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# SCHOOL OF MANAGEMENT STUDIES

# UNIT-I - SECURITIES LAW - SBAA3010

## INDIAN FINANCIAL SYSTEM AND SECURITIES CONTRACT ACT

Indian financial system - Meaning, Functions Structure; Securities Contract (Regulation) Act (SCR) 1956 - Objectives, Rules and Regulations - Recognized Stock Exchanges - Application for recognition of stock exchanges, Grant of recognition to stock exchanges - Withdrawal of recognition stock exchanges

### Meaning of Indian financial system

The financial system enables lenders and borrowers to exchange funds. India has a financial system that is controlled by independent regulators in the sectors of insurance, banking, capital markets and various services sectors.

Thus, a financial system can be said to play a significant role in the economic growth of a country by mobilizing the surplus funds and utilizing them effectively for productive purposes.

### FEATURES OF INDIAN FINANCIAL SYSTEM

- It plays a vital role in economic development of a country.
- It encourages both savings and investment.
- It links savers and investors.
- It helps in capital formation.
- It helps in allocation of risk.
- It facilitates expansion of financial markets.

### Main Functions of Financial System

The functions of financial system can be enumerated as follows:

- Financial system works as an effective conduit for optimum allocation of financial resources in an economy.
- It helps in establishing a link between the savers and the investors.
- Financial system allows 'asset-liability transformation'. Banks create claims (liabilities) against themselves when they accept deposits from customers but also create assets when they provide loans to clients.
- Economic resources (i.e., funds) are transferred from one party to another through financial system.
- The financial system ensures the efficient functioning of the payment mechanism in an economy. All transactions between the buyers and sellers of goods and services are affected smoothly because of financial system.
- Financial system helps in risk transformation by diversification, as in case of mutual funds.
- Financial system enhances liquidity of financial claims.
- Financial system helps price discovery of financial assets resulting from the interaction of buyers and sellers. For example, the prices of securities are determined by demand and supply forces in the capital market.
- Financial system helps reducing the cost of transactions.

As discussed above, financial markets play a significant role in economic growth through their role of allocation capital, monitoring managers, mobilizing of savings and promoting technological changes among others. Economists had held the view that the development of the financial sector is a crucial element for stimulating economic growth.

Financial development can be defined as the ability of a financial sector acquire effectively information, enforce contracts, facilitate transactions and create incentives for the emergence of particular types of financial contracts, markets and intermediaries, and all should be at a low cost. Financial development occurs when financial instruments, markets and intermediaries ameliorate through the basis of information, enforcement and transaction costs, and therefore better provide financial services.The financial functions or services may influence saving and investment decisions of an economy through capital accumulation and technological innovation and hence economic growth.

Capital accumulation can either be modeled through capital externalities or capital goods produced using constant returns to scale but without the use of any reproducible factors to generate steady-state per capita growth. Through capital accumulation, the functions performed by the financial system affect the steady growth rate thereby influencing the rate of capital formation. The financial system affects capital accumulation either by altering the savings rate or by reallocating savings among different capital producing levels. Through technological innovation, the focus is on the invention of new production processes and goods.

## COMPONENTS/ CONSTITUENTS OF INDIAN FINANCIAL SYSTEM

The following are the four major components that comprise the Indian Financial System:

- Financial Institutions
- Financial Markets
- Financial Instruments/ Assets/ Securities
- Financial Services.

## FINANCIAL INSTITUTIONS

Financial institutions are the intermediaries who facilitate smooth functioning of the financial system by making investors and borrowers meet. They mobilize savings of the surplus units and allocate them in productive activities promising a better rate of return. Financial institutions also provide services to entities (individual, business, government) seeking advice on various issue ranging from restructuring to diversification plans. They provide whole range of services to the entities who want to raise funds from the markets or elsewhere.

Financial institutions are also termed as financial intermediaries because they act as middle between savers by accumulating Funds them and borrowers by lending these funds.

It is also act as intermediaries because they accept deposits from a set of customers (savers lend these funds to another set of customers (borrowers). Like - wise investing institutions such ICCIC, mutual funds also accumulate savings and lend these to borrowers, thus perform the role of financial intermediaries.

## TYPES OF FINANCIAL INSTITUTIONS

Financial institutions can be classified into two categories:

A. Banking Institutions

B. Non - Banking Financial Institutions

## A. BANKING INSTITUTIONS (Reserve Bank of India)

Indian banking industry is subject to the control of the Central Bank. The RBI as the apex institution organises, runs, supervises, regulates and develops the monetary system and the financial system of the country. The main legislation governing commercial banks in India is the Banking Regulation Act, 1949.

The Indian banking institutions can be broadly classified into two categories:

1. Organised Sector

2. Unorganised Sector.

**1. Organised Sector**

The organized banking sector consists of commercial banks, cooperative banks and the regional rural banks.

**(a)Commercial Banks**

The commercial banks may be scheduled banks or non – scheduled banks. At present only one bank is a non - scheduled hank. All other banks are schedule banks. The commercial banks consist of 27 public sector banks, private sector banks and foreign banks. Prior to 1969, all major banks with the exception of State Bank of India in the private sector. An important step towards public sector banking was taken in July 1969, when 14 major private banks with a deposit base of 50 crores or more were nationalised. Later in 1980 another 6 were nationalised bringing up the total number banks nationalised to twenty.

**(b) Co-operative banks**

An important segment of the organized sector of Indian banking is the co-operative banking. The segment is represented by a group of societies registered under the Acts of the states relating to cooperative societies. In fact, co-operative societies may be credit societies or non-credit societies.

Different types of co-operative credit societies are operating in Indian e conomy. These institutions can be classified into two broad categories:

**(i) Rural credit societies-** which are primary agriculture

**(ii) Urban credit societies-** which are primarily non-agriculture.

For the purpose of agriculture credit there are different co-operative credit institutions to meet different kinds of needs.

**(c)Regional Rural Banks (RRBs)**

Regional Rural Banks were set by the state government and sponsoring commercial banks with the objective of developing the rural economy. Regional rural banks provide banking services and credit to small farmers, small entrepreneurs in the rural areas. The regional rural banks were set up with a view to provide credit facilities to weaker sections. They constitute an important part of the rural financial architecture in India. There were 196 RRBs at the end of June 2002, as compares to 107 in 1981 and 6 in 1975.

**(d)Foreign Banks**

Foreign banks have been in India from British days. Foreign banks as banks that have branches in the other countries and main Head Quarter in the Home Country. With the deregulation (Elimination of Government Authority) in 1993, a number of foreign banks are entering India.

Foreign Banks are: Citi Bank. Bank of Ceylon.

**2. Unorganised Sector**

In the unorganised banking sector are the Indigenous Bankers, Money Lenders.

**1.Indigenous Bankers**

Indigenous Bankers are private firms or individual who operate as banks and as such both receive deposits and given loans. Like bankers, they also financial intermediaries. They should be distinguished professional money lenders whose primary business is not banking and money lending. The indigenous banks are trading with the Hundies, Commercial Paper.

**2.Money Lenders**

Money lenders depend entirely to on their one funds. Money Lenders may be rural or urban, professional or non-professional. They include large number of farmer, merchants, traders. Their operations are entirely unregulated. They charge very high rate of interest.

**B. NON – BANKING INSTITUTIONS**

The non – banking institutions may be categorized broadly into two groups:

(a) Organized Non – Banking Financial Institutions.

(b) Unorganized Non – Banking Financial Institutions.

The organised non - banking financial institutions include:

**(i) Development Finance Institutions-** These include: The institutions like IDBT, ICICI, IFCI, IIBI, IRDC at all India level.

The State Finance Corporations (SFCs), State Industrial Development Corporations (SIDCs) at the state level. Agriculture Development Finance Institutions as NABARD,LDBS etc. Development banks provide medium and long term finance to the corporate and industrial sector and also take up promotional activities for economic development

**(ii) Institution**

These include those financial institutions which mobilise savings at the public at large through various schemes and invest these funds in corporate and government securities. These include LIC, GIC, LTT, and mutual funds.

**Unorganised Non - Banking Financial Institution**

The unorganised non - banking financial institutions include number of non - banking financial companies (NBFCs) providing whole range of financial services. These include hire - purchase 300 consumer finance companies, leasing companies, housing finance companies, factoring companies, Credit rating agencies, merchant banking companies etc. NBFCs mobilise public funds and provide loanable funds.

**FINANCIAL MARKET**

It is through financial markets and institutions that the financial system of an economic works. Financial markets refer to the institutional arrangements for dealing in financial assets and credit instruments of different types such as currency, cheques, bank deposits, bills, bonds etc.

**Functions of financial markets**

- To facilitate creation and allocation of credit and liquidity
- To serve as intermediaries for mobilisaton of savings.
- To assist the process of balanced economic growth.
- To provide financial convenience.
- To cater to the various credit needs of the business houses.

These organised markets can be further classified into two they are,

(i)Capital Market

(ii)Money Market

**CAPITAL MARKET**

The capital market is a market for financial assets which have a long or indefinite maturity. Generally, it deals with long term securities which have a maturity period of above one year. Capital market may be further divided into three namely:

- Industrial securities market
- Government securities market and
- Long term loans market

**I. INDUSTRIAL SECURITIES MARKET**

As the very name implies, it is a market for industrial securities namely:

(i)Equity shares or ordinary shares,

(ii)Preference shares and

(iii)Debentures or bonds.

It is a market where industrial concerns raise their capital or debt by issuing appropriate instruments. It can be further subdivided into two.

(i)Primary market or New issue market

(ii)Secondary market or Stock exchange

**Primary Market**

Securities are created for the first time for investors to purchase. New securities are issued in this market through a stock exchange, enabling the government as well as companies to raise capital.

In the primary market, borrowers exchange new financial securities for long term funds. Thus, primary market facilitates capital formation. There are three ways by which a company may raise capital in a primary market. They are:

1) Rights issue
2) Private placement
3) Public issue

The most common method of raising capital by new companies is through sale of securities to the public. It is called public issue. When an existing company wants to raise additional capital, securities are first offered to the existing shareholders on a pre-emptive basis. It is called rights issue. Private placement is a way of selling securities privately to a small group of investors.

**Secondary Market**

Secondary market is a market for secondary sale of securities. In other words, securities which have already passed through the new issue market are traded in this market. Generally, such securities are quoted the Stock Exchange and it provides a continuous and regular market to buying and selling of securities. This market consists of all stock exchanges recognised by the Government of

India. The stock exchanges in India are regulated under the Securities Contracts (Regulation) Act 1956. The Bombay Stock Exchange is the principal stock exchange in India which sets the tone of the other stock markets.

**II.GOVERNMENT SECURITIES MARKET**

It is otherwise called Gilt - Edged securities market. It is a market where Government securities are traded. In India there are many kinds of Government Securities - short term and long term.

Long term securities are traded in this market while short term securities are traded in the money market. Securities issued by the Central Government, State Governments, Semi Government authorities like City Corporations, Port Trusts etc. Improvement Trusts, State Electricity Boards, All India and State level financial institutions and public sector enterprises are dealt in this market.

**III.LONG TERM LOANS MARKET**

Development banks and commercial banks play a significant role in this market by supplying long term loans to corporate customers. Long term loans market may further be classified into:

(1)Term loans market

(ii)Mortgages market

(iii)Financial Guarantees market.

**Term Loans Market**

In India, many industrial financing institutions have been created by the Government both at the national and regional levels to supply long term and medium term loans to corporate customers directly as well as indirectly. These development banks dominate the industrial finance in India. Institutions like IDBI, IFCI, ICICI, and other financial corporations come under this category.

**Mortgages Market**

A mortgage loan is a loan against the security of immovable property like real estate. The transfer of interest in a specific immovable property to secure a loan is called mortgage. This mortgage may be equitable mortgage or legal one.

**Financial Gurantees Market**

A financial guarantee is a type of promise given by a guarantor to take responsibility for the borrower in the case of default in payments to the lender or investor. Generally, insurance companies give guarantee to back the debt of large corporations (the borrower) in payments to the market (the lender).

## MONEY MARKET

Money market is a market for dealing with financial assets and securities which have a maturity period of upto one year. In other words, it is a market for purely short term funds. The money market may be subdivided into four. They are:

(i) Call money market

(ii) Commercial bills market

(iii) Treasury bills market

(iv) Short term loan market.

**Call Money Market**

The call money market is a market for extremely short period loans say one day to fourteen days. So, it is highly liquid. The loans are repayable on demand at the option of either the lender or the borrower. In India, call money markets are associated with the presence of stock exchanges and hence, they are located in major industrial towns like Bombay, Calcutta, Madras, Delhi, Ahmedabad etc. The special feature of this market is that the interest rate varies from day to day and even from hour to hour and Centre to Centre. It is very sensitive to changes in demand and supply of call loans.

**Commercial Bills Market**

It is a market for Bills of Exchange arising out of genuine trade transactions. In the case of credit sale, the seller may draw a bill of exchange on the buyer. The buyer accepts such a bill promising to pay at a later date specified in the bill. The seller need not wait until the due date of the bill. Instead, he can get immediate payment by discounting the bill.

**Treasury Bills Market**

The Treasury bill market is the market that deals in treasury bills. These bills are short-term (91-day) liability of the Government of India. In theory, they are issued to meet temporary needs for funds of the government, arising from temporary excess of expenditure over receipts.

**Short - Term Loan Market**

It is a market where short - term loans are given to corporate customers for meeting their working capital requirements. Commercial banks play a significant role in this market. Commercial banks provide short term loans in the form of cash credit and overdraft Over draft facility is mainly given to business people whereas cash credit is given to industrialists. Overdraft is purely a temporary accommodation and it is given in the current account itself. But cash credit is for a period of one year and it is sanctioned in a separate account.

**FINANCIAL INSTRUMENTS**

Financial instruments refer to those documents which represents financial claims on assets. As discussed earlier, financial asset refers to a claim to a claim to the repayment of a certain sum of money at the end of a specified period together with interest or dividend. Examples: Bill of exchange, Promissory Note, Treasury Bill. Financial securities can be classified into:

(i)Primary or direct securities.

(ii)Secondary or indirect seurities.

**Primary Securities**

These are securities directly issued by the ultimate investors to the ultimate savers. Eg. shares and debentures issued directly to the public.

**Secondary Securities**

These are securities issued by some intermediaries called financial intermediaries to the ultimate savers. Eg. Unit Trust of India and mutual funds issue securities in the form of units to the public and the money pooled is invested in companies. Again these securities may be classified on the basis of duration as follows:

(i) Short - term securities - Short - term securities are those which mature within a period of one year. Eg, Bill of Exchange, Treasury bill, etc.

