shares trading and making shares more affordable to retail investors.

When a stock is split, there is no increase or decrease in the company's cash reserves. In contrast, when a company issues bonus shares, the shares are paid for out of the cash reserves, and the reserves deplete.

8.13 PREFERENTIAL ISSUE

A preferential issue is an issue of shares or of convertible securities by listed companies to a select group of persons under Section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue. This is a faster way for a company to raise equity capital. The issuer company has to comply with the Companies Act and the requirements contained in Chapter pertaining to preferential allotment in SEBI (DIP) guidelines which inter-alia include pricing, disclosures in notice etc.

8.14 SUMMARY

Pre issue management is time bound program and concerned with Issue of shares, marketing, Coordination and underwriting of the issue. The post-issue merchant banker shall maintain close coordination with the registrars to the issue and arrange to depute its officers to the offices of various intermediaries at regular intervals after the closure of the issue

8.15 GLOSSARY

- Merchant bank — company that conducts underwriting, loan services, financial advising, and fundraising services for large corporations and high net worth individuals
- Underwriters — a person or company that underwrites an insurance risk

- Credit analysis method by which one calculates the creditworthiness of a business or organisation.

8.16 SELF-ASSESSMENT QUESTIONS

Q1. What is pre issue management?

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Q2. What is underwriting?

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Q3. Define the following

a) Book building

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b) Right issue

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c) Due diligence

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Q4. What is green shoe option facility?

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8.17 LESSON END EXERCISE

Q1. What is the difference between pre issue management and post issues management?

Q2. Elaborate the important points under book building process.

Q3. What are the Advantages and Disadvantages of Issuing Bonus Shares?

8.18 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

M.Y. Khan : Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi – 110 002.

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QUALIFIED INSTITUTIONS PLACEMENT

STRUCTURE

9.1 INTRODUCTION

A qualified institutional placement (QIP) is, at its core, a way for listed companies to raise capital, without having to submit legal paperwork to market regulators. It is common in India and other Southeast Asian countries. The Securities and Exchange Board of India (SEBI) created the rule to avoid the dependence of companies on foreign capital resources.

QIPs are helpful for a couple of reasons. Their use saves time as the issuance of QIPs and the access to capital is far quicker than through an FPO. The speed is because QIPs have far fewer legal rules and regulations to follow, making them much more cost-efficient. Further, there are fewer legal fees, and there is no cost of listing overseas.

Fast Facts

- *Qualified Institutional Placements are a way to issue shares to the public without going through standard regulatory compliance.*
- *QIPs instead follow a looser set of regulations, but where allottees are more highly regulated.*
- *The practice is mostly used in India and other Southeastern Asian countries.*

A qualified institutional placement was initially a designation of a securities issue given by the Securities and Exchange Board of India (SEBI). The QIP allows an Indian-listed company to raise capital from domestic markets without the need to submit any pre-issue filings to market regulators. The SEBI limits companies to only raising money through issuing securities.

The SEBI put forth the guidelines for this unique avenue of Indian financing on May 8th of 2006. The primary reason for developing QIPs was to keep India from depending too much on foreign capital to fund its economic growth. Before the QIP, there was growing concern from Indian regulators that its domestic companies were accessing international funding too readily via American depository receipts (ADRs), Foreign Currency Convertible Bonds (FCCBs) and Global Depository Receipts (GDR), rather than Indian-based capital sources. Authorities proposed the QIP guidelines to encourage Indian companies to raise funds domestically instead of tapping into overseas markets.

9.1.1 Regulations for Qualified Institutional Placements

To be allowed to raise capital through a QPI, a firm must be listed on a stock exchange along with the minimum shareholding requirements as specified in their listing agreement. Also, the company must issue at least ten percent of its issued securities to mutual funds or allottees.

Regulations also exist for the number of allottees on a QIP, depending on the specific factors within an issue. Additionally, no single allottee is allowed to own more than 50% of the total debt issue. Furthermore, allottees must not be related to in any way to promoters of the issue. Several more regulations dictate who may or may not receive QIP securities issues.

QIPs and Qualified Institutional Buyers (QIBs)

The only parties eligible to purchase QPIs are qualified institutional buyers (QIBs), which is an accredited investor, as defined by whatever securities and exchange governing body preside over it. This limitation is due to the perception that QIBs are institutions with expertise and financial power which allows them to evaluate and participate in capital markets, at that level, without the legal assurances of a follow-on public offer (FPO).

Real World Example

According to Business Standard, a leading news content provider in India, 47 firms together raised Rs 551 billion (USD 8 billion) through QIPs in FY 2018. This figure is the highest ever in a financial year. However, as of early 2019, 30 of those 47 QIPs were trading below their original issue prices.

9.2 OBJECTIVES

After reading this lesson you will be able to understand the concept of:

- Qualified Institutional Placements
- Placements Documents
- Placements program

9.3 PLACEMENT DOCUMENT

The placement document is personal to each prospective investor and does not constitute an offer or invitation or solicitation of an offer to the public or any other person or class of investors within or outside India, other than qualified institutional buyers, as defined in the SEBI Regulations.

9.4 PRICING

Method adopted by a firm to set its selling price is called pricing. It usually depends on the firm's average costs, and on the customer's perceived value of the product in comparison to his or her perceived value of the competing products. Different pricing methods place varying degree of emphasis on selection, estimation, and evaluation of costs, comparative analysis, and market situation.

9.5 INSTITUTIONAL PLACEMENT PROGRAMMES

❖ **About Institutional Placement Programme (IPP):** The Securities & Exchange Board Of India (SEBI) has notified the amendment of ICDR (issue of capital and disclosure requirements) Chapter VIII A regarding Institutional Placement Programme (IPP). The details of the Institutional Placement Programme (IPP) are as listed below

Applicability

The provisions of this Chapter shall apply to issuance of fresh shares and or offer for sale of shares in a listed issuer for the purpose of achieving minimum public shareholding in terms of Rule 19(2)(b) and 19A of the Securities Contracts (Regulation) Rules, 1957.

Definitions:

- "eligible securities" shall mean equity shares of same class listed and traded in the stock exchange(s);
- "eligible seller" include listed issuer, promoter/promoter group of listed issuer;
- "Institutional placement programme" means a further public offer of eligible securities by an eligible seller, in which the offer, allocation and allotment of such securities is made only to qualified institutional buyers in terms of this Chapter.

❖ **Conditions for institutional placement program:** An institutional placement program may be made only after a special resolution approving the institutional placement program has been passed by the shareholders of the issuer in terms of section 81(1A) of the Companies Act, 1956.

- No partly paid-up securities shall be offered.

- The issuer shall obtain an in-principle approval from the stock exchange(s).

❖ **Appointment of merchant banker:** An institutional placement program shall be managed by merchant banker(s) registered with the Board who shall exercise due diligence.

❖ **Offer Document :**

- The institutional placement program shall be made on the basis of the offer document which shall contain all material information, including those specified in Schedule XVIII.
- The issuer shall, simultaneously while registering the offer document with the Registrar of Companies, file a copy thereof with the Board and with the stock exchange(s) through the lead merchant banker.
- The issuer shall file the soft copy of the offer document with the Board as specified in Schedule V, along with the fee as specified in Schedule IV.
- The offer document shall also be placed on the website of the concerned stock exchange and of the issuer clearly stating that it is in connection with institutional placement program and that the offer is being made only to the qualified institutional buyers.
- The merchant banker shall submit to the Board a due diligence certificate as per Form A of Schedule VI, stating that the eligible securities are being issued under institutional placement program and that the issuer complies with requirements of this Chapter.

❖ **Pricing and allocation/allotment:**

- The eligible seller shall announce a floor price or price band at least one day prior to the opening of institutional placement program.
- The eligible seller shall have the option to make allocation/allotment as per any of the following methods –

  i) Proportionate basis;

  ii) Price priority basis; or

iii) Criteria as mentioned in the offer document.

- The method chosen shall be disclosed in the offer document.
- Allocation/allotment shall be overseen by stock exchange before final allotment.

❖ **Restrictions:**

- The promoter or promoter group who are offering their eligible securities should not have purchased and/ or sold the eligible securities of the company in the twelve weeks period prior to the offer and they should undertake not to purchase and / or sell eligible securities of the company in the twelve weeks period after the offer.
- Allocation/allotment under the institutional placement program shall be made subject to the following conditions:
- Minimum of twenty five per cent. of eligible securities shall be allotted to mutual funds and insurance companies: Provided that if the mutual funds and insurance companies do not subscribe to said minimum percentage or any part thereof, such minimum portion or part thereof may be allotted to other qualified institutional buyers;
- No allocation/allotment shall be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to promoters of the issuer:

  Provided that a qualified institutional buyer who does not hold any shares in the issuer and who has acquired the rights in the capacity of a lender shall not be deemed to be a person related to promoters.
- The issuer shall accept bids using ASBA facility only.
- The bids made by the applicants in institutional placement program shall not be revised downwards or withdrawn.

❖ **Minimum number of allottees:**

- The minimum number of allottees for each offer of eligible securities made under institutional placement program shall not be less than ten:

- Provided that no single allottee shall be allotted more than twenty five per cent of the offer size.
- The qualified institutional buyers belonging to the same group or who are under same control shall be deemed to be a single allottee.

❖ **Restrictions on size of the offer:**

- The aggregate of all the tranches of institutional placement programme made by the eligible seller shall not result in increase in public shareholding by more than ten per cent. or such lesser per cent. as is required to reach minimum public shareholding.
- Where the issue has been oversubscribed, an allotment of not more than ten per cent. of the offer size shall be made by the eligible seller.

❖ **Period of Subscription and display of demand:**

- The issue shall be kept open for a minimum of one day or maximum of two days.
- The aggregate demand schedule shall be displayed by stock exchange(s) without disclosing the price.

❖ **Withdrawal of offer:**

- The eligible seller shall have the right to withdraw the offer in case it is not fully subscribed.

❖ **Transferability of eligible securities:**

- The eligible securities allotted under institutional placement programme shall not be sold by the allottee for a period of one year from the date of allocation/ allotment, except on a recognised stock exchange.

9.6 SUMMARY

A qualified institutional placement (QIP) is, at its core, a way for listed companies to raise capital, without having to submit legal paperwork to market regulators. It is common in India and other Southeast Asian countries. Method adopted by a firm to set its selling price is called pricing. It usually depends on the firm's average costs, and on the customer's perceived value of the product.

9.7 GLOSSARY

- Document — a piece of written, printed, or electronic matter that Provides information or evidence or that serves as an official record
- Qualified institutional placement — capital-raising tool, primarily used in India and other parts of southern Asia, whereby a listed company can issue equity shares, fully and partly convertible

9.8 SELF-ASSESSMENT QUESTIONS

Q1. Who are called as qualified institutional buyers?

Q2. What do you mean by placement documents?

Q3. What is pricing?

9.9 LESSON END EXERCISE

Q1. Briefly explain the institutional placements program.

Q2. Define the QIBs and the regulations associated with them.

Q3. What do you mean by pricing explain with example?

9.10 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

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APPOINTMENT OF MERCHANT BANKERS

STRUCTURE

10.1 INTRODUCTION

(1) The issuer shall appoint one or more merchant bankers, at least one of whom shall be a lead merchant banker and shall also appoint other intermediaries, in consultation with the lead merchant banker, to carry out the obligations relating to the issue.

(2) The issuer shall, in consultation with the lead merchant banker, appoint only those intermediaries which are registered with the Board.

(3) Where the issue is managed by more than one merchant banker, the rights, obligations and responsibilities, relating inter aliato disclosures, allotment, refund and underwriting obligations, if any, of each merchant banker shall be predetermined and disclosed in the offer document as specified in Schedule I

Provided that where any of the merchant bankers is an associate of the issuer, it shall declare itself as a marketing lead manager and its role shall be limited to marketing of the issue.

(4) The lead merchant banker shall, only after independently assessing the capability of other intermediaries to carry out their obligations, advise the issuer on their appointment.

(5) The issuer shall enter into an agreement with the lead merchant banker in the format specified in Schedule II and with other intermediaries as required under the respective regulations applicable to the intermediary concerned:

Provided that such agreements may include such other clauses as the issuer and the intermediary may deem fit without diminishing or limiting in any way the liabilities and obligations of the merchant bankers, other intermediaries and the issuer under the Act, the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the rules and regulations made there under or any statutory modification or statutory enactment thereof:

Provided further that in case of ASBA process, the issuer shall take cognizance of the deemed agreement of the issuer with Self Certified Syndicate Banks.

(6) An issuer shall, in case of an issue made through the book building process, appoint syndicate members and in the case of any other issue, appoint bankers to issue, at all mandatory collection centers as specified in Schedule III and such other collection centres as it may deem fit.

(7) The issuer shall appoint a registrar which has connectivity with all the depositories:

Provided that if issuer itself is a registrar to an issue registered with the Board, then another registrar to an issue shall be appointed as registrar to the issue:

Provided further that the lead merchant banker shall not act as a registrar to the issue in which it is also handling the post issue responsibilities.

For the purpose of this regulation, in case of a book built issue, the lead merchant banker appointed by the issuer shall act as the lead book runner.

Fundamentally, merchant banks are financial institutions. They engage in business loans as well as underwriting. They mostly cater to large enterprises and individuals of high net worth. They perform a combination of consultancy and banking services. They provide consultancy on matters pertaining the finances, marketing, management, and law. Such consultancy services assist starting of businesses, raise finance, modernise, expand or restructure a business, revival of sick units as well as provide assistance to companies in registering, buying and selling shares. They do not perform the functions of depositories or retail lender institutions. They are, instead, intermediaries. They also often assist international transactions that involve multinational corporations.

For example, if ABC, a multinational corporation intends to take over a smaller company, MNO, it will approach a merchant bank for advice on the acquisition and might also make use of the merchant bank in the financing aspect of the acquisition, in the form of underwriting or loans.

It was in 1967 that National Grindlays Bank introduced the concept of merchant banks in India. In 1972, the State Bank of India became the first Indian Commercial Bank to set up a separate Merchant Banking Division. Till date, however, merchant banks in India have been operating mostly as issue houses and not full- fledged merchant banks like in other countries.

The Securities Board of India, under the SEBI Regulations[3], exercising its powers under Section 30, SEBI Act, 1992[4], has made regulations for various components of the capital market. The merchant bankers are regulated by SEBI (Merchant Bankers) Regulations, 1992. H.R.Machirajuhas described the objectives of these regulations in the following terms:

"The merchant bankers regulations which seek to regulate the raising of funds in the primary market would assure for the issuer a market for raising resources at low cost, effectively and easily, ensure a high degree of protection of the interest of the investors and provide for the merchant bankers a dynamic and competitive market with high standard of professional competence, honesty, integrity and solvency. The nine regulations would promote a primary market which is fair, efficient, flexible and inspire confidence."

10.1.1 SEBI (Merchant Bankers) Regulations, 1992

This regulation has five chapters pertaining to definitions, compulsory registration with SEBI, renewal of certificate and fee payable to SEBI, capital adequacy requirements, obligations and responsibilities, code of conduct, procedure for inspection by SEBI, of documents, records and books of accounts, procedure in case of default, i.e. the action to be taken against concerned merchant banker (cancellation or suspension of registration by SEBI).

10.1.2 Categories of Merchant bankers

The Securities Exchange Board of India segregated merchant bankers into the following four categories:

- Category-I advisor, issue manager, consultant, portfolio manager and underwriter.

- Category-II Consultant, advisor, portfolio manager, and underwriter.
- Category-III Advisor, underwriter, and consultant only.
- Category-IVAdvisor or consultant to issue of capital.

Given the above provisions, the role of lead managers of an issue could be fulfilled only by merchant bankers registered under Category-I alone. From 9 December 1997, however, all other categories were abolished, and merchant bankers can now only be registered under Category-I by SEBI.

10.1.3 Capital Adequacy Norms

The Securities Exchange Board of India (SEBI) has prescribed capital adequacy norms for merchant bankers to register under the various categories. The minimum 'net worth' set by SEBI for Category-I of merchant bankers was initiallyfixed at the value of Rs. 1 crore and later raised to the value of Rs. 5 crores through an amendment of the regulations in the year 1995.[13]

Other guidelines in the SEBI (Merchant Bankers) Regulations, 1992

SEBI has laid down several other guidelines in that are a must to be complied with. These are as follows:

- Submission of the half-yearly unaudited result of financial documents to SEBI.[14]
- Compulsory Appointment of Compliance Officer.[15]
- SEBI may send in an officer for inspection of records, books, etc.[16]
- SEBI may collect an authorization fee followed by annual or renewal fees.[17]
- There exists a minimum underwriting obligation upon lead managers to the extent of 5% of the size of the issue or of Rs. 25 lakh, whichever is lesser

10.1.4 Code of conduct for merchant banker

Since merchant banking is a profession, like all other professionals, merchant bankers must abide by a specific and strict code of conduct. The code of conduct for merchant bankers states that a merchant banker must:

- Protect the interest of the investors to the best of his capabilities
- Conduct business with a high level of dignity, integrity, and fairness
- Professionally and ethically fulfill all obligations
- Refrain from discriminating against clients
- Make sure that all necessary documents like letter of offer, prospectus, etc. are available at the time of issue to all investors
- Advise clients in the most efficient way possible
- Inform clients about any penal action taken against them by the Securities Exchange Board of India.
- Inform SEBI regarding any legal proceedings that have been initiated against him or her.
- Develop an internal code of conduct to govern internal operations
- Make sure that all the employees are working under them are capacitated to be merchant bankers.
- Be responsible for all the acts of its agents and employees
- Not create false markets
- Abide strictly by the rules and guideline laid down in Securities Exchange Board of India (Merchant Bankers) Regulations, 1992.

10.1.5 Role of merchant bankers

- Raising finance

Merchant Bankers help their clients in raising finance by way of issue of a debenture, shares, bank loans, etc. They tap both the domestic as well as the international markets. Finance raised by this method may be used for commencing a new project or business or it may even be used for expansion and modernization of an existing business.

- Promotional activities

In India, merchant bankers play the role of promoter of industrial enterprises. They help entrepreneurs in conceiving ideas, identifying projects, preparation of feasibility reports, getting Government approvals as well as incentives, etc. Merchant bankers may, at times, also provide assistance in financial and technical collaborations and i joint ventures.

- Brokers in stock exchanges

Merchant bankers buy and sell shares in the stock exchange on behalf of the clients. They additionally conduct researches on equity shares, advise the clients on the share to be purchased, the time of purchase, quantity of such purchase and the time for selling these shares. Mutual funds offer merchant banking services, large brokers, investment banks, and venture capitals.

- Project management

Merchant bankers offer help to clients in several ways in the process of project management. They offer advice regarding the location of the project, preparation of project report, in carrying out feasibility studies, planning out the financing of the project, tapping sources of such finance, information regarding incentives and concessions from the government.

- Advise on modernisation and expansion

Merchant bankers advise on amalgamations, mergers, acquisitions, takeovers, foreign collaborations, diversification of business, technology up-gradation, joint-ventures, etc.

- Managing public issue

They provide the following services in the above-mentioned process:

- the timing of the public issue
- the size of the issue
- the price of the issue
- acting in the capacity of manager to the issue

- assisting in receiving applications as well as allotment of securities
- appointment of brokers as well as underwriters of the issue
- listing of the shares on the relevant stock exchange.

Initially, merchant bankers mostly performed the function of managing new public issues of corporate securities of either newly formed companies or existing companies and foreign companies in the process of dilution of equity provided under the FERA. Here, they acted as sponsors of issues. They get the permission of the Controller of Capital Issues (which is now the SEBI). They also provide several other services to guarantee success in the process of marketing of securities. These services include, preparation of the prospectus, making underwriting arrangements, appointing registrars, bankers, brokers to the issue, arranging for advertising and publicity as well as compliance with the listing requirements of the relevant stock exchanges, etc. A merchant banker acts as experts on the terms, type and timing of the issues of the corporate securities and makes them suitable for investors and provides freedom and flexibility to issuing companies.

- Credit syndication

A merchant banker provides specialized services in the stages of preparation of a project, the loan applications required for the raising of short-term and long-term credit from various banks and financial institutions, etc. They help in managing Euro-issues and raising funds abroad.

- Handling government consent for industrial projects

A merchant banker completes all formalities for his or her client, about government permission to expand and modernize business (necessary for companies) and commencing new businesses (necessary for business people).

- Special assistance to entrepreneurs and small companies

Merchant banker advises entrepreneurs and small companies on availability and existence of business opportunities, concessions, incentives and government policies and helps them to take advantage of this option available to them, to the best of their capabilities.

- Services to PSU's

Merchant banker offers numerous services to public sector undertakings and units and their public utilities. They assist in raising capital (long-term), in the marketing of securities, in foreign collaborations as well as in arranging for long-term finances from lending institutions.

- Revival of sick units

A merchant bank helps in reviving sick industrial units. They negotiate with various agencies such as banks, long-term lending institutions, and the Board for Industrial and Financial Reconstruction (BIFR). They also plan and execute full revival packages

- Portfolio management of sick units

Merchant bankers offer revival services to companies that issue the securities as well as investors. These bankers advise clients, which are usually institutional investors, on investment decisions. They undertake purchase and sale of securities to provide them with portfolio management services. Some of these bankers are operating mutual funds as well as offshore funds.

- Corporate restructuring

These services of merchant bankers include mergers, acquisitions (about existing units), the sale of units and disinvestment. These procedures demand proper negotiations, thorough preparation of numerous documents and completion of lengthy legal formalities. Merchant bankers fulfill all these formalities on behalf of the clients.

- Money market operations

A merchant bank deals with as well as underwrites short-term instruments like:

- government bonds
- certificate of deposit issued by banks and financial institutions
- commercial paper issued by large corporate firms
- treasury bills issued by the government (in India by the Reserve Bank of India)

- Leasing and finance services

Merchant banks also assist leasing and financing services. A lease refers to a contract that exists between a lessor and a lessee, by which the lessor permits the use of a specific asset that belongs to him or her(like equipment, land) by the lessee for a specified period. There is a fee charged by the lessor charges which is referred to asthe rentals. Several merchant bankers offer leasing and financing facilities to the customers. Some banks also keep venture capital funds to assist entrepreneurs. These banks also help the companies to raise finance through public deposits.

- Servicing issues

Merchant bankers now also act as the paying agents for service of the debt-securities and act as the registrars as well as the transfer agents. In this way, they maintain the registers of the shareholders and the debenture holders and also arrange the payment of dividend and or the interest that is due to them.

- Management of dividend and interest

Merchant banks help the clients in the management of the interest on the debentures or loans, as well as the dividend on the shares. In addition to this, they advise the client with respect to the timings (whether interim or annual) of the dividend as well as the rate of the dividend.

- Other services

Along with all the services mentioned above, the merchant bankers also offer certain other specialised services such as advisory services on matters such as mergers, amalgamations, tax related matters, on the matter of recruitment of executives, the cost of audit as well as its management among several others. The scope of functions, activities and the services provided by the merchant bankers are ever increasing and growing with the constant development in the money market.

10.2 OBJECTIVES

After reading this lesson you will be able to understand the concept of:

- SEBI

- Merchant bankers
- Offer Documents
- Listing agreements

10.3 OFFER DOCUMENT

Offer document means Prospectus in case of a public issue or offer for sale and Letter of offer in case of a rights issue, which is filed with the Registrar of Companies (ROC) and Stock Exchanges. An offer document covers all the relevant information to help an investor to make his/her investment decision.

An offer document is a formal legal document that is required by and filed with the regulatory bodies providing details about the investment offerings sale to the public or on private placement basis. This document contains facts that are essential for the investors to make informed investment decisions.

10.3.1 Types of Offer Documents

Since 1992, the entire IPO/FPO regulation is driven by disclosures inform the investors as much as is possible and is relevant for him to take an informed investment decision. The disclosure requirements regarding the issuance of securities are covered in detail in the SEBI ICDR Regulations 2009.

'Offer document' is a document which contains all the relevant information about the company, promoters, projects, financial details, objects of raising the money, forms of the issue etc. and is using for inviting subscription to the issue being made by the issuer. Offer document is called 'Prospectus' in case of a public issue and 'letter of offer' in case of rights issue.

- Draft Offer Document refers to the first document filed by companies with SEBI and stock exchanges for approval, who after reviewing, communicate their observations to the Company, which the company has to incorporate in the offer document. SEBI typically requires a period of 30 days for processing a draft offer document. The draft offer document is placed by SEBI on its website. It is also placed on the websites of recognized stock exchanges where specified securities are proposed to be listed and merchant bankers associated with the issue for public comments for a period of at least 21 days. Furthermore, the issuer either on the date of filing the draft offer document with SEBI or on the next day has to make a public announcement in one English national daily newspaper, one Hindi national daily newspaper and one regional language newspaper at the place where its registered office is situated, disclosing to the public the fact of filing of draft offer document and inviting the public to give their comments to SEBI.

The lead merchant bankers, after expiry of the above period (of at least 21 days), file with SEBI a statement giving information of the comments received by them or the issuer on the draft offer document during that period and the consequential changes, if any, to be made in the draft offer document.

- Red herring prospectus red herring prospectus (RHP) is a preliminary registration document that is filed with SEBI in the case of book building issue which does not have details of either price or number of shares being offered or the amount of issue. This means that in case price is not disclosed, the number of shares and the upper and lower price bands are disclosed. On the other hand, an issuer can state the issue size and the number of shares are determined later. In the case of book-built issues, it is a process of price discovery as 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 filed thereafter with ROC is called a prospectus.