(ii) Medium term securities - Medium term securities are those which have a maturity period ranging between one and five years. Eg. Debentures maturing within a period of 5 years

(iii) Long - term securities.- , Long - term securities are those which have a maturity period of more than five years. Eg, Government Bonds maturing after 10 years.

## FINANCIAL SERVICES

Efficiency of emerging financial system largely depends upon the quality and variety of financial services provided by financial intermediaries. The term financial services can be defined as “activities, benefits, and satisfactions, connected with the sale of money, that offer to users and customers, financial related value. within the financial services industry the main sectors are banks, financial institutions, and non-banking financial companies.

## KINDS OF FINANCIAL SERVICES

Financial services provided by various financial institutions, commercial banks and merchant bankers can be broadly classified into two categories.

### (A)Asset based/fund based services

The asset/fund based services provided by banking and non - banking financial institutions as discussed below briefly.

### 1.Equipment Leasing/ Lease Financing

Leasing is an arrangement that provides a firm with the use and control over assets without buying and owning the same. It is a form of renting assets. However, in making an investment, the firm need not own the asset. It is basically interested in acquiring the use of the asset. Thus, the firm may consider leasing of the asset rather than buying it.

In comparing leasing with buying, the cost of leasing the asset should be compared with the cost of financing the asset through normal sources of financing, i. e. debt and equity. Since payment of lease rentals is similar to payment of interest on borrowings and lease financing is equivalent to debt.

**2.Hire Purchase and Consumer Credit**

Hire purchase means a transaction where goods are purchased and sold on the terms that

(i) payment will be made it installments,

(ii) the possession of the goods is given to the buyer immediately,

(iii) the property ownership) in the goods remains with the vendor till the last installment is paid,

(iv) the seller can repossess the goods in case of default in payment of any instalment, and

(v) each instalment is treated as hire charges till the last instalment is paid.

Consumer credit includes all asset based financing plans offered to individuals to help them acquire durable consumer goods. In a consumer credit transaction the individual/ consumer/ buyer pays a part of the cash purchase price at the time of the delivery of the asset and pays the balance with interest over a specified period of time.

### 3.Venture capital

In the real sense, venture capital financing is one of the most recent entrants in the Indian capital market. There is a significant scope for venture capital companies in our country because of increasing emergence of technocrat entrepreneurs who lack capital to be risked. These venture capital companies provide the necessary risk capital to the entrepreneurs so as to meet the promoters contribution as required by the financial institutions. In addition to providing capital, these VCFS (venture capital firms) take an active interest in guiding the assisted firms.

### 4.Insurance Services

Insurance is a contract where by the insurer e. insurance company agrees/ undertakes, in consideration of a sum of money (premium) to make good the loss suffered by the insured (policy holder) against a specified risk such as fire or compensate the beneficiaries (insured) on the happening of a specified event such as accident or death. The document containing the terms of contract, in black and white, between the insurer and the insured is called policy. The property which is insured is the subject matter of insurance. The interest which the insured has in the subject matter of insurance is known as insurable interest. Depending upon the subject matter, insurance services are divided into (i) life (ii) general.

### 5.Factoring

Factoring, as a fund based financial service provides resources to finance receivables as well as it facilitates the collection of receivables. It is another method of raising short - term finance through account receivable credit offered by commercial banks and factors.

A commercial bank may provide finance by discounting the bills or invoices of its customers. Thus, a firm gets immediate payment for sales made on credit. A factor is a financial institution which offers services relating to management and financing of debts arising out of credit sales.

## B. FEE BASED ADVISORY SERVICES

### (i)Merchant Banking

Merchant Bank is a company that provides services like fundraising activities like IPOs, FPOs, loans, underwriting, financial advising or market making for big companies and individuals having huge net worth but they do not provide for the basic banking services such as checking accounts, etc.

It provides financial services, including underwriting, loan services, fundraising services, and financial advising to high net-worth individuals and small/mid-sized corporations.

### (ii)Credit Rating

Credit rating is an analysis of the credit risks associated with a financial instrument or a financial entity. It is a rating given to a particular entity based on the credentials and the extent to which the financial statements of the entity are sound, in terms of borrowing and lending that has been done in the past.

### (iii)Stock - Broking

Stockbroking is a service which gives retail and institutional investors the opportunity to buy and sell equities. Stockbrokers will trade shares both on exchange and over-the-counter, dependent on where they can find the best price and liquidity. Stock exchanges place strict regulations on who can trade shares directly on their books, which is why most individual investors hoping to trade shares will do so via a stockbroker. Typically, a stockbroking firm will charge commission on the trades it makes on a client's behalf, or a fee for retaining its services.

**Securities Contracts (Regulation) Act, 1956** 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 28 February 1957.

## DEFINITION OF STOCK EXCHANGE

**According to securities contracts regulations Act 1956** "stock exchange" means,

(a) any body of individuals, whether incorporated or not, constituted before corporatisation and demutualisation under sections 4A and 4B, or

(b) a body corporate incorporated under the Companies Act, 1956 (1 of 1956) whether under a scheme of corporatisation and demutualisation or otherwise, for the purpose of assisting, regulating or controlling the business of buying,selling or dealing in securities.

## FUNCTIONS OF STOCK EXCHANGE

The stock exchanges play an important role in the economic development of a country. The importance of stock exchange will be clear from the functions they perform and discussedas follows:

**1.Ensure Liquidity of Capital**

The stock exchanges where buyers and sellers are converted into cash. The exchanges provide a ready market.Had are always available and those who are in need of hard cash can sell their holdings this not been possible then many persons would have feared for blocking their savings in Securities as they can not again convert them into cash.

**2.Continuous Market for Securities**

The stock exchanges provide a ready market in securities. The securities once listed continue to be traded at the exchanges irrespective the fact that owners go on changing. The exchanges provide a regular market for trading in securities.

**3.Mobilizing Surplus Savings**

The stock exchanges provide a ready market for various securities. The investors do not have any difficulty in investing their savings by purchasing shares, bonds etc, from the exchanges. If this facility is not there then many persons who want to invest their savings will not find avenues to do so. In this way stock exchanges play an important role in mopping up surplus funds of investors.

**4.Helpful in Raising New Capital**

The new and existing concerns need capital for their activities. The new concerns raise capital for the first time and existing units increase their capital for expansion and diversification purposes. The shares of new concerns are registered at stock exchanges and existing companies also sell their shares through brokers etc, at exchanges. The exchanges are helpful in raising capital both by nets old concerns.

**5.Safety in Dealings**

The dealings at stock exchanges are governed by well - defined rules and regulations of Securities Contract (Regulation) Act, 1956. There is no scope manipulating transactions. Every contact is done according to the procedure laid down and there is no fear in the minds of contracting parties.The safety in dealings brings confidence in the minds of all concerned parties and helps in increasing various dealings.

**6.Listing of Securities**

Only listed securities can be purchased at stock exchanges. Every company desirous of listing its securities will apply to the exchange authorities. The listing is allowed only after a critical examination of capital structure, management and prospects of the company. The listing of securities gives privilege to the company. The investors can form their own views about the securities because listing a security does not guarantee the financial stability of the company.

**7. Smoothens the Price Movements**

A stock exchange smoothens the price movements of stocks in the market by ensuring a continuous flow of securities,

**8. Investor Protection**

The stock exchange renders safeguarding activities for investors in securities. It provides a grievance redressal mechanism for investors. Stock exchanges also operate a compensation fund for the protection of investors.

## BENEFITS OF STOCK EXCHANGE

The stock exchange has benefitted difference stakeholders in the capital market; it has greatly influenced every country's section socially, politically and economically. Some of the significant benefits of the stock exchange are as follows;

## BENEFITS FOR COMPANY AND ITS MANAGEMENT

### Access to capital

1. The prime objective of the stock exchange its to raise money for the listed corporation in the market; the stock exchange facilitates an easy rise in affordable capital to run business
2. Stock exchange's easy marketability and liquidity ensure a quick and steady supply of capital to the business through provisioning the buying and selling of stocks and securities
3. This forum also helps the companies to generate additional capital funds without any collateral.
4. The stock exchange also facilitates better negotiation in issuing stocks and securities by providing fair pricing of the published stocks.
5. High profiling and enhanced visibility
6. Stock exchange benefits the stock listed company to gain higher status and reputation in the business marketplace by enjoying the confidence of the investing public
7. It brings the company under the limelight and enhances its visibility in the public sphere, which helps fund capital and provides more significant support in increasing the market demand and supply.

8. Stock exchange creates a continuous display of the listed company's name and profiles through marketing its stocks and securities on the stock exchange platform.
9. More control over the management

A stock exchange facilitates the company to have more control over its management; by generating capital form the stock exchange, the company is protected from external control of its managerial affairs.

Unnecessary interference of the financial institutions such as venture capitals, banks, and others who lend collateral loans are entirely avoided.

**Savings in cost**

1. High collateral value for bank loans and other capital fundings are wholly avoided by listing stocks in the stock exchange. Its imposition of huge costs is saved through public issuing of capitals.
2. The stock exchange allows companies to raise funds through the capital market instruments at a low cost compared to other loans.
3. Economic Benefits
4. Enhance market liquidity

Liquidity refers to the degree to which an asset can be quickly bought or sold in the market at a price reflecting its intrinsic value. Stock exchange market's performance is measured with market liquidity, analyzing how well the country's stock market allows stocks and securities to be bought and sold at stable, transparent prices. One of the significant advantages of the stock exchange to the economy is that the stocks traded are liquid circulated into two market -issuers who indulge in continuous buying a itks and investments by buying and selling the securities at any time, which is the secondary market

## INVESTOR BENEFIT

### High returns

In stock exchanges, high returns are often supplied by long-term financial trends, where the price value of the stock occurs after some time but provide significantly high returns. This factor is one of the most promising benefits of the stock exchange to investors.

### Transparency

- A stock exchange facilitates transparency in managing the stock in the capital market;
- it evaluates the actual worth of securities and provides the intrinsic value of the company to avoid deceitful investments
- Safeguarding general public interest by ensuring equitable allotment, easy transfer, disclosure of proper information, etc.,
- Assures the existence of good faith or an absence of fraud concerning the issue of securities.
- Providing activities of quick transfer registration and corporate information

### Safety in investing

Stock exchanges' seamless physical and electronic trading platforms perform to ensure complete safety and security to the market participants.Its mechanism offers more excellent protection to investors by adequately investigating the company and the projects before listing and marketing its stocks to the capital market. Its fundamental function of handling stocks and securities are governed under proper rules and regulations and is abided by the stock exchange to ensure protected tradingAll the fraudulent activities will be duly enquired and sanctioned.

**Tax deferments**

Investors have the advantage of deferring from paying tax for the invested stock; there is no need to include the trading in assessment for the purchased stocks when filing tax returns.

**Accessibility**

Since the stock exchange is a growing market and is dynamic; it creates new opportunities and serves people; it has been designed as a single-window trading platform accessible to many people throughout the country and worldwide.

Buying and selling may be resorted to from any part of the world through online trading platformsIt facilitates faster deal settlement for investors across the counters spread over the entire county.

**OTHER BENEFITS**

- The interconnected network of the stock exchange, which the country creates, facilitates financial operations by integrating the entire capital market under one roof.
- Boon to closely-held companies whose stocks are held by a small number of people, these corporations are encouraged to go public because the stocks can be listed even if only 40 per cent of public capital (now a minimum of 20 per cent in case of closely-held and new companies) is offered for public trading.

- Facilitates wider dispersal of economic activities by encouraging small companies and small investors to participate in stock exchanges to expand and diversify their businesses
- Promoting over-all stimulation to venture capital activities there-by promoting entrepreneurship.

**Name of all the approved stock exchange in India is given below**

1.U.P.Stock Exchange,Kanpur
2. Vadodara Stock Exchange,Vadodara
3.Koyambtour Stock Exchange,Coimbatore
4. Meerut Stock Exchange,Meerut
5. Mumbai Stock Exchange,Mumbai
6. OverTheCounter Exchange of India,Mumbai
7. National Stock Exchange.Mumbai
8. Ahmedabad Stock Exchange,Ahmedabad
9. Bangalore Stock Exchange,Bangalore
10. Bhubaneshwar Stock Exchange,Bhubaneshwar
11. Calcutta Stock Exchange,Kolkata
12. CochinStockExchange,Cochin
13. DelhiStockExchange,Delhi
14. GuwahatiStockExchange,Guwahati
15. Hyderabad Stock Exchange, Hyderabad

16. Jaipur Stock Exchange, Jaipur

17. Canara Stock Exchange, Mangalore

18. Ludhiana Stock Exchange, Ludhiana

19. Chennai Stock Exchange, Chennai

20. M.P.Stock Exchange, Indore

21. Magadh Stock Exchange, Patna

22. Pune Stock Exchange, Pune

**23.** Capital Stock Exchange Kerala Ltd.,Thiruvananthapuram, Kerala

**Application for recognition of stock exchanges**

(1) Any stock exchange, which is desirous of being recognised for the purposes of this

Act, may make an application in the prescribed manner to the Central Government.

(2) Every application under sub-section (1) shall contain such particulars as may be

prescribed, and shall be accompanied by a copy of the bye-laws of the stock exchange for the regulation and control of contracts and also a copy of the rules relating in general to the constitution of the stock exchange and in particular, to—

(a) the governing body of such stock exchange, its constitution and powers of

management and the manner in which its business is to be transacted;

(b) the powers and duties of the office bearers of the stock exchange;

(c) the admission into the stock exchange of various classes of members, the qualifications for membership, and the exclusion, suspension, expulsion and re-admission of members therefrom or thereinto;

(d) the procedure for the registration of partnerships as members of the stock exchange

in cases where the rules provide for such membership; and the nomination and appointment of authorised representatives and clerks.

**Grant of recognition to stock exchanges**

(1) If the Central Government is satisfied, after making such inquiry as may be necessary in this behalf and after obtaining such further information, if any, as it may

require,—(a) that the rules and bye-laws of a stock exchange applying for registration are in conformity with such conditions as may be prescribed with a view to ensure fair dealing and to protect investors;

(b) that the stock exchange is willing to comply with any other conditions (including conditions as to the number of members) which the Central Government, after consultation with the governing body of the stock exchange and having regard to the area served by the stock exchange and its standing and the nature of the securities dealt with by it, may impose for the purpose of carrying out the objects

(c) that it would be in the interest of the trade and also in the public interest to grant recognition to the stock exchange; it may grant recognition to the stock exchange subject to the conditions imposed upon it as aforesaid and in such form as may be prescribed.

(2) The conditions which the Central Government may prescribe under clause (a) of sub-section (1) for the grant of recognition to the stock exchanges may include, among other matters, conditions relating to,—

(i) the qualifications for membership of stock exchanges;

(ii) the manner in which contracts shall be entered into and enforced as between members;

(iii) the representation of the Central Government on each of the stock exchange by such number of persons not exceeding three as the Central Government may nominate in this behalf; and

(iv) the maintenance of accounts of members and their audit by chartered accountants whenever such audit is required by the Central Government.

(3) Every grant of recognition to a stock exchange under this section shall be published in the Gazette of India and also in the Official Gazette of the State in which the principal office as of the stock exchange is situate, and such recognition shall have effect as from the date of its publication in the Gazette of India.

(4) No application for the grant of recognition shall be refused except after giving an opportunity to the stock exchange concerned to be heard in the matter; and the reasons for such refusal shall be communicated to the stock exchange in writing.

(5) No rules of a recognised stock exchange relating to any of the matters specified in sub-section (2) of section 3 shall be amended except with the approval of the Central Government.

**Withdrawal of recognition**

If the central government finds that the withdrawal of recognition granted to any stock exchange as per the provisions of this Act will serve the interests of public or trade in a better way, then a written notice will be served by the central government to the body that governs the management of the stock exchange.

The reason for withdrawal has to be stated in the notice and an opportunity has to be provided to the governing body to make a representation of its case and henceforth, it is a mandate for the central government to follow the rules laid down by the principles of natural justice.

The central government has to make an official and public announcement of the withdrawal of the recognised status by publishing it as a notification in the official gazette of India. The authority to withdraw the status of 'recognised' from any stock exchange is granted to the central government

(1)If the Central Government is of opinion that the recognition granted to a stock exchange under the provisions of this Act should, in the interest of the trade or in the public interest, be withdrawn, the Central Government may serve on the governing body of the stock exchange a written notice that the Central Government is considering the withdrawal of the recognition for the reasons stated in the notice, and after giving an opportunity to the governing body to be heard in the matter, the Central Government may withdraw, by notification in the Official Gazette, the recognition granted to the stock exchange;

Provided that no such withdrawal shall affect the validity of any contract entered into or made before the date of the notification, and the Central Government may, after consultation with the stock exchange, make such provision as it deems fit in the notification of withdrawal or in any subsequent notification similarly published for the due performance of any contracts outstanding on that date.

(2)Where the recognised stock exchange has not been corporatised or demutualised or it fails to submit the scheme referred to in sub-section (1) of section 4B within the specified time therefor or the scheme has been rejected by the Securities and Exchange Board of India under sub-section (5) of section 4B, the recognition granted to such stock exchange under section 4, shall, notwithstanding anything to the contrary contained in this Act, stand withdrawn and the Central Government shall publish, by notification in the Official Gazette, such withdrawal of recognition:

Provided that no such withdrawal shall affect the validity of any contract entered into or made before the date of the notification, and the Securities and Exchange Board of India may, after consultation with the stock exchange, make such provisions as it deems fit in the order rejecting the scheme published in the Official Gazette under sub-section (5) of section 4B.

## QUESTION BANK

UNIT-I

PART-A

1 List the main functions of a financial system.

2 Outline the components of the Indian Financial system.

3 Who are Indigenous bankers?

4 Identify the instrument indicate in the given statement? “It is used for inter-bank transactions. It is short-term finance repayable on demand with a maturity period of one day to fifteen days”.

5 Name the Factors that affects the capital market.

6 Define Stock Exchange.

7 What is meant by Factoring?

8 What is a Commercial Bills Market?

9 Recall the ways in which a company raises funds through a Primary market.

10 Identify the main functions of NBFC.

## PART-B

1 Explain in detail the functions of Stock Exchange.

2 Classify the kinds of financial services.

3 Summarize the components of financial instruments and its types.

4 Explain in detail the functions of Capital Market and its types.

5 Assess in detail the benefits of a Stock Exchange.

6 Discuss the types of Indian Banking institutions in detail.

7 Distinguish between the two segments of financial market on any five bases.

8 Illustrate the components of Indian Financial system and explain in brief about them.

9 Enumerate the objectives of Securities Contract (Regulation) Act (SCR) 1956.

10 Determine the application for recognition of stock exchanges and Grant of a Recognised Stock Exchange under SCR Act 1956.

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# UNIT 2

# SECURITIES MARKET INTERMEDIARIES

Primary Market and Secondary Market Intermediaries - Role, Function - Merchant Bankers - Stock Brokers - Registrars - Underwriters - Bankers to an Issue - Portfolio Managers - Debenture Trustees - Foreign Institutional Investor - Custodians - Credit Rating Agencies - venture capitalists.

## SECURITIES MARKET INTERMEDIARIES

### Introduction

Intermediary by definition, in any field, is an individual who is in the role of a mediator facilitating an agreement or a reconciliation. Accordingly, intermediaries of SEBI too are the bridges or links between the investor and the stock exchange and/or SEBI.

Section 11 and section 12 of SEBI Act, 1992 defines an Intermediary. Stockbrokers, sub-brokers, portfolio managers, depositories, investment advisers, share transfer agents, merchant bankers, underwriters, registrars to an issue, foreign institutional investors, custodians of securities, venture capital funds, mutual funds, asset management companies, credit rating agencies, those in connection and associated with the securities market in any manner, are all broadly categorised as ‘Intermediaries of SEBI’.

Financial intermediaries and financial markets can in many cases act as substitute sources of financial services. Lenders/savers in particular have a choice between the risk, return and liquidity offered by both segments of the financial system. Each segment is able to offer a different range of investments and offers services to firms that are not complete substitutes. Broadly speaking, financial markets provide lower cost arms length debt or equity finance to a smaller group of firms able to obtain such finance, while financial intermediaries offer finance with a higher cost reflecting the expense of uncovering information and ongoing monitoring. Financial intermediaries and markets may also provide complementary financial services to many firms.

**Evolution of how intermediaries came into operation**

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. Interestingly, the SEBI does not offer any conceptual or exhaustive definition of "market intermediaries."

**"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[ii]. According to these provisions, intermediaries comprise the following:

- Stockbrokers
- sub-brokers
- portfolio managers
- depositories
- investment advisers
- share transfer agents
- merchant bankers
- underwriters
- registrars to an issue
- foreign institutional investors

- custodians of securities
- venture capital funds
- mutual funds
- asset management companies
- credit rating agencies

**PRIMARY MARKET INTERMEDIARIES**

- **Merchant bankers**

Merchant bankers play an important role in issue management process. Lead managers (category I merchant bankers) have to ensure correctness of the information furnished in the offer document. They have to ensure compliance with SEBI rules and regulations as also Guidelines for Disclosures and Investor Protection. To this effect, they are required to submit to SEBI a due diligence certificate confirming that the disclosures made in the draft prospectus or letter of offer are true, fair and adequate to enable the prospective investors to make a well informed investment decision. The role of merchant bankers in performing their due diligence functions has become even more important with the strengthening of disclosure requirements and with SEBI giving up the vetting of prospectuses. SEBI's various operational guidelines issued during the year to merchant bankers primarily addressed the need to enhance the standard of disclosures.

It was felt that a further strengthening of the criteria for registration of merchant bankers was necessary, primarily through an increase in the net worth requirements, so that their capital would be commensurate with the level of activities undertaken by them. With this in view, the net worth requirement for category I merchant bankers was raised in 1995-96 to Rs. 5 crore. In 1996-97, the SEBI (Merchant Bankers) Regulations, 1992 were amended to require the payment of fees for each letter of offer or draft prospectus that is filed with SEBI. Part III gives further details of the registration of merchant bankers during 1996-97.

**Underwriters**

Underwriters are required to register with SEBI in terms of the SEBI (Underwriters) Rules and Regulations, 1993. In addition to underwriters registered with SEBI in terms of these regulations, all registered merchant bankers in categories I, II and III and stockbrokers and mutual funds registered with SEBI can function as underwriters. Part III gives further details of registration of underwriters. In 1996-97, the SEBI (Underwriters) Regulations, 1993 were amended mainly pertaining to some procedural matters.

- **Bankers to an Issue**

Scheduled banks acting as bankers to an issue are required to be registered with SEBI in terms of the SEBI (Bankers to the Issue) Rules and Regulations, 1994. These regulations lay down eligibility criteria for bankers to an issue and require registrants to meet periodic reporting requirements. Part III gives further details of registration of bankers to an issue.

- **Portfolio managers**

Portfolio managers are required to register with SEBI in terms of the SEBI (Portfolio Managers) Rules and Regulations, 1993. The registered portfolio managers exclusively carry on portfolio management activities. In addition all merchant bankers in categories I and II can act as portfolio managers with prior permission from SEBI. Part III gives further details of the registration of portfolio managers.

- **Debenture trustees**

Debenture trustees are registered with SEBI in terms of the SEBI (Debenture Trustees) Rules and Regulations, 1993. Since 1995-96, SEBI has been monitoring the working of debenture trustees by calling for details regarding compliance by issuers of the terms of the debenture trust deed, creation of security, payment of interest, redemption of debentures and redressal of complaints of debenture holders regarding non-receipt of interest/redemption proceeds on due dates. Part III gives further details of the registration of debenture trustees.

- **Registrars to an Issue and Share Transfer Agents**

Registrars to an issue (RTI) and share transfer agents (STA) are registered with SEBI in terms of the SEBI (Registrar to the Issue and Share Transfer Agent) Rules and Regulations, 1993. Under these regulations, registration commenced in 1993-94 and is granted under two categories: category I - to act as both registrar to the issue and share transfer agent and category II - to act as either registrar to an issue or share transfer agent. With the setting up of the depository and the expansion of the network of depositories, the traditional work of registrars is likely to undergo a change.

## SECONDARY MARKET INTERMEDIARIES

- **Stock brokers**

All stock brokers dealing in securities are registered with SEBI in terms of SEBI (Stock Brokers and Sub Brokers) Regulation 1992. During 1996-97, 391 additional brokers were registered with SEBI making the total registered membership to 8,867 as on March 31, 1997.

- **Sub brokers**

In many cases, individual investors transact in securities through sub brokers. It is therefore absolutely imperative to regulate this class of intermediary. As on March 31, 1997 only 1,798 sub brokers were registered with SEBI. The main reason for the limited success in registering large number of sub brokers is that brokers are reluctant to take responsibility of the acts of the sub-brokers. Measures initiated by SEBI for bringing sub-brokers more fully under the ambit of regulatory oversight have been described earlier in this Report.

## REGULATION OF FINANCIAL INTERMEDIARIES BY SEBI

Financial market in India is developing with speed and being among the oldest in the world enjoys a good reputation and standing among the developing economies. Procurement and vending of monetary entitlements, possessions, services and securities are central to any financial market. Banking and non-banking financial institutions, merchants, debtors and creditors, depositors and debtors, and negotiators are the contributors on demand and supply side in these markets. Financial markets may be a definite address or locality, e.g., stock exchange, or it may merely be an on-mobile-set market. There are governing institutions outlining rules and regulations in the financial markets for smooth operations and working of monetary markets.

Ministry of Finance, Ministry of Company Affairs (MCA), Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI) are the primary regulators ensuring proficiency and efficacy of the financial market. Besides there are several other regulatory network bodies, i.e., Company Law Board, Registrar of Companies, the Stock Exchanges. Keeping in view the dynamic changes in the economy, the regulatory structure also has been modified to cater to it. Above is a perspective of the regulations in the financial market in general. In the ensuing paras, the regulation of Intermediaries specifically by SEBI has been enunciated.

## PRIMARY MARKET AND SECONDARY MARKET

### Primary Market

The primary market refers to the market where securities are created, while the secondary market is one in which they are traded among investors. Various types of issues made by the corporation are a Public issue, Offer for Sale, Right Issue, Bonus Issue, Issue of IDR, etc. The company that brings the IPO is known as the issuer, and the process is regarded as a public issue. The process includes many investment banks and underwriters through which the shares, debentures, and bonds can directly be sold to the investors.

For example, company XYZ Inc. hires four underwriting firms to determine the financial details of its IPO. The underwriters detail that the issue price of the stock will be $20. Investors can then buy the IPO at this price directly from the issuing company. This is the first opportunity that investors have to contribute capital to a company through the purchase of its stock. A company's equity capital is comprised of the funds generated by the sale of stock on the primary market.

## ROLE AND FUNCTIONS OF PRIMARY MARKET

The functions of such a market are manifold –

### New issue offer

The primary market organises offer of a new issue which had not been traded on any other exchange earlier. Due to this reason, it is also called a New Issue Market. Organising new issue offers involves a detailed assessment of project viability, among other factors. The financial arrangements for the purpose include considerations of promoters' equity, liquidity ratio, debt-equity ratio and requirement of foreign exchange

### Underwriting services

Underwriting is an essential aspect while offering a new issue. An underwriter's role in a primary marketplace includes purchasing unsold shares if it cannot manage to sell the required number of shares to the public. A financial institution may act as an underwriter, earning a commission on underwriting. Investors rely on underwriters for determining whether undertaking the risk would be worth its returns. It may so thus happen that an underwriter ends up buying all the IPO issue, and subsequently selling it to investors.

**Distribution of new issue**

A new issue is also distributed in a primary marketing sphere. Such distribution is initiated with a new prospectus issue. It invites the public at large to buy a new issue and provides detailed information on the company, issue, and involved underwriters.

**Examples of Primary Stock Market Selling**

| **Company** | **Details** |
|---|---|
| Facebook | One of the remarkable IPOs that were undertaken includes the Facebook initial public offering. The offer initiated in 2012 is to date the largest IPO in the technology sector. The company successfully raised $16 billion through its initial public offering. As an effect, its turnover increased by close to 100%.<br>Also, there was a high demand for the stock in the primary market, which led to the pricing of Facebook’s stock to be fixed at $38 for each share as determined by the underwriters. The valuation of the stock eventually |

| | |
|---|---|
| | amounted to $104 billion, highest for a newly formed public company. |
| Coal India | The biggest IPO undertaken in India was by Coal India in 2010, which raised Rs. 15,200 Crore. The shares were listed at Rs. 287.75 and eventually increased to Rs.340. The company offered a 5% discount on the final IPO price to retail investors, along with the subsidiaries and employees of the company. |

**ADVANTAGES OF PRIMARY MARKET**

- Companies can raise capital at relatively low cost, and the securities so issued in the primary market provide high liquidity as the same can be sold in the secondary market almost immediately.
- The primary market is an important source for mobilisation of savings in an economy. Funds are mobilised from commoners for investing in other channels. It leads to monetary resources being put into investment options.