- Abridged Prospectus is an abridged version of offer document in public issue and is issued along with the application form of a public issue. It contains all the salient features of the prospectus.

- Prospectus is an offer document in case of a public issue which has all relevant details including price and number of shares or convertible securities being offered. This document is registered with ROC before the issue opens in case of a fixed price issue and alters the closure of the issue in case of a book built issue.

- Shelf prospectus is a prospectus which enables an issuer to make a series of issues with in a period of 1 year without the need of filing a fresh prospectus every time. This facility is available to public sector banks, schedule banks and public financial institutions.

- Letter of offer is an offer document in case of a Right issue of shares or convertible securities and is filled with stock exchanges before the issue opens.

- Abridged letter of offer is an abridged version of the letter of offer. It is sent to all the shareholders along with the application form.

- Placement document is an offer document for the purpose of Qualified Institutional Placement and contains all the relevant and material disclosures.

Accessing draft offer documents before even the IPO/FPO is cleared by SEBI

The draft offer document/letter of offer remains posted on SEBI website for a period of 21 days from the date of filing the same to SEBI and can also be downloaded from there

Public comments/complaints on the issuer company or others connected with the issue.

The objective of making an offer document public is to invite public comments. The comments should be submitted within 21 days of the filing of the draft offer document by the company with SEBI. Full copy of the offer document is available from the company, its lead managers and syndicate members. These are also available on the websites of SEBI, the lead managers, the stock exchanges and the company

10.4 LISTING AGREEMENT

A listing agreement is a document in which a property owner (as principal) contracts with a real estate broker (as agent) to find a buyer for the owner's property. The owner executes the listing agreement to give a real estate broker the authority to act as the owner's agent in the sale of the owner's property, for which the owner agrees to pay a commission.

A listing agreement can also cover documentation for an company's listing of its securities on an exchange, such as the New York Stock Exchange (NYSE).

In the first definition, a listing agreement authorizes the broker to represent the principal and the principal's property to third parties, including securing and submitting offers for the property. Under the provisions of real estate license laws, only a broker can act as an agent to list, sell or rent another person's real estate, and in most states, listing agreements must be in writing. Because the same considerations arise in nearly all real estate transactions, most listing agreements require similar information, including a description of the property (which should have lists of any personal property that will be left with the real estate when it is sold, and of any fixtures and appliances that aren't included), listing price, broker's duties, seller's duties, broker's compensation, terms for mediation, a listing-agreement termination date, and additional terms and conditions. There are several different types of listing agreements:

All Issuers whose securities are listed on the NSE shall comply with the listing conditions and requirements contained in the Listing Agreement Form appearing in Appendix F to this Regulation or such other conditions and requirements as the Relevant Authority may from time to time prescribe in addition thereto or in modification or substitution thereof.

The listing agreement is a contract between the seller and the listing broker. It sets out the conditions of the listing. While the details of the agreement should be negotiated, a listing agreement generally includes the following:

(1) the length of the listing period -as the seller you'd want to be able to switch brokers if the sale does not happen as quickly as you like, while the broker wants to have the listing period as long as possible, recognizing that it often takes a fair amount of time and effort and expense to generate other broker interest and a sale, and that if the time is too short s/he loses the commission.

(2) The desired sales price, as well as a price that might be accepted;

(3) the amount of the commission - while the commission rate is generally claimed to be "standard" within a community, don't believe it, and it is sometimes possible to negotiate different rates up front — such as 2% to the

listing broker and 3% to the selling broker. However, if the rates are too low, the listing broker may not want to do all that is necessary to "push" your house, such as advertising it heavily, while the selling broker may prefer to sell her prospects a home that carries a higher commission than she'd get on your home.

(4) Any exceptions to the commission. For example, would there be a reduced fee (or no fee at all) if you sell the house on your own, or you sell it to a friend who expressed interest? Generally the broker will insist on you naming any such persons in the listing agreement.

The seller should pay very careful attention to the listing agreement, and probably should have it reviewed by a lawyer. It is a critically important document to the seller. Once a broker produces a willing and able buyer, assuming all conditions are met, the seller owes the broker his or her full commission unless the terms of the listing agreement provide otherwise (for example, "The commission is payable at close of escrow and is conditioned upon the close of escrow"). If for any reason the seller chooses not to sell (perhaps s/he wants to hold out for more money, or a proposed job transfer falls through), the commission must still be paid unless the terms of the listing agreement are negotiated otherwise

10.5 EVENT BASED AND TIME BASED COMPLIANCE UNDER LISTING AGREEMENT

The landscape of listing compliance underwent a change for the better with introduction of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations") which was notified on 2nd September, 2015 and made effective from 1st December, 2015. It brought a consolidated legislation into force and repealed the Listing Agreement along with innumerable circulars/notifications issued thereunder.

With the advent of time and experience gained in implementing the Listing Regulations by the Stock Exchanges and the SEBI. The SEBI has come out with several amendments to the Listing Regulations and issued several Circulars and Notifications which have further changed/streamlined the regulatory & compliance landscape.

Further, the recommendations of the Uday Kotak Committee on Corporate Governance notified by SEBI vide the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018 dated May 9, 2018 has raised several action points which require active consideration and decision by the management of listed entities for its implementation, documentation and appropriate disclosures, inter-alia, in the Annual Report for the Financial Year 2018-19 onwards.

Consequentially, sole reading of the Listing Regulations as it stands today may be insufficient in understanding the current compliance framework of an Equity Listed entity in its totality, unless they are correlated with the Circulars and Notifications issued by SEBI and directives issued by the Stock Exchanges.

The Author has compiled, analyzed and summarized the relevant amendments to the Listing Regulations, several Circulars and Notifications issued by SEBI and directives issued by the Stock Exchanges with the actions to be taken in order to give the readers a comprehensive view of the regulatory requirements.

(Note: All Regulations mentioned hereunder pertain to Listing Regulations only unless mentioned otherwise)

1) SEBI Circular No. CIR/CFD/CMD/4/2015 dated 9th September, 2015 – Disclosure under Regulation 30 of LODR – Continuous disclosure requirements for listed entities.

   Companies must refer to this Circular in addition to Regulation 30 and Schedule III of the Listing Regulations for the details to be covered while disclosure of material events/information under Regulation 30 of the Listing Regulations is being made – Insufficiency in this respect is usually followed by query/warning from stock exchanges.

2) The SEBI (LODR) (Amendment) Regulations, 2015 vide notification no. SEBI/ LAD-NRO/GN / 2015-16/27 dated December 22, 2015

   Requirement of providing Business Responsibility Report as part of the Annual Report has been extended to Top 500 listed entities based on market capitalization from Top 100 earlier. Companies other than Top 500 may voluntarily comply.

3) SEBI FAQs dated 19th, 21st & 29th January, 2016 on Listing Regulations Key takeaways:

a) Criteria under both Companies Act, 2013 and applicable AS to be considered for determining Associate Company and Related Party – if either is fulfilled, such entity to be classified as Associate Company and Related Party.

b) Certificate of compliance under Regulation 17(8) may be signed by officials (Managing Director/Wholetime Director) holding powers, duties, responsibilities of CEO/CFO irrespective of designation.

c) Related parties to abstain from voting on material RPTs whether party to the particular transaction or not. (As per latest version of Reg. 23(4) a Related party, can now vote against, but not in favour of a resolution for approval of a material RPT)

d) Director of a listed entity can be member of upto 10 committees and chairman of upto 5 committees in other listed companies /unlisted public companies put together.

e) Listed Holding company has to make disclosure under Regulation 30(9) of events or information with respect to subsidiaries which are *material* for the listed entity though its listed subsidiary company may have made disclosure to stock exchange in its own right.

f) Company's policy for determination of material subsidiary can have stricter criteria than Listing Regulations, i.e. Income or Net Worth exceeding 20% of consolidated figures.

g) Listed company having subsidiary to be submit two sets of Form A/Form B for financial results *(should be read as Statement of Impact of Audit Qualification/ Declaration of unmodified audit opinion)*

h) Agreements with media companies or their associates, which are not in the ordinary course of business are only to be disseminated on company's website under Regulation 46(2)(n).

i) Requirement to update change in website within 2 days of change pertains to content uploaded in terms of Regulation 46.

j) “Working day” shall mean working day of the stock exchange where the securities of the company are listed.

k) Policy for Preservation of documents pertain to documents which are maintained under “securities laws” defined under Regulation 2(1)(zf) i.e. the SEBI Act, the Securities Contracts(Regulation) Act, 1956, the Depositories Act, 1996, and the provisions of the Companies Act, 1956 and Companies Act, 2013, and the rules, regulations, circulars or guidelines made there under.

l) Disclosure under Regulation 30 on acquisition of 5% or more shares/voting rights in a company includes acquisition of both listed and unlisted companies.

4) The SEBI (LODR) (Amendment) Regulations, 2016 vide notification no. SEBI/ LAD-NRO/GN/ 2016-17/001 dated May 25, 2016

Amendments in brief:

a) In Regulation 33, i.e. Financial Results, Form A (for audit report with unmodified opinion) or Form B (for audit report with modified opinion) has been done away with;

   Statement of Impact of Audit Qualification introduced for companies with Audit Report with modified opinion. For Audit Reports with unmodified opinion, listed entities are required to furnish a declaration to that effect to the Stock Exchange(s) while publishing the annual audited financial results.

b) Regulation 33(7) – omitted – which earlier read “The listed entity shall on the direction issued by the Board, carry out the necessary steps, for rectification of modified opinion and/or submission of revised pro-forma financial results, in the manner specified in Schedule VIII.”

c) Annual Report shall include Statement on Impact of Audit Qualifications as stipulated in regulation 33(3)(d), if applicable.

d) Cumulative impact of Audit qualification on earning per share, total expenditure, total liabilities or any other financial item(s) which may be impacted to be disclosed.

e) Management of listed entity has option to explain its views on audit qualifications to be included in Statement on Impact of Audit Qualification.

f) If management is unable to quantify impact of audit qualification, then estimate of impact to be prepared and reviewed by auditor, if estimate not possible, then provide reason which is to be reviewed by auditor.

g) Deletion of Schedule VIII (Manner of reviewing Form B accompanying audited financial results).

5) The SEBI (LODR) (Second Amendment) Regulations, 2016 vide notification no. SEBI/ LAD-NRO/GN/2016-17/008 dated July 08, 2016

   Amendments in brief: Introduction of Dividend Distribution Policy to be formulated by Top 500 listed entities based on market capitalization to be calculated as of 31st March of every financial year which shall be disclosed in their annual reports and on their websites. Other than Top 500 listed entities may comply voluntarily.

6) The SEBI (LODR) (Third Amendment) Regulations, 2016 vide notification no. SEBI/LAD-NRO/GN/2016-17/025 dated January 4, 2017.

Amendments in brief:

a) Ambit of Regulation 26 extended to Employees, KMPs and Promoters – Heading changed from ”Obligations with respect to directors and senior management” to ”Obligations with respect to employees including senior management, key managerial persons, directors and promoters”

b) Addition of sub-regulation (6) to Regulation 26 which states –

   “No employee including key managerial personnel or director or promoter of a listed entity shall enter into any agreement for himself or on behalf of any other person, with any shareholder or any other third party with regard to compensation or profit sharing in connection with dealings in the securities of such listed entity, unless prior approval for the same has been obtained from the Board of Directors as well as public shareholders by way of an ordinary resolution:

   Provided that such agreement, if any, whether subsisting or expired, entered during the preceding three years from the date of coming into force of this sub-regulation, shall be disclosed to the stock exchanges for public dissemination:

Provided further that subsisting agreement, if any, as on the date of coming into force of this sub-regulation shall be placed for approval before the Board of Directors in the forthcoming Board meeting:

Provided further that if the Board of Directors approve such agreement, the same shall be placed before the public shareholders for approval by way of an ordinary resolution in the forthcoming general meeting:

Provided further that all interested persons involved in the transaction covered under the agreement shall abstain from voting in the general meeting.

Explanation – For the purposes of this sub-regulation, 'interested person' shall mean any person holding voting rights in the listed entity and who is in any manner, whether directly or indirectly, interested in an agreement or proposed agreement, entered into or to be entered into by such a person or by any employee or key managerial personnel or director or promoter of such listed entity with any shareholder or any other third party with respect to compensation or profit sharing in connection with the securities of such listed entity."

7) SEBI Circular No. SEBI/HO/CFD/CIR/P/2017/004 dated January 5, 2017 – Guidance note on Board Evaluation: The Guidance crystallizes the Board Evaluation criteria, procedure and removes ambiguities.

8) The SEBI (LODR) (Amendment) Regulations, 2017 vide notification no. SEBI/ LAD/NRO/ GN/ 2016-17/029 dated February 15, 2017

   Amendment in brief – Requirement of No Objection letter from stock exchanges before filing of draft scheme relaxed for schemes solely for merger of a wholly owned subsidiary with its holding company done away with. However, that such draft scheme shall be filed with the stock exchanges for the purpose of disclosures.

9) SEBI Circular No. SEBI/HO/OIAE/IGRD/CIR/P/2018/58 dated March 26, 2018 on "Investor grievance redress mechanism – new policy measures".

   The Circular states that SEBI has received inputs from listed companies and intermediaries that investor grievances can be resolved faster if the grievance been taken up directly with the entity at the first instance.

Accordingly, with effect from August 01, 2018, aggrieved investors may use SCORES platform to submit the grievance directly to companies / intermediaries and the complaint shall be forwarded to the entity for resolution. The entity is required to redress the grievance within 30 days, failing which the complaint shall be registered in SCORES. In case, the listed company or registered intermediary fails to redress the complaint to the investor's satisfaction, the investor may file a complaint in SCORES.

An Investor may lodge a complaint on SCORES within limitation period of 3 years from the date of cause of complaint, where –

- Investor has approached the listed company or registered intermediary for redressal
- The company or intermediary rejected the complaint, or
- Complainant does not receive any communication from Company or Intermediary, or
- Complainant is not satisfied with the reply given or redressal action taken.

10) SEBI Circular No. SEBI/HO/MIRSD/DOP1 /CIR/P/2018/73 dated 20th April, 2018 titled: "Strengthening the Guidelines and Raising Industry standards for RTA, Issuer Companies and Banker to an Issue"

This Circular is intended to remove lack of clarity and establish a framework in matters of payment of Dividends/Interests/Redemptions, Handling/Maintenance/ Update of Records, Transfer of Securities, Due Diligence and introduces Internal Audit of RTAs. Though applicability extends to activities in the domain of RTAs and Bankers, the onus of compliance with the Circular is on the listed entity.

10.6 SUMMARY

The issuer shall appoint one or more merchant bankers, at least one of whom shall be a lead merchant banker and shall also appoint other intermediaries, in consultation with the lead merchant banker, to carry out the obligations relating to the issue.

Offer document means Prospectus in case of a public issue or offer for sale and Letter of offer in case of a rights issue, which is filed with the Registrar of Companies (ROC) and Stock Exchanges. An offer document covers all the relevant information to help an investor to make his/her investment decision.

An offer document is a formal legal document that is required by and filed with the regulatory bodies providing details about the investment offerings sale to the public or on private placement basis. A listing agreement is a document in which a property owner (as principal) contracts with a real estate broker (as agent) to find a buyer for the owner's property. The owner executes the listing agreement to give a real estate broker the authority to act as the owner's agent in the sale of the owner's property, for which the owner agrees to pay a commission

10.7 GLOSSARY

- Merchant bank — a bank dealing in commercial loans and investment
- Capital Adequacy Ratio — known as Capital to Risk Assets Ratio, is the ratio of a bank's capital to its risk
- Code of conduct — set of rules outlining the social norms and rules and responsibilities of, or proper practices for, an individual, party or organization
- Modernisation — the process of adapting something to modern needs or habits
- Expansion — the action of becoming larger or more extensive

10.8 SELF-ASSESSMENT QUESTIONS

Q1. Who are Merchant Bankers?

Q2. What is offer document?

Q3. What are the different categories of merchant bankers?

10.9 LESSON END EXERCISE

Q1. What are the guidelines issued by SEBI to regulate the functioning of merchant bankers?

Q2. Explain the different types of offer documents.

Q3. What do you mean by listing agreement?

Q4. What is event based and time based compliance under listing agreements?

10.10 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

M.Y. Khan : Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi – 110 002.

Shashi K Gupta : Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Nishja Aggarwal Ram Road, 24, Daryaganj, New Delhi -

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https://www.moneycontrol.com/glossary/ipo/offer-document_939.htm

https://www.investopedia.com/terms/l/listing-agreement.asp

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SECONDARY MARKET–STOCK EXCHANGE

STRUCTURE

11.1 INTRODUCTION

When people talk stocks, they are usually talking about companies listed on major stock exchanges like the New York Stock Exchange (NYSE) or the Nasdaq. Many of the major American companies are listed on the NYSE, and it can be difficult for investors to imagine a time when the bourse wasn't synonymous with investing and trading stocks. But, of course, it wasn't always this way, there were many steps along the road to our current system of stock exchanges. You may be surprised to learn that the first stock exchange thrived for decades without a single stock being traded of a stock exchange that dealt exclusively in promissory notes and bonds, but in the 1500's there were no real stocks. There were many flavors of business-financier partnerships that produced income like stocks do, but there was no official share that changed hands

Belgium boasted a stock exchange as far back as 1531, in Antwerp. Brokers and moneylenders would meet there to deal with business, government and even individual debt issues. It is odd to think of a stock exchange that dealt exclusively in promissory notes and bonds, but in the 1500's there were no real stocks. There were many flavors of business-financier partnerships that produced income like stocks do, but there was no official share that changed hands.

11.1.1 History of Stock Exchange

The stock exchange or market is a place where stocks, shares and other long-term commitments or investment are bought and sold. The economic significance of a stock market results from the increased marketability resulting from a stock exchange share quotation. The stock exchange is an essential institution for the existence of the capitalist system of the economy and for the smooth functioning of the corporate form of organisation.

The Securities Contracts (Regulation) Act of 1956 defines, a stock exchange as "an association, organisation or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling, business in buying, selling and dealing in securities."

Stock Exchanges are noted as "an essential concomitant of the Capitalistic System of economy. It is indispensable for the proper functioning of corporate enterprise. It brings together large amounts of capital necessary for the economic progress of a country. It is a citadel of capital and pivot of money market. It provides necessary mobility to capital and indirect the flow of capital into profitable and successful enterprises. It is the barometer of general economic progress in a country and exerts a powerful and significant influence as a depressant or stimulant of business activity."

The first organised stock exchange in India was started in 1875 at Bombay and it is stated to be the oldest in Asia. In 1894 the Ahmadabad Stock Exchange was started to facilitate dealings in the shares of textile mills there. The Calcutta stock exchange was started in 1908 to provide a market for shares of plantations and jute mills.

Then the madras stock exchange was started in 1920. At present there are 24 stock exchanges in the country, 21 of them being regional ones with allotted areas. Two others set up in the reform era, viz., the National Stock Exchange (NSE) and Over the Counter Exchange of India (OICEI), have mandate to have nation-wise trading.

They are located at Ahmedabad, Vadodara, Bangalore, Bhubaneswar, Mumbai, Kolkata, Kochi, Coimbatore, Delhi, Guwahati, Hyderabad, Indore, Jaipur' Kanpur, Ludhiana, Chennai Mangalore, Meerut, Patna, Pune, Rajkot.

The Stock Exchanges are being administered by their governing boards and executive chiefs. Policies relating to their regulation and control are laid down by the Ministry of Finance. Government also Constituted Securities and Exchange Board of India (SEBI) in April 1988 for orderly development and regulation of securities industry and stock exchanges.

In the 1600's, the Dutch, British, and French governments all gave charters to companies with East India in their names. On the cusp of imperialism's high point, it seems like everyone had a stake in the profits from the East Indies and Asia except the people living there. Sea voyages that brought back goods from the East were extremely risky on top of Barbary pirates, there were the more common risks of weather and poor navigation.

To lessen the risk of a lost ship ruining their fortunes, ship owners had long been in the practice of seeking investors who would put up money for the voyage - outfitting the ship and crew in return for a percentage of the proceeds if the voyage was successful. These early limited liability companies often lasted for only a single voyage. They were then dissolved, and a new one was created for the next voyage. Investors spread their risk by investing in several different ventures at the same time, thereby playing the odds against all of them ending in disaster.

When the East India companies formed, they changed the way business was done. These companies issued stock that would pay dividends on all the proceeds. These were the first modern joint stock companies. This allowed the companies to demand more for their shares and build larger fleets. The size of the companies, combined with royal charters forbidding competition, meant huge profits for investors.

- **The New York Stock Exchange**

The first stock exchange in London was officially formed in 1773, a scant 19 years before the New York Stock Exchange. Whereas the London Stock Exchange (LSE) was handcuffed by the law restricting shares, the New York Stock Exchange has dealt in the trading of stocks, for better or worse, since its inception. The NYSE wasn't the first stock exchange in the U.S. however. That honor goes to the Philadelphia Stock Exchange, but the NYSE quickly became the most powerful.

Formed by brokers under the spreading boughs of a buttonwood tree, the New York Stock Exchange made its home on Wall Street. The exchange's location, more than anything else, led to the dominance that the NYSE quickly attained. It was in the heart of all the business and trade coming to and going from the United States, as well as the domestic base for most banks and large corporations. By setting listing requirements and demanding fees, the New York Stock Exchange became a very wealthy institution.

The NYSE faced very little serious domestic competition for the next two centuries. Its international prestige rose in tandem with the burgeoning American economy, and it was soon the most important stock exchange in the world. The NYSE had its share of ups and downs during the same period, too. Everything from the Great Depression to the Wall Street bombing of 1920 left scars on the exchange the 1920 bombing, believed to have been carried out by anarchists, left 38 dead and also literally scarred many of Wall Street's prominent buildings. The less literal scars on the exchange came in the form of stricter listing and reporting requirements.

On the international scene, London emerged as the major exchange for Europe, but many companies that were able to list internationally still listed in New

York. Many other countries including Germany, France, the Netherlands, Switzerland, South Africa, Hong Kong, Japan, Australia and Canada developed their own stock exchanges, but these were largely seen as proving grounds for domestic companies to inhabit until they were ready to make the leap to the LSE and from there to the big leagues of the NYSE. Some of these international exchanges are still seen as dangerous territory because of weak listing rules and less rigid government regulation.

11.2 OBJECTIVES

After reading this lesson you will be able to

- Understand the concept of stock exchange
- Obligation and disclosures
- Post listing activities

11.3 CONTINUING COMPLIANCE OBLIGATION AND DISCLOSURE

Governments or governmental entities issuing bonds generally have an obligation to meet specific continuing disclosure standards set forth in continuing disclosure agreements (CDAs, also called continuing disclosure certificates or undertakings). Issuers enter into CDAs at the time of bond issuance to enable their underwriters to comply with Securities and Exchange Commission (SEC) Rule 15c2-12. This rule, which is under the Securities Exchange Act of 1934, sets forth certain obligations of (i) underwriters to receive, review and disseminate official statements prepared by issuers of most primary offerings of municipal securities, (ii) underwriters to obtain CDAs from issuers and other obligated persons to provide material event disclosures and annual financial information on a continuing basis, and (iii) broker-dealers to have access to such continuing disclosure in order to make recommendations of municipal securities in the secondary market.[1]

When bonds are issued, the issuer commits (via the CDA) to provide certain annual financial information and material event notices to the public. In accordance with SEC Rule 15c2-12, those filings must be made electronically at the Electronic Municipal Market Access (EMMA) portal.

The SEC's Municipalities Continuing Disclosure Cooperation (MCDC) initiative in 2014, along with other recent federal regulatory actions, have highlighted the importance of maintaining a reliable system to adequately manage continuing disclosure.

Issuers may choose to provide periodic voluntary financial information to investors in addition to fulfilling the specific SEC Rule 15c2-12 responsibilities undertaken in their CDA. It is important to note that issuers should disseminate any financial information to the market as a whole and not give any one investor certain information that is not readily available to all investors. Issuers should also be aware that any information determined to be "communicating to the market" can be subject to regulatory scrutiny.

In addition to filing information via EMMA, a government may choose to post its annual financial information and other financial reports and information on the investor section of its web site.

11.3.1 Recommendation

GFOA recommends that finance officers responsible for their government's debt management program adopted a thorough continuing disclosure policy and adhere to the following best practices. Issuers should determine how to apply best practices in the manner that is relevant and most practical for their entity. Incorporating robust disclosure practices and demonstrating a solid disclosure track record will benefit an issuer by encouraging regulatory compliance and by enhancing credibility among investors, credit rating agencies and the public, thereby resulting in optimal bond issuance results. Issuers should consider the following elements in creating policies and practices related to require continuing disclosure responsibilities:

1. Issuers should have a clear understanding of their specific reporting responsibilities as defined in the bond's CDA. If the issuer has determined that financial information is material and must be included in its official statement, its CDA must require that the information be updated annually. Issuers should work with their bond counsel, underwriter and municipal advisor to determine the appropriate information and detail to be included in a CDA, and should be aware of the events that must be disclosed. Prior to execution, CDAs should be discussed with the issuer's bond counsel, underwriter and financial advisor to ensure a full

understanding of issuer obligations.

2. Governments should develop continuing disclosure procedures that:

- Identify the information that is obligated to be submitted in an annual filing
- Disclose the dates on which filings are to be made
- List the required reporting events as stated by the SEC and your CDA
- Ensure accuracy and timeliness of reported information and
- Identify the person who is designated to be responsible for making the filings.