**DISADVANTAGES OF PRIMARY MARKET**

- There may be limited information for an investor to access before investment in an IPO since unlisted companies do not fall under the purview of regulatory and disclosure requirements of the Securities and Exchange Board of India.

- Each stock is exposed to varying degrees of risk, but there is no historical trading data in a primary market for analysing IPO shares because the company is offering its shares to the public for the first time through an initial public offering.

**SECONDARY MARKET**

This includes the New York Stock Exchange (NYSE), NASDAQ, and all major exchanges around the world. The defining characteristic of the secondary market is that investors trade among themselves. In this market existing shares, debentures, bonds, options, commercial papers, treasury bills, etc. of the corporates are traded amongst investors. The secondary market can either be an auction market where trading of securities is done through the stock exchange or a dealer market, popularly known as Over The Counter where trading is done without using the platform of the stock exchange.

For example, if you go to buy Amazon (AMZN) stock, you are dealing only with another investor who owns shares in Amazon. Amazon is not directly involved with the transaction.

**Role and Functions of Secondary Market:**A stock exchange provides a platform to investors to enter into a trading transaction of bonds, shares, debentures and such other financial instruments.

- Transactions can be entered into at any time, and the market allows for active trading so that there can be immediate purchase or selling with little variation in price among different transactions. Also, there is continuity in trading, which increases the liquidity of assets that are traded in this market.

- Investors find a proper platform, such as an organised exchange to liquidate the holdings. The securities that they hold can be sold in various stock exchanges.
- A secondary market acts as a medium of determining the pricing of assets in a transaction consistent with the demand and supply. The information about transactions price is within the public domain that enables investors to decide accordingly.
- It is indicative of a nation's economy as well, and also serves as a link between savings and investment. As in, savings are mobilised via investments by way of securities.

**Examples Of Secondary Market Transactions**

Secondary market transactions provide liquidity to all kinds of investors. Due to high volume transactions, their costs are substantially reduced. Few secondary market examples related to transactions of securities are as follows.

In a secondary market, investors enter into a transaction of securities with other investors, and not the issuer. If an investor wants to buy Larsen & Toubro stocks, it will have to be purchased from another investor who owns such shares and not from L&T directly. The company will thus not be involved in the transaction.Individual and corporate investors, along with investment banks, engage in the buying and selling of bonds and mutual funds in a secondary market.

## ADVANTAGES OF SECONDARY MARKET

- Investors can ease their liquidity problems in a secondary market conveniently. Like, an investor in need of liquid cash can sell the shares held quite easily as a large number of buyers are present in the secondary market.
- The secondary market indicates a benchmark for fair valuation of a particular company.
- Mobilisation of savings becomes easier as investors' money is held in the form of securities.

## DISADVANTAGES OF SECONDARY MAR KET

- Prices of securities in a secondary market are subject to high volatility, and such price fluctuation may lead to sudden and unpredictable loss to investors.
- Before buying or selling in a secondary market, investors have to duly complete the procedures involved, which are usually a time-consuming process.

## DIFFERENCE BETWEEN PRIMARY AND SECONDARY MARKET

| Basis of Comparison | Primary Market | Secondary Market |
|---|---|---|
| Meaning | A marketplace for new shares is Primary Market | The place where formerly issued securities are traded is Secondary Market |
| Another name | New Issue Market (NIM) | After Market |

| Type of Purchasing | Direct | Indirect |
|---|---|---|
| Financing | It helps to supply funds to budding enterprises and also to existing companies for expansion and diversification | It does not provide funding to enterprises |
| How many times security can be sold? | Only once | Multiple times |
| Buying and Selling | Buying & selling is between Company and Investors | Buying & selling is only between Investors |
| Who will gain the amount on the sale of shares? | Company | Investors |
| Intermediary | Underwriters | Brokers |
| Price | Fixed-price | Fluctuates depends on the demand and supply forces |
| Organizational difference | Not rooted in any specific spot or geographical location | It has a physical existence |

**Intermediaries in a stock market**

An intermediary in a stock market is a person or an organisation which helps people to invest their money in various company stocks. A person involved in such intermediary activities is usually called a fund manager.

**Kinds of intermediaries**

Further, these intermediaries are again classified into two broad categories. The primary and secondary Intermediaries. The major role holders of Primary market intermediaries are briefly defined below:

**Merchant bankers**

Merchant bankers have a central role in the procedure of issue management. Lead managers have to confirm perfection of the material supplied in the offer document. They have to guarantee amenableness and adherence with SEBI rules, principles and Guidelines for Disclosures and Investor Safeguard. A due diligence credential is submitted to SEBI confirming that the disclosures are reliable, unbiased and acceptable to enable the potential stakeholders to make a well informed investment. SEBI progressively propagates and doctrines the need to enhance the standard of disclosures. One such requirement is evaluating the net worth of the intermediary and judging if it is in consonance with the level of transactions being indulged by it. These are institutions that extend funds to a company in place of loans and share the ownership of that particular company. So, they gain a right to have a say in the corporate affairs of that organisation where they have invested.

Hence, merchant bankers become a link between large organisations and external markets. For instance, in India, State Bank of India, ICICI Bank, Punjab National Bank are some of the merchant bankers.

**REGULATION :SEBI (Merchant Bankers) Regulation), 1992**

## FUNCTIONS OF MERCHANT BANKERS

### Raising Finance for Clients

Merchant Banking helps its clients to raise finance through issue of shares, debentures, bank loans, etc. It helps its clients to raise finance from the domestic and international market. This finance is used for starting a new business or project or for modernization or expansion of the business.

### Brokers in stock exchanges

Merchant bankers act as brokers in the stock exchange. They buy and sell shares on behalf of their clients. They conduct research on equity shares. They also advise their clients about which shares to buy, when to buy, how much to buy and when to sell.

### 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.

### Corporate counselling

Merchant bankers render advise to corporate enterprises from time to time in order to improve performance and build better image/reputation among investors and to increase the market value of its equity shares. Counselling laws as applicable to the business unit.

**Project management or Project Advisor**

Merchant bankers help their clients in the many ways. For e.g. Advising about location of a project, preparing a project report, conducting feasibility studies, making a plan for financing the project, finding out sources of finance, estimation of the cost of the project, advising about concessions and incentives from the government.

**Advice on modernization and expansion**

Merchant bankers give advice for expansion and modernization of the business units. They give expert advice on mergers and amalgamations, acquisition and takeovers, diversification of business, foreign collaborations and joint-ventures, technology up-gradation, etc.

**Managing Public Issue of Companies**

Merchant bank advice and manage the public issue of companies. They provide following services:

- Advise on the timing of the public issue.
- Advise on the size and price of the issue.
- Acting as manager to the issue, and helping in accepting applications and allotment of securities.
- Help in appointing underwriters and brokers to the issue.
- Listing of shares on the stock exchange, etc.

**Loan /Credit syndication**

Merchant bankers provide specialised services in preparation of project, loan applications for raising short-term as well as long-term credit from various banks and financial institutions for financing the project or meeting the working capital requirements. They also manage Euro-Issues and help in raising funds abroad.

**Portfolio Management**

A merchant bank manages the portfolios (investments) of its clients. This makes investments safe, liquid and profitable for the client. It offers expert guidance to its clients for taking investment decisions.

**Bill Discounting and Acceptance Credit**

In foreign countries, acceptance credit and bill discounting function is another important area which is recognised as a merchant banking activity. But in India this facility is not provided to the corporate units by the merchant bankers.

The need for such services was recognised when Banking Commission 1972, in its report had recommended the establishment of acceptance and discount house in India following the development of bill market.

**Leasing Service**

Merchant bankers also help in leasing services. Lease is a contract between the lessor and lessee, whereby the lessor allows the use of his specific asset such as equipment by the lessee for a certain period. The lessor charges a fee called rentals.

**Revival of Sick Industrial Units**

Merchant banks help to revive (cure) sick industrial units. It negotiates with different agencies like banks, term lending institutions, and BIFR (Board for Industrial and Financial Reconstruction). It also plans and executes the full revival package

**Corporate Restructuring**

It includes mergers or acquisitions of existing business units, sale of existing unit or disinvestment. This requires proper negotiations, preparation of documents and completion of legal formalities. Merchant bankers offer all these services to their clients.

**Services to Public Sector Units**

Merchant banks offer many services to public sector units and public utilities. They help in raising long-term capital, marketing of securities, foreign collaborations and arranging long-term finance from term lending institutions.Merchant bankers also help companies in raising finance by way of public deposits.

**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 joint ventures.

**Stockbroker**

It applies to all stock brokers trading in stocks/securities. Such brokers are part of the stock market as they assist in trading of securities. Although they charge a specific fee for facilitating such trading, their work is more effective than others. One of the most viable reasons behind such efficiency is their knowledge of the stock market.

A trader lacks such knowledge and is likely to end up buying or selling securities at a higher price than it should be. In such conditions, an intermediator can help in linking the stock exchanges and traders rightfully.

**REGULATION :SEBI (Stock Brokers and Sub Brokers) Regulation 1992**

**FUNCTION OF STOCKBROKER**

**Advisory Services**

Stock Market brokers possess expertise related to the working of stock market, performance of stocks, market trends, and so on. Besides, they have access to the data base and research findings of brokerage firms that they are associated with. Hence, they can provide excellent investment advice to their clients.

**Limited banking services**

Stock market brokers are authorized to provide limited banking services such as interest-bearing accounts, electronic deposits, and withdrawals. The clients can avail such banking-related services from the stock brokers by paying them a nominal brokerage charge.

**Other Investments**

Apart from stocks, many stock brokers also deal in other securities such as mutual funds, bonds, exchange traded funds, futures, options and commodity trading. They also provide investment advice related to all these products, to their clients.

**Understanding the Role of a Stockbroker**

Buying or selling stocks requires access to one of the major exchanges such as the New York Stock Exchange (NYSE) or the NASDAQ. To trade on these exchanges you must be a member of the exchange or belong to a member firm. Member firms and many of the individuals who work for them are licensed as brokers or broker-dealers by the Financial Industry Regulatory Authority (FINRA).

**Sub Broker**

Sub-brokers play a major role in transactions of securities by singular stockholders/depositors. This also falls under the category of secondary markets and the need to regulate this market is also unquestionably domineering. Brokers are hesitant to take accountability of the deeds of the sub-brokers resulting in major challenges faced in registering them with SEBI.

A sub-broker is not directly linked to the stock exchanges but is a proxy member who has the necessary knowledge to act on behalf of the trading member. He can assist trading members and also investors in matters of securities dealing.

**REGULATION : SEBI (Stock Brokers and Sub Brokers) Regulation 1992**

**Registrars to An Issue and Share Transfer Agent**

It applies to the Registrars to an issue (RTI) and are share transfer agents (STA). Registration is approved in two categories: category I – as registrar to the issue plus share transfer agent; category II – as either registrar to an issue or share transfer agent. Secondary Market Intermediaries.

**REGULATION :SEBI (Registrar to the Issue and Share Transfer Agent) Rules and Regulations, 1993**

**The role of a 'Registrar to an issue'**

- Collecting applications from investors with respect of an issue.
- Proper maintenance of applications, and any monies received from investors or paid to the seller of securities, and
- Assisting the body corporate in terms of; determining the basis of allotment of securities in consultation with the stock exchange, finalizing the list of persons entitled to allotment of securities and; processing and dispatching allotment letters, refund orders or certificates and other related documents in respect of the issue.
- The merchant banker co-ordinates with the Registrar to ensure the proper execution of the process.

## The role of Share Transfer Agent

'Share transfer agent' is an agent who, on behalf of the body corporate, maintains recorders of holders of securities issued by such body corporate and deals with the processes of transfer and redemption of securities.

Certain roles, as per SEBI guidelines, must only be performed by a 'Share transfer agent'. These activities are:

- Endorsement of certificates/for allotment/call monies.
- Transmission, consolidation, sub-division of securities.
- Dispatch of transferred securities and securities received for transmission/consolidation/sub-division etc, directly to the investors.
- Cancel the name and certificate of the shareholder who had sold the shares of securities, and replace it with the new shareholder.

## Underwriter

As the name implies, underwriters are entities directly associated with a company or an organisation. Their primary function is to manage people and talk to them regarding investment in multiple schemes or so.

Additionally, all SEBI registered merchant bankers of defined categories, stockbrokers and mutual funds can also play the role as underwriters.

In India, for instance, an insurance company can be an underwriter. It charges a certain fee for providing you with insurance services under certain terms and conditions.

**REGULATION : SEBI (Underwriters) Rules and Regulations, 1993**

**FUNCTIONS OF UNDERWRITERS**

- The investment banker purchase the entire issue from the issuer and resells the security to the investing public.
- The firm charges a commission for providing this service
- For municipal bonds, the underwriting function is performed by both investment banking firms and commercial banks.

**TYPES OF UNDERWRITER**

**Insurance Underwriter**

Insurance underwriters asses the risk of insuring a home, car or driver. They also assess individuals who are applying for life insurance policies. Insurance underwriters determine if the contract is profitable for the insurer. They consider if the applicant meets certain criteria to qualify for an insurance policy. From there, they establish the type of policy for which an applicant is eligible. Finally, they provide an outline of what the policy covers for the applicant's unique circumstance.

Insurance underwriters are insurance professionals. They understand insurance risks and how to avoid them. They use their risk assessment to decide if they will insure someone and under what terms they'll provide a policy.In cases without special circumstances, underwriting is done through an automated system. Underwriting programming is similar to a quoting system. It's able to determine if an applicant meets the insurer's specific requirements for coverage.

## Mortgage Underwriter

Mortgage underwriters are some of the most commonly used underwriters among the loan industry. Even if a new homeowner has a good income and great credit score, buying a home is still a risky endeavor. A mortgage underwriter must do a thorough risk assessment. Once an assessment is done, the underwriter can confirm if the loan is a manageable undertaking for the applicant.

At any rate, underwriters may review internal information such as the number of mortgages the company has given out. They also review an applicant's credit score and history, proof of steady income, debt-to-income ratio, overall savings and other important factors that determine their risk. Additionally, the underwriter will assess features in and outside of the mortgage applicant's control, such as the value and type of property. This helps determine if the mortgage terms are fair for all parties.If an underwriter denies the mortgage, the applicant can appeal the decision. However, the process can be lengthy and often requires a large amount of evidence to be overturned.

## Loan Underwriter

Similar to mortgage underwriters, loan underwriters asses the risk involved in lending an applicant a loan such as an auto loan. The objective is to determine if the loan is safe for all parties. Large banks often use a combination of underwriters and underwriting software to determine the risk of lending funds to an applicant. Using the combination of software and an underwriter is a common practice among big and small banks. In some cases, underwriters may need to assist financial institutions with underwriting for business loans. Depending on the size of the business, an underwriter may need to work with multiple banks.

**Securities Underwriter**

A securities underwriter is a different type of underwriter. Securities underwriters often work with initial public offerings (IPOs). They asses the investment's risk to determine an appropriate price for an IPO. Typically, a securities underwriter is an employee of the investment bank or another specialist.

One of the biggest risks involved with securities underwriting is the sales period. For instance, if a security doesn't sell for the suggested price, the investment bank is liable for the difference.

**Bankers to an Issue**

It applies to the scheduled banks standing-in as bankers to an issue. The eligibility criteria and reporting periodicity for bankers to an issue is documented in these regulations.

**REGULATION :SEBI (Bankers to the Issue) Rules and Regulations, 1994**

**ROLE OF BANKER TO AN ISSUE**

"Banker to an issue" means a scheduled bank carrying on all or any of the following issue related activities namely:-

- Acceptance of application and application monies
- Acceptance of allotment or call monies;
- Refund of application monies;
- Payment of dividend or interest warrants.

## PORTFOLIO MANAGERS

It applies to registration of portfolio managers with SEBI. The portfolio management activities are the sole and core responsibility of the registered portfolio managers. All merchant bankers of categories I and II can act as portfolio managers with previous authorization from SEBI.

It can be a person or a group of person or even an institution that manages money to be traded in the stock market. These intermediaries discuss the entire plan of investment with their team or with the organisation and then they trade in stocks or securities in the market.

Also, these types of Intermediaries invest in bonds, derivatives, mutual funds, etc to make more money out of their investments.

**REGULATION :SEBI (Portfolio Managers) Rules and Regulations, 1993**

### Role and Responsibilities of Portfolio Manager

- A portfolio manager plays a pivotal role in deciding the best investment plan for an individual as per his income,age as well as ability to undertake risks.
- A portfolio manager is responsible for making an individual aware of the various investment tools.
- portfolio manager is responsible for designing customised investment solutions for the clients.
- A portfolio manager should keep himself updated with the latest changes in the financial market.

## Functions

- To frame investment strategies and select investment mix.
- Hedge against inflation and also optimize returns
- To make timely decision about sell and purchase of securities.
- To maximize after tax return by investing part of the portfolio in tax saving investments.

## Factors that influence portfolio decisions

- Investors characteristics
- Liquidity needs
- Tax consideration
- Safety of principal
- Assurance of income
- Investment risk
- Interest rate risk

## Debenture Trustees

It shall apply to debenture trustees to be registered with SEBI. Their active role is in ensuring the amenability by the issuers with the norms of the deed pertaining to the debenture trust, creation of the security, imbursement of interest, debenture redemption, handling of grievances of debenture holders w.r.t interest/redemption proceeds not received on payable dates.

These personnel are registered with the Securities and Exchange Board of India (or SEBI) and function based on the rules cited in SEBI Guidelines, 1993. These personnel are monitored by SEBI on their functions of creating security, complaints redressal, interest payments and debenture redemption.

They act as the connecting links between debenture holders and the organisation or company whose debentures have been purchased by those holders.

**REGULATION :SEBI (Debenture Trustees) Rules and Regulations, 1993.**

**Functions of Debenture Trustees**

The function of Debenture Trustees shall generally be to protect the interests of holders of the Debenture( including the creation of securities within the stipulated time) and to redress the grievances of holders of Debenture effectively.

- To redress the grievances of holders of Debenture effectively.
- To protect the interests of Debenture holders
- Ensuring that the securities have been created within a stipulated time.
- Inform the Debenture holders immediately if there is breach of terms of issue of Debenture
- Call upon the meeting of a Debenture holders wherever required
- Call for the report on the utilisation of funds raised by issue of Debentures.\

**Foreign Institutional Investors**

A foreign institutional investor (FII) is an investor or investment fund investing in a country outside of the one in which it is registered or headquartered. The term foreign institutional investor is probably most commonly used in India, where it refers to outside entities investing in the nation's financial markets. The term is also used officially in China.

Foreign Institutional Investors is an institutional, individual or group entity seeking to invest in the economy of a country other than where the entity is headquartered. FIIs are important to emerging economies because they bring funds and capital to businesses in developing countries.

FIIs can include hedge funds, insurance companies, pension funds, investment banks, and mutual funds. FIIs can be important sources of capital in developing economies, yet many developing nations, such as India, have placed limits on the total value of assets an FII can purchase and the number of equity shares it can buy, particularly in a single company. This helps limit the influence of FIIs on individual companies and the nation's financial markets, and the potential damage that might occur if FIIs fled en masse during a crisis.

**Foreign Institutional Investors (FIIs) in India**

Some of the countries with the highest volume of foreign institutional investments are those with developing economies, which generally provide investors with higher growth potential than mature economies. This is one reason FIIs are commonly found in India, which has a high-growth economy and attractive individual corporations to invest in. All FIIs in India must register with the Securities and Exchange Board of India (SEBI) to participate in the market.

- A foreign institutional investor is an investor in a financial market outside its official home country.
- Foreign institutional investors can include pension funds, investment banks, hedge funds, and mutual funds.
- Some countries place restrictions on the size of investments by foreign investors.

## ADVANTAGES OF FII'S

- FII's will enhance the flow of capital into the country
- These investors generally prefer equity over debt. So this will also help maintain and even improve the capital structures of the companies they are investing in.
- They have a positive effect on the competition in the financial markets
- FII help with the financial innovation of capital markets
- These institutions are professionally managed by asset managers and analysts. They generally improve the capital markets of the country.

## DISADVANTAGES OF FII'S

- The demand for the local currency (rupee) increases. This can cause severe inflation in the economy.

- These FII’s drive the fortune of big companies in which they invest. But their buying and selling of securities have a huge impact on the stock market. The smaller companies are taken along for the ride.
- Sometimes these FII’s seek only short-term returns. When they pull their investments banks can face a shortage of funds.

**ROLE OF FII’S**

- FII work on strengths of developing countries and then they invest in respective countries.
- This also helps developing countries to know about their strengths and opportunities available. FII investment in India helped in achieving a higher degree of liquidity at domestic stock market.
- It had increased price earnings ratios .
- Reduced the cost of capital for investment.
- Along with this they also help in improving the functioning of the domestic stock market.
- Foreign institutional Investors (FIIs) only aid the domestic investment by increasing capital inflows through the secondary markets and are very volatile
- FDI provides not only inflow of foreign funds and investments but also transfer of advanced technology and skills, thus creating job opportunities

## Custodians

Custodians are SEBI-registered market intermediaries, primarily responsible for safe-keeping of securities (such as shares) of their clients. They offer a variety of services to clients, such as corporate action reconciliation, post-trading services of clearing and settlement.

Custodians, as an important market intermediary, help in reducing systemic risk in the capital market. They also facilitate issuance of cross-border securities, such as American Depository Receipts and Global Depository Receipts.

Custodians are appointed mostly by institutional clients to avail the above-mentioned services. They charge fees from their clients for providing these services, which are mostly based on value of assets held by them on behalf of their clients.

Some of the leading custodians globally are Bank of New York Mellon Corp., State Street Corp., etc. In India, the leading custodians are Stock Holding Corp. of India, HDFC Bank Ltd., ICICI Bank Ltd., et

## Role of Custodians

- Custodians are clearing members but not trading members.
- They settle trades on behalf of their clients that are executed through other trading members.
- A trading member may assign a particular trade to a custodian for settlement.

- If the custodian rejects the trade, the obligation is assigned back to the trading member.

**Examples of Custodian responsibilities**

- Use cleaning supplies and equipment to keep the interior of the office building looking clean and professional
- Respond to repair requests quickly and with a professional manner
- Maintain a library of user manuals for office furniture and fixtures that can be referred to when needed
- Adhere to the company's safety policies to create a safe work environment for everyone
- Perform routing cleaning tasks based on a schedule created by the facility management team.

**Credit Rating Agencies**

Credit rating agencies (CRAs) play a key role in financial markets by helping to reduce the informative asymmetry between lenders and investors, on one side, and issuers on the other side, about the creditworthiness of companies or countries. A credit rating agency (CRA) evaluates and assesses an individual's or a company's creditworthiness. That is, these agencies consider a debtor's income and credit lines to analyse the debtor's ability to repay the debt or if there is any credit risk associated. Securities and Exchange Board of India (SEBI) reserves the right to authorise and regulate credit rating agencies according to SEBI Regulations, 1999 of the SEBI Act, 1992

**credit rating:**

A credit score is a 3-digit number that represents the creditworthiness of the borrower. Credit rating is the analysis of the possible credit risks associated with granting a financial instrument to an individual or a company. Based on the credit score, a lender determines whether the borrower can repay the loan amount or not.

The credit score is determined based on the following factors.

- Payment History: 35%
- Credit Utilisation: 30%
- Credit History Duration: 15%
- Credit Mix: 10%
- New Credit: 10%

**List of registered credit rating agencies**

- CRISIL Limited
- India Ratings and Research Pvt Ltd
- ICRA Limited
- CARE
- Brickwork Ratings India Pvt Ltd
- SMERA Ratings Limited
- Infometrics Valuation and Rating Pvt Ltd

**Functions of Credit rating agencies**

**Business Analysis**

A credit rating company will analyze the business condition of the borrowing company not merely by the profits the borrowing concern has made, but by the use of capital in a more productive purpose. The return on capital and the cost of capital will be analyzed.

**Evaluation of industrial risks**

Every industry will have its risks which are due to natural or market conditions such as competition or due to the substitutes that have arrived in the market. The extent of risks and measures to overcome them will be taken into account while judging the credit rating of the company.

**Market position of the company within the industry**

What is the share of the market of the company seeking credit rating? A higher percentage of market share will involve more risks as the company has to be vigilant to maintain its share. So, a credit rating agency will give due weightage for the market share of the borrowing concern.

**Operating efficiency**

This is judged from the point of view of utilization of the capacity. When full capacity is utilized, the company has an advantage over others. This may be possible due to location advantage or better labor relations. These will be looked into by the credit rating agency.

**Legal position in terms of prospectus**

The statements made in the prospectus, should be true and factual. If tall claims are made, they will hamper the growth of the company and the credit rating agency will not rely on the prospectus of the company. It may also be construed as a willful fraud for attracting more funds. So, the contents of prospectus will also be a factor for credit rating considerations.

**Financial analysis based on accounting quality**

If accrued incomes are taken for making a window-dressing of balance sheet, it will not reflect well on the quality of accounting of the borrowing concern. Companies relying on realized income, will be in a better position to provide a realistic balance sheet.

**Statement of profits**

There may be over statement or under statement of profits depending upon the purpose for which the statement is prepared. Here, again the credit rating agency has to scrutinize the realistic position of the company.

**Adequacy of cash flow**

Is the cash flow sufficient to meet its current commitments as well as any other contingencies? This factor is taken into consideration by the rating agencies.

**Capacity to overcome adverse situations (catastrophe management**)

Agency studies the available mechanism for recovery with the company for meeting any sudden unforeseen calamities.

## Asset quality

Here, the value of assets and the price of the assets according to the market conditions and the provisions made for these assets will be taken into account credit rating authorities. Performance of assets will also be taken. The extent of standard, sub standard, doubtful and bad assets will also be taken into account while granting credit rating

## VENTURE CAPITALIST

### Meaning

A venture capitalist (VC) is a private equity investor that provides capital to companies exhibiting high growth potential in exchange for an equity stake. This could be funding startup ventures or supporting small companies that wish to expand but do not have access to equities markets.

- A venture capitalist (VC) is an investor who provides capital to firms that exhibit high growth potential in exchange for an equity stake.
- VCs target firms that are at the stage where they are looking to commercialize their idea.
- Well-known venture capitalists include Jim Breyer, an early Facebook (FB) investor, and Peter Fenton, an investor in Twitter (TWTR).
- VCs experience high rates of failure due to the uncertainty that is involved with new and unproven companies.

## Venture capital firms in India

- Blume Ventures
- Accel Partners
- Helion Venture Partners
- Sequoia Capital India Advisors Private Limited
- Sequoia Capital
- Matrix Partners
- Matrix Partners India

## ROLE AND FUNCTIONS OF VENTURE CAPITALISTS

- Finance new and rapidly growing company for longer time horizon.
- Purchase equity or securities.
- Assist in the development of  new products or services.
- Deplay professional for giving proper input to venture.
- Add value to the company through active participation.
- Obtain finance capital for starts- ups.
- Evaluate projects for other participation in venture.
- Provide expertise for the development of the firm.
- Central coordinator for the participation involved in firms.

## ADVANTAGES OF VENTURE CAPITALIST

### Raising Huge Capital

Venture capital is beneficial for those companies which are need of enormous funds for growing their business. Expert Advice and Guidance: A venture capitalist not only finances an organization but also provides the necessary support and guidance.No Monthly Installments: Unlike loans, the owner does not need to pay any monthly or fixed instalments (which is charged right from the borrowing date), in venture capital.

### Additional Funding

In case, the business requires more capital; venture capitalists can either invest themselves or recommend other such firms.

No Collateral Required: Unlike other debt instruments, a venture capitalist does not ask for mortgaging any personal asset or valuables.

### Building Strong Business Network

It also helps the startups to develop a robust network, since venture capital firms have connections with the top entrepreneurs whom they have previously funded.

**Better Exposure and Publicity:** A startup business backed by venture capitalists receives attention and recognition from the potential investors, partners, associates, customers and employees.

**Risk Management and Decision Making**

The expert assistance and support to handle various situations in the initial stage of business reduces the risk level and provides for effective decision making.

Operational Assistance and Superior Leadership: The chances of growth and success increase with an experienced team leading the operational and managerial activities of the organization.