3. Issuer representatives responsible for filing continuing disclosure should carefully review and understand the specific requirements in the CDA for each individual bond issue. For some governments, filing the complete Comprehensive Annual Financial Report (CAFR) on EMMA may fulfill annual financial information obligations. Issuers should carefully compare information in their CAFR to information required by a CDA to ensure full compliance. If a government has agreed in the CDA to furnish information that is outside the scope of its CAFR, that information may be included as a supplement to the CAFR when filing with EMMA. Some governments – especially those with multiple types of bond issues – may choose to prepare a supplemental annual disclosure document that provides the specific information identified in a CDA (in addition to filing the CAFR).

4. As recommended in the GFOA's Certificate of Achievement for Excellence in Financial Reporting program, a government should complete its audited annual financial information within six months of the end of its fiscal year. Upon its completion, the CAFR should immediately be submitted to EMMA.

5. EMMA allows an option for governments to indicate if they make their filing of annual financial information within 120 or 150 days of the end of the year; however, governments might need a longer timeline to ensure compliance. Governments should only select the EMMA-provided timing options if those dates are consistent with the specific maximum timing commitment in the CDA. The GFOA supports use of required timing commitments within a government's CDA that are reasonable to achieve, which in many cases may be longer than 120 or 150 days. Identifying

unreasonably short timelines can be very difficult to meet, and failure to adhere to such a timeframe would result in violation of the CDA.

6. Event notices should be filed for events specifically identified in accordance with SEC Rule 15c2-12:

- For bonds issued after December 1, 2010, the SEC requires issuers to file event notices within 10 business days of the event.
- For bonds issued before December 1, 2010, the rule states that governments should file event notices in a "timely manner." However, governments are encouraged to adopt a policy to submit all event notices within 10 business days of the event to prevent any confusion regarding timeliness.

7. Issuers may be expected to include language in their Official Statements for new bond issues regarding any material non-compliance with continuing disclosure requirements within the past five years. Issuers should consult carefully with bond counsel and their municipal advisor regarding appropriate language to include in this primary disclosure, which is heavily subject to regulatory scrutiny.

Governments, in consultation with internal and external counsel, may wish to submit other financial information to EMMA (and post it on their websites) that goes beyond the minimum requirements in the CDA. Issuers who choose to disclose information above and beyond the minimum requirements in a CDA should consider the following:

1. Types of additional information to be disclosed may include annual budgets, financial plans, financial materials sent to governing bodies for council or board meetings, monthly financial summaries, investment information, and economic and revenue forecasts. Governments are encouraged to place this additional or interim financial information on the investor section of their websites, including use of a feature within EMMA that allows governments to post a link directly to their website so that investors and the public can directly access the information.
2. Issuers may want to provide additional information to investors about other debt-related agreements. Rating agencies and investors may expect these disclosures to be publicly communicated, and issuers are advised of the benefits of providing

this additional voluntary disclosure. These disclosures should provide information that will enable investors to make judgments about the volatility and risk exposure of agreements that may include financial risks that should be disclosed and quantified. Examples of agreements for which voluntary disclosure is recommended include:

- Direct placements, loans, lines of credit or other credit arrangements with private lenders or commercial banks. Example of the type of information to be disclosed include an interest rate or debt service schedule, legal security pledge, legal covenants, call options and other key terms.
- Letters of credit issued in connection with variable rate debt issuance;
- Interest rate swaps entered into in connection with debt issuance;
- Investment agreements for bond proceeds, including reserve funds, particularly where such investments may be pledged or anticipated bond security; and
- Insurance sureties used to fund reserve fund requirements.

Any sensitive information (such as bank accounts and wire information) should be redacted from documents prior to posting.

3. Legal and regulatory implications of voluntary postings remain uncertain. Issuers should consult with bond counsel and their municipal advisor to determine the best strategy to support the market benefits of additional communication without harming the issuer's ability to meet regulatory expectations.

Upon implementation of a formal set of continuing disclosure policies and procedures, issuers should also take steps to ensure standards are being diligently followed. Continuing disclosure policies and practices should be periodically reviewed to ensure consistency with market and regulatory expectations.

11.4 POST LISTING ACTIVITIES

Once your extension gets listed, it will be open to all users to be installed into their products. But, due to the sheer large number of extensions, a little extra push in marketing your extension could show you better usage metrics.

Here are a few ways you could improve your extension's visibility:

1. A press release announcing the availability of your extension in Zoho Marketplace and thereby forging a partnership with us.
2. A blog post explaining the working of the extensions and the business solutions it satisfies.
3. Social media posts informing your followers and user communities about the new extension
4. A separate landing page that comprehensively describes the extension and its functionalities.
5. An interactive webinar where you can educate as well as converse with your customers.
6. A video tutorial hosted on any video sharing platform so that existing and potential customers can view it and give it a try.
7. Making a mention of your extension in your newsletter or any other customer-centric mailers

11.5 CORPORATE ACTIONS

A corporate action is any activity that brings material change to an organization and impacts its stakeholders, including shareholders, both common and preferred, as well as bondholders. These events are generally approved by the company's board of directors. Shareholders may be permitted to vote on some events as well. Some corporate actions require shareholders to submit a response.

When a publicly traded company issues a corporate action, it is initiating a process that directly affects the securities issued by that company. Corporate actions can range from pressing financial matters, such as bankruptcy or liquidation, to a firm changing its name or trading symbol, in which case the firm must often update its CUSIP number, which is the identification number given to securities. Dividends, stock splits, mergers, acquisitions and spinoffs are all common examples of corporate actions. Corporate actions can be either mandatory or voluntary. Mandatory corporate actions are automatically applied to the investments involved while voluntary corporate actions require an investor's response to be applied. Stock splits, acquisitions and company name changes are examples of mandatory corporate actions; tender offers, optional dividends and rights issues are examples of voluntary corporate actions.

Corporate actions that must be approved by shareholders will typically be listed on a firm's proxy statement, which is filed in advance of a public company's annual meeting. Corporate actions can also be revealed in 8-K filings for material events. A cash dividend is a common corporate action that alters a company's stock price. A cash dividend is subject to approval by a company's board of directors, and it is a distribution of a company's earnings to a specified class of its shareholders. For example, assume company ABC's board of directors approves a $2 cash dividend. On the ex-dividend date, company ABC's stock price would reflect the corporate action and would be $2 less than its previous closing price.

A stock split is another common corporate action that alters a company's existing shares. In a stock split, the number of outstanding shares is increased by a specified multiple, while the share price is decreased by the same factor as the multiple. For example, in June 2015, Netflix Inc. announced its decision to undergo a seven-for-one stock split. Therefore, Netflix's share price decreased by a factor of seven, while its shares outstanding increased by a factor of seven. On July 15, 2015, Netflix closed at $702.60 per share and had an adjusted closing price of $100.37. Although Netflix's stock price changed substantially, the split did not affect its market capitalization.

Mergers and acquisitions (M&A) are a third type of corporate action that bring about material changes to companies. In a merger, two or more companies synergize to form a new company. The existing shareholders of merging companies maintain a shared interest in the new company. Contrary to a merger, an acquisition involves a transaction in which one company, the acquirer, takes over another company, the target company. In an acquisition, the target company ceases to exist, but the acquirer assumes the target company's business, and the acquirer's stock continues to be traded.

11.6 SUMMARY

The stock exchange or market is a place where stocks, shares and other long-term commitments or investment are bought and sold. The economic significance of a stock market results from the increased marketability resulting from a stock exchange share quotation. The stock exchange is an essential institution for the existence of the capitalist system of the economy and for the smooth functioning of the corporate form of organisation.

The Stock Exchanges are being administered by their governing boards and executive chiefs. Policies relating to their regulation and control are laid down by the Ministry of Finance. Government also Constituted Securities and Exchange Board of India (SEBI) in April 1988 for orderly development and regulation of securities industry and stock exchanges. A corporate action is any activity that brings material change to an organization and impacts its stakeholders, including shareholders, both common and preferred, as well as bondholders. These events are generally approved by the company's board of directors. Shareholders may be permitted to vote on some events as well. Some corporate actions require shareholders to submit a response.

11.7 GLOSSARY

- Imperialism's — a policy of extending a country's power and influence through colonization, use of military force, or other means
- Debt management — agreement between a debtor and a creditor that addresses the terms of an outstanding debt
- Disclosure — the action of making new or secret information known

11.8 SELF-ASSESSMENT QUESTIONS

Q1. What is a stock exchange?

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Q2. What are post listing activities?

Q3. What are the recommendations continuing compliance obligation and disclosure?

11.9 LESSON END EXERCISE

Q1. Briefly explain the history of stock exchange in India.

Q2. What do you mean by corporate actions also explain the different types of corporate actions?

Q3. What is the requirement of continuing compliance obligation and disclosure?

11.10 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

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UNIT 3	LESSON NO. 12

LISTING OF STOCK EXCHANGES

STRUCTURE

12.1 INTRODUCTION

All Entities whose Securities are listed on the Exchange shall comply with these Rules and such additional Rules as may be introduced from time to time at the discretion of the Exchange.

It is the duty of the board of directors of every Entity whose Securities are listed to ensure that all the Rules of the Exchange are met on a continuing basis so long as the Securities of such Entity remain on the Exchange.

12.1.1 Requirement for Continuing Listing: the following are the requirements for continuing listing:

- **Dividend Payment**

a. The Entity shall, immediately upon authorizing a dividend distribution, make an announcement to the Exchange. The announcement to the Exchange shall include:-

(i) Dividend per share

(ii) Whether the dividend distribution is subject to the shareholder approval or not

(iii) Date of dispatch of dividend payment

(iv) Book closure date (if applicable)

(v) Financial year applicable for the dividend

(vi) In the event of a scrip dividend: - The number of shares to be issued - The proportion in which shares are to be issued - The consideration for which the shares are to be issued - The current stated capital of the Entity - The value of reserve/s to be capitalized for the issue of shares - The following statement: "The scrip dividend is subject to the Exchange approving in principle the issue and listing of shares and obtaining shareholder approval (if required in terms of the Articles of Association of the Entity).

(vii) A resolution passed by the board of directors of the Entity stating that the Board has reasonable grounds for believing that the Entity would satisfy the Solvency Test immediately after the dividend distribution

- **Resolutions**

The Exchange must be notified at the same time as shareholders regarding any resolution to be voted on at any members' meeting. The Exchange shall be notified immediately after the meeting whether the resolution was passed or not.

- **Circulars to Shareholders**

Fifty (50) copies of circulars to shareholders should be sent to the Exchange at the same time as they are dispatched to the holders of Listed Securities.

- **Interim Financial Statements**

A Listed Entity shall prepare and submit Interim Financial Statements to the Exchange for public release as follows:

1. Where the Securities are listed on the Main Listing Segment, the Interim Financial Statements (hereinafter referred to as 'Financial Statements') shall be prepared and submitted on a quarterly basis as soon as the figures have been approved by the Board of Directors of the Entity and in any event not later than forty five (45) days from the end of the first, second and third quarters and two (2) months from the end of the fourth quarter; and,

2. Where the Securities are listed on the Empower Board in the Alternate Market Segment, the Financial Statements shall be prepared and submitted on a half yearly basis, as soon as the figures have been approved by the Board of Directors of the Entity and in any event not later than two (2) months from the end of the half year.

Such Financial Statements shall include the following:

1. A statement of financial position as of the end of the current interim period and a comparative statement of financial position as of the end of the immediately preceding financial year.

2. A statement of comprehensive income for the current interim period and cumulatively for the current financial year to date, with comparative statements of comprehensive income for the comparable interim periods (current and year-to-date) of the immediately preceding financial year.

3. A statement of changes in equity and a cash flow statement, cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.

12.2 OBJECTIVES

After reading this lesson you will be able to understand:

- the continuing listing
- Corporate governance norms and disclosure

12.3 CORPORATE GOVERNCE NORMS DISCLOSURES AS PER LISTING AGREEMENTS

The term governance refers to the act of managing an entity. What makes the governance of a company so special, as opposed to the governance of a mom-and-pop business, is the separation of ownership from management in the corporate structure. Public limited companies pool capital from thousands of shareholders to build and run a business. But these owners effectively play no active role in the day to day running of company, delegating all the 'governance' to a management team. Ensuring that the management team runs the company in the interests of its owners, instead of lining its own pockets, is what good corporate governance is all about.

Governance norms for Indian listed companies are set out in the Companies Act, a detailed clause (Clause 49) in the listing agreement that companies sign with the exchanges and in SEBI's new Listing Obligations and Disclosure Requirement Regulations of 2015.

Most listed companies and large corporate groups in India were born as family-owned businesses, with family members occupying managerial positions and making all the key business decisions. This also meant very little distinction between the company's finances and that of the family owners. With the evolution of the equity markets though, many of these family-owned businesses listed themselves on the exchanges. However, the traditional (mis) governance practices continued. Promoters, though no longer the sole owners, continued to wield disproportionate influence over decisions. Companies freely extended loans to group entities, folks from the family secured berths on the Board with generous pay packets and companies entered into cosy business deals with family and friends. The rights of public shareholders were freely trampled upon.

This was sought to be fixed in the Companies Act 1956, by requiring company Boards to seek Central Government permission for certain decisions (managerial remuneration beyond a certain limit, loans to directors) and shareholder approvals for others (appointment of relatives, for instance). As these checks proved inadequate, SEBI constituted a series of committees — Kumar Mangalam Birla Committee in 2000, Narayana Murthy Committee in 2003 and Adi Godrej Committee in 2012 —

to come up with more elaborate governance norms for India Inc. The present corporate governance norms, enshrined in the Companies Act, SEBI listing regulations and Clause 49 of the listing agreement are the result of deliberations by these committees. Yet another committee — the Uday Kotak committee — has recently been tasked with a further review.

Today, India's corporate governance framework requires listed companies to have independent directors, one-third of their Board, disclose all related party deals, disclose comparative metrics on managerial pay, appoint audit and nomination committees, and require the CEO and CFO to sign off on the governance norms being met in the financial statements. Minority shareholders with 10 per cent voting rights also have the right to drag companies to Court for 'oppression and mismanagement'.

Shareholders obviously have the most to lose if a company is prone to bad governance. Creative accounting, related party deals, exorbitant managerial remuneration, freebies to friends and family and risky mergers and acquisitions, directly deprive shareholders of profits that are rightfully theirs. But this apart, bad governance practices can have a bearing on all the stakeholders a company deals with – lenders/banks who extend finance, suppliers who sell it goods or services, employees who invest their career in it and customers who put faith in its brand, product or service quality. The ongoing fracas at Infosys has not just decimated the stock price by over 15 per cent, it may also lead to uncertainty for clients and employees. It is therefore in interests of all these stakeholders that corporate governance is treated with the seriousness it deserves.

12.4 SUMMARY

All Entities whose Securities are listed on the Exchange shall comply with these Rules and such additional Rules as may be introduced from time to time at the discretion of the Exchange. The term governance refers to the act of managing an entity. What makes the governance of a company so special, as opposed to the governance of a mom-and-pop business, is the separation of ownership from management in the corporate structure. Governance norms for Indian listed companies are set out in the Companies Act, a detailed clause (Clause 49) in the listing agreement that companies sign with the exchanges and in SEBI's new Listing Obligations and Disclosure Requirement Regulations of 2015.

12.5 GLOSSARY

- Dividend — a sum of money paid regularly (typically annually) by a company to its shareholders out of its profits
- Resolution — a firms decision to do or not to do something
- Financial Statements — records of the financial activities and position of a business, person, or other entity. Relevant financial information is presented in a structured manner and in a form which is easy to understand
- Governance — the action or manner of governing a state, organization, etc

12.6 SELF ASSESSMENT QUESTIONS

Q1. What are the requirements for continuing listing?

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Q2. What do you mean by dividend?

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Q3. What is corporate governance?

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Q4. What is interim financial statement?

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12.7 LESSON END EXERCISE

Q1. As per listing agreements what are the corporate governance norms disclosures?

Q2. Briefly explain the requirements for continuing listing.

12.8 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

M.Y. Khan : Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi – 110 002.

Shashi K Gupta : Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Nishja Aggarwal Ram Road, 24, Daryaganj, New Delhi - 110002 Neeti Gupta

Vishal Saraogi : Capital Markets and Securities Laws simplified, Lawpoint Publication, 6C, R.N. Mukherjee Road, Kolkata-70000

PRICE SENSITIVE INFORMATION

STRUCTURE

13.1 INTRODUCTION

Knowledge is the key to being successful in any walk of life. This is true for trading and business too. In every company, there exists some piece of information which if made public will have an effect on the value of securities of the company. Such information should be released in the market in such a way that it is not prejudicial to the interest of a particular section and is beneficial for all. Anyone who leaks out such information for acquiring personal gains is guilty of insider trading. Any matter which is unpublished and is not available in the public domain, and relates to internal matter is known as insider information. This information might have a material effect on the price of the securities if disclosed. Any information regarding public matters can't be called sensitive information, because, without any specific information, the price of the securities will not be affected. In accordance with the Regulations provided by the SEBI, no insider (including employees, directors or associates of the company) shall either on his own behalf or on behalf of any other person deal in securities of the company on the basis of such price sensitive and insider information

Unpublished price sensitive information means any information which relates to the internal matter of a company and is not disclosed by the company in the regular course of business. If such information is leaked, it affects the price of securities of the company in the stock market.

13.1.1 Price Sensitive Information

Price Sensitive Information means ant information which relates directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the company. This can be clearly understand by getting an idea about insider tading.

Insider trading means entering into a transaction with regards to the securities of the company by the insiders of the company such as the employees or the associates, based on the information which they have derived within the company. Insiders are those whose association with the company gives them the access to information about internal information of the company.

Trading by insiders is not totally restricted. Insiders such as employees, associates, directors, etc. can trade as long as they are not using the information which relates to the internal affair of the company and is not present in the public sphere. This type of trading is also regulated through reporting and monitoring.

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13.1.2 Functions of SEBI

Securities Exchange Board of India (SEBI) is the regulatory bodies of stocks and securities present in the Indian Capital Market. There are other regulatory bodies also like Central Electricity Regulatory Commission (CERC) and Telecom Regulatory Authority of India (TRAI), but SEBI is one of the prime regulatory bodies. Functions of SEBI includes-

1. Development of Market
2. Protection of Investors
3. Proper Regulation on Security Markets

In order to fulfill these functions, the regulators must be given genuine powers through various legislations.

One of the most important aspects of "corporate governance" is the concept of insider trading. It has to be made sure that insiders who possess the knowledge about internal matters do not exploit their positions and take undue advantage of that knowledge. To prevent this from happening, companies should publish and circulate sensitive information in proper and suitable manner. They should also make sure that insiders of the company do not enter into transactions based on such information, till the information is made public. For this, the company should have an internal system of regulation that discloses information sufficiently and at the opportune moment, maintain confidentially norms, report in a proper manner and come up with specific rules or code of conduct for the insiders. Insider trading is not trading with the knowledge of market regulators but trading with the knowledge of unpublished and undisclosed information.

Section 15G of the SEBI Act, 1992 states the penalty for insider trading. An issuer of securities may face unexpected events or situations which will have an impact on the price of the securities and the business activities. It is very crucial that the issuer of securities makes a proper assessment to decide what information can turn out to be price sensitiveand need to be disclosed. The company may also go for suspension of its securities, if necessary, till a formal step can be taken. Some examples can be given of such events-

- The signing of important deals and contracts.
- Entering into a crucial joint venture with some other company.
- Exceptional matters such as merger, acquisition, etc.
- Fund-raising campaign.
- A large amount of loss relating to foreign exchange.
- Cancellation of an agreement with any party which may affect the business operations.
- Any significant change in the accounting policy of the company which will affect the business activities.
- Comments on potential future earnings by the company.
- Premature removal of any Chief Official of the company before their term ended.

There cannot be a definite list of events which might impact the price of securities if disclosed. It depends on case to case. What may be price sensitive for one may turn out to be irrelevant for the other? An example of this can be given. A fundraising campaign will be considered material for a company which is facing insolvency. But the same thing will become relevant when the company starts functioning properly.

The Listing Rules ensures that the market functions properly and efficiently through timely and competent disclosure of insider information. They also make sure that any information which is being disclosed is done in a general manner, and it is not disclosed only to a particular section. Clause 32 (b) of the new listing puts the issuer under a duty to keep the Stock Exchange, holders of their listed securities and their shareholders informed about price sensitive information as soon as it is reasonably practicable. This is often known as the general disclosure obligation. The principle behind this policy is to set out practices and policies in relation to-

- Administration of the company policies;
- Monitoring of any event so that any information which has the potential to

become insider/ price sensitive information is identified and the Board of Directors can take decisions regarding such information.

- Disclosure of Information
- The guiding principle relating to insider/ price sensitive information is that it should be announced and disclosed in a proper manner without any delay after it becomes known to the management of the company. Until any such disclosure is made, the management of the company should ensure that the information remains strictly confidential, and no insider of the company trades on the basis of such information.
- The issuer company may consider implementing additional means of broad communication such that the news will be disseminated to the shareholders and the public in a timely and uniform manner.
- Unusual Movement in Trading Volume and Prices of the Securities
- The Stock Exchange usually informs the issuing company if they see any unusual and eccentric movement in the trading volume or price of its securities. In such circumstances the issuing company should respond immediately to the Exchange, and if practicable, issue a statement through the Board of Directors, as to whether the company is aware or not about the reasons for such unusual movement in the trading volume and price of securities.

Guidance in Particular Situations

1. **Unintended Publication of Insider Information–** If the company comes to know that some information, which might affect the price of its securities has been published inadvertently to a third party, the issuer should make an announcement and disclose the information to the general public so that the third party isn't able to take advantage of the information. If necessary, they should suspend the trading of their securities till the information is properly disclosed.
2. **Profit Warning Statement–** where the company gains the knowledge that

the actual results may be significantly worse than what they estimated, the company should publish a "profit warning" statement as it may impact the price of the securities in the market.

3. **Profit Forecast-** If the company makes a public forecast and later realizes that the basis on which the forecast was made may not be correct, it should make an announcement, as soon as possible and should disclose the impact of the incorrect estimates. They should also disclose how the actual outcome will differ from the previous forecast.

4. **Incomplete Negotiations-** If a company has entered into any discussion and negotiations which related to some price sensitive or insider information, sometimes it becomes difficult to maintain the confidentially as a lot of parties are involved in the discussion and negotiations. In case the discussion or the negotiation has reached a delicate stage, where any information related to it will affect the securities of the company or if major elements of the negotiations are yet to be finalized, the company should consult with the Exchange as soon as possible and if necessary suspend trading of securities until such negotiations are finalized.

5. **Annual Report and Meeting-** A Company should always communicate with the investors. A company can strengthen its goals and provide indications about the future to its investors through the annual reports. Such arrangement should be made by the company so that they can aptly disclose and discuss price-sensitive information in the meetings with the investors.

6. **Making a party an "Insider"-** Sometimes, it may happen that a Company is compelled to give confidential information to some parties, for example, to potential business partners, financers,

7. **Parties with whom they are negotiating or underwriters-** Before a meeting, a proper procedure should be followed where the opposite party should be told that whatever information is being provided to the party is strictly confidential, and the party wouldn't be able to trade in the company's security using the provided information before it is made public. The party should

give consent to become an "insider" which should be recorded.

8. **Employees-** many employees have access to insider information because of the nature of their duty. The employee should be made aware that they are under the obligation to keep the information confidential. There should be an internal policy in place that restricts the access of an employee to price sensitive information. Also, strict action should be taken against any employee who leaks such information.

   It can be very easy for a person with insider information to take advantage of the fact that he has got a piece of information about which others have no knowledge and engage in deals which will benefit him personally. But business ethics calls for prudence and that such information shouldn't be used for trading.

13.2 OBJECTIVES

After reading this lesson you will be able to Understand

- The concept of price sensitive information
- Corporate governance norms and disclosure

13.3 MATERIAL CHANGES

A change in the meaning of a legal document, such as a contract, deed, lease, or Commercial Paper, that is madeby one party to the document without the consent of the other after it has been signed or completed. The alteration of an instrument materially changes it. The document no longer reflects the terms that the parties originally intended to serve as the basis of their legal obligation to each other. To be material the change must affect an important partof the instrument and the rights of the parties to it. Any material alteration relieves the nonconsenting party of any obligationto perform according to the terms of the instrument. If the altered instrument is a contract, then the original contract is void. The nonconsenting party cannot be legally obligated by the new contract since he or she never agreed to it. A document that has been materially altered does not regain its original validity if it is restored to its original form by erasing or deletingunauthorized words.

The date of an instrument is often considered a material provision when it establishes the time within which the parties to adocument must perform their obligations under it. An unauthorized change of date that shortens the time of payment or extends the time of performance so that more interest will become due is a material alteration.

An alteration of a signature that changes the legal effect of an instrument is material Erasing words that show that the signeris acting as an agent, for example changes the signer's liability under the instrument and therefore, is a material alteration. However, when a signature that was improperly placed on a document is erased, there is no material alteration since the legal meaning of the document is not changed.

Any change in the terms of the instrument that affects the obligations of the parties is material. In a contract to sell land oncommission a change in the rate of commission is material. A change in a description in a deed so that it transfers a smallerpiece of land, a change in the name of a purchaser in a sales contract, or an alteration in the terms of financing set forth in amortgage is also material.

If such a change is made by a third party without the consent of either party to the instrument, it is called a spoliation or mutilation.