## IMPORTANCE OF VENTURE CAPITAL FINANCING

1. **Promotes Entrepreneurs:** Just as a scientist brings out his laboratory findings to reality and makes it commercially successful, similarly, an entrepreneur converts his technical know-how to a commercially viable project with the assistance of venture capital institutions.
2. **Promotes products:** New products with modern technology become commercially feasible mainly due to the financial assistance of venture capital institutions.
3. **Encourages customers**: The financial institutions provide venture capital to their customers not as a mere financial assistance but more as a package deal which includes assistance in management, marketing, technical and others.
4. **Promotes exports**: The Venture capital institution encourages export oriented units because of which there is more foreign exchange earnings of the country.
5. **As Catalyst**: A venture capital institution acts as more as a catalyst in improving the financial and managerial talents of the borrowing concern.The borrowing concerns will be more keen to become self dependent and will take necessary measures to repay the loan.

6. **Creates more employment opportunities:** By promoting entrepreneurship, venture capital institutions are encouraging self employment and this will motivate more educated unemployed to take up new ventures which have not been attempted so far.
7. **Brings financial viability:** Through their assistance, the venture capital institutions not only improve the borrowing concern but create a situation whereby they can raise their own capital through the capital market. In the process they strengthen the capital market also.
8. **Helps technological growth:** Modern technology will be put to use in the country when financial institutions encourage business ventures with new technology.
9. **Helps sick companies**: Many sick companies are able to turn around after getting proper nursing from the venture capital institutions.
10. **Helps development** of Backward areas: By promoting industries in backward areas, venture capital institutions are responsible for the development of the backward regions and human resources.
11. **Helps growth of economy:** By promoting new entrepreneurs and by reviving sick units, a fillip is given to the economic growth. There will be increase in the production of consumer goods which improves the standard of living of the people.

# QUESTION BANK

## UNIT-II

## PART-A

1.What are the challenges faced by merchant bankers?

2.State the advantages and disadvantages of a Primary market.

3.Who regulates rating agencies?

4.Who can be appointed a Debenture Trustee?

5.What services are offered by a Custodian?

6.List any 5 Credit rating Agencies.

7."Venture Capitalists are Angel Investors"- Justify

8.What are the common factors that are taken into account while awarding the credit rating?

9.Write short note on bankers to an issue

10.Why are intermediary in stock exchange also called as Fund managers?

## PART-B

1.Differentiate Primary market from Secondary Market

2.Explain in detail the meaning and Functions of Credit rating Agencies.

3.Determine Venture capital guidelines of SEBI

4. Explain the roles and responsibilities of a Custodian.

5.Analyse the functions of an underwriter.

6.Classify the types of Primary Market Intermediaries.

7.Summarize the role of Debenture Trustee in detail.

8.Criticize the role and functions of a Primary Market.

9.Summarize the role and functions of a Secondary Market.

10.Explain about the SEBI Regulations on Merchant Banking

## REFERENCE


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## UNIT 3 LISTING OF SECURITIES

**Rules relating to Public Issue and Listing of Securities; Issue of Capital and Disclosure Requirements (ICDR) Procedure for Issue of Various Types of Shares and Debentures -Employee Stock Option Scheme and Employee Stock Purchase Scheme.**

### What is a Security?

A security is a financial instrument, typically any financial asset that can be traded. The nature of what can and can't be called a security generally depends on the jurisdiction in which the assets are being traded.

In the United States, the term broadly covers all traded financial assets and breaks such assets down into three primary categories:

1) Equity securities – which includes stocks
2) Debt securities – which includes bonds and banknotes
3) Derivatives – which includes options and futures

### Types of Securities

### 1. Equity securities

Equity almost always refers to stocks and a share of ownership in a company (which is possessed by the shareholder). Equity securities usually generate regular earnings for shareholders in the form of dividends. An equity security does, however, rise and fall in value in accord with the financial markets and the company's fortunes.

**2. Debt securities**

Debt securities differ from equity securities in an important way; they involve borrowed money and the selling of a security. They are issued by an individual, company, or government and sold to another party for a certain amount, with a promise of repayment plus interest. They include a fixed amount (that must be repaid), a specified rate of interest, and a maturity date (the date when the total amount of the security must be paid by).

Bonds, bank notes (or promissory notes), and Treasury notes are all examples of debt securities. They all are agreements made between two parties for an amount to be borrowed and paid back – with interest – at a previously-established time.

**3. Derivatives**

Derivatives are a slightly different type of security because their value is based on an underlying asset that is then purchased and repaid, with the price, interest, and maturity date all specified at the time of the initial transaction.

The individual selling the derivative doesn't need to own the underlying asset outright. The seller can simply pay the buyer back with enough cash to purchase the underlying asset or by offering another derivative that satisfies the debt owed on the first.

A derivative often derives its value from commodities such as gas or precious metals such as gold and silver. Currencies are another underlying asset a derivative can be structured on, as well as interest rates, Treasury notes, bonds, and stocks.

Derivatives are most often traded by hedge funds to offset risk from other investments. As mentioned above, they don't require the seller to own the underlying asset and may only require a relatively small down payment, which makes them favorable because they are easier to trade.

## Listing of Securities

Listing means the admission of securities of a company to trading on a stock exchange. Listing is not compulsory under the Companies Act. It becomes necessary when a public limited company desires to issue shares or debentures to the public. When securities are listed in a stock exchange, the company has to comply with the requirements of the exchange.

## Objectives of Listing

The major objectives of listing are

1. To provide ready marketability and liquidity of a company's securities.

2. To provide free negotiability to stocks.

3. To protect shareholders and investors interests.

4. To provide a mechanism for effective control and supervision of trading.

**Listing requirements**

A company which desires to list its shares in a stock exchange has to comply with the following requirements:

1. Permission for listing should have been provided for in the Memorandum of Association and Articles of Association.
2. The company should have issued for public subscription at least the minimum prescribed percentage of its share capital (49 percent).

3. The prospectus should contain necessary information with regard to the opening of subscription list, receipt of share application etc.

4. Allotment of shares should be done in a fair and reasonable manner. In case of over subscription, the basis of allotment should be decided by the company in consultation with the recognized stock exchange where the shares are proposed to be listed.
5. The company must enter into a listing agreement with the stock exchange. The listing agreement contains the terms and conditions of listing. It also contains the disclosures that have to be made by the company on a continuous basis.

**Minimum Public Offer**

A company which desires to list its securities in a stock exchange, should offer at least sixty percent of its issued capital for public subscription. Out of this sixty percent, a maximum of eleven percent in the aggregate may be reserved for the Central government, State government, their investment agencies and public financial institutions.

The public offer should be made through a prospectus and through newspaper advertisements. The promoters might choose to take up the remaining forty percent for themselves, or allot a part of it to their associates.

**Fair allotment**

Allotment of shares should be made in a fair and transparent manner. In case of over subscription, allotment should be made in an equitable manner in consultation with the stock exchange where the shares are proposed to be listed.

In case, the company proposes to list its shares in more than one exchange, the basis of allotment should be decided in consultation with the stock exchange which is located in the place in which the company's registered office is located.

**Listing Procedure**

The following are the steps to be followed in listing of a company's securities in a stock exchange:

1. The promoters should first decide on the stock exchange or exchanges where they want the shares to be listed.

2.They should contact the authorities to the respective stock exchange/ exchanges where they propose to list.

3. They should discuss with the stock exchange authorities the requirements and eligibility for listing.

4. The proposed Memorandum of Association, Articles of Association and Prospectus should be submitted for necessary examination to the stock exchange authorities

5. The company then finalizes the Memorandum, Articles and Prospectus

6. Securities are issued and allotted.

7. The company enters into a listing agreement by paying the prescribed fees and submitting the necessary documents and particulars.

8. Shares are then and are available for trading.

**Benefits of Listing / Going Public**

Listing means the formal admission of securities of a company to the trading platform of the Exchange. It is a significant occasion for a company in the journey of its growth and development. It enables a company to raise capital while strengthening its structure and reputation. It provides liquidity to investors and ensures effective monitoring of compliance of the issuer and trading of the securities in the interest of investors.

**A LISTING STATUS COULD OFFER A COMPANY THE FOLLOWING BENEFITS:**

**Access to Capital for Growth**

Most companies reach a level wherein additional capital is required to be infused to fund the company's growth / expansion plans. Going public is thereby a method of overcoming these constraints. By listing on a Stock Exchange, the company increases shareholder base and enhances credibility.

**Enhanced Visibility**

Going public improves company’s visibility and credibility among institutions and the investing public due to complying with various regulatory norms and ensuring transparency while conducting operations.

**Liquidity**

Listing stimulates liquidity, giving shareholders the opportunity to realize the value of their investments. It allows shareholders to transact in the shares of the company, sharing risks as well as benefitting from any increase in the organizational value.

**Increase in employee morale**

Going public increases visibility and improves public perception of the organization, thereby increasing employee value and morale. It may also lead to hiring of new staff and may facilitate stock-based payments such as ESOPs etc.

**Transparency and efficiency**

Listing brings transparency and efficiency in the overall operations of the company. The board and management team of a listed company has accountability towards it shareholders. Further, listed companies also need to ensure timely compliance by providing information / disclosure to the Exchange / shareholders as laid down in the Listing Agreement or applicable guidelines.

**Conditions for Listing**

Before listing securities, a company has to fulfill the following conditions:

1. Shares of the company must be offered to the public through a prospectus and 25% of each class of securities must be offered.

2. The prospectus should clearly mention opening of subscription, receipt of application, etc.

3. The capital structure of the company should be broad-based and there should-be public interest in securities.

4. The minimum issued capital must be Rs. 3 crores of which Rs. 1.80 crores must be offered to the public.

5. There must be at least five public shareholders for every Rs. 1 lakh of fresh issue of capital and 10 shareholders for every Rs. 1 lakh of offer for sale of existing capital. On the excess application money, the company will have to pay interest from 4% to 15%, if there is delay in refund and delay should not be more than 10 weeks from the date of closure of subscription list.

6. A company with paid up capital of more than Rs. 5 crores should get itself listed in more than one stock exchange, it includes the compulsory listing on regional stock exchange.

7. The auditor or secretary of the company applying for listing should declare that the share certificates have been stamped so that shares belonging to the promoter's quota cannot be sold or hypothecated or transferred for a period of 5 years.

8. Articles of Association of the company must have the following provisions:

- A common form of transfer shall be used
- Fully paid shares shall be used
- No lien on fully paid shares
- Calls paid in advance will not carry a right to dividend and will not be forfeited before the claim becomes time-barred.
- Option to call off shares shall be given only after sanction by the general meeting.

9. Letter of allotment, Letter of regret and letter of rights shall be issued simu1taneously.

10. Receipts for all the securities deposited, whether for registration or split and no charges will be made for the services.

11. The company will issue consolidation and renewal certificates for split certificate, letter of allotment, letter of rights and transfer, etc. when required.

12. The stock exchange should be notified by the company regarding the date of board meeting, change in the composition of board of directors, and any new issue of securities, in place of reissue of forfeited shares.

13. Closing the transfer books for the purpose of declaration of dividend, rights issue or bonus issue. And for this purpose, due notice should be given to stock exchange.

14. Annual return of the company to be filed soon after the annual general body meeting.

**Types of Listing of Securities:**

1. **Initial listing**: Here, the shares of the company are listed for the first time on a stock exchange.
2. **Listing for public Issue**: When a company which has listed its shares on a stock exchange comes out with a public issue.
3. **Listing for Rights Issue**: When the company which has already listed its shares.in the stock exchange issues securities to the existing shareholders on rights basis.

4. **Listing of Bonus shares**: When a listed company in a stock exchange is capitalizing its profit by issuing bonus shares to the existing shareholders.
5. **Listing for merger or amalgamation**: When the amalgamated company issues new shares to the shareholders of amalgamated company, such shares are listed.

**Procedure for listing requirements**

For listing the shares in the stock exchange, the public limited company will have to submit supporting documents. They are:

1. Certified copies of Memorandum, Articles of Association, prospectus and agreements with Underwriters.
2. All particulars regarding capital structure.
3. Copies of advertisements offering securities for sale during the last 5 years.

4. Copies of Balance sheet, audited accounts and auditors' report for the last 5 years.

5.Specimen copies of shares and debentures, certificate letter of allotment, and letter of regret.

6. A brief history of the company since incorporation with any changes in capital structure, borrowings, etc.

7. Details of shares and debentures issued for consideration other than cash.

8. Statement showing distribution of shares and particulars of commission, brokerage, discounts or special terms towards the issue of shares.

9. Any agreement with financial institutions.

10. Particulars of shares forfeited.

11. Details of shares or debentures for which permission to deal with is applied for.

12. Certified copy of consent from SEBI.

**Procedure at the Stock Exchange**

After the application is made the Listing Committee of the stock exchange will scrutinize the application form of the company. Here, the stock exchange will ensure the following—

1. The financial position of the company is sound
2. Solvency and liquidity positions are good

3. The issue is large and broad based to generate public interest. If the application for listing is accepted, the listed company will be called to execute listing agreement with the stock exchange. The company must follow certain obligations which are:

- the company will treat all the applications with equal fairness.
- in case of over subscription, the allotment will be decided in consultation with stock exchanges; and
- the company will notify to the stock exchange any change in its management, business, capital structure or bonus or rights issue of shares.

**SEBI (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2021:**

These regulations may be called the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2021.

As per Securities and Exchange Board of India (Issue of Capital And Disclosure Requirements) Regulations, 2018, Regulation 112 has been amended where minimum promoter's contribution is not required.

After amendment, w.e.f. 08.01.2021, Regulation 112(b) has been substituted where minimum promoter's contribution is not required in case of-the equity shares of the issuer are frequently traded on a stock exchange for a period of at least three years immediately preceding the reference date, and:

i. the issuer has redressed at least ninety-five per cent of the complaints received from the investors till the end of the quarter immediately preceding the month of the reference date, and;

ii. the issuer has been in compliance with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 for a minimum period of three years immediately preceding the reference date

However, if the issuer has not complied with the provisions of the SEBI (LODR) Regulations, 2015, relating to composition of board of directors, for any quarter during the last three years immediately preceding the date of filing of draft offer document/offer document, but is compliant with such provisions at the time of filing of draft offer document/offer document, and adequate disclosures are made in the offer document about such non-compliances during the three years immediately preceding the date of filing the draft offer document/offer document, it shall be deemed as compliance with the condition

Furthermore, where the promoters propose to subscribe to the specified securities offered to the extent greater than higher of the two options available in clause (a) of sub regulation (1) of regulation 113, the subscription in excess of such percentage shall be made at a price determined in terms of the provisions of regulation 164 or the issue price, whichever is higher.