- **Method**

  The face of an instrument is changed by its alteration. A difference in handwriting, a change in words or figures, an erasure, and the striking out of particular words are some methods used to alter an instrument. Since there must be a change in themeaning or language of a document, retracing an original writingas when a figure written in pencil is retraced in ink is not an alteration.

- **Time of Alteration**

  A modification in a document before its completion is not an alteration. The parties are bound to review the document and tohave agreed upon its terms before executing it. In order for an alteration to nullify the legal effect of an instrument, the change must be made after its completion.

- **Intention**

  A material change must be intentionally made. The motive behind the alteration is unimportant. If a mistake or accident causes a change, this is not considered a material alteration, but the document may be reformed or rescinded.

- **The Person Making the Change**

  The change to the instrument must be made by a party or someone authorized by him or her to do so. No change made by athird person without the consent of either party to the document will invalidate it if its original terms can be learned. When amaterial alteration is made by a party to commercial paper, uch as a check or promissory note, the paper will be enforced asoriginally written against the party who made the changes.

- **Consensual Alteration**

  A change in an instrument made with the consent of the parties is binding upon them. Such consensual alteration is usually evidenced by the signing by each party of his or her initials and the date that the agreement to the changes to the instrument was reached.

13.4 QUARTERLY RESULTS

A quarterly report is a set of financial statements issued by a company every three months. A quarterly report for a public company typically includes an income statement, balance sheet, and cash flow statement for the quarter and the year-to-date (YTD), as well as comparative results for the prior year. Quarterly reports also include a discussion and analysis of the company's financial condition, disclosures about risk factors that may affect the value of the company, a discussion of matters submitted to a vote by shareholders during the quarter; and any other pertinent information related to the company and its business.

Generally, quarters end in March, June, September, and December, and quarterly reports are filed a few weeks later. Quarterly reports are issued by companies every three months. Most companies have a financial year-end of Dec. 31 and quarters that end on March 31, June 30, Sept. 30 and Dec. 31.

Quarterly reports help investors take the pulse of public companies. By comparing the quarterly information to the previous year's information for the same quarter, investors can get rich insight into a business's performance and growth. Furthermore, quarterly reports help investors predict future earnings potential, which is highly correlated to a company's share price.

13.5 SUMMARY

Unpublished price sensitive information means any information which relates to the internal matter of a company and is not disclosed by the company in the regular course of business. Insider trading means entering into a transaction with regards to the securities of the company by the insiders of the company such as the employees or the associates, based on the information which they have derived within the company. Insiders are those whose association with the company gives them the access to information about internal information of the company. Securities Exchange Board of India (SEBI) is the regulatory bodies of stocks and securities present in the Indian Capital Market

13.6 GLOSSARY

- Sensitive information — information that is protected against unwarranted disclosure
- Insider — a person within a group or organization, especially someone privy to information unavailable to others.
- Regulatory bodies — is a public *authority* or government agency responsible for exercising autonomous *authority* over some area of human activity in a *regulatory* or supervisory capacity.

- Corporate governance — system of rules, practices and processes by which a firm is directed and controlled
- Quarterly — after every three months

13.7 SHORT ANSWER QUESTIONS

Q1. What is price sensitive information?

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Q2. What do you mean by insider trading?

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Q3. What is material changes mean?

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Q4. What kind of results can be announced quarterly?

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13.8 LESSON END EXERCISE

Q1. What is price sensitive information and why it should not be leaked?

Q2. Why insider trading is considered as unauthorised activity?

13.9 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

M.Y. Khan : Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi – 110 002.

Shashi K Gupta : Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Nishja Aggarwal Ram Road, 24, Daryaganj, New Delhi - 110002 Neeti Gupta

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http://www.corporate-cases.com/2013/01/clause-32-of-listing-agreement.html

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UNIT 3 **LESSON NO. 14**

FUNCTIONING OF AN EXCHANGE

STRUCTURE

14.1 INTRODUCTION

A stock exchange, securities exchange or bourse, is a facility where stock brokers and traders can buy and sell securities, such as shares of stock and bonds and other financial instruments. Stock exchanges may also provide for facilities the issue and redemption of such securities and instruments and capital events including the payment of income and dividends.Securities traded on a stock exchange include stock issued by listed companies, unit trusts, derivatives, pooled investment products and bonds. Stock exchanges often function as "continuous auction" markets with buyers and sellers consummating transactions via open outcry at a central location such as the floor of the exchange or by using an electronic trading platform.

To be able to trade a security on a certain stock exchange, the security must be listed there. Usually, there is a central location at least for record keeping, but trade is increasingly less linked to a physical place, as modern markets use electronic communication networks, which give them advantages of increased speed and reduced cost of transactions. Trade on an exchange is restricted to brokers who are members of the exchange. In recent years, various other trading venues, such as electronic communication networks, alternative trading systems and "dark pools" have taken much of the trading activity away from traditional stock exchanges.

Initial public offerings of stocks and bonds to investors is done in the primary market and subsequent trading is done in the secondary market. A stock exchange is often the most important component of a stock market. Supply and demand in stock markets are driven by various factors that, as in all free markets, affect the price of stocks (see stock valuation).

There is usually no obligation for stock to be issued through the stock exchange itself, nor must stock be subsequently traded on an exchange. Such trading may be *off exchange* or over-the-counter. This is the usual way that derivatives and bonds are traded. Increasingly, stock exchanges are part of a global securities market. Stock exchanges also serve an economic function in providing liquidity to shareholders in providing an efficient means of disposing of shares

14.1.1 Functioning of an Exchange

1. **Continuous market for securities**

The Investors are able to invest in good securities and in case of any risk, it enables people to switch over from one security to another. So stock market provides ready and continuous opportunities for securities.

2. **Evaluation of securities**

It the stock exchange, the prices of securities clearly indicate the performance of the companies. It integrates the demand and supply of securities in an effective manner. It also clearly indicates the stability of companies. Thus, investors are in a better position to take stock of the position and invest according to their requirements.

3. **Mobilizes savings**

The savings of the public are mobilized through mutual funds, investments trusts and by various other securities. Even those who cannot afford to invest in huge amount of securities are provided opportunities by mutual funds and investment trusts.

4. **Healthy speculation**

The stock exchange encourages healthy speculation and provides opportunities to shrewd businessmen to speculate and reap rich profits from fluctuations in security prices. The price of security is based on supply and demand position. It creates a healthy trend in the market. Any artificial scarcity is prevented due to the rules and regulations of the market.

5. **Mobility of funds**

The stock exchange enables both the investors and the companies to sell or buy securities and thereby enable the availability of funds. By this, the money market also is strengthened as even short-term funds are available. The banks also provide funds for dealing in the stock exchanges.

6. **Stock exchange Protect investors**

As only genuine companies are listed and the activities of the stock exchange are controlled, the funds of the investors are very much protected.

7. **Stock exchange helps Capital formation**

Stock exchange plays an active role in the capital formation in the country. Companies are able to raise funds either by issuing more shares through rights shares or bonus shares. But when a company wants to go in for diversification, they can issue the shares and raise more funds. Thus, they are able to generate more capital and this promotes economic growth in the country.

14.2 OBJECTIVES

After reading this lesson you will be able to Understand

- the functions of stock exchange
- margining
- trading clearing and settlement
- Trading software and arbitration mechanism

14.3 MARGINING

Margining allows investors to buy securities by borrowing money from a broker. The margin is the difference between the market value of a stock and the loan a broker makes. In the context of hedging and futures contracts, the cash collateral deposited with a trader or exchanged as insurance against default

1. Money that an investor has borrowed from a broker in order to buy securities. An investor who buys on margin can realize huge gains if the price of the security moves in a favorable direction however, he/she also take on a great deal of risk because it may not move in such a direction. See also minimum maintenance, margin call.
2. A measure of how well a company controls its costs. It is calculated by dividing a company's profit by its revenues and expressing the result as a

percentage. The higher the margins, the better the company is thought to control costs. Investors use the margin to compare companies in the same industry as well as between industries to determine which are the most profitable. It is also called the profit margin

Margin is the minimum amount of collateral in either cash or securities you must have in your margin account to buy on margin, sell short, or invest in certain derivatives.

The initial margin requirement is set by federal law and varies from product to product. For example, to buy stock on margin, you must have at least50% of the purchase price in your account.

After the initial transaction, maintenance rules set by the self-regulatory organizations, such as the New York Stock Exchange (NYSE) and NASD, apply.

Under those rules, you must have a minimum of 25% of the total market value of the margin investments in your account at all times. Individual firms may set their maintenance requirement higher at 30% or 35%,forexample.

If your equity in the account falls below the maintenance level, you'll receive a margin call for additional collateral to bring the account value back above the minimum level.

14.4 TRADING, CLEARING AND SETTLEMENT

NSE Clearing carries out clearing and settlement functions as per the settlement cycles provided in the settlement schedule. The clearing function of the clearing corporation is designed to work out

a) What members are due to deliver and

b) What members are due to receive on the settlement date? Settlement is a two way process which involves transfer of funds and securities on the settlement date.

NSE Clearing has also devised mechanism to handle various exceptional situations like security shortages, bad delivery, company objections, auction settlement etc.

Clearing is the process of determination of obligations, after which the obligations are discharged by settlement.

NSE Clearing has two categories of clearing members: trading clearing members and custodians. Trading members can trade on a proprietary basis or trade for their clients. All proprietary trades become the member's obligation for settlement. Where trading member's trade on behalf of their clients they could trade for normal clients or for clients who would be settling through their custodians. Trades which are for settlement by Custodians are indicated with a Custodian Participant (CP) code and the same is subject to confirmation by the respective Custodian. The custodian is required to confirm settlement of these trades on T + 1 day by the cut-off time 1.00 p.m. Non-confirmation by custodian devolves the trade obligation on the member who had input the trade for the respective client.

A multilateral netting procedure is adopted to determine the net settlement obligations (delivery/receipt positions) of the clearing members. Accordingly, a clearing member would have either pay-in or pay-out obligations for funds and securities separately. In the case of securities in the Trade for Trade – Surveillance segment and auction trades, obligations are determined on a gross basis i.e. every trade results into a deliverable and receivable obligation of funds and securities. Members pay-in and pay-out obligations for funds and securities are determined by 2.30 p.m. on T + 1 day and are downloaded to them so that they can settle their obligations on the settlement day (T+2).

For pay-in through NSDL / CDSL a facility has been provided to members wherein delivery-out instructions will be generated automatically by the Clearing Corporation based on the net delivery obligations of its Clearing Members. These instructions will be released on the T+1 day to NSDL / CDSL and the securities in the Clearing Members' pool accounts will be marked for pay-in. Clearing members desirous of availing this facility shall send a letter in the format provided in the Annexure.

NSE Clearing carries out the clearing and settlement of trades executed on the exchange except Trade for trade - physical segment of capital market. Primary responsibility of settling these deals rests directly with the members and the Exchange only monitors the settlement. The parties are required to report settlement of these deals to the Exchange.

14.5 TRADE GUARANTEE FUND

The Scheme has come into force with effect from May 12, 1997

14.5.1 Objectives

- To guarantee settlement of transactions of members of the Exchange so as to protect the interest of investors and the members of the Exchange.
- To inculcate confidence in the minds of secondary market participants and global investors
- To promote the development of and regulation of the secondary market.
- To ensure that market equilibrium is not disturbed in case of payment default by the members.

14.6 TRADING SOFTWARE

Trading software facilitates the trading and analysis of financial products, such as stocks or currencies. Often times, brokerage firms provide their clients with trading software to easily place trades and manage their accounts, but traders can also purchase third-party trading software that supplements or enhances the software provided by brokerages.

Trading software have proliferated in recent years due to the growing popularity of electronic communication networks, or ECNs, and the availability of application programming interfaces, or APIs. ECNs are alternative trading networks that enable trading outside of traditional stock exchanges or bourses, which have made it far more co-effective for discount brokers to offer their own trading software. At the same time, APIs that provide real-time price and fundamental data have made it easier for third-party software developers to enter the market.

14.6.1 Types of Trading Software

There are many different types of trading software with different features provided by both brokerages and third-party developers.

Some of the most common features include:

- **Placing Trades -** Most trading software has the ability to place trades, including market orders, limit orders, and other advanced order types, as well as the ability to look up real-time quotes and view the Level 2 order book.
- **Technical Analysis** - Most trading software includes interactive charting capabilities, including both chart patterns (e.g. trendlines and shapes) and technical indicators (e.g. moving averages or momentum oscillators).
- **Fundamental Analysis** - Some trading software provides access to fundamental information, including financial statements, analyst ratings, and other proprietary tools designed for investors to simplify due diligence.
- **Programmatic Trading** - Advanced trading software enables traders to develop trading systems that can be executed programmatically rather than having to manually click a button. In addition, these software solutions may provide backtesting functionality designed to help traders see how their automated trading systems would have performed in the past.
- **Paper Trading** - Some trading software includes the ability to place faux trades, which is known as paper trading. That way, traders can test out their skills to see how they would perform before committing actual capital. This is especially common in the forex markets.

Before deciding on trading software, traders and investors should carefully consider what features they need. Active traders that rely on automated trading systems may choose entirely different trading software than an investor only looking for the ability to place trades. In addition, these software applications may have different fee structures, performance characteristics, and other factors that impact profitability. Traders should consider all of these factors before making a decision to help maximize their profitability.

- These days, computer applications have made it simple to automate trading. In order to ensure the accurate and effective execution of trades, it is essential to have the right type of software.

- Faulty software or one without desired features can lead to huge losses. In simple words, computer programs that help in trading of financial products like currencies and stocks are known as trading software.
- Brokerage firms usually provide software that helps clients to trade financial products and to handle their accounts. Different brokerages have different software that determine an interface where trades are made and information is researched.
- Moreover, a software must be stable, easy to navigate, and should be extremely secure. There are many trading software that are simple to use and filled with features, such as *NEST Trader*.
- Well, it's trading software where orders are placed to buy and sell shares in the foreign exchange market. Now days, trading software offer comparable features; although, a couple of these features are only accessible on NEST.

Let's take a look at some of the basic features of NEST:

1- Semi-Auto trading is accessible with the help of Ami broker or Ninja trader.

2- It has a feature to run constant-time data by exporting it to excel.

3- It can be worked from any part of the world.

4- NEST plus gives a plug-in to use charts. This is a free tool, but NEST plus additionally has several paid packages, which incorporates technical and news based features.

- It likewise gives the customer an ability to check the amount of SPAN margin available for NFO expiry contracts by giving the customer a calculation, which is required to check the margin.
- This facility is incredibly helpful for those who need to check on how much of initial margin is required on a real-time basis for positional and intra-day trades.

- Another tool offered by this software is VWAP statistics. These statistics help to fetch the minute by minute OHLC with the value weighted normal prices.

On the whole, novice traders who have just entered the world of trading can choose software applications that have decent reputation with required basic functionality at a minimal cost.

14.7 ARBITRATION MECHANISM

In simple words, arbitration is the act of dispute settlement through an arbitrator, i.e. a third party, who is not involved in the dispute.

It is an alternative dispute settlement mechanism, aiming at settlement outside the court.

14.7.1 Advantages of arbitration

- It minimizes the court intervention.
- It brings down the costs of dispute settlement.
- It fixes timelines for expeditious disposal.
- It ensures the neutrality of arbitrator and enforcement of awards.
- Having an arbitration law encourages foreign investments to a country. It projects the country as an investor friendly one having a sound legal framework and ease of doing business.
- Having an arbitration law facilitate effective conduct of international and domestic arbitrations raised under various agreements.

14.7.2 Mechanism of arbitration in India

A High Level Committee set up to review the Institutionalization of Arbitration Mechanism in India has submitted its report to the Union Law Ministry.

It was headed by Justice (retired) BN Sri krishna. The Union Government is committed for speedy resolution of commercial disputes and to make India an international hub of Arbitration. So government has decided to look into the recommendations and amended laws according to need.

14.7.3 Key Recommendation

Arbitration Promotion Council of India (APCI): The committee has recommended for setting up APCI, an autonomous body having representatives from all s stakeholders for grading arbitral institutions in India. The APCI may recognize professional institutes providing for accreditation of arbitrators. It It may be also empowered to hold training workshops and interact with law firms and law schools to train advocates with interest in arbitration and with a goal to create a specialist arbitration bar comprising of advocates dedicated to the field.

Specialist Arbitration Bench: It also recommended f for creation of a specialist Arbitration Bench to deal with such Commercial disputes, in the domain of the Courts.

Changes in Arbitration and Conciliation Act: It has suggested in various changes in provisions of the 2015 Amendments in the Arbitration and Conciliation Act with a view to make arbitration speedier and more efficacious and incorporate international best practices.

National Litigation Policy (NLP): The Committee also has opinion that the NLP must promote arbitration in Government Contracts.

14.8 MARKET INSTRUMENTS

Money market instruments are debt obligations that are used as investments by many brokerages and mutual fund companies. These could be any debt obligations that last for less than one year. Some examples of money market instruments are Treasury bills, commercial paper, and securities from government-sponsored enterprises. Individual investors can access money market instruments by investing in a money market account or a money market mutual fund. This type of investment is viewed as very safe in the investment community.

Considered to be short-term debt, money market instruments may be used by a business or government entity that needs to raise funds for a short-term purpose. To raise the money, they may issue this type of debt to investors. This debt will be paid back relatively quickly at low interest.

Individual investors can choose to invest in the money market. The two most common avenues of doing this are money market mutual funds and money market accounts. These investments are similar, but are provided by two different entities. Money market accounts are provided by financial brokerages while money market mutual funds are created by mutual fund companies

Both of these types of investments may use money market instruments in order to provide a return to the investors. Most of the time, the interest that is generated from these accounts is minimal compared to other investments. Most investors look at these types of investments as a safe place to park excess cash when no other investment is readily apparent.

Money market accounts and mutual funds invest in a variety of different money market instruments to provide returns for the investors. One of the most common instruments that is invested in is Treasury bills. The United States Treasury regularly issues short-term debt in the form of T-bills. These debt instruments are backed by the full faith and credit of the United States government and are therefore viewed as extremely safe to investors.

Another common instrument that is included in the money market is debt issued by government-sponsored enterprises. These companies are sponsored by the federal government and have government backing. This means that these debt securities are viewed as extremely safe as well.

Commercial paper is another type of money market investment. This is a short-term loan between businesses. In most cases, companies have to have a very good credit rating in order to issue this type of debt obligation. If a company does not have good credit, it will not be considered for money market instrument inclusion.

Publicly traded corporations often turn to the capital markets in order to raise money for some designated purpose. These issuers could turn either to the debt or equity capital markets. A capital instrument is the financial security that is issued into the financial markets, and it may be an equity or debt share. When a company issues equity, it sells stocks in the markets. If that organization chooses to issue debt, it offers different types of bonds.

One type of a capital instrument could be an equity share that trades in the capital markets. Many shares are typically offered in a single issuance. These capital instruments provide investors with equity ownership in a corporation and a chance to share in profits. Also, investors become exposed to risk because there is no guarantee that the value of an equity share will rise. Possibly, a company may issue equity capital instruments in a debut trading session, known as an initial public offering (IPO), or in a secondary offering, when the entity seeks to raise additional capital for an expansion or some project.

A bond is a form of debt that represents another type of capital instrument. Bond issuers could be corporations or municipalities, for instance, and investors represent the lenders of this debt. Capital instruments in the debt market have interest rates attached that dictate the return that investors will earn on the allocation. Also, time duration is joined to a bond, and this determines the period of time over which interest payments will be made to investors before the principal amount is returned. Investors may select short-term or long-term bonds that could vary from a period of three months to several decades.

It is possible for a new type of capital instrument to begin trading in the financial markets. The federal government in a region can participate in the trading environment by making certain requests for different capital instruments to be designed with a known amount of risk and likely reward, or profits, for investors. These financial securities might have unique characteristics, such as entering the markets as a security with debt-like features but later being converted into shares of equity that are designed to help a specific type of issuing entity, such as one that might be in financial distress. Investment bankers not only create these products but also must prove the merits of a new capital instrument to investors.

14.9 SUMMARY

Stock exchange is a continuous market for securities. margining allows investors to buy securities by borrowing money from a broker. The margin is the difference between the market value of a stock and the loan a broker makes. Margin is the minimum amount of collateral in either cash or securities you must have in your margin account to buy on margin, sell short, or invest in certain derivatives. Arbitration is the act of dispute settlement through an arbitrator, i.e. a third party, who is not involved in the dispute.

Money market instruments are debt obligations that are used as investments by many brokerages and mutual fund companies

14.10 GLOSSARY

- Stock Exchange — a market in which securities are bought and sold
- Speculation — investment in stocks, property, etc. in the hope of gain but with the risk of loss
- Funds — a sum of money saved or made available for a particular purpose.
- Capital Formation — net capital accumulation during an accounting period for a particular country
- Trading Software — software that enables investors and traders to place trades and monitor accounts through financial intermediaries
- Arbitration — the use of an arbitrator to settle a dispute

14.11 SELF-ASSESSMENT QUESTIONS

Q1. What is stock exchange?

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Q2. Define the term margining.

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Q3. What is trade guarantee fund?

Q4. What is arbitration?

Q5. What are market instruments?

14.12 LESSON END EXERCISE

Q1. Briefly explain trade clearing and settlement.

Q2. Briefly explain the arbitration mechanism.

Q3. Give the detailed explanation of market instruments.

14.13 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

M.Y. Khan : Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi – 110 002.

Shashi K Gupta : Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Nishja Aggarwal Ram Road, 24, Daryaganj, New Delhi - 110002 Neeti Gupta

Vishal Saraogi : Capital Markets and Securities Laws simplified, Lawpoint Publication, 6C, R.N. Mukherjee Road, Kolkata-70000

www.managementparadise.com/forums/financial-management/199978..

https://www.quora.com/What-is-the-importance-of-software-in-trading

https://www.investopedia.com/terms/t/trading-software.asp

https://www.clearias.com/arbitration-in-india

https://currentaffairs.gktoday.in/tags/arbitration-mechanism

www.wisegeek.com/what-are-money-market-instruments.htm

www.wisegeek.com/what-is-a-capital-instrument.htm

https://en.wikipedia.org/wiki/Stock_exchange

STOCK MARKET INDICES

STRUCTURE

15.1 Introduction

15.2 Objectives

15.3 Stock Market Indices

15.3.1 Types of indices

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`15.3.3 The importance of stock market indexes

15.4 Computation of Stock Index

15.4.1 Criteria for selection of securities for the BSE index

15.4.1.1 Quantitative Criteria

15.4.1.2 Qualitative Criteria

15.5 Difference Between Indices, Sensex, BSE Sectoral Indices

15.5.1 Indices

15.5.2 Sensex

15.5.3 BSE sectoral indices

15.6 Summary

15.7 Glossary

15.8 Self-Assessment Questions

15.9 Lesson End Exercise

15.10 Suggested Readings

15.1 INTRODUCTION

A stock market, equity market or share market is the aggregation of buyers and sellers (a loose network of economic transactions, not a physical facility or discrete entity) of stocks (also called shares), which represent ownership claims on businesses; these may include securities listed on a public stock exchange, as well as stock that is only traded privately. Examples of the latter include shares of private companies which are sold to investors through equity crowdfunding platforms. Stock exchanges list shares of common equity as well as other security types, e.g. corporate bonds and convertible bonds.

15.2 OBJECTIVES

After reading this lesson you will be able to Understand

- The concept of stock market
- Stock market indices and its importance
- Stock index
- difference between indices, sensex, bse, sectoral indices

15.3 STOCK MARKET INDICES

Index based on a statistical compilation of the share prices of a number of representative stocks. Index number a number or ratio (a value on a scale of measurement) derived from a series of observed facts can reveal relative changes as a function of time.

A stock index or stock market index is a measurement of a section of the stock market. It is computed from the prices of selected stocks (typically a weighted average). It is a tool used by investors and financial managers to describe the market, and to compare the return on specific investments.

Two of the primary criteria of an index are that it is investable and transparent, the method of its construction should be clear. Many mutual funds and exchange-traded funds attempt to "track" an index (see index fund) with varying degrees of success. The difference between an index fund's performance and the index is called tracking error.

15.3.1 Types of indices

Stock market indices may be classified in many ways. A 'world' or 'global' stock market index such as the MSCI World or the S&P Global 100includes stocks from multiple regions. Regions may be defined geographically (e.g., Europe, Asia) or by levels of industrialization or income (e.g., Developed Markets, Frontier Markets). A 'national' index represents the performance of thestock market of a given nation and by proxy, reflects investor sentiment on the state of its economy. The most regularly quoted market indices are national indices composed of the stocks of large companies listed on a nation's largest stock exchanges, such as the American S&P 500, the Japanese Nikkei 225, the Indian NIFTY 50, and the British FTSE 100. Other indices may be regional, such as the FTSE Developed Europe Index or the FTSE Developed Asia Pacific Index. Indexes may be based on exchange, such as the NASDAQ-100 or NYSE US 100, or groups of exchanges, such as the Euro next 100 or OMX Nordic 40. The concept may be extended well beyond an exchange. The Wilshire 5000 Index, the original total market index, represents the stocks of nearly every publicly traded company in the United States, including all U.S. stocks traded on the New York Stock Exchange (but not ADRs or limited partnerships), NASDAQ and American Stock Exchange. Russell Investment Group added to the family of indices by launching the Russel Global Index. More specialized indices exist tracking the performance of specific sectors of the market. Some examples include the Wilshire US REIT which tracks more than 80 American real estate investment trusts and the Morgan Stanley Biotech Index which consists of 36 American firms in the biotechnology industry. Other indices may track companies of a certain size, a certain type of management, or even more specialized criteria — one index published by Linux Weekly News tracks stocks of companies that sell products and services based on the Linux operating environment. Some indices, such as the S&P 500, have multiple versions. These versions can differ based on how the index components are weighted and on how dividends are accounted for. For example, there are three versions of the S&P 500 index: price return, which only considers the price of the components, total return, which accounts for dividend reinvestment, and net total return, which accounts for dividend reinvestment after the deduction of a withholding tax. As another example, the Wilshire 4500 and Wilshire 5000 indices have five versions each: full capitalization total return, full capitalization price, float-adjusted total return, float-adjusted price, and equal weight. The difference between the full capitalization, float-adjusted, and equal weight versions is in how index components are weighted. An index may also be classified according to the method used to determine its price. In a price-weighted index such as the Dow Jones Industrial Average, NYSE Arca Major Market Index, and the NYSE ARCA Tech 100 Index, the price of each component stock is the only consideration when determining the value of the index. Thus, price movement of even a single security will heavily influence the value of the index even though the dollar shift is less significant in a relatively highly valued issue, and moreover ignoring the relative size of the company as a whole. In contrast, a capitalization-weighted (also called market-value-weighted) index such as the S&P 500 or Hang Seng Index factors in the size of the company. Thus, a relatively small shift in the price of a large company will heavily influence the value of the index. Traditionally, capitalization- or share-weighted indices all had a full weighting, i.e. all outstanding shares were included. Recently, many of them have changed to a float-adjusted weighting which helps indexing. An equal-weighted index is one in which all components are assigned the same value. For example, the Barron's 400 Index assigns an equal value of 0.25% to each of the 400 stocks included in the index, which together add up to the 100% whole. A modified capitalization-weighted index is a hybrid between capitalization weighting and equal weighting. It is similar to a capitalization weighting with one main difference: the largest stocks are capped to a percent of the weight of the total stock index and the excess weight will be redistributed equally amongst the stocks under that cap. Moreover, in 2005, Standard & Poor's introduced the S&P Pure Growth Style Index and S&P Pure Value Style Index which was attribute-weighted. That is, a stock's weight in the index is decided by the score it gets relative to the value attributes that define the criteria of a specific index, the same measure used to select the stocks in the first place. For these two indexes, a score is calculated for every stock, be it their growth score or the value score (a stock cannot be both) and accordingly they are weighted for the index. Criticism of capitalization-weight: One argument for capitalization weighting is that investors must, in aggregate, hold a capitalization-weighted portfolio anyway. This then gives the average return for all investors; if some investors do worse, other investors must do better (excluding costs). Investors use theories such as modern portfolio theory to determine allocations. This considers risk and return and does not consider weights relative to the entire market. This may result in overweighting assets such as value or small-cap stocks, if they are believed to have a better return for risk profile. These investors believe that they can get a better result because other investors are not very good. The capital asset pricing model says that all investors are highly intelligent, and it is impossible to do better than the market portfolio, the capitalization-weighted portfolio of all assets. However, empirical tests conclude that market indices are not efficient. This can be explained by the fact that these indices do not include all assets or by the fact that the theory does not hold. The practical conclusion is that using capitalization-weighted portfolios is not necessarily the optimal method. As a consequence, capitalization-weighting has been subject to severe criticism (see e.g. Haugen and Baker 1991, Amenc, Goltz, and Le Sourd 2006, or Hsu 2006), pointing out that the mechanics of capitalization-weighting lead to trend-following strategies that provide an inefficient risk-return trade-off. Also, while capitalization-weighting is the standard in equity index construction, different weighting schemes exist. First, while most indices use capitalization-weighting, additional criteria are often taken into account, such as sales/revenue and net income (see the "Guide to the Dow Jones Global Titan 50 Index", January 2006). Second, as an answer to the critiques of capitalization-weighting, equity indices with different weighting schemes have emerged, such as "wealth"-weighted (Morris, 1996), "fundamental"-weighted (Arnott, Hsu and Moore 2005), "diversity"-weighted (Fernholz, Garvy, and Hannon 1998) or equal-weighted indices.Indices and passive investment management. There has been an accelerating trend in recent decades to invest in passively managed mutual funds that are based on market indices, known as index funds. SPIVA's annual "U.S. Scorecard", which measures the performance of indices versus actively managed mutual funds, finds the vast majority of actively managed mutual funds underperform their benchmarks.[14] One study claimed that over time, the average actively managed fund has returned 1.8% less than the S&P 500 index - a result nearly equal to the average expense ratio of mutual funds (fund expenses are a drag on the funds' return by exactly that ratio). Since index funds attempt to replicate the holdings of an index, they eliminate the need for and thus many costs of the research entailed in active management, and have a lower churn rate (the turnover of securities which lose fund managers' favor and are sold, with the attendant cost of commissions and capital gains taxes). Indices are also a common basis for a related type of investment, the exchange-traded fund or ETF. Unlike an index fund, which is priced daily, an ETF is priced continuously, is optional, and can be sold short. Ethical stock market indices: A notable specialized index type is those for ethical investing indices that include only those companies satisfying ecological or social criteria, e.g. those of The Calvert Group, KLD, FTSE4Good Index, Dow Jones Sustainability Index, STOXX Global ESG Leaders Index, several Standard Ethics Aei indices and Wilderhill Clean Energy Index.In 2010, the OIC announced the initiation of a stock index that complies with Islamic law's ban on alcohol, tobacco and gambling. Other such equities, such as the Dow Jones Islamic Market World Index, already exist. Another important trend is strict mechanical criteria for inclusion and exclusion to prevent market manipulation, e.g. in Canada when Nortel was permitted to rise to over 30% of the TSE 300 index value. Ethical indices have a particular interest in mechanical criteria, seeking to avoid accusations of ideological bias in selection, and have pioneered techniques for inclusion and exclusion of stocks based on complex criteria. Another means of mechanical selection is mark-to-future methods that exploit scenarios produced by multiple analysts weighted according to probability, to determine which stocks have become too risky to hold in the index of concern. Critics of such initiatives argue that many firms satisfy mechanical "ethical criteria", e.g. regarding board composition or hiring practices, but fail to perform ethically with respect to shareholders, e.g. Enron. Indeed, the seeming "seal of approval" of an ethical index may put investors more at ease, enabling scams. One response to these criticisms is that trust in the corporate management, index criteria, fund or index manager, and securities regulator, can never be replaced by mechanical means, so "market transparency" and "disclosure" are the only long-term-effective paths to fair markets. From a financial perspective, it is not obvious whether ethical indices or ethical funds will out-perform their more conventional counterparts. Theory might suggest that returns would be lower since the investible universe is artificially reduced and with it portfolio efficiency. On the other hand, companies with good social performances might be better run, have more committed workers and customers, and be less likely to suffer reputational damage from incidents (oil spillages, industrial tribunals, etc.) and this might result in lower share price volatility. The empirical evidence on the performance of ethical funds and of ethical firms versus their mainstream comparators is very mixed for both stock and debt markets.

15.3.2 Determining which index to use

Studies have shown that all the indexes are correlated that is, they all move together in the same direction. However, there are some differences. The Nasdaq and the AMEX indexes are not as highly correlated with the S&P 500 and the DJIA. This makes sense because companies in the Nasdaq and AMEX indexes are younger, smaller, and riskier than the companies in the DJIA and S&P 500 Index. The best approach is to choose the index that closely resembles the makeup of your stock portfolio. Individual measures of the market are convenient indicators or gauges of the stock market. These market indexes are convenient gauges of the stock market that also indicate the direction of the market over a period of time. By using these market indexes, you can compare how well individual stocks and mutual funds have performed against comparable market indicators for the same period.

15.3.3 The importance of stock market indexes

Although the stock market is much more dynamic than the indexes suggest, along with the fact that there are different ways to calculate the indexes, causing calculation bias, the stock market indexes are useful in a number of ways to stock investors. First, the market indexes provide an historical perspective of stock market performance, giving investors more insight into their investment decisions. Investors who do not know which individual stocks to invest in can use indexing as a method of choosing their stock investments. By wanting to match the performance of the market, investors can invest in index mutual funds or index exchange-traded funds (ETFs) that track the performance of the indexes with which they are aligned. This form of investing gives investors the opportunity to do as well as the markets and not significantly underperform the markets.

The second benefit of stock market indexes is that they provide a yardstick with which investors can compare the performance of their individual stock portfolios. Individual investors with professionally managed portfolios can use the indexes to determine how well their managers are doing in managing their money.

The third major use of stock market indexes is as a forecasting tool. Studying the historical performance of the stock market indexes, you can forecast trends in the market. The Internet bubble is a prime example, which in hindsight provides 20/20 vision. The price-to-earnings (P/E) ratio of the stock markets was in the high 20s to low 30s in 1999–2000, indicating that the markets could not sustain the rapid increase in stock prices. The P/E ratio for the market historically has ranged between the high single digits and the low 30s, with an average around 15. The P/E ratio for the S&P 500 was 17 on August 4, 2006, an indication that the stock market was not particularly overvalued. Consequently, the market indexes provide investors with a useful tool for forecasting trends in the market.

15.4 Computation of stock index

There are three different types of stock indexes.

- Market capitalization weighted index
- Price weighted index
- Equally weighted index

Market capitalization based index is the famous one among the above and is used by most of the exchanges worldwide. BSE Sensex and NSE NIFTY are calculated based on the method of market capitalization weight.

The market value weighted method computes a stock index in which each stock affects the index in proportion to its market value. This is also called the capitalization-weighted index. The price weighted method gives weights to each security forming the index according to the price per share prevailing in the market. Weights can also be given equally to all the shares. This method of computing the index is known as equal weight method.

Example- Assume that stocks A1, A2 and A3 constitute the sample companies for the computation of an index. The base index is 100 and the base date price and current market prices are given below. Compute the current stock index when no change in share representation takes place, dividends or stock splits have not occurred, and no additional shares have been issued. Use the market value weighted method; price weighted method, and equal weight method.

Share	Outstanding shares	Base price	Current price
A1	500,000	120	200
A2	800,000	150	900
A3	600,000	110	150

i. Market value weighted method

Share	Outstanding shares	Base price	Base value	Current price	Current value
A1	500,000	120	60,000,000	200	100,000,000
A2	800,000	150	120,000,000	900	720,000,000
A3	600,000	110	66,000,000	150	90,000,000
Total value			246,000,000		910,000,000

Market price weighted index = 910000000/246000000 × 100 = 370

ii. Price weighted method

Share	Base price	Current price
A1	120	200
A2	150	900
A3	110	150
Total	380	1,250

Market price weighted index = 1250/380 × 100 = 329

iii. Equal weight method

Share	Outstanding shares	Base price	Current price
A1	500,000	120	200
A2	800,000	150	900
A3	600,000	110	150

Equal weighted index = 100 + 201.01 = 301.01

The stock exchanges in India compute and publish indices representing different sets of portfolios using the market capitalization weighted average method. In this method, the number of equity shares outstanding is multiplied by the price to arrive at market capitalization. This will ensure that each security will influence the index in proportion to its respective market importance. The current market capitalization is compared with the base market capitalization (base value) in order to get the index value at any point of time.

Index = (Total market capitalization of constituent scrip/base value × base index

The advantage of this method of compilation is that it has the flexibility to adjust for price changes caused by various corporate actions. The methodology of calculation is the same as the one employed in many of the popular indices such as the S & P 500, NASDAQ. Hang Seng Index, and FTSE 100 Index.

All stock exchanges constitute an index committee to identify the representative shares for the index. The Index Committee meets frequently to review the indices. In case of a revision in the constituent scrip of the index, the announcement of the incoming and outgoing scrips will be made ahead of the actual revision of the index.

15.4.1 Criteria for selection of securities for the BSE index

The selection of securities for the BSE index will be made on the basis of certain quantitative and qualitative criteria such as market capitalization, liquidity, depth, trading frequency, and industry representation.

15.4.1.1 Quantitative Criteria

1. Market Capitalization:

   The scrip should figure in the top 100 companies listed by market capitalization. Also market capitalization of each scrip should be more than 0.5 % of the total market capitalization of the Index i.e. the minimum weight should be 0.5 %. Since the SENSEX is a market capitalization weighted index, this is one of the primary criteria for scrip selection. (Market Capitalization would be averaged for last six months)

2. Liquidity:

   i. Trading Frequency: The scrip should have been traded on each and every trading day for the last one year. Exceptions can be made for extreme reasons like scrip suspension etc.

   ii. Number of Trades: Number of Trades: The scrip should be among the top 150 companies listed by average number of trades per day for the last one year.

   iii. Value of Shares Traded: Value of Shares Traded: The scrip should be among the top 150 companies listed by average value of shares traded per day for the last one year.

3. Continuity:

   Whenever the composition of the index is changed, the continuity of historical series of index values is re-established by correlating the value of the revised index to the old index (index before revision). The back calculation over the last one-year period is carried out and correlation of the revised index to the old index should not be less than 0.98. This ensures that the historical continuity of the index is maintained.

4. Industry Representation:

   Scrip selection would take into account a balanced representation of the listed companies in the universe of BSE. The index companies should be leaders in their industry group.

5. Listed History:

   The scrip should have a listing history of at least one year on BSE.

15.4.1.2 Qualitative Criteria

Track Record:

In the opinion of the Index Committee, the company should have an acceptable track record.

Adjustment for bonus, rights, and newly issued capital :

Index calculation needs to be adjusted for issue of bonus and rights issue. If no adjustments were made, a discontinuity would arise between the current value of the index and its previous value despite the non-occurrence of any economic activity of substance. At the BSE Index Cell, the base value is adjusted, which is used to alter market capitalization of the component stocks to arrive at the index value.

The BSE Indices & Department keeps a close watch on the events that might affect the index on a regular basis and carries out daily maintenance of all BSE Indices.

- Adjustments for Rights Issues

  When a company, included in the compilation of the index, issues right shares, the free-float market capitalization of that company is increased by the number of additional shares issued based on the theoretical (ex-right) price. An offsetting or proportionate adjustment is then made to the Base Market capitalization.

- Adjustments for Bonus Issue

  When a company, included in the compilation of the index, issues bonus shares, the market capitalization of that company does not undergo any change. Therefore, there is no change in the Base Market capitalization; only the ‘number of shares’ in the formula is updated.

- Other Issues

  Base Market capitalization Adjustment is required when new shares are issued by way of conversion of debentures, mergers, spin-offs etc. or when equity is reduced by way of buy-back of shares, corporate restructuring etc.

  The market value weighted method incorporates the adjustment effectively into the index while the other index computation methods do not show the effect of a bonus issue.

Example. Compute the index using the market value weighted method and price weighted method for the following market information. The base index is 100.

Share	Outstanding shares (Base period)	Current price	Base price
A1	800,000	80	50
A2	500,000	60	40
A3	300,000	100	60

Company A2 issued bonus shares in the ratio of 1 : 2. the current price reflects the share price after the bonus share has become effective in the market. There is no other change in other companies.

i. Market value weighted method

Share	Outstanding shares	Base price	Base value	Current price	Current value
A1	800,000	50	40,000,000	80	64,000,000
A2	500,000	40	20,000,000	60	90,000,000*
A3	300,000	60	18,000,000	100	30,000,000
Total value			78,000,000		184,000,000

*Outstanding shares for A2 after the issue of bonus will be 1,500,000

Market value weighted index = 184000000 / 78000000 × 100 = 236

ii. Market price weighted method

Share	Base price	Current price
A1	50	80
A2	40	60
A3	60	100
Total	150	240

When a company, included in the computation of the index, issues rights shares, the number of additional shares issued increases the weighting factor for that share. An offsetting or proportionate adjustment is then made to the base year average. Weight factors get revised when new shares are issued by way of conversion of debentures, of loans into equity by financial institutions, mergers, and so on. The base year average is also suitably adjusted to offset the change in the market value thus added. Similarly, when convertible/non-convertible bonds /debentures, preference shares, and so on are issued as rights to equity shareholders, the base year average is adjusted on the basis of the ex-right price of the equity shares.

For the computation of the index, the base value is adjusted and used as a denominator for arriving at the index value.

One of the important aspects of maintaining continuity with the past is to update the base year average. The base year value adjustment ensures that the rights issue and the new capital of the index scrips do not destroy the value of the index.The changes are, in effect, proportional adjustments in the base year to offset the price changes in the market values upon which the index is based. The formula for changing the base year average is as follows:

New Base Year Average = Old Base Year Average ×

Example. A company included in the computation of the index issues rights shares which increases the market value of its shares by Rs. 500 crores. If the existing base year average value is Rs. 7,590 crores and the aggregate market value of all the shares included in the index before the right issue is Rs. 9,586 crores, the revised base year average will then be computed as follows:

= Rs. 7,985.89 crores

This calculated amount (Rs. 7,985.89) will be used as the base year average for calculating the index number from then onwards till the next base change becomes necessary.

Dividend payment by the constituting company also needs to be adjusted against the ex-dividend price. The dividend declared per share is deducted from the cum-dividend price per share. The ex-dividend price quoted in the market is taken as the price of the constituent security, which will be less than the price of the security earlier.

15.5 DIFFERENCE BETWEEN INDICES, SENSEX AND BSE SECTORAL INDICES

The following point describes the difference between indices, Sensex and BSE sectoral indices

15.5.1 INDICES

A stock market index is a measure of the relative value of a group of stocks in numerical terms. As the stocks within an index change value, the index value changes. An index is important to measure the performance of investments against a relevant market index.

15.5.2 SENSEX

SENSEX, otherwise known as the S&P BSE SENSEX index, is the benchmark index of the Bombay Stock Exchange (BSE) in India. SENSEX is composed of 30 of the largest and most actively-traded stocks on the BSE, providing an accurate gauge of India's economy. Initially compiled in 1986, the SENSEX is the oldest stock index in India. Analysts and investors use the SENSEX to observe the overall growth, development of particular industries, and booms and busts of the

Indian economy.

SENSEX experienced enormous growth in the first decade of the 21st century, rising from a close of 3,377.28 in 2002 to one of 20,286.99 in 2007. This reflects India's gross domestic product (GDP) growth since the turn of the century, which ranks as one of the fastest in the world. According to International Monetary Fund (IMF) estimates, India's GDP grew rapidly between 2002 and 2007, and then stunted a bit in 2008, in stride with the global financial crisis of that year, but was back on a strong growth rate in 2010. India's growing GDP owes much credit to the rise of the Indian middle class, which stood at less than 1 percent of the global middle class in 2000 but is expected to account for 10 percent by 2020. The middle class is an important driver of consumption demand.

The SENSEX-(or SENSitve indEX) was introduced by the Bombay stock exchange on January 1 1986. It is one of the prominent stock market indexes in India. The SENSEX is designed to reflect the overall market sentiments. It comprises of 30 stocks. These are large, well-established and financially sound companies from main sectors.

a) Method adopted for SENSEX calculation

The method adopted for calculating SENSEX is the market capitalisation weighted method in which weights are assigned according to the size of the company. Larger the size, higher the weightage.

The base year of Sensex is 1978-79 and the base index value is set to 100 for that period.

b) Why is the base value set to 100 points?

The total value of shares in the market at the time of index construction is assumed to be '1002 in terms of 'points'. This is for the purpose of ease of calculation and to logically represent the change in terms of percentage. So, next day, if the market capitalization moves up 10%, the index also moves 10% to 110.

c) How are the stocks selected?

The stocks are selected based on a lot of qualitative and quantitative criterias.

You can view the listing criteria here.

d) How is the index constructed?

The construction technique of index is quite easy to understand if we assume that there is only one stock in the market. In that case, the base value is set to 100 and let's assume that the stock is currently trading at 200. Tomorrow the price hits 260 (30% increase in price) so, the index will move from 100 to 130 to indicate that 30% growth. Now let's assume that on day 3, the stock finishes at 208. That's a 20% fall from 260. So, to indicate that fall, the Sensex will be corrected from 130 to 104(20%fall).As our second step to understand the index calculation, let us try to extend the same logic to two stocks – A and B. A is trading at 200 and let's assume that the second stock 'B' is trading at 150. Since the Sensex follows the market capitalization weighted method, we have to find the market capitalization (or size of the company- in terms of price) of the two companies and proportionate weightage will have to be given in the calculation.

How do we compute size of the company- in terms of price?

That's simple. Just multiply the total number of shares of the company by the market price. This figure is technically called 'market capitalization'.

Back to our example-

We assume that company A has 100,000 shares outstanding and B has 200,000 shares outstanding. Hence, the total market capitalization is (200 x 100000 + 150 x 200000) Rs 500 lakhs. This will be equivalent to 100 points.

Let's assume that tomorrow, the price of A hits 260 (30% increase in price) and the price of B hits 135. (10% drop in price). The market capitalization will have to be reworked. It would be – 260 x 100,000 + 135 x 200,000 = 530 lakhs. That means, due to the changes in price, the market capitalization has moved from 500 lakhs to 530 indicating a 6% increase. Hence, the index would move from 100 to 106 to indicate the net effect.This logic is extended to many selected stocks and this calculation process is done every minute and that's how the index moves.

What is free float?

- That's the total number of shares available for the public to trade in the market. It excludes shares held by promoters, governments or trusts, FDIs etc..
- To find the free float market value, the total value of the company (total shares x market price) is further multiplied by a free float market value factor, which is nothing but the percentage of free float shares of a particular company.
- So logically, the company which has more public holding will have the highest free float factor in the Sensex. This equalizes everything.
- Example- let's assume that the market value of a company is Rs 100,000 Crore and it has 100 Crore shares having a value of Rs 1,000 each but only 20% of it are available to the public for trade. The free float factor would be 20/100 or 0.20 and the free float market value would be .20 x 100,000 = 20,000 Crores.
- You need not calculate the free float market capitalization since its available straight on the BSE website – Click this link to get it.
- SENSEX value = Current free-float market value of constituents stocks/ Index Divisor

So, the numerator is available straight from the BSE site. It's the total of free float factors of 30 stocks x market capitalization.

15.5.3 BSE SECTORAL INDICES

An index is a compilation of stocks constructed in such a manner to track a particular market or sector. These stocks would be a part of some industry or sector. Check out the sector weightage of the stocks in the various BSE and NSE indices. Also see the weightage of the sub-sectors within these sectors for these indices

15.6 SUMMARY

A stock index or stock market index is a measurement of a section of the stock market. It is computed from the prices of selected stocks (typically a weighted average). It is a tool used by investors and financial managers to describe the market, and to compare the return on specific investments. Studies have shown that all the indexes are correlated that is, they all move together in the same direction. Individual measures of the market are convenient indicators or gauges of the stock market. These market indexes are convenient gauges of the stock market that also indicate the direction of the market over a period of time. Although the stock market is much more dynamic than the indexes suggest, along with the fact that there are different ways to calculate the indexes, causing calculation bias, the stock market indexes are useful in a number of ways to stock investors. First, the historical perspective of stock market performance, the second benefit of stock market indexes, third major use of stock market indexes is as a forecasting tool.

There are three different types of stock indexes.

- Market capitalization weighted index
- Price weighted index
- Equally weighted index

15.7 GLOSSARY

- Stock market — A stock exchange.
- Index — link the value of (prices, wages, or other payments) automatically to the value of a price index
- Capitalization — The provision of capital for a company, or the conversion of income or assets into capital.
- SENSEX — A figure indicating the relative prices of shares on the Mumbai (Bombay) Stock Exchange
- BSE — The first and largest securities market in India and was established in 1875 as the Native Share and Stock Brokers' Association

15.8 SELF-ASSESSMENT QUESTIONS

Q1. What do you mean by stock market indices?

Q2. Write down the importance of stock market indexes.

Q3. What is Sensex?

Q4. Define BSE sectoral indices.

15.9 LESSON END EXERCISE

Q1. Briefly explain the importance of stock market indices.

Q2. What are the different factors determining which index is to be used?

Q3. What is the difference between indices, sensex, bse sectoral indices.

15.10 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

M.Y. Khan : Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi – 110 002.