Provided further that where the promoters propose to subscribe to the specified securities offered to the extent greater than higher of the two options available in clause (a) of sub-regulation (1) of regulation 113, the subscription in excess of such percentage s hall be made at a price determined in terms of the provisions of regulation 164 or the issue price, whichever is higher."

II. In regulation 115, the existing proviso after clause (c), shall be omitted.

III. In regulation 167, after the existing sub-regulation (4), the following new proviso shall be inserted, namely, –

"Provided that the lock-in provision shall not be applicable to the specified securities to the extent to achieve 10% public shareholding."

**Issue of shares and debentures**

A limited company may raise finance either by issuing shares or by raising loans. Debentures are simply a type of loan.

## Issue of shares

A share is a unit of ownership in a company or an organisation. It is also considered as an asset, because in case a company makes a profit, an amount in proportion to share held by you will be provided to you in the form of a dividend. Anyone who holds a share is called a shareholder for that specific organisation.

It should be noted that an organisation is allowed to offer shares to be purchased by others through the Companies Act 2013 and has to follow the rules predefined under the act.

Generally, the iss ue of shares is of two kinds - common shares and preference shares. While the former allows for voting rights to the shareholders, the latter does not permit the holders of any rights.

However, the dividend is passed on to both in case of a profit. On another instance, when there is a bankruptcy, the preference shareholders are given preference in matters of dividend sharing. So, they receive the dividend even before the common shareholders and have an upper hand.

## What is the Issue of Shares?

The meaning of Issue of shares is that the shares of an enterprise or any financial asset are distributed among shareholders whoever wishes to purchase it. These shareholders can be either individuals or corporates who take part in buying the shares at a specific price.

## Types of shares

A company may have many different types of shares that come with different conditions and rights in relation to **profit entitlement, entitlement to capital** if the business is wound up and **voting rights** within the business.

### Share types

The **five main types of shares** are:

**1. Ordinary shares** are the most common type of shares and are standard shares with no special rights or restrictions. They have the potential to give the highest financial gains, but also have the highest risk. Ordinary shareholders are entitled to voting rights, however, they are the last to be paid if the company is wound up.

**2. Non-voting ordinary shares** carry the same conditions as ordinary shares except with regards to voting rights. Shareholders may have voting rights under certain circumstances or they may have no voting rights at all.

**3. Preference shares** typically carry a right that gives the holder preferential treatment when annual dividends are distributed to shareholders. Shares in this category receive a fixed dividend, which means that a shareholder would not benefit from an increase in the business' profits. However, usually they have rights to their dividend ahead of ordinary shareholders if the business is in trouble. Preference shares carry no voting rights.

### Classes of Preference Shares with reference to Dividend

With reference to Dividend preference shares are of two types:

**1. Cumulative Preference Shares**

Cumulative Preference Shares are those Preference Shares which carry right to receive arrears of dividend before the company makes payment to Equity Shareholders.

**2. Non- Cumulative Preference Shares**

Non-Cumulative Preference Shares do not carry any rights for receiving arrears of the dividend.

Classes of Preference Shares With reference to Participation in Surplus Profits with reference to  Participation in Surplus Profits Preference Shares are of two types:

**1. Participating Preference Shares**

The Articles of Association of a company may provide that after the company pays the dividend to the Equity Shareholders, the holders of Preference Shares will also have a right to participate in the remaining profits.The Preference Shares who carries this right are called Participating Preference Shares.

**2. Non-Participating Preference Shares**

Preference Shares which do not carry the right to participate in the profits remaining after Equity Shareholders are paid are called Non-Participating Preference Shares.

**Classes of Preference Shares With reference to Convertibility**

With reference to Convertibility Preference Shares are of two types:

**1. Convertible Preference Shares**

Those Preference Shares which have the right to be converted into Equity Shares are called Convertible Preference Shares.

**2. Non-Convertible Preference Shares**

Non-Convertible Preference Shares do not have the right to be converted into Equity Shares.Classes of Preference Shares With reference to Redemption

**With reference to Redemption Preference Shares are of two types:**

**1. Rdeemable Preference Shares**

Redeemable Preference Shares are those Preference Shares which are redeemed by the company at a specific time (not exceeding 20 years from the date of issue) for the repayment or earlier. We call this repayment of the amount as Redemption.

**2. Irredeemable Preference Shares**

The amount returned by the company at the time of wind up to the holders of such shares is called Irredeemable Preference Shares.

## Equity Shares

Equity Shares are those shares which are other than Preference Shares. These are the most common class of shares that issues and carries maximum ‘risks and rewards’ of the business.If a company incur a loss than risk is of losing part or all the shares and rewards being payment of higher dividends and appreciation in the market value.

Most companies use ordinary shares, however, it is possible to **issue more than one kind of share class** as a way to vary shareholder voting, dividend and capital rights.

## Debentures

Debentures are a **debt instrument used by companies and government to issue the loan**. The loan is issued to corporates based on their reputation at a fixed rate of interest. Debentures are also known as a bond which serves as an IOU between issuers and purchaser.

## Types of Debenture

### 1. Secured and Unsecured

Secured debenture creates a charge on the assets of the company, thereby mortgaging the assets of the company. Unsecured debenture does not carry any charge or security on the assets of the company.

### 2. Registered and Bearer

A registered debenture is recorded in the register of debenture holders of the company. A regular instrument of transfer is required for their transfer. In contrast, the debenture which is transferable by mere delivery is called bearer debenture.

**3. Convertible and Non-Convertible**

Convertible debenture can be converted into equity shares after the expiry of a specified period. On the other hand, a non-convertible debenture is those which cannot be converted into equity shares.

**4. First and Second**

A debenture which is repaid before the other debenture is known as the first debenture. The second debenture is that which is paid after the first debenture has been paid back.

**Procedure for Issuing of Shares**

The directors on behalf of the company take necessary steps to raise the capital as-soon-as the company gets the certificate of incorporation. These steps,, are briefly, described below:

- The directors of a. public limited company issue prospectus inviting the public to apply for the purchase of the shares of the company.
- The prospective share-holders apply for the purchase of shares on the prescribed forms.
- The applications along with a specified amount are sent to the company's banker by the prescribed date. After the closing date, the banker sends these applications to the directors of the company.

- The directors scrutinize the applications. If the subscription is within the issued capital, the directors allot shares to all the applicants. The applicants are informed about the allotment of the shares by the letter called as “allotment letter”. The applicants become the shareholders of the company as soon as they get the letter of allotment from the directors of the company.
- The directors may reject some applications. In that case, the company issues letters of regret to those applicants. The bank is directed to return the money to these applicants. The money should be refunded within ten days of the date of decision regarding allotment of shares.
- If the directors of the company do not want to take the risk of issuing shares, then they transfer the risk to specialized persons known, as underwriters. The underwriters in exchange of certain commissiön take the responsibility of issuing or taking up themselves the shares which can not be sold in the market.

**Sale Price of Shares:**

Shares can be issued at the following three prices:

**At Par**

if the shares are issued at the price equal to the nominal value or face value of the shares are called issuance of shares at par. For instance, a share of $10 is issued at $10.

**At Premium**

If the shares are issued at price above the nominal value or face value of the shares it is called issuance of shares at premium. For example a share of $10 issued at $12, $2 is premium on the issuance of shares.

**At Discount**

If the shares are issued at a price less than the face value, it is called issuance of shares at discount. For instance a share of $10 issued at $ 8 each, here $2 is discount.

**Payment of Shares:**

Payment of shares may be:

- Lump sum payment
- Instalment payment.

**PROCEDURE FOR ISSUE OF DEBENTURES**

**MANDATORY REQUIREMENTS**

1.Debentures cannot be issued with voting rights.

2.A Company cannot issue debentures to more than 500 people without appointing a debenture trustee, whose duty would be to protect the interest of Debenture Holders and redress their grievances.

3.On issue of debenture, a Company shall create a Debenture Redemption Reserve (DRR).

4.If there is any default in repayment of amount in the event of maturity or default in payment of the interest thereon then the Tribunal will be approached by the Debenture Trustee to take appropriate measures

**FOLLOWING PROCEDURE IS TO BE FOLLOWED**

1. **Intimation to the Stock Exchange [Regulation 29 of the SEBI (LODR) Regulations, 2015]**

   Listed Companies shall give prior intimation to the stock exchange about the meeting of the Board of Directors in which the proposal for issue of debentures through Private Placement is due to be considered at least 2 working days in advance, excluding the date of intimation and date of meeting.

2. **Convene a Meeting of Board of Directors [As per section 173 & SS-1]**

a. Issue Notice of Board Meeting to all the Directors of Company at their addresses registered with the Company, at least 7 days before the date of Board Meeting. A shorter notice can be issued in case of urgent business.

b. Attach Agenda, Notes to Agenda and Draft Resolution with the Notice.

c.Hold a meeting of Board of Directors of the Company and pass the necessary Board Resolution

- ❖ to consider and approve issue of debentures through private placement.
- ❖ to approve Private Placement, Offer Letter.
- ❖ to identify the group of persons to whom Private Placement shall be made.
- ❖ to fix day, date, time and venue for holding General Meeting of the Company.
- ❖ to approve the draft notice of General Meeting along with explanatory statement annexed to the notice as per requirement of the **Section 102** of the Companies Act, 2013.

- ❖ to authorize the Director or Company Secretary to sign and issue notice of the General Meeting and to do such acts, deeds and things as may be necessary to give effect to the Board's decision.

a) Listed Company shall submit the outcome of Board Meeting within the timelines specified therein from the conclusion of the Board Meeting and post the same on the website of the Company within 2 working days. **[Regulation 30 & 46(3) of the SEBI (LODR) Regulations, 2015]**
b) and Circulate Draft Minutes within 15 days from the conclusion of the Board Meeting, by Hand/Speed Post/Registered Prepare Post/Courier/E-mail to all the Directors for their comments. [Refer the Procedure for Preparation and Signing of Minutes of Board Meeting]

**d.File Form MGT-14 with ROC**

Company shall file copy of Board Resolution to ROC in Form MGT-14 within 30 days of passing of resolution in Board Meeting.

**e.Obtain Shareholders' Approval**

- ❖ By Convening a General Meeting, OR
- ❖ By Passing a Resolution by Postal Ballot. **[Refer the Procedure for Passing of a Resolution by Postal Ballot]**

**3.Convene General Meeting [Section 96, 100 and SS-2]**

- ❖ Notice of General Meeting shall be given at least clear 21 days before the actual date of a General Meeting in writing, by hand or by ordinary post or by speed post or by registered post or by courier or by facsimile or by e-mail or by any other electronic means or a Shorter Notice can be issued with the consent of at least majority in number and ninety five percent of such part of the paid up share capital of the company giving a right to vote at such a meeting in accordance with Section 101.

- Notice will be sent to all the Directors, Members, Auditors of Company, Secretarial Auditor, Debenture Trustees and to others who are entitled to receive the notice of the General Meeting.
- Notice shall specify the day, date, time and full address of the venue of the Meeting and contain a statement on the business to be transacted at the Meeting.
- Hold the General Meeting on fixed day and pass Special Resolution for issue of debenture through Private Placement.
- Listed Companies shall disclose the proceedings of General Meeting to the Stock Exchange within 24 hours from the conclusion of General Meeting and same shall be posted on the website of the company within 2 working days. [Regulation 30 and 46(3) of the SEBI (LODR) Regulations, 2015]
- Listed Companies shall submit to the stock exchange the details of the voting results within two working days from the conclusion of the meeting and post the same on the website of the Company. [Regulation 44 of the SEBI (LODR) Regulations, 2015]
- Prepare the minutes of General Meeting, get them signed and compile accordingly. [Refer the Procedure for Preparation and Signing of Minutes of General Meeting].

**File Form MGT-14 with ROC**

Company shall file Form MGT-14 with the ROC within 30 days of passing Special Resolution in General Meeting along with fee as specified in the Companies (Registration offices and fees) Rules, 2014 and with the following attachments

- ❖ Certified True Copies of the Special Resolution passed along with Explanatory Statement.
- ❖ Copy of the Notice of meeting sent to members along with all the annexure
- ❖ Shorter Notice Consent Letters from the members in case the General Meeting was convened at shorter notice.
- ❖ Copy of Attendance Sheet of General Meeting
- ❖ Any other attachment as may be applicable.

**5.Open Separate Bank Account**

Company shall open a separate Bank Account in a Scheduled Bank for keeping the monies received on the application.

**Preparation and Filing of Private Placement Offer Letter**

- ❖ Company shall record the names of the persons to whom the debenture through Private Placement shall be offered.
- ❖ Company shall make a Private Placement Offer Letter in Form PAS-4 and shall send these offer letters either in writing or in electronic mode within 30 days of recording of names of such person with an application form serially numbered to the person to whom it is made.
- ❖ Company shall maintain a complete record of persons to whom the private placement offer letter is sent in Form PAS-5.

**Receive the Amount of Subscription**

- ❖ Company shall receive the amount of subscription through cheque or demand draft or other banking channels from the Bank Account of the person subscribing to debentures except in case of issue of debentures for consideration other than cash.
- ❖ Company shall keep the record of the Bank account from where such payments for subscriptions have been received.

**Allotment of securities by Private Placement**

After closing the Private Placement Offer, Company shall

- ❖ Employees Convene a Board Meeting, OR
- ❖ Pass a Board Resolution by Circulation **[Refer the Procedure for Passing a Resolution by Circulation]** within 60 days from the date of receipt of the application money.

**Employee stock option scheme and employee stock purchase scheme :**

The Securities and Exchange Board of India (SEBI), in the year 1999, had framed "Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999" (hereinafter "existing guidelines") which provides for the stock based incentive schemes to employees. On 28th October, 2014, SEBI has notified **Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014,** [1] (hereinafter "Regulations") the provisions of which shall be applicable on the following:

i. employee stock option schemes;
ii. employee stock purchase schemes;

iii. stock appreciation rights schemes;
iv. general employee benefits schemes; and
v. retirement benefit schemes consequent upon which the existing guidelines have been repealed.

The Regulations has been framed by the market regulator SEBI in order to bring into its wide ambit, all the shares related schemes issued by the companies for the benefit of its employees.

**Applicability**

As per the Regulation 1 (4), of the Regulations shall be applicable to those companies whose shares are listed on any recognised stock exchange in India, and which fulfills the following:

i. has a scheme for direct or indirect benefit of employees;
ii. involves dealing in or subscribing to or purchasing securities of the company, directly or indirectly; and
iii. which satisfies, directly or indirectly, any one of the following conditions:

a. the scheme is set up by the company or any other company in its group;

b. the scheme is funded or guaranteed by the company or any other company in its group;

c. the scheme is controlled or managed by the company or any other company in its group.