Shashi K Gupta : Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Nishja Aggarwal Ram Road, 24, Daryaganj, New Delhi - 110002 Neeti Gupta

Vishal Saraogi : Capital Markets and Securities Laws simplified, Lawpoint Publication, 6C, R.N. Mukherjee Road, Kolkata-70000

UNIT 4 **LESSON NO. 16**

LEGAL FRAMEWORK

STRUCTURE

16.1 INTRODUCTION

SEBI had issued SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("ICDR Regulations"), to promote the development of a healthy capital market and to protect the interests of investors in securities. SEBI carefully monitors the dealings and actions of companies planning to raise money on the stock exchanges. The Regulations were notified on September 3, 2009 and replace the Disclosure and Investor Protection (DIP) Guidelines 2000 that now stand rescinded. Debt securities which are convertible, either partially or fully or optionally into listed or unlisted equity shall be guided by the disclosure norms applicable to equity or other instruments offered on conversion in terms of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. (3) SEBI (Issue and Listing of Debt Securities) Regulations, 2008 SEBI (Issue and Listing of Debt Securities) Regulations, 2008 pertaining to issue and listing of debt securities which are not convertible, either in whole or part into equity instruments. They provide for a rationalized disclosure requirements and a reduction of certain onerous obligations attached to an issue of debt securities. SEBI had notified amendments to the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (Debt Regulations) on November 13, 2012. SEBI has undertaken a series of reforms in order to make regulatory framework for debt markets more robust. However, despite constant regulatory efforts to improve the debt markets, the private placement of debt securities has been highly unregulated. Therefore, SEBI has introduced additional disclosure requirements in the recent amendment with a view to make the regulatory framework for private placement of debt securities more robust, and to align the same with the disclosure requirements that are applicable to public issuance of equity shares. (4) SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations"). The listing of securities is ensured by way of an agreement which is entered into between a stock exchange and the issuing company. This agreement called listing agreement. All Listed entities shall comply with the listing conditions as stipulated in Listing Regulations to provide substantial information about the company to the stock exchanges on a daily basis. The provisions of Chapter V from Regulation 49 to 62 of 'Listing Regulations' shall apply only to a listed entity which has listed its 'Non-convertible Debt Securities' and/or 'Non-Convertible Redeemable Preference Shares' on a recognised stock exchange in accordance with SEBI (Issue and Listing of Debt Securities) Regulations, 2008 or SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013 respectively. The provisions of chapter V shall also be applicable to "perpetual debt instrument" and "perpetual non-cumulative preference share" listed by banks. (5) RBI Guidelines RBI guidelines allow banks to raise capital by issue of non-equity instruments such

16.1.1 Issue and Listing of Securities

The Companies Act, 2013 & the Companies (Share Capital and Debentures) Rules, 2014 Section 71 of the Companies Act, 2013 provides the condition for issue of debentures. A debenture is a legal document that represents a secure means by which a creditor can lend money to the debtor. A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. The issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting. This means debenture may be non-convertible debenture or convertible debenture. Convertible debenture may either be Fully Convertible Debenture (FCD) or Partly Convertible Debenture. The companies is required to comply section 71 (Debentures) read with rule 18 of the Companies (Share Capital and Debentures) Rules 2014.

As Perpetual Non-Cumulative Preference Shares (PNCPS) and innovative Perpetual Debt Instruments (PDI), these instruments need to be in compliance with the specified criteria for inclusion in Additional Tier I Capital. Further, these instruments inter-alia should be able to absorb loss either through: (i) conversion to common shares at an objective pre-specified trigger point or (ii) a write-down mechanism that allocates losses to the instruments at a pre-specified trigger point. Whereas RBI vide circular dated September 01, 2014 on the "Implementation of Basel III Capital Regulations in India – Amendments" has inter-alia allowed banks to issue Additional Tier 1 (AT1) instruments to retail investors. Further, RBI vide its Master Circular on Basel III Capital Regulations dated July 1, 2015 has also specified additional disclosure requirements for PNCPS and PDIs.

16.2 OBJECTIVES

After reading this lesson you will be able to understand:

- The legal framework of securities
- Securities market intermediaries

16.3 REGULATORY FRAMEWORK RELATING TO SECURITIES MARKET INTERMEDIARIES

In the era of closed markets, intermediaries were not common because buyers and sellers transacted in close proximity to one another and a "middleman" was not required. However, as financial markets expanded and matured, it was no longer possible for buyers and sellers to have direct dealing; thus, contemporary capital markets are substantially dependent on market intermediaries. To understand this dependence, to comprehend how market intermediaries are driving the market today, and to ascertain the regulatory contours of India's securities market regulator the Securities and Exchange Board of India (SEBI) in respect of intermediary governance, it is imperative to understand who these market intermediaries are.

In simple terms, market intermediaries operate as the bridge between capital providers and capital seekers. According to this understanding, any person operating in the capital markets other than the issuer and the investor may be considered a market intermediary. Does the regulatory understanding of "market intermediaries" conform to this interpretation? Interestingly, the SEBI does not offer any conceptual or exhaustive definition of "market intermediaries."

16.3.1 Market intermediaries under SEBI regulations,2008

It is worthwhile to refer to the definition of intermediaries provided in the SEBI (Intermediaries) Regulations, 2008 (henceforward, the Intermediaries Regulations), which in turn makes reference to Sections 11(2)(b), (ba) and Section 12(1), (1A) of the SEBI Act, 1992. According to these provisions, intermediaries comprise the following:

(a) Stock brokers and sub-brokers

(b) Share transfer agents

(c) Bankers to an issue

(d) Trustees of trust deeds

(e) Registrars to an issue

(f) Merchant bankers

(g) Underwriters

(h) Portfolio managers

(i) Investment advisers

(j) Depositories and depository participants

(k) Custodians of securities

(l) Credit rating agencies

(m) Asset management companies

(n) Clearing members

(o) Trading members

(p) Any other intermediary who may be associated with securities markets in any manner

The Intermediaries Regulations specifically excludes foreign institutional investors, foreign venture capital investors, mutual funds, collective investment schemes, and venture capital funds from the definition of intermediaries. Further, it is imperative to note that since only Chapters V and VI of the Intermediary Regulations are effective, the clause containing the definition is not yet operative. Nevertheless, it may be referred to in order to understand the concept from a regulatory perspective.

Interpreting the term "associated with securities market" under SEBI regulations, 2008

Ambiguity arises while interpreting the residual category, much of which depends on how the SEBI interprets "associated with securities market." Although not in the context of intermediaries, courts have held that "persons associated with market" would include everyone who has something to do with the securities market. For instance, audit firms without any direct association with share market activities are reckoned to be "associated with securities market," since the auditing accounts of a company has a direct impact on the investor's interest and market stability. While this issue is currently pending in appeal before the Supreme Court of India, a study of decided cases indicates that the SEBI interprets "associated with market" to include all persons having any direct or indirect link with the securities market.

16.4 SUMMARY

SEBI had issued SEBI (Issue of Capital and Disclosure Requirements)

Regulations, 2009 ("ICDR Regulations"), to promote the development of a healthy capital market and to protect the interests of investors in securities. Market intermediaries operate as the bridge between capital providers and capital seekers. The Intermediaries Regulations specifically excludes foreign institutional investors, foreign venture capital investors, mutual funds, collective investment schemes, and venture capital funds from the definition of intermediaries. Further, it is imperative to note that since only Chapters V and VI of the Intermediary Regulations are effective, the clause containing the definition is not yet operative. Nevertheless, it may be referred to in order to understand the concept from a regulatory perspective.

16.5 GLOSSARY

- Debentures — a long-term security yielding a fixed rate of interest, issued by a company and secured against assets.
- Listing of securities — investment instrument (such as stock/shares, bonds) that is officially listed (quoted) on a stock exchange for public trading
- Intermediaries — a person who acts as a link between people in order to try and bring about an agreement; a mediator
- Regulatory — serving or intended to regulate something.
- Securities market — a component of the wider **financial market** where securities can be bought and sold between subjects of the economy, on the basis of demand and supply.

16.6 SELF-ASSESSMENT QUESTIONS

Q1. What do you mean by issuing and listing of securities?

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Q2. Who are security market intermediaries?

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Q3. What do you mean by merchant banking?

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16.7 LESSON END EXERCISE

Q1. Briefly explain the SEBI regulations, 2009 to protect the interest of the investors.

Q2. Gives the detailed explanation of the capital market intermediaries

16.8 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

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UNIT 4	LESSON NO. 17

MINISTRY OF FINANCE

STRUCTURE

17.1 INTRODUCTION

The Ministry of Finance is an important ministry within the Government of India concerned with the economy of India, serving as the Indian Treasury Department. In particular, it concerns itself with taxation, financial legislation, financial institutions, capital markets, centre and state finances, and the Union Budget.The Ministry of Finance must manage government financial assets, propose economic and financial policy, and coordinate and supervise these actions as empowered by law. Its main duties and functions are to:

- Prepare the annual fiscal budget and issue adequate regulations for its execution.
- Manage government financial assets.
- Propose bills related to the management of government employees, particularly bills related to staffing, salaries, benefits and pensions.
- Amortize debt and coordinate financial activities carried out within the scope of its power, for the different ministries and their related entities.
- Be aware of and report on any initiative of a financial nature involving public expenditure and indebtedness before it is debated by Congress.
- Participate in the negotiation of international free trade and financial agreements.
- Exercise all powers and rights as conferred on it in the Central Bank Law.

17.1.1 Objectives

- Maintaining a stable macroeconomic/macro-fiscal framework.
- Maintaining sound public finances
- Securing a competitive and efficient private sector led economy that provides expanding economic and employment opportunities for all through easing distortions in the incentives system by:
- Promoting a fair and efficient tax and benefit system with incentives to work, save and invest;
- Promoting trade liberalization with a view to promoting economic efficiency and international competitiveness and thus create a stronger basis for long-term economic expansion through:
- Proceeding with tariff liberalization in line with WTO obligations and trade agreements.
- Simplifying and liberalizing customs procedures

- More efficient government spending
- Improving the quality and the cost effectiveness of public services

The Department of Financial Services covers Banks, Insurance and Financial Services provided by various government agencies and private corporations. It also covers pension reforms and Industrial Finance and Micro, Small and Medium Enterprise. It started the Pradhan Mantri Jan Dhan Yojana.

PFRDA, Pension Fund Regulatory and Development Authority (PFRDA) is a statutory body which also works under this department.

Rajiv Kumar is the current secretary of this department.

17.2 OBJECTIVES

After reading this lesson you will be able to Understand

- Capital market division
- Ministry of corporate affairs
- Companies Act, 2013

17.3 CAPITAL MARKET DIVISION

Leumi's Capital Markets Division was established in order to provide its clients with capital markets solutions that address their unique needs. The Division is the leading team in Israel in which all capital market transactions associated with trading liquidity, trading risk, securities brokering, and financial instruments here and around the world, are carried out - all at one professional address.At the heart of the Division's work is a focus on overcoming the local and global challenges of interest rate volatility, currency risk, and the pricing of various securities and other financial instruments. The professionals of the Capital Markets Division work closely with Client Managers and Investment Advisers in all our business divisions, in order to provide our clients with a complete and comprehensive solution to all of their capital market needs.

The term capital market broadly defines the place where various entities trade different financial instruments. These venues may include the stock market, the bond market, and the currency and foreign exchange markets. They are concentrated in major financial centers including New York, London, Singapore, and Hong Kong. Capital markets consist of the suppliers and users of funds. Suppliers include households and the institutions serving them pension funds, life insurance companies, charitable foundations, and non-financial companies who generate cash beyond their needs for investment. Users of funds include home and motor vehicle purchasers, non-financial companies, and governments financing infrastructure investment and operating expenses.

Capital markets are used to sell financial products like equities and debt securities. Equities are stocks, which are ownership shares in a company. Debt securities, such as bonds, are interest-bearing IOUs.These markets are divided into two different categories: primary markets—where new equity stock and bond issues are sold to investors—and secondary markets, which trade existing securities. Capital markets are a crucial part of a functioning modern economy because they move money from the people who have it to those who need it for productive use.

17.4 MINISTRY OF CORPORATE AFFAIRS

The Ministry of Corporate Affairs (MCA), earlier known as Department of Corporate Affairs under Ministry of Finance an Indian government ministry. This Ministry is primarily concerned with administration of the Companies Act 2013, the Companies Act 1956, the Limited Liability Partnership Act, 2008 & other allied Acts and rules & regulations framed there under mainly for regulating the functioning of the corporate sector in accordance with law. It is responsible mainly for regulation of Indian enterprises in Industrial and Services sector. The current minister of corporate affairs is Piyush Goyal (additional charge). The current Minister of State for Corporate Affairs is Mr. PP Choudhary.

17.5 COMPANY ACT, 2013

The Companies Act, 2013 passed by the Parliament received the assent of the President of India on 29th August 2013. The Act consolidates and amends the law relating to companies. The Companies Act 2013 was notified in the Official Gazette on 30th August 2013. Download the complete Act: Companies Act 2013. Some of the provisions of the Act have been implemented by a notification published on 12th September, 2013. The provisions of Companies Act 1956 are still in force.

Parliament approved the long-awaited overhaul of legislation governing Indian companies on 9 August 2013. The new law is aimed at easing the process of doing business in India and improving corporate governance by making companies more accountable. The 2013 Act also introduces new concepts such as one – Person Company, small company, dormant company and corporate social responsibility (CSR) etc. The Act introduces significant changes in the provisions related to governance, e-management, compliance and enforcement, disclosure norms, auditors, mergers and acquisitions, class action suits and registered values. The act is now in force w.e.f. 1st April 2014.

There are more than 450 + sections, 7 schedules and 29 chapters, but today we will highlight few important ones which may be relevant to financial advisors who transact business as a Pvt. Ltd. Company or Small company (as per the new definition) or for those who would like to start an One person Company. Under any circumstances this is not an exhaustive list. Those who are interested may visit http://www.mca.gov.in to get the complete details about the Companies Act 2013.

- **Introduction of One Person Company (OPC)**

It's a Private Company having only one Member and at least One Director. This concept is already prevalent in the Europe, USA, China, Singapore and in several countries in the Gulf region. It was first recommended in India by an expert committee (headed by Dr. J.J. Irani) in 2005. The one basic pre-requisite to incorporate an OPC is that the only natural-born citizens of India, including small businessmen, entrepreneurs, artisans, weavers or traders among others can take advantage of the 'One Person Company' (OPC) concept outlined in the new Companies Act. The OPC shall have minimum paid up capital of INR 1 Lac and shall have no compulsion to hold AGM (Annual General meeting).

- **What is a small Company**

It means a company, other than a public company, paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five Crore rupees; or turnover of which as per its last profit and loss account does not exceed two Crore rupees or such higher amount as may be prescribed which shall not be more than twenty Crore rupees. The 2013 Act provides exemptions to Small Companies primarily from certain requirements relating to board meeting, presentation of cash flow statement and certain merger process

- **Minimum members for private company**

The new act has increased the limit of the number of members from 50 to 200.

- **Immediate changes in stationery**

The letterhead, bills or invoices, quotations, emails, publications & notifications, letters or other official communications, should bear the full name of contact person, address of company's registered office, Corporate Identity Number (CIN No. which is a 21 digit number allotted by Government), Telephone number, fax number, Email id, contact website (if any).

- **Articles of Association**

In the next General Meeting, it is desirable to adopt Table F as standard set of Articles of Association of the Company with relevant changes to suite the requirements of the company. Further, every copy of Memorandum and Articles (MOA) issued to members should contain a copy of all resolutions / agreements that are required to be filed with the Registrar of companies (ROC).

- **Commencement of business**

For all the companies (public/private Company) registered under Companies Act 2013 needs to file the following with the Registrar of Companies (ROC) in order to commence their business .

A declaration by the director in prescribed form stating that the subscribers/ promoters to the memorandum have paid the value of shares agreed to be taken by them. A confirmation that the company has filed a verification of its registered office with the Registrar of companies (ROC)

In the case of a company requiring registration from any sectoral regulators such as RBI, SEBI etc., approval from such regulator shall be required prior to starting the business.

- **Financial Year**

The Companies Act 1956 Act provided companies to elect financial year. The Companies Act 2013 Act eliminates the existing flexibility in having a financial year different than 31 March. The 2013 Act provides that the financial year for all companies should end on 31 March, with certain exceptions approved by the National Company Law Tribunal. Companies should align the financial year to 31 March within two years from 01 April 2014.

- **Eligibility age to become Managing Director or whole time Director**

The eligibility criteria for the age limit have been revised to 21 years as against the existing requirement of 25 years.

- **Number of directorships held by an individual**

Section 165 provides that a person cannot have directorships (including alternate directorships) in more than 20 (twenty) companies, including ten (ten) public companies. It provides a transition period of one year from 1 April 2014 to comply with this requirement

- **Board of Directors and Disqualifications for appointment of director**

The 2013 Act requires that the company shall have a maximum of 15 (fifteen) directors (earlier it was 12) and appointing more than 15 (fifteen) directors will require special resolution by shareholders.

Further, it requires appointment of at least one woman director on the board for prescribed class of companies. It also requires that company should have at least 1 (one) resident director i.e. who has stayed in India for a total period of not less than 182 (hundred and eighty two days) in the previous calendar year. All existing directors must have Directors Identification Number (DIN) allotted by central government. Directors who already have DIN need not take any action. However, Directors not having DIN should initiate the process of getting DIN allotted to him and inform the respective companies on which he is a director. The Company, in turn, has to inform the registrar of companies (ROC).

- **Independent Directors**

The 2013 Act defines the term "Independent Director" . In case of listed companies, one third of the board of directors should be independent directors. There is a transition period of 1 (one) year form 01 April 2014 to comply with this requirement. The 2013 Act also provides additional qualifications/ restrictions for independent directors as compared to the 1956 Act.

Section 150 enables manner of selection of independent directors and maintenance of databank of independent directors and enables their selection out of data bank maintained by a prescribed body

- **Resident Director**

Every Company must have at least one director who has stayed in India for a total period of 182 days or more in previous calendar year. For existing companies, the compliance need to be made before 31st March 2015.

- **Loans to director**

The Company cannot advance any kind of loan / guarantee / security to any director, Director of holding company, his / her partner/s, his/ her relative/s, Firm in which he or his relative is partner, private limited in which he is director or member or any bodies corporate whose 25% or more of total voting power or Board of Directors is controlled by him.

Appointment of managing director, whole time director or manager [section 196 of 2013 Act] - The re-appointment of a managerial person cannot be made earlier than one year before the expiry of the term instead of two years as per the existing provision of section 317 of the 1956 Act. However, the term for which managerial personnel can be appointed remains as five years. Further, the 2013 Act lifts the upper bar for age limit and thus an individual above the age of 70 years can be appointed as key managerial personnel by passing a special resolution.

- **Key Managerial Personnel (KMP)**

The Provisions relating to appointment of KMP includes (i) the Chief Executive Officer (CEO) or the managing director (MD) or the manager (ii) the company secretary (iii) the whole-time director; (iv) the Chief Financial Officer (CFO); and (v) such other officer as may be prescribed is applicable only for Public Limited Companies having paid up capital more than 10 crores and Private Limited Companies are exempted from appointment of KMPs.

- **Attending Board Meetings**

As per section 167 of the Act, a Director shall vacate his/her office if he/she absents himself from all the meetings of the Board of Directors held during a period of 12 (twelve months) with or without seeking leave of absence of the Board. Simply speaking, attending at least one Board Meeting by a director in a year is a must else he has to vacate his/her office.

- **Board meetings**

At least 7 days notice to be given for Board Meeting. The Board needs to meet atleast 4 times within a year. There should not be a gap of more than 120 days between two consecutive meetings.

- **Appointment of Statutory Auditors**

Every Listed company can appoint an individual auditor for 5 years and a firm of auditors for 10 years. This period of 5 / 10 years commences from the date of their appointment. Therefore, those companies who have reappointed their statutory auditors for more than 5 / 10 years have to appoint another auditor in their Annual General Meeting for year 2014.

- **Other specialized services which cannot be provided by Statutory Auditors**

The Statutory Auditor of the Company cannot give following specialized services directly or indirectly to the company –

Accounting and book keeping services

- **Corporate Social Responsibility (CSR)**

The company has to constitute a CSR committee of the Board and 2% of the average net profits of the last three financial years are to be mandatorily spent on

CSR activities by an Indian company if any of the following criteria is met:

Net worth of Rs.500 Crore or Turnover of Rs. 1000 Crore or more or net profit of Rs. 5 Crore or more

Contributing to Incubators, which has been notified by the Government of India, is eligible for spending under CSR. This is a prosperous time for incubators and entrepreneurs and can really change the entrepreneurial eco system in India.

- **Financial statements**

Financial Statements are now defined under the Act as comprising of the following. All companies (except one person Company, small company and dormant company)are now mandatorily required to maintain the following :

A balance sheet as at the end of the financial year

A profit and loss account / an income and expenditure account for the financial year, as the case may be

Cash flow statement for the financial year

A statement of changes in equity (if applicable)

Any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv)

17.5.1 Formation of company

(*1*) A company may be formed for any lawful purpose by

(*a*) Seven or more persons, where the company to be formed is to be a public Company

(*b*) Two or more persons, where the company to be formed is to be a private Company or

(*c*) One person, where the company to be formed is to be One Person Company that is to say, a private company,

By subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration. Provided that the memorandum of One Person Company shall indicate the name of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles:

Provided further that such other person may withdraw his consent in such manner as may be prescribed. Provided also that the member of One Person Company may at any time change the name of such other person by giving notice in such manner as may be prescribed. Provided also that it shall be the duty of the member of One Person Company to intimate the company the change, if any, in the name of the other person nominated by him by indicating in the memorandum or otherwise within such time and in such manner as maybe prescribed, and the company shall intimate the Registrar any such change within such time and in such manner as may be prescribed. Provided also that any such change in the name of the person shall not be deemed to be an alteration of the memorandum.

(*2*) A company formed under sub-section (*1*) may be either—

(*a*) A company limited by shares; or

(*b*) A company limited by guarantee; or

(*c*) An unlimited company.

17.6 SUMMARY

The Ministry of Finance is an important ministry within the Government of India concerned with the economy of India, serving as the Indian Treasury Department. In particular, it concerns itself with taxation, financial legislation, financial institutions, capital markets, centre and state finances, and the Union Budget. The Department of Financial Services covers Banks, Insurance and Financial Services provided by various government agencies and private corporations. The term capital market broadly defines the place where various entities trade different financial instruments. The Ministry of Corporate Affairs (MCA) is primarily concerned with administration of the Companies Act 2013, the Companies Act 1956, the Limited

Liability Partnership Act, 2008 & other allied Acts and rules & regulations framed there-under mainly for regulating the functioning of the corporate sector in accordance with law. The Companies Act 2013 passed by the Parliament received the assent of the President of India on 29th August 2013

17.7 GLOSSARY

• Treasury Department	the executive agency responsible for promoting economic prosperity and ensuring the financial security
• Macroeconomic	relating to the branch of economics concerned with large-scale or general economic factors, such as interest rates and national productivity.
• Liberalization	the removal or loosening of restrictions on something, typically an economic or political system
• Financial Services	professional services involving the investment, lending, and management of money and assets
• Capital Markets	the part of a financial system concerned with raising capital by dealing in shares, bonds and other long-term investments

17.8 SELF-ASSESSMENT QUESTIONS

Q1. What are the main objectives of ministry of finance?

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Q2. What do you mean by capital market division?

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Q3. What is a Company Act, 2013?

17.9 LESSON END EXERCISE

Q1. Briefly explain the functions of Ministry of Finance.

Q2. What are the different functions performed by the ministry of affairs?

Q3. What are the steps need to be followed in formation of the company?

17.10 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

M.Y. Khan : Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi – 110 002.

Shashi K Gupta : Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Nishja Aggarwal Ram Road, 24, Daryaganj, New Delhi - 110002 Neeti Gupta

Vishal Saraogi : Capital Markets and Securities Laws simplified, Lawpoint Publication, 6C, R.N. Mukherjee Road, Kolkata-70000

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SEBI ACT - 1992

STRUCTURE

18.1 INTRODUCTION: SEBI REGULATORY AND GUIDELINES OVERVIEW

18.1.1 History of SEBI

1. It was officially established by The Government of India in the year 1988 and given statutory powers in 1992 with SEBI Act 1992 being passed by the Indian Parliament.

2. SEBI has its Headquarters at the business district of Bandra Kurla Complex in Mumbai, and has Northern, Eastern, Southern and Western Regional Offices in New Delhi, Kolkata, Chennai and Ahmadabad respectively.

3. Controller of Capital Issues was the regulatory authority before SEBI came into existence. It derived authority from the Capital Issues (Control) Act, 1947.

4. Initially SEBI was a non statutory body without any statutory power.

5. However in the year of 1995, the SEBI was given additional statutory power by the Government of India through an amendment to the Securities and Exchange Board of India Act, 1992.

6. In April, 1988 the SEBI was constituted as the regulator of capital markets in India under a resolution of the Government of India.

7. The SEBI is managed by its members, which consists of following:

   a) The chairman who is nominated by Union Government of India.

   b) Two members, i.e. Officers from Union Finance Ministry.

   c) One member from The Reserve Bank of India.

   d) The remaining 5 members are nominated by Union Government of India, out of them at least 3 shall be whole-time members.

8. The office of SEBI is situated at SEBI Bhavan, Bandra Kurla Complex, Bandra East, Mumbai- 400051, with its regional offices at Kolkata, Delhi,Chennai & Ahmadabad.

9. It has recently opened local offices at Jaipur and Bangalore and is planning to open offices at Guwahati, Bhubaneswar, Patna, Kochi and Chandigarh in Financial Year 2013 – 2014.

SEBI Agency overview

1. Formed 12 April 1992
2. Jurisdiction Government of India
3. Headquarters Mumbai, Maharashtra
4. Employees 643 (2012)
5. Agency executive U. K. Sinha, Chairman

18.1.2 Functions and responsibilities

1. The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto.
2. SEBI has to be responsive to the needs of three groups, which constitute the market:

   a) The issuers of securities

   b) The investors

   c) The market intermediaries.
3. SEBI has three functions rolled into one body: quasi-legislative, quasi-judicial and quasi-executive.
4. It drafts regulations in its legislative capacity, it conducts investigation and enforcement action in its executive function and it passes rulings and orders in its judicial capacity.
5. Though this makes it very powerful, there is an appeal process to create accountability.

6. There is a Securities Appellate Tribunal which is a three-member tribunal and is presently headed by Mr. Justice J P Devadhar, a former judge of the Bombay High Court.
7. A second appeal lies directly to the Supreme Court.
8. SEBI has taken a very proactive role in streamlining disclosure requirements to international standards.

18.1.3 Powers of SEBI

For the discharge of its functions efficiently, SEBI has been vested with the following powers:

1. To approve by laws of stock exchanges.
2. To require the stock exchange to amend their by law.
3. Inspect the books of accounts and call for periodical returns from recognized stock exchanges.
4. Inspect the books of accounts of a financial intermediary.
5. Compel certain companies to list their shares in one or more stock exchanges.
6. Registration brokers. : There are two types of brokers.

   1. Circuit broker

   2. Merchant broker

18.2 OBJECTIVES

After reading this lesson you will be able to Understand

- Guidelines of SEBI
- Securities Contract Act, 1956
- Ministry of corporate affairs
- Depositories Act, 1996
- Companies Act, 2013

18.3 SECURITIES CONTRACTS (REGULATION) ACT, 1956

An Act to prevent undesirable transactions in securities by regulating the business of dealing therein, by providing for certain other matters connected therewith. The Securities Contracts (Regulation) Act, 1956 also known as SCRA is an Act of the Parliament of India enacted to prevent undesirable exchanges in securities and to control the working of stock exchange in India. It came into force on 20 February 1957.

BE it enacted by Parliament in the Seventh Year of the Republic of India as follows:

Preliminary: Short title, extent and commencement:-

(1) This Act may be called the Securities Contracts (Regulation) Act, 1956. (2) It extends to the whole of India. (3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.

In this Act, unless the context otherwise requires

(a) "Contract" means a contract for or relating to the purchase or sale of securities.

(b) "Government security" means a security created and issued, whether before or after the commencement of this Act, by the Central Government or a State Government for the purpose of raising a public loan and having one of the forms specified in clause (2) of section 2 of the Public Debt Act, 1944 (18 of 1944).

(c) "Member" means a member of a recognised stock exchange.

(d) "Option in securities" means a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a teji, a mandi, a teji mandi, a galli, a put, a call or a put and call in securities.

(e) "Prescribed" means prescribed by rules made under this Act.

(f) "Recognised stock exchange" means a stock exchange which is for the time being recognised by the Central Government under section 4.

(g) “Rules”, with reference to the rules relating in general to the constitution and management of a stock exchange, includes, in the case of a stock exchange which is an incorporated association, its memorandum and articles of association.

18.4 DEPOSITORIES ACT, 1996

An Act to provide for regulation of depositories in securities and for matters connected therewith or incidental thereto.

Preliminary

1. Short title, extent and commencement:-

(1) This Act may be called the **Depositories Act, 1996**

(2) It extends to the whole of India.

(3) It shall be deemed to have come into force on the 20th day of September, 1995.

2. Definitions:-

(1) In this Act, unless the context otherwise requires, -

(*a*) “beneficial owner” means a person whose name is recorded as such with a depository

(*b*) “Board” means the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992)

(*c*) “Bye-laws” means bye-laws made by a depository under section 26

(*d*) “Company Law Board” means the Board of Company Law Administration constituted under section 10E of the Companies Act, 1956 (1 of 1956)

(*e*) “depository” means a company formed and registered under the Companies Act, 1956 (1 of 1956), and which has been granted a certificate of registration under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992)

(*f*) "Issuer" means any person making an issue of securities

(*g*) "Participant" means a person registered as such under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992)

(*h*) "Prescribed" means prescribed by rules made under this Act

(*i*) "Record" includes the records maintained in the form of books or stored in a computer or in such other form as may be determined by regulations

(*j*) "Registered owner" means a depository whose name is entered as such in the register of the issuer

(*k*) "Regulations" means the regulations made by the Board 1[(*ka*) "Securities Appellate Tribunal" means a Securities Appellate Tribunal established under sub-section (1) of section 15K of the Securities and Exchange Board of India Act, 1992 (15 of 1992)

(*l*) "Recurity" means such security as may be specified by the Board

(*m*) "Rervice" means any service connected with recording of allotment of securities or transfer of ownership of securities in the record of a depository.

(2) Words and expressions used herein and not defined but defined in the Companies Act, 1956 (1 of 1956), or the Securities Contracts (Regulation) Act, 1956 (42 of 1956), or the Securities and Exchange Board of India Act, 1992 (15 of 1992), shall have the meanings respectively assigned to them in those Acts.

18.5 SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS

Dealing in securities' means an act of subscribing, buying, selling or agreeing to subscribe, buy, sell or deal in any securities by any person either as principal or agent.

'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.

A **"connected person"** means any person who-

(i) Is a director, as defined in clause (13) of section 2 of the Companies Act, 1956 of a company, or is deemed to be a director of that company by virtue of sub-clause (10) of section 307 of that Act, or

(ii) Occupies the position as an officer or an employee of the company or holds a position involving a professional or business relationship between himself and the company whether temporary or permanent and who may reasonably be expected to have an access to unpublished price sensitive information in relation to that company.

A person is **'deemed to be a connected person'** if such person-

(i) Is a company under the same management or group or any subsidiary company thereof within the meaning of section (1B) of section 370, or sub-section (11) of section 372, of the Companies Act, 1956 or sub clause (g) of section 2 of the Monopolies and Restrictive Trade Practices Act, 1969 as the case may be; or

(ii) Is an intermediary as specified in section 12 of SEBI Act, 1992, Investment company, Trustee Company, Asset Management Company or an employee or director thereof or an official of a stock exchange or of clearing house or corporation;

(iii) Is a merchant banker, share transfer agent, registrar to an issue, debenture trustee, broker, portfolio manager, Investment Advisor, sub-broker, Investment Company or an employee thereof, or, is a member of the Board of Trustees of a mutual fund or a member of the Board of Directors of the Asset Management Company of a mutual fund or is an employee thereof who have a fiduciary relationship with the company;

(iv) Is a member of the Board of Directors, or an employee, of a public financial institution as defined in Section 4A of the Companies Act, 1956;

v) Is an official or an employee of a self regulatory organisation recognised or authorised by the Board of a regulatory body;

(vi) Is a relative of any of the aforementioned persons;

(vii) Is a banker of the company.

(viii) Relatives of the connected person; or

(ix) Is a concern, firm, trust, Hindu Undivided Family, company or association of persons wherein any of the connected persons mentioned in sub-clause (i) of clause (c) of this regulation or any of the persons mentioned in sub-clauses (vi), (vii) or (viii) of this clause have more than 10% of the holding or interest

"Price sensitive information" means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of that company.

The following shall be deemed to be price sensitive information:–

(i) Periodical financial results of the company;

(ii) Intended declaration of dividends (both interim and final);

(iii) Issue of securities or buy-back of securities;

(iv) Any major expansion plans or execution of new projects;

(v) Amalgamation, mergers or takeovers;

(vi) Disposal of the whole or substantial part of the undertaking;

(vii) Any significant changes in policies, plans or operations of the company. Unpublished means information which is not published by the company or its agents and is not specific in nature. Speculative reports in print or electronic media shall not be considered as published information.

Prohibition on dealing, communicating or counseling (Regulation 3)

No insider shall

- Either on his own behalf or on behalf of any other person, deal in securities of a company listed on any stock exchange when in possession of any unpublished price sensitive information;
- Communicate, counsel or procure, directly or indirectly, any unpublished price sensitive information to any person who while in possession of such unpublished price sensitive information shall not deal in securities; Provided that nothing contained above shall be applicable to any communication required in the ordinary course of business or profession or employment or under any law.

Regulation 3A

No company shall deal in the securities of another company or associate of that other company while in possession of any unpublished price sensitive information.

18.5.1 Violation of Provisions Relating To Insider Trading

Any insider, who deals in securities in contravention of the provisions of regulation 3 or 3A shall be guilty of insider trading (regulation 4). If SEBI suspects any person of having violated the provisions of insider regulation, it may make inquiries with such person or with the stock exchanges, mutual funds, other persons associated with the securities

Market, intermediaries and self-regulatory organisation in the securities market to form a prima facie opinion as to whether there is any violation of insider regulations. Where SEBI forms a prima facie opinion that it is necessary to investigate and inspect the books of accounts, either documents and records of an insider or the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organisation in the securities market, it may appoint an investigating authority for the following purpose

i) to investigate into the complaints received from investors, intermediaries or any other person on any matter having a bearing on the allegations of insider trading; and

ii) To investigate suo moto upon its own knowledge or information in its possession to protect the interest of investors in securities against breach of insider trading regulations.

A reasonable notice has to be given to the insider before undertaking any investigation. Such notice is not required to be given if SEBI is satisfied that it is in the public interest or in the interest of the investors. During such investigation and inspection of the books of accounts, the insider or the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organisation in the securities market shall be bound to discharge their obligations as provided in the regulations. The investigating authority has to submit his report to SEBI within reasonable time.

SEBI after considering the report shall communicate its findings to the suspected person and seek a reply from such person. Such suspected person shall reply to the findings within 21 days to SEBI. After receipt of such reply, SEBI may take such measures to safeguard and protect the interest of investors, securities market and for due compliance with the insider trading regulations.

SEBI also has powers to appoint an auditor to investigate into the books of accounts or the affairs of the insider or the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organisation in the securities market.

To protect the interest of investor and securities market and for due compliance of the insider trading regulations, SEBI may issue order as per Regulation 11 in accordance with SEBI(Prohibition of Insider Trading) Regulations, 1992 , or initiate criminal prosecution under Section 24 or any action under Chapter VIA of the Securities and Exchange Board of India Act, 1992

Policy on disclosures and internal procedure for prevention of insider trading:

Chapter IV of the Regulations deals with policy on disclosures and internal procedure for prevention of insider trading. Accordingly, all listed companies and organisations associated with securities markets including:

(a) The intermediaries as mentioned in section 12 of the Act, asset management company and trustees of mutual funds

(b) The self regulatory organisations recognised or authorised by the Board

(c) The recognised stock exchanges and clearing house or corporations

(d) The public financial institutions as defined in Section 4A of the Companies Act, 1956 and

(e) the professional firms such as auditors, accountancy firms, law firms, analysts, consultants, etc., assisting or advising listed companies, shall frame a code of internal procedures and conduct as near there to the Model Code specified in Schedule I of these Regulations.

Disclosures

Disclosure of interest or holding by directors and officers and substantial shareholders in listed companies –

Initial Disclosure:

(1) Any person who holds more than 5% shares or voting rights in any listed company shall disclose to the company in Form A, the number of shares or voting rights held by such person, on becoming such holder, within 4 working days of:-

(a) The receipt of intimation of allotment of shares; or

(b) The acquisition of shares or voting rights, as the case may be.

(2) Any person who is a director or officer of a listed company shall disclose to the company in Form B, the number of shares or voting rights held by such person, within 4 working days of becoming a director or officer of the company.

Continual Disclosure

(3) Any person who holds more than 5% shares or voting rights in any listed

company shall disclose to the company in Form C the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below 5%, if there has been change in such holdings from the last disclosure made under sub-regulation (1) or under this sub-regulation; and such change exceeds 2% of total shareholding or voting rights in the company.

(4) Any person who is a director or officer of a listed company, shall disclose to the company in Form D, the total number of shares or voting rights held and change in shareholding or voting rights, if there has been a change in such holdings from the last disclosure made under sub-regulation (2) or under this sub-regulation, and the change exceeds Rupees 5 lakh in value or 25000 shares or 1% of total shareholding or voting rights, whichever is lower.

(5) The disclosure mentioned in sub-regulations (3) and (4) shall be made within 4 working days of :

(a) The receipt of intimation of allotment of shares, or

(b) The acquisition or sale of shares or voting rights, as the case may be.

Disclosure by company to stock exchanges

(6) Every listed company, within five days of receipt, shall disclose to all stock exchanges on which the company is listed, the information received under sub-regulations (1), (2),(3) and (4) of Regulation 13.

Code of Ethics

SEBI has advised stock exchanges to adopt the Code of Ethics for their directories and functionaries with effect from 31st May 2001. This is aimed at improving the professional and ethical standards in the functioning of exchanges thereby creating better investors confidence in the integrity of the market.

18.6 SEBI (SUBSTANTIAL ACQUISITIONS OF SHARES AND TAKEOVERS) REGULATIONS, 2011

Substantial Acquisition of Shares means an acquirer acquires substantial quantity of shares or voting rights of the Target Company. Takeover is an acquirer takes over the control of the target company. Target Company means a company and includes a body corporate or corporation established under a Central legislation, State legislation or Provincial legislation for the time being in force, whose shares are listed on a stock exchange. A letter of offer is a document addressed to the shareholders of the target company containing disclosures of the acquirer/PACs, target company, their financials, justification of the offer price, the offer price, number of shares to be acquired from the public, purpose of acquisition, change in control over the target company, if any, the procedure to be followed by acquirer in accepting the shares tendered by the shareholders and the period within which all the formalities to the offer would be completed. Draft letter of offer means the letter of offer in draft stage. SEBI has revised format for submitting the draft letter of offer (DLOF) with SEBI in terms of SAST Regulations and certain instructions which should be followed by merchant bankers while filing the Draft letter of offer.

SEBI has reviewed advertisement guidelines for Mutual Funds with respect to disclosing Performance related information in Mutual Fund advertisements and Celebrity endorsements of Mutual Funds at industry level. In Performance Advertisements of Mutual Fund Schemes: SEBI has mandated that performance of the Mutual Fund scheme should be advertised in terms of CAGR for the past 1 year, 3 years, 5 years and since commencement. In addition to CAGR of the scheme, point to point returns on standard investment of Rs. 10,000 should be disclose in order to provide ease of understanding to retail investors.

18.7 SUMMARY

SEBI was officially established by The Government of India in the year 1988 and given statutory powers in 1992 with SEBI Act 1992 being passed by the Indian Parliament. SEBI has three functions rolled into one body: quasi-legislative, quasi-judicial and quasi-executive. **Dealing in securities'** means an act of subscribing, buying, selling or agreeing to subscribe, buy, sell or deal in any securities by any person either as principal or agent. A reasonable notice has to be given to the insider before undertaking any investigation. Such notice is not required to be given if SEBI is satisfied that it is in the public interest or in the interest of the investors. During such investigation and inspection of the books of accounts, the insider or the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organisation in the securities market shall be bound to discharge their obligations as provided in the regulations. The investigating authority has to submit his report to SEBI within reasonable time. Substantial Acquisition of Shares means an acquirer acquires substantial quantity of shares or voting rights of the Target Company. Takeover is an acquirer takes over the control of the target company.

18.8 GLOSSARY

SEBI	most important regulatory body of the securities market in the Republic of India Prohibition the action of banning something, especially by law
Insider trading	the illegal practice of trading on the stock exchange to one's own advantage through having access to confidential information
Suo moto	a Latin term meaning "on its own motion". It is used in situations where a government or court official acts of its own initiative
Acquisitions of shares	a situation whereby one company purchases most or all of another Company's shares in order to take control
Takeovers	an act of assuming control of something, especially the buying out of one company by another.

18.9 SELF-ASSESSMENT QUESTIONS

Q1. What is SEBI?

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Q2. What do you mean by insider trading?

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Q3. What is acquisition of shares?

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18.10 LESSON END EXERCISE

Q1. Briefly explains the functions and responsibilities of SEBI.

Q2. Explain in detail SEBI (prohibition of insider trading) regulations, 1992

Q3. Give brief explanation about SEBI (substantial acquisitions of shares and takeovers) regulations, 2011

18.11 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

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Vishal Saraogi : Capital Markets and Securities Laws simplified, Lawpoint Publication, 6C, R.N. Mukherjee Road, Kolkata-70000

PREVENTION OF MONEY LAUNDERING ACT, 2002 AND GRIEVANCE REDRESSAL MECHANISM

STRUCTURE

19.1 INTRODUCTION

The Prevention of Money Laundering Act, 2002

An Act to prevent land laundering and to provide for confiscation of property derived from, or involved in, money-laundering and for matters connected therewith or incidental thereto.

Citation Act No.15 of 2003

Enacted by Parliament of India

Date enacted 17 January 2003

Date assented to 17 January 2003

Date commenced 1 July 2005

Amends

The Prevention of Money Laundering (Amendment) Act, 2005, The Prevention of Money Laundering (Amendment) Act, 2009

Status: In force

Prevention of Money Laundering Act, 2002 is an Act of the Parliament of India enacted by the NDA government to prevent money-laundering and to provide for confiscation of property derived from money-laundering.PMLA and the Rules notified there under came into force with effect from July 1, 2005. The Act and Rules notified there under impose obligation on banking companies, financial institutions and intermediaries to verify identity of clients, maintain records and furnish information in prescribed form to Financial Intelligence Unit - India (FIU-IND).

The act was amended in the year 2005, 2009 and 2012

On 24 Nov 2017, in favour of citizens' liberty, the Supreme Court has set aside a clause in the Prevention of Money Laundering Act, which made it virtually impossible for a person convicted to more than three years in jail to get bail if the public prosecutor opposed it. (Section 45 of the PMLA Act, 2002, provides that no person can be granted bail for any offence under the Act unless the public prosecutor, appointed by the government, gets a chance to oppose his bail. And should the public prosecutor choose to oppose bail, the court has to be convinced that the accused was not guilty of the crime and additionally that he/she was not likely to commit any offence while out on bail- a tall order by any count.) (It observed that the provision violates Articles 14 and 21 of the Indian Constitution)

19.1.1 Objectives

The PMLA seeks to combat money laundering in India and has three main objectives:

- To prevent and control money laundering
- To confiscate and seize the property obtained from the laundered money; and
- To deal with any other issue connected with money laundering in India.

19.1.2 Key terms

- **Attachment**: Prohibition of transfer, conversion, disposition or movement of property by an appropriate legal order.

- **Proceeds of crime:** Any property derived or obtained, directly or indirectly, by any person as a result of criminal activity relating to a scheduled offence.
- **Money-laundering:** Whosoever directly or indirectly attempts to indulge or assist other person or actually involved in any activity connected with the proceeds of crime and projecting it as untainted property.
- **Payment System:** A system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them. It includes the systems enabling credit card, debit card, smart card, money transfer or similar operations.

19.1.3 Salient features

- **Punishment for money-laundering**

  The act prescribes that any person found guilty of money-laundering shall be punishable with rigorous imprisonment from three years to seven years and where the proceeds of crime involved relate to any offence under paragraph 2 of Part A of the Schedule (Offences under the Narcotic Drugs and Psychotropic Substance Act, 1985), the maximum punishment may extend to 10 years instead of 7 years.

- **Powers of attachment of tainted property**

  Appropriate authorities, appointed by the Govt. of India, can provisionally attach property believed to be "proceeds of crime" for 180 days. Such an order is required to be confirmed by an independent Adjudicating Authority.

- **Adjudicating Authority**

  The Adjudicating Authority is the authority appointed by the central government through notification to exercise jurisdiction, powers and authority conferred under PMLA. It decides whether any of the property attached or seized is involved in money laundering.

  The Adjudicating Authority shall not be bound by the procedure laid down by the Code of Civil Procedure,1908, but shall be guided by the principles of natural justice and subject to the other provisions of PMLA. The Adjudicating Authority shall have powers to regulate its own procedure.

- **Presumption in inter-connected transactions**

  Where money laundering involves two or more inter-connected transactions and one or more such transactions is or are proved to be involved in money laundering, then for the purposes of adjudication or confiscation, it shall presumed that the remaining transactions form part of such inter-connected transactions.

- **Burden of proof**

  A person, who is accused of having committed the offence of money laundering, has to prove that alleged proceeds of crime are in fact lawful property.

- **Appellate Tribunal**

  An Appellate Tribunal is the body appointed by Govt. of India. It is given the power to hear appeals against the orders of the Adjudicating Authority and any other authority under the Act. Orders of the tribunal can be appealed in appropriate High Court (for that jurisdiction) and finally to the Supreme Court.

- **Special Court**

  Section 43 of Prevention of Money Laundering Act, 2002 (PMLA) says that the Central Government, in consultation with the Chief Justice of the High Court, shall, for trial of offence punishable under Section 4, by notification, designate one or more Courts of Session as Special Court or Special Courts for such area or areas or for such case or class or group of cases as may be specified in the notification.

- **FIU-IND**

  Financial Intelligence Unit – India (FIU-IND) was set by the Government of India on 18 November 2004 as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions. FIU-IND is also responsible for coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering and related crimes. FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the Finance Minister.

19.2 OBJECTIVES

After reading this lesson you will be able to Understand

- Money laundering Act, 2002
- Grievance redressal mechanism
- Stock exchange investor protection fund

19.3 GRIEVANCE REDRESSAL MECHANISM

Grievance Redress Mechanism is part and parcel of the machinery of any administration. No administration can claim to be accountable, responsive and user-friendly unless it has established an efficient and effective grievance redress mechanism. In fact, the grievance redress mechanism of an organization is the gauge to measure its efficiency and effectiveness as it provides important feedback on the working of the administration.

19.3.1 Structure of Grievance Refress Machinery at Apex Level

The grievances of public are received at various points in the Government of India .There is primarily two designated nodal agencies in the Central Government handling these grievances. These agencies are:-

(i) Department of Administrative Reforms and Public Grievances , Ministry of Personnel, Public Grievances and Pensions

(ii) Directorate of Public Grievances, Cabinet Secretariat

19.3.2 Department of Administrative Reforms & Public Grievances

- Department of Administrative Reforms & Public Grievances is the nodal agency in respect of policy initiatives on public grievances redress mechanism and citizen centric initiatives. The role of Department of Administrative Reforms and Public Grievances consists primarily to undertake such citizen-centric initiatives in the fields of administration reforms and public grievances in the Government so as to enable the Government machinery to deliver quality public services to the citizen in a hassle-free manner and eliminate the causes of grievance.

- The grievances received by the Department are forwarded to the concerned Ministries/Departments/State Governments/UTs, who are dealing with the substantive function linked with the grievance for redress under intimation to the complainant. The Department 'takes up' about 1000 grievances every year depending upon the seriousness of the grievance and follows them regularly till their final disposal. This enables the Department to evaluate the effectiveness of the grievance redress machinery of the concerned government agency.
- On the basis of the grievances received, Department identifies the problem areas in Government which are complaint-prone. These problem areas are then subjected to studies and remedial measures are suggested to the Department/Organisation concerned.

19.3.3 Directorate of Public Grievances (DPG)

- Based on the review of the public grievances redress machinery in Government of India carried out in 1987, the Directorate of Public Grievances was set up in the Cabinet Secretariat with effect from 01.04.88. This Directorate was set up initially to look into individual complaints pertaining to four Central Government Departments which were more prone to public complaints. Subsequently, more Departments having larger public interface were added to its purview and presently this Directorate is handling grievances pertaining to 16 Central Government Organisations.
- The Directorate was envisaged as an appellate body investigating grievances selectively and particularly those where the complainant had failed to get

redress at the hands of internal machinery and the hierarchical authorities. Unlike the Department of AR&PG, Directorate of Public Grievances has been empowered to call for the files and officers for discussion to see that grievance handling has been done in a fair, objective and just manner. Wherever the Directorate is satisfied that the grievance has not been dealt in such a manner, it makes suitable recommendations for consideration and adoption by the concerned Ministry/Department which are required to be implemented within a period of one month.

- The empowered and enlightened citizenry of today is far more demanding and the government, therefore, has to develop, evolve and enable itself to meet the evolving demands of the society that it has to serve. The society today is impatient with the old system of governance which is not coming up to its expectations. To them, a government employee is perceived as insensitive, aloof, corrupt and overall the administrative system as autocratic, opaque and with no work culture

- This requires a paradigm shift in governance to a system where the citizen is in the center and he is consulted at various stages of formulation and implementation of public policy. To achieve this objective, India needs a public service which is capable, innovative and forward looking. The traditional role of civil service which was of administrator, service provider and controller of development activities has to make way for the new roles of facilitator and regulator so as to create best environment and conditions in the country for building a nation of excellence.

- Department of Administrative Reforms & Public Grievances is the nodal agency in Government of India for formulation and implementation of such policies and strategic initiatives so as to enable and equip the government machinery to meet the challenges involved in achieving this objective.

- Department of Administrative Reforms and Public Grievances is the driving engine of reforms in administration and governance. The Department proposes to introduce and lead Change to establish a public service of quality, efficiency, integrity and effectiveness and modernize the public service. It is the nodal agency in government for facilitating administrative improvements and reengineering of processes across the government. Citizen's Charter initiative, Public Grievance Policy, Quality Management in Government, e-Governance, Review of Administrative Laws etc. Documentation and Dissemination of Best Practices, Organisation & Methods, Information & Facilitation Counters and Civil Services Reforms are some of the areas under the ambit of Department of Administrative Reforms & Public Grievances.

- Following are the necessary conditions for successful implementation of any reforms agenda:

  a) Political mandate

  b) Committed and strong executive

  c) Willingness and capability to take on vested interests in the system

19.3.4 Public Grievance Redress Mechanism in Central Government Ministries/ Departments/ Organisations

- The Public Grievance Redress Mechanism functions in Government of India on a decentralized basis. The Central Government Ministries/Departments, their attached and subordinate offices and the autonomous bodies dealing with substantive functions as per Allocations of Business Rules, 1961 have their respective grievance redress machinery. An officer of the level of Joint Secretary is required to be designated as Director of Grievances of the Ministry/Department/Organisation. The role and functions of Directors of Grievances are given in Department of Administrative Reforms and Public Grievances O.M.no.1/PLCY/PG-88(7) dated 01.03.1988. This inter alia empowers the Directors of Grievances to call for files/reports and take decisions or review decisions already taken, in consultation with Secretary/ HOD even in those areas which do not fall within his/her domain/charge.

- The functioning of Public Grievance Redress Machineries in various Ministries/Departments/Organisations is regularly reviewed by a Standing Committee of Secretaries under the Chairmanship of Cabinet Secretary with Additional Secretary Department of Administrative Reforms and Public

Grievances as member-secretary.

- With a view to ensure prompt and effective redress to the grievances, a number of instructions have been issued by Department of AR&PG from time to time which, inter alia include:-

a) Observe every Wednesday as a meeting less day in the Central Secretariat Offices when all the officers above a specified level should be available their desks from 1000hrs.to 1300hrs. to receive and hear public grievances. Field level offices having contact with the public have also to declare one day in the week as a meetingless day.

b) Designate a Joint Secretary level officer as Director of Grievances including in autonomous bodies and public sector undertakings.

c) Deal with every grievance in a fair, objective and just manner and issue reasoned speaking reply for every grievance rejected.

d) Analyse public grievances received to help identification of the problem areas in which modifications of policies and procedures could be undertaken with a view to making the delivery of services easier and more expeditious.

e) Issue booklets/pamphlets about the schemes/services available to the public indicating the procedure and manner in which these can be availed and the right authority to be contacted for service as also the grievance redress authority.

f) Pick up grievances appearing in newspaper columns which relate to them and take remedial action on them in a time bound manner. Issue rejoinders to newspapers after investigation in cases which are found to be baseless and/or damaging to the image of the Organisation.

g) Strengthen the machinery for redress of public grievance through, strictly observing meeting less day, displaying name designation, room number, telephone number etc. of Director of Grievances at the reception and other convenient places, placing locked complaint box at reception.

h) Set up Staff Grievance Redress Machinery and designate a Staff Grievance

Officer.

i) Include the public grievances work and receipt/disposal statistics relating to redress of public grievances in the Annual Action Plan and Annual Administrative Report of the Ministries/Departments.

j) Fix time limits for disposal of work relating to public grievances and staff grievances and strictly adhere to them.

k) Acknowledge each grievance petition within three days of receipt, indicating the name, designation and telephone number of the official who is processing the case. The time frame in which a reply will be sent should also be indicated.

l) Constitute Lok Adalats/Staff Adalats, if not already constituted, and hold them every quarter for quicker disposal of public as well as staff grievances and pensioners' grievances.

m) Constitute a Social Audit Panel or such other machinery, if not already constituted, for examining areas of public interface with a view to recommending essential changes in procedures to make the organization more people-friendly.

n) Establish a single window system at points of public contact, wherever possible to facilitate disposal of applications.

o) Indicating telephone/fax number of the officer whose signature over a communication regarding the decision/reply is to issue to the petitioner.

p) Monitoring of grievances in organisations under Ministries/Departments on a monthly basis.

q) Publicising the grievance redress mechanism through the print and electronic media.

r) Review of receipt and disposal of grievances by Secretaries of Ministries/ Departments in the weekly meetings taken by them.

19.3.5 Identification of Grievance Prone Areas and Analysis

- Identify areas susceptible to corruption and/or grievance generation and conduct work audit of such areas. In addition, consider external/social audit in areas of very high public interface, with the aim of identifying wrong doers and improving processes and systems. Involve NGOs in the exercise.

- Analyse the nature and cause of grievances with the aim of identifying systemic deficiencies in laws, rules, regulations, policies, instructions, work practices and procedures, and effecting systemic changes to remove/correct these deficiencies. The Directors of Grievances be the nodal officers for such purpose. The analysis should be conducted in the month of April every year and studies of identified grievance prone areas are undertaken. Recommendations made in the studies should be implemented by December of that year so as to bring systemic changes and remove the cause of grievances.

- Fix responsibility in each and every case of delay, default or dereliction in performance of every day duties on failure to deliver services, and take disciplinary action to avoid recurrence. This will send a clear signal that in the event of failure to perform duties or deal appropriately with grievances within the time frame norms prescribed, a real possibility of having responsibility fixed on one's shoulder exists. Consider the feasibility of prescribing specific penalty clauses in such cases.

19.3.6 Online Registration of Grievances

- Make Public Grievance Redress and Monitoring System (PGRAMS) software, operational with every Director of Grievances. This shall enable the Director of Grievances to immediately place the details of grievances received in a database (efficient 'dak' management) as well as record the fact whether he intends to monitor its progress, identify the section/division where it is being sent, etc., generate the time taken in dealing with the grievance, enable review of pending grievances in the organisation or across the organisations, generate acknowledgements to complainants, conduct analysis etc. The system should also have the facility of on-line registration of grievances by the citizens and access to information on the status of his/her grievances.

19.3.7 Prompt and Effective Redress of Grievances

- Grievances should be necessarily acknowledged, with an interim reply within 3 days of receipt and redressed within 3 months of receipt in the Organisation. The same time limit should apply even if co-ordination with subsidiary offices or another Department/Organisation is involved. In such instances special efforts, to be suo moto disclosed when reports are called, should be made.

a) No grievance is to be rejected without having been independently examined. At a minimum, this means that an officer superior, to the one who delayed taking the original decision or took the original decision that is cause for grievance, should actually examine the case as well as the reply, intended to be sent to the grievance holder.

b) Make the 'Director of Grievances' effective through the following inter-related steps:

i) Secretaries/Organisational Heads ensuring that Directors of Grievances are fully 'empowered' in accordance with instructions to perform their role.

ii) All grievance representations received in the Department/Organisation, either by mail, fax, e-mail to be invariably routed through Director of Grievances before they go to concerned sections/divisions. At this stage, Office of the Director of Grievances shall go through the representations and come to a prima-facie view regarding the gravity of the matter involved and decide whether it shall monitor the case or allow down-the-line functionaries to independently deal with it. Directors of Grievances should monitor and follow up at least 3 to 5 percent of grievances received to enable them to assess the efficacy of grievance redress mechanism.

iii) Fix responsibility in each case of delay, default and dereliction of duty, identified by Director of Grievances, and take appropriate action against concerned personnel. In addition, consider feasibility of prescribing specific penalty clauses for such failures.

iv) Ensure meaningful review of the performance of grievance redress machinery of the Ministry/Organisation as well as that of attached/ subordinate organization by Secretary/ Head of the Department on a monthly basis. Review should also cover action against defaulters.

19.3.8 Role of Regulators, Ombudsman and Like Bodies

- An explosive issue today in context of public grievance redress is the pace and phasing of the movement towards open markets after the gradual abandonment of centralized planning model. The Government is today withdrawing from various service sectors traditionally monopoloised by it and private enterprise is moving in. This may lead to a scenario where the Government monopolies are replaced by even more vicious private monopolies or cartels in the absence of adequate regulation, enforcement and recourse to grievance redress.
- This has significant implications for the role of Government. The Government can not just abandon the interests of citizens to be taken care of by the market forces in areas of service delivery covered by the private sector. In the open market scenario, it is often the major stakeholders and players which define the cost, quality and mechanism etc. of service delivery.
- The Government therefore needs to put in place appropriate mechanisms in the regulatory authorities, ombudsmen and like bodies in such sectors so that the concerns of individual citizens are also accorded equal importance and weightage and are appropriately and effectively addressed. They should safeguard the interests of the common citizens and ensure that the grievances of the citizens are attended to promptly and effectively.

19.4 STOCK EXCHANGE INVESTOR PROTECTION FUND

ISE has set up an Investor Protection Fund (IPF) to meet the claims of investors against defaulter Members, in accordance with the Guidelines issued by the Ministry of finance, Government of India.

ISE has established an Inter-connected Stock Exchange Investor Protection Fund Trust (ISE-IPF Trust) with the objective of compensating investors in the event of defaulters' assets not being sufficient to meet the admitted claims of investors, promoting investor education, awareness and research. The Investor Protection Fund

(IPF) is administered by way of registered Trust created for the purpose. The Inter-connected Stock Exchange Investor Protection Fund Trust is managed by Trustees.

The Inter-connected Stock Exchange Investor Protection Fund Trust, based on the recommendations of the Defaulters' Committee, compensates the investors to the extent of funds found insufficient in Defaulters' account to meet the admitted value of claim, subject to a maximum limit as per decided by Trust per investor per defaulter/expelled member.

19.5 SEBI (SAT)

SAT was formed as a statutory body to hear and dispose of appeals against the orders passed by the SEBI, PFRDA and IRDAI

19.5.1 Role of (SAT) the Securities Appelate Tribunal

- It acts as the judicial arm of SEBI.
- Its role will be similar to that of a Civil Court when performing its duties.

19.5.2 Members of SAT

- Securities Appellate Tribunal will consist of 3 members and 1 of them would be the presiding officer.
- The Presiding officer of SAT is either a sitting or retired judge of the supreme court or a sitting or retired Chief Justice of the High Court or A sitting or retired Judge of a High court, who has completed at least 7 years of service as a Judge in a High Court.
- The members of SAT should be a person of ability, integrity and standing and he should have shown capacity in dealing with problems relating to securities market. He should also have experience and qualifications related to corporate law, Securities laws, Finance, economics or accountancy.

19.5.3 Powers of SAT

As mentioned above, the Securities Appellate Tribunal's role is similar to that of a Civil court, hence, its powers are also same as a Civil courts powers as defined under the Code of Civil Procedure, 1908. They are as follows –

- Summoning and enforcing the attendance of any person and examining him on oath;
- Requiring the discovery and production of documents;
- Receiving evidence on affidavits;
- Issuing commissions for the examination of witnesses or documents;
- Reviewing its decisions;
- Dismissing an application for default or deciding it *ex parte*
- Setting aside any order of dismissal of any application for default or any order passed by it *ex parte* and
- Any other matter which may be prescribed.

19.6 SUMMARY

Prevention of Money Laundering Act, 2002 is an Act of the Parliament of India enacted by the NDA government to prevent money laundering and to provide for confiscation of property derived from money laundering. Grievance Redress Mechanism is part and parcel of the machinery of any administration. No administration can claim to be accountable, responsive and user-friendly unless it has established an efficient and effective grievance redress mechanism. The grievances of public are received at various points in the Government of India .There is primarily two designated nodal agencies handling these grievances including,

(i) Department of Administrative Reforms and Public Grievances and **(ii)** Directorate of Public Grievances, Cabinet Secretariat

The Investor Protection Fund (IPF) is administered by way of registered Trust created for the purpose. The Inter-connected Stock Exchange Investor Protection Fund Trust is managed by Trustees.

SAT was formed as a statutory body to hear and dispose of appeals against the orders passed by the SEBI, PFRDA and IRDAI. It acts as the judicial arm of

SEBI. Its role will be similar to that of a Civil Court when performing its duties.

19.7 GLOSSARY

• Money laundering	large amounts of money generated by a criminal activity
• Prohibition	the action of forbidding something, especially by law
• Grievance	redress resolution to problems or complaints
• Ombudsman	an official appointed to investigate individuals' complaints against a company or organization, especially a public authority

19.8 SELF-ASSESSMENT QUESTIONS

Q1. What do you mean by money laundering?

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Q2. What is grievance redress mechanism?

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Q3. What is the importance of investor's protection fund?

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19.9 LESSON END EXERCISE

Q1. Define the salient features of money laundering.

Q2. Explain procedure for online registration of grievances.

Q3. Briefly explain the functioning of investor's protection fund.

Q4. Define the role and powers of sat.

19.10 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

M.Y. Khan : Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi – 110 002.

Shashi K Gupta : Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Nishja Aggarwal Ram Road, 24, Daryaganj, New Delhi - 110002 Neeti Gupta

Vishal Saraogi : Capital Markets and Securities Laws simplified, Lawpoint Publication, 6C, R.N. Mukherjee Road, Kolkata-70000

FINANCIAL INTELLIGENCE, UNIT AND FINANCIAL MECHANISM

STRUCTURE

20.1 INTRODUCTION: ECONOMICS OFFENCES WING

Economic Offences Wings which investigate complicated white collar crime involves general, cheating, frauds in banking and medical fields, job racketing, shares and bogus stamp cases. Economic Offences Wings are responsible for organizing various training programs and new strategies for enhancing the efficiency of the economic offence wing.

Enforcement is an act of compelling observance of or compliance with a law, rule or obligation. The Directorate of Enforcement is a law enforcement agency and economic intelligence agency responsible for enforcing economic laws and fighting economic crime in India. It is part of the Department of Revenue, Minister of Finance, Govt. of India.

20.2 OBJECTIVES

After reading this lesson you will be able to understand:

- Economic offense wing
- Financial intelligence unit
- Central bureau of investigation
- stock exchanges and clearing corporations regulations, 2012

20.3 FINANCIAL INTELLIGENCE UNIT

Financial intelligence (FININT) is the gathering of information about the financial affairs of entities of interest, to understand their nature and capabilities, and predict their intentions. Generally the term applies in the context of law enforcement and related activities.

One of the main purposes of financial intelligence is to identify financial transactions that may involve tax evasion, money laundering or some other criminal activity. FININT may also be involved in identifying financing of criminal and terrorist organisations.

Financial intelligence can be broken down into two main areas, collection and analysis. Collection is normally done by a government agency, known as a financial intelligence organisation or Financial Intelligence Unit (FIU). The agency will collect raw transactional information and suspicious activity reports (SAR) usually provided by banks and other entities as part of regulatory requirements. Data may be shared with other countries through intergovernmental networks.

Analysis may consist of scrutinizing a large volume of transactional data using data mining or data-matching techniques to identify persons potentially engaged in a particular activity. SARs can also be scrutinized and linked with other data to try and identify specific activity.

FININT involves scrutinizing a large volume of transactional data, usually provided by banks and other entities as part of regulatory requirements. Alternatively, data mining or data-matching techniques may be employed to identify persons potentially engaged in a particular activity.

Many industrialized countries have regulatory reporting requirements for its financial organisations. It may be possible for the FININT organization to obtain access to raw data at a financial organization. From a legal standpoint, this type of collection can be quite complex. For example, the CIA obtained access to the Society for Worldwide Interbank Financial Telecommunication (SWIFT) data streams through the Terrorist Finance Tracking Program, but this violated Belgian privacy law.

Reporting requirements may not affect Informal value transfer systems (IVTS) the use of which may simply be customary in a culture, and of amounts that would not require reporting if in a conventional financial institution. IVTS also can be used for criminal purposes of avoiding oversight.

Examples of financial intelligence analysis could include:

- Identifying high-risk housing tenants on the basis of past rental histories.
- Detecting tax payers trying to avoid their fiduciary obligations by moving wealth surreptitiously out of a tax-levying jurisdiction.
- Discovering safe havens where criminals park the proceeds of crime.
- Accounting for how a large sum of money handed to a targeted individual disappears
- Checking to see if a corrupt individual has had any sudden and unexplained windfalls.
- Detecting relationships between terrorist cells through remittances.

20.4 CENTRAL BUREAU OF INVESTIGATION

The agency was established in 1941 as the Special Police Establishment.

The Central Bureau of Investigation was later established on 1 April 1963. Its motto is "Industry, Impartiality, and Integrity".

CBI is a police organization established pursuant to Resolution No. 4/31/61/-T, 1st April, 1963 of the Ministry of Home Affairs of the Government of India

The Central Bureau of Investigation (CBI) is a governmental agency belonging to Government of India that serves as both a criminal investigation body, national security agency and intelligence agency. The CBI is a premier investigating police agency in India. It is an elite force playing a major role in preservation of values in public life and in ensuring the health of the national economy. It is also the nodal police agency in India which coordinates investigation on behalf of Interpol Member countries. The services of its investigating officers are sought for all major investigations in the country.

The agency headquarters is a state-of-the-art building located in New Delhi. The agency has other field offices located in major cities throughout the India. The CBI is controlled by the Department of Personnel and Training in the Ministry of Personnel, Public Grievances and Pension of the Union Government usually headed by a Union Minister who reports directly to the Prime Minister. While analogous in structure to the FBI, the CBI's powers and function are severely limited to specific crimes based on Acts (mainly the Delhi Special Police Establishment Act, 1946). The CBI is the official Interpol unit for India.

20.5 FINANCIAL ACTION TASK FORCE SECURITIES CONTRACT (REGULATION)

On 25 October 2018, the Financial Action Task Force (FATF) published the final version of their guidance for a risk-based approach (RBA) for the securities sector (the Guidance). The RBA is a key for businesses to understand the money laundering and terrorist financing (ML/TF) risks to which they are exposed. The Guidance offers specific advice for securities providers and supervisors to implement the RBA approach.

The Guidance is aimed at countries and their competent authorities including anti money laundering / counter terrorist financing (AML/CTF) supervisors and practitioners in the securities sector.

Section I of the Guidance offers an overview of the FATF's RBA generally, and presents examples of securities transaction structures that may expose risk with regards ML/TF. Section II, which should be read alongside the FATF Report on Money Laundering and Terrorist Financing in the Securities Sector (October 2009), offers guidance for securities providers and intermediaries. Risk assessment guidance is provided covering:

- country / geographic risk;
- customer / investor risk;
- product / service / transactions risk; and
- Distribution channel risk.

Risk mitigation techniques are also provided including advanced due diligence methods, a high level summary of which is provided on page 30 of the Guidance. Comprehensive advice is also provided on internal monitoring and compliance controls.

Section III offers guidance for supervisory authorities. The FATF recommends that more supervisory resources be allocated to areas of higher ML/TF risk. Examples of ways to do this include:

- performing additional enhanced checks, as appropriate, as part of their authorisation function;
- adjusting the type of AML/CTF supervision (i.e. on and off site supervision); and
- Adjusting the frequency and intensity of AML/CTF supervision.

The Guidance continues by offering supervisors a general approach to the supervision of the RBA to the securities sector, with supporting documents on how certain countries have implemented the RBA in the securities sector provided in Annex A to the Guidance.

20.6 STOCK EXCHANGES AND CLEARING CORPORATIONS, REGULATIONS, 2012

In exercise of the powers conferred by sections 4, 8A and 31 of the Securities Contracts (Regulation) Act, 1956, read with sections 11 and 30 of the Securities and Exchange Board of India Act, 1992, the Securities and Exchange Board of India hereby makes the following regulations to regulate recognition, ownership and governance in stock exchanges and clearing corporations and matters connected therewith.

1. Short title and commencement

(1) These regulations may be called the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012.

(2) They shall come into force on the date of their notification in the Gazette of India.

2. Definitions

(1) In these regulations, unless the context otherwise requires, the terms defined herein shall bear the meanings assigned to them below, and their cognate expressions shall be construed accordingly,-

(a) "Act" means the Securities Contracts (Regulation) Act, 1956 (42 of 1956);

(b) "Associate" in relation to a person shall include another person:

(i) Who, directly or indirectly, by himself, or in combination with other persons, exercises control over the first person;

(ii) Who holds fifteen percent or more shares in the paid up equity capital of the first person;

(iii) Whose director or partner is also a director of the first person or its subsidiary or holding company, or partner of the first person, as the case may be.

(iv) Who is a holding company or a subsidiary company of the first person or a company under the same management as of the first person?

(v) Who is a relative of the first person?

(vi) Who is a member of a Hindu Undivided Family wherein the first person is also a member?

(c) "Board" means the Securities and Exchange Board of India established under the provisions of section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);

(d) "clearing corporation" means an entity that is established to undertake the activity of clearing and settlement of trades in securities or other instruments or products that are dealt with or traded on a recognized stock exchange and includes a clearing house;

(e) "Clearing member" means a person having clearing and settlement rights in any recognised Clearing Corporation

Provided that any person who, on the date of commencement of these regulations, is acting as clearing member of a clearing house or a clearing corporation shall be deemed to be clearing member, till his request for registration, if any, is refused by the Board or till cessation of his membership with clearing corporation, whichever is earlier;

(f) "Company" shall mean a company as defined in section 3 of the Companies Act, 1956 (1 of 1956);

(g) "control" shall have the same meaning as assigned to it under clause (e) of sub- regulation (1) of regulation 2 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 or any modification thereof;

(h) "Governing board" means the board of directors of a recognised stock exchange or a recognised clearing corporation;

(i) "key management personnel" means a person serving as head of any department or in such senior executive position that stands higher in hierarchy to the head(s) of department(s) in the recognised stock exchange or the recognised clearing corporation or in any other position as declared so by such stock exchange or clearing corporation;

(j) "netting" means the determination of net payment or delivery obligations among the clearing members of a recognised clearing corporation by setting off or adjustment of the inter se obligations or claims arising out of buying and selling of securities, discontinuation of business, dissolution, winding-up or insolvency or such other circumstances as may be specified in the bye-laws of the clearing corporation

(k) "novation" means the act of a clearing corporation interposing itself between both parties of every trade, being the legal counterparty to both;

(l) "persons acting in concert" in the context of acquisition or holding of shares or voting rights or control shall mutatis mutandis have the same meaning as assigned to it in clause (q) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 or any modification thereof;

(m) "Public" includes any member or section of the public but does not include any trading member or clearing member or their associates and agents:

Provided that a public sector bank, public financial institution, an insurance company, mutual fund and alternative investment fund in public sector, that has associate(s) as trading members or clearing members, shall be deemed as public for the purposes of these regulations;

(n) "Public interest director" means an independent director, representing the interests of investors in securities market and who is not having any association, directly or indirectly, which in the opinion of the Board, is in conflict with his role;

(o) "Recognised Clearing Corporation" means a clearing corporation which is recognised by the Board under section 4 read with section 8A of the Act;

(p) "Regulatory department" means a department of a recognised stock exchange or a recognised clearing corporation which is entrusted with regulatory powers and duties and includes such department as may be specified by the Board;

(q) "Rules" mean the Securities Contracts (Regulations) Rules, 1957;

(r) "Shareholder director" means a director who represents the interest of shareholders, and elected or nominated by such shareholders who are not trading members or clearing members, as the case may be, or their associates and agents;

(s) "Trading member" means a person having trading rights in any recognised stock exchange and includes a stock broker.

(2) Words and expressions used and not defined in these regulations but defined in the Act, the Companies Act, 1956, the Securities and Exchange Board of India Act, 1992, the Depositories Act, 1996 or any rules or regulations made there under shall have the same meanings respectively assigned to them in those Acts, rules or regulations made there under or any statutory modification or re-enactment thereto, as the case may be.

3. Obligation to seek recognition

No person shall conduct, organise or assist in organising any stock exchange or clearing corporation unless he has obtained recognition from the Board in accordance with the Act, rules and these regulations: Provided that a stock exchange, which has been recognised under the Act as on the date of commencement of these regulations, shall be deemed to have been recognised under these regulations and all the provisions of these regulations as they apply to a recognised stock exchange shall also apply to such stock exchange:

Provided further that an existing clearing house of a recognised stock exchange or any person who clears and settles trades of a recognised stock exchange, as on the date of the commencement of these regulations, may continue to do so for a period of three months from the date of commencement of these regulations or, if he has made an application under regulation 4 for recognition, till disposal of such application.

4. Application for recognition

Subject to compliance with the provisions of Act, rules and these regulations, an application for recognition as a stock exchange shall be submitted to the Board in Form A as prescribed under rule 3 of the rules and an application for recognition as a clearing corporation shall be submitted to Board in Form A as specified in Schedule - I of these regulations.

5. Fee for application

An applicant seeking recognition as a stock exchange shall pay application fee in terms of rule 4 of the rules, and an applicant seeking recognition as a clearing corporation shall also pay application fee as payable by a stock exchange.

6. Documents and particulars for application

(1) An application for recognition as a stock exchange or a clearing corporation, as the case may be, shall be accompanied by copies of memorandum of association, articles of association, bye-laws and other documents as provided in sections 3 and 4 of the Act, rule 5 of the rules and these regulations.

(2) In addition to the documents specified in sub-regulation (1), the application for recognition as a clearing corporation shall be accompanied by the agreement(s) entered into by the applicant with the recognised stock exchange(s) and depositories.

20.7 SUMMARY

Economic Offences Wings investigates complicated white collar crime. The Central Bureau of Investigation (CBI) is a governmental agency belonging to Government of India that serves as both a criminal investigation body, national security agency and intelligence agency. The Securities and Exchange Board of India regulates the recognition, ownership and governance in stock exchanges and clearing corporations and matters connected therewith

20.8 GLOSSARY

- **Offence** a breach of a law or rule; an illegal act
- **Bogus** not genuine or true
- **Scrutinizing** examine or inspect closely and thoroughly.

- **Task Force** force organized for a special operation.
- **Money laundering** the concealment of the origins of illegally obtained money, typically by means of transfers involving foreign banks or legitimate businesses.

20.9 SELF-ASSESSMENT QUESTIONS

Q1. What do you mean by economics offence wing?

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Q2. What is financial intelligence unit?

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Q3. What are financial task force securities?

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20.10 LESSON END EXERCISE

Q1. Briefly explain the stock exchanges and clearing corporation's regulations, 2012.

Q2. Explain the functioning of financial units with some examples

20.11 SUGGESTED READINGS

E. Gordon & : Capital Market in India; Himalaya Publishing House, Ramdoot, K.Natarajan Dr. Bhalerao Marg, Girgaon, Mumbai - 400004.

Sanjeev Aggarwal : Guide to Indian Capital Market; Bharat Law House, 22, Tarun Enclave, Pitampura, New Delhi – 110 034.

M.Y. Khan : Indian Financial Systems; Tata McGraw Hill, 4/12, Asaf Ali Road, New Delhi – 110 002.

Shashi K Gupta : Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Nishja Aggarwal Ram Road, 24, Daryaganj, New Delhi - 110002 Neeti Gupta

Vishal Saraogi : Capital Markets and Securities Laws simplified, Lawpoint Publication, 6C, R.N. Mukherjee Road, Kolkata-70000