As far as applicability of these regulations are concerned, Regulation 1(5) provides that these Regulations shall not be applicable to shares issued to employees in compliance with the provisions pertaining to preferential allotment as specified in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Further, it has been clarified that the provisions pertaining to preferential allotment as specified in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 shall not be applicable in case of a company issuing new shares in pursuance and compliance of these Regulations.

**Employee stock option :**

**Employee stock options** (**ESO**) is a label that refers to compensation contracts between an employer and an employee that carries some characteristics of financial options.

Employee stock options are commonly viewed as an internal agreement providing the possibility to participate in the share capital of a company, granted by the company to an employee as part of the employee's remuneration package. Regulators and economists have since specified that ESOs are compensation contracts.

These nonstandard contracts exist between employee and employer, whereby the employer has the liability of delivering a certain number of shares of the employer stock, when and if the employee stock options are exercised by the employee. The contract length varies, and often carries terms that may change depending on the employer and the current employment status of the employee. In the United States, the terms are detailed within an employer's "Stock Option Agreement for Incentive Equity Plan. Essentially, this is an agreement which grants the employee eligibility to purchase a limited amount of stock at a predetermined price. The resulting shares that are granted are typically restricted stock. There is no obligation for the employee to exercise the option, in which case the option will lapse.

AICPA's Financial Reporting Alert describes these contracts as amounting to a "short" position in the employer's equity, unless the contract is tied to some other attribute of the employer's balance sheet. To the extent the employer's position can be modeled as a type of option, it is most often modeled as a "short position in a call". From the employee's point of view, the compensation contract provides a conditional right to buy the equity of the employer and when modeled as an option, the employee's perspective is that of a "long position in a call option".

Stock options are a benefit often associated with startup companies, which may issue them in order to reward early employees when and if the company goes public. They are awarded by some fast-growing companies as an incentive for employees to work towards growing the value of the company's shares. Stock options can also serve as an incentive for employees to stay with the company. The options are canceled if the employee leaves the company before they vest. ESOs do not include any dividend or voting rights.

**Understanding ESOs**

Corporate benefits for some or all employees may include equity compensation plans. These plans are known for providing financial compensation in the form of stock equity. ESOs are just one type of equity compensation a company may offer. Other types of equity compensation may include:

1. **Restricted Stock Grants:** these give employees the right to acquire or receive shares once certain criteria are attained, like working for a defined number of years or meeting performance targets.
2. **Stock Appreciation Rights (SARs):** SARs provide the right to the increase in the value of a designated number of shares; such increase in value is payable in cash or company stock.
3. **Phantom Stock:** this pays a future cash bonus equal to the value of a defined number of shares; no legal transfer of share ownership usually takes place, although the phantom stock may be convertible to actual shares if defined trigger events occur.
4. **Employee Stock Purchase Plans:** these plans give employees the right to purchase company shares, usually at a discount.

In broad terms, the commonality between all these equity compensation plans is that they give employees and stakeholders an equity incentive to build the company and share in its growth and success.

For employees, the key benefits of any type of equity compensation plan are:

- An opportunity to share directly in the company's success through stock holdings
- Pride of ownership; employees may feel motivated to be fully productive because they own a stake in the company
- Provides a tangible representation of how much their contribution is worth to the employer
- Depending on the plan, it may offer the potential for tax savings upon sale or disposal of the shares

The benefits of an equity compensation plan to employers are:

- It is a key tool to recruit the best and the brightest in an increasingly integrated global economy where there is worldwide competition for top talent
- Boosts employee job satisfaction and financial wellbeing by providing lucrative financial incentives
- Incentivizes employees to help the company grow and succeed because they can share in its success
- May be used as a potential exit strategy for owners, in some instances

In terms of stock options, there are two main types:

1. Incentive stock options (ISOs), also known as statutory or qualified options, are generally only offered to key employees and top management. They receive preferential tax treatment in many cases, as the IRS treats gains on such options as long-term capital gains.
2. Non-qualified stock options (NSOs) can be granted to employees at all levels of a company, as well as to board members and consultants. Also known as non-statutory stock options, profits on these are considered as ordinary income and are taxed as such.

**Procedure for Issue of Employee Stock Option Plan**

The Employee Stock Option Plan (ESOP) is an employee benefit plan. It is issued by the company for its employees to encourage employee ownership in the company. The shares of the companies are given to the employees at discounted rates. Any company can issue ESOP. All companies other than listed companies should issue it in accordance with the provisions of the Companies Act, 2013 and Companies (Share Capital and Debentures) Rules, 2014. In the case of listed companies, they should issue in accordance with Securities and Exchange Board of India Employee Stock Option Scheme Guidelines.

Section 2(37) of the Companies Act, 2013 defines employees stock option as the option given to the directors, employees or officers of the company or of its holding or subsidiary company, the right to purchase or benefit or subscribe for the shares of the company at a predetermined price on a future date. Thus, ESOP is a scheme where a company proposes to increase its subscribed share capital by issuing further shares to its employees at a predetermined rate.

ESOP benefits the company as well as its employees. It benefits the startups where employees can be rewarded after the company goes public. Any employee of the company can be offered ESOP if they fit the criteria.

To Whom Can The E SOP Be Issued?

Rule 12(1) of Companies (Share Capital and Debentures) Rules, 2014 states that ESOP can be issued to the following employees-

- A permanent employee of the company who is working in India or outside India.
- A Director of the company, including a whole-time or part-time director but not an independent director.
- A permanent employee or director of a subsidiary company in India or outside India, or holding company, or an associate company.
- A company cannot issue ESOP to the following employees-

- An employee who is belonging to the promoter group or is a promoter of the company.
- A director who either himself or through any body corporate or through his relative holds more than ten per cent of the outstanding equity shares of the company, whether directly or indirectly.

However, the above two conditions do not apply to Startup Companies for a period of ten years from the date of its incorporation.

**Process Of Issue Of ESOP**

Section 62(1)(b) of the Companies Act, 2013 and Rule 12 of Companies (Share Capital and Debentures) Rules, 2014 ("Rules") governs the issuance of ESOP. The procedure for issuance of ESOP under the Rules is similar to that of the procedure under the Securities and Exchange Board of India Employee Stock Option Scheme Guidelines for listed companies. The process for issuing ESOP by a company are:

- Prepare the draft of ESOP in accordance with the Companies Act, 2013 and Rules.
- Prepare the notice for the board meeting along with the draft resolution to be passed in the board meeting.
- Send the notice of the board meeting to all the directors at least seven days before the meeting.
- Pass the resolution for the issuance of shares through ESOP, determine the price of shares to be issued pursuant to ESOP and fix time and date and approve for calling the general meeting to pass a special resolution for issuing ESOP.

- Send the draft minutes of the board meeting to all the directors within fifteen days of its conclusion and file the MGT-14 form with the Registrar of Companies of passing the board resolution.
- Send notice of the general meeting to all the directors, auditors, shareholders and secretarial auditors of the company at least before twenty-one days of the date of the meeting.
- Pass the special resolution for the issuance of shares under the ESOP to the employees, directors and officers of the company in the general meeting.
- File MGT-14 form with the Registrar of Companies within thirty days of passing the special resolution in the general meeting along with the documents.
- Send options to the employees, directors and officers of the company for purchasing shares under ESOP.
- Maintain a 'Register of Employee Stock Options' in Form No.SH-6 and enter the particulars of the ESOP granted to the employees, directors or officers of the company.

If a private company wants to issue ESOP, then it should ensure that the Articles of Association (AoA) authorises for issuance of shares through ESOP. If the AoA does not authorise, then the company should first hold an extraordinary general meeting to alter the AoA to include the provisions of issuance of shares through ESOP and then proceed with holding the board meeting for the passing of the resolution and getting the shareholder's approval for ESOP Scheme.

**Allotment of ESOP**

There are three terms that are mainly focused on the time of issuance of shares through ESOP to the employees. They are as follows-

**Grant**- Grant means the issue of stocks to the employees. It means informing the employee that he is eligible for ESOP. The company will have the freedom to determine the exercise price while providing the option of ESOP to the employees.

**Vest-**Vest means the right of the employees to apply for the shares granted to them. There shall be a minimum of one year between the grant of option and vesting of option for the ESOP scheme.

**Exercise-** The exercise period is where the employees can exercise the option of buying the shares. The company will have the freedom to specify the lock-in period for the shares issued (if any) after the exercise of the option. The employees will not have the right to receive any dividend or to vote or enjoy the advantages of a shareholder in respect of the ESOP granted to him until the shares are issued on exercise of his option.

Disclosures To Be Made While Issuing ESOP

I. The company should make the following disclosures in the explanatory statement annexed to the notice for passing the special resolution for the issuance of ESOP-

II. The total number of stock options which is to be granted,

III. The identified class of employees who can participate in the ESOP,

IV. Requirements of vesting period of ESOP,

V. Maximum period within which the options can be vested,

VI. The exercise price and process of exercise,

VII. The lock-in period, if any,

VIII. The grant of the maximum number of options for an employee,

IX. The methods used by the company to value its options,

X. The conditions of lapsing of the options vested in employees,

XI. A statement that the company will comply with the applicable accounting standards.

**Employee stock purchase scheme**

In the United States, an **employee stock purchase plan** (**ESPP**) is a means by which employees of a corporation can purchase the corporation's stock, often at a discount. Employees contribute to the plan through payroll deductions, which build up between the offering date and the purchase date. At the purchase date, the company uses the accumulated funds to purchase shares in the company on behalf of the participating employees. Th amount of the discount depends on the specific plan but can be as much as 15% lower than the market price. ESPPs can also be subject to a vesting schedule, or length of time before the stock is available to the employees, typically one or two years of service.

Depending on when the employee sells the shares, the disposition will be classified as either qualified or not qualified. If the position is sold two years after the offering date and at least one year after the purchase date, the shares will fall under a qualified disposition. If the shares are sold within two years of the offering date or within one year after the purchase date the disposition will not be qualified. These positions will have different tax implications.

ESPPs differs from other types of employee stock ownership, such as Employee Stock Ownership Plans (ESOPs), both in how the stocks are bought, access to the stocks (either after vesting or upon retirement), taxation for the employees, and how much these plans cost to implement for the company.

An employee stock purchase plan (ESPP) is a company-run program in which participating employ yes can purchase company stock at a discounted price. Employees contribute to the plan through payroll deductions which build up between the offering date and the purchase date. At the purchase date, the company uses the employee's accumulated funds to purchase stock in the company on behalf of the participating employees.

**Understanding Employee Stock Purchase Plans (ESPP)**

With employee stock purchase plans, the discount rate on company shares depends on the specific plan but can be as much as 15% lower than the market price. ESPPs may have a "look back" provision allowing the plan to use a historical closing price of the stock. This price may be either the price of the stock offering date or the purchase date – often whichever figure is lower.

**Qualified Vs. Non-qualified Plans**

ESPPs are categorized in two ways: qualified and non-qualified. Qualified plans require the approval of shareholders before implementation, and all plan participants have equal rights in the plan. The offering period of a qualified ESPP cannot be greater than three years and there are restrictions on the maximum price discount allowable. Non-qualified plans are not subject to as many restrictions as a qualified plan. However, non-qualified plans do not have the tax advantages of after-tax deductions that qualified plans do.

**Eligibility**

ESPPs typically do not allow individuals who own more than 5% of company stock to participate. Restrictions are often in place to disallow employees who have not been employed with the company for a specified duration – often one year. All other employees typically have the option, but not the obligation, to participate in the plan.

## Key Figures

During the application period, employees state the amount to be deducted from their pay and contributed to the plan. This may be subject to a percentage limitation. In addition, the Internal Revenue Service (IRS) restricts the total dollar amount to be contributed to $25,000 per calendar year. Most ESPPs grant employees a price discount of up to 15%.

## Administration and implementation :

- Subject to the provisions of these regulations, the ESPS scheme shall contain the details of the manner in which the scheme will be implemented and operated.

## Pricing and lock-in

(1) The company may determine the price of shares to be issued under an ESPS, provided they conform to the provisions of accounting policies under regulation 15.

(2) Shares issued under an ESPS shall be locked-in for a minimum period of one year from the date of allotment:

Provided that in case where shares are allotted by a company under an ESPS in lieu of shares acquired by the same person under an ESPS in another company which has merged or amalgamated with the first mentioned company, the lock-in period already undergone in respect of shares of the transferor company shall be adjusted against the lock-in period required under this sub-regulation.

(3) If ESPS is part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employees pursuant to ESPS shall not be subject to lock-in.

### The Emergence of ESOPs in India

India is the third-largest startup ecosystem in the world and it attracts all kinds of global investors. This is evident with the huge expansion India has seen in the recent past with regards to the list of 'unicorn' companies that have come into existence. A unicorn refers to a startup that gains value of over $1 billion. This brings into the picture Employee Stock Option Plans (ESOPs) to ensure that all the employees of the company have the same goal which—to increase the performance of the company, which in turn makes it more profitable.

### Employee Stock Option Plan and Regulatory Framework

An Employee Stock Option Plan (ESOP) in India is an incentive granted to employees of a company to buy or subscribe to shares of the company at a predetermined price for the future. The software industry was the first to bring about this plan because of the "brain drain" and poaching of high performing employees. Employees want more than just a salary because they need the incentive to stay on with the same company and not move jobs as easily. Ownership of part of the company gives employees a sense of belonging as well as an incentive to continue their employment long term.

Employee Stock Option was first introduced by way of clause 15A in section 2 of the Companies Act, 1956. It defines what an employee stock option is and enumerates the conditions that need to be fulfilled for the issue of such shares. The Securities and Exchange Board of India (SEBI) which is the governing body for ESOPs and Employee Stock Option Schemes (ESOS) set guidelines in 1999. Section 62 of the Companies Act, 2013, further incorporates enabling provisions for the issue of ESOPs subject to the sanction of a special resolution and compliance rules (in case of unlisted companies) and SEBI rules (in case of listed companies).

Employee ownership plans in India are simply stock option plans. Approximately 68% of listed companies, and 29% of unlisted companies, give ESOP benefits to their employee amounting to one time the cost to the company. Unlisted companies issue ESOPs to retain employees and give them an incentive for when stocks are listed which will unlock the value and give a high potential for great earnings. Listed Companies use it mostly as a rewarding tool. Indian employees exercise the vested option early with 90% of them doing it within 2 years. This may be because of the taxation laws which state that if an employee holds shares of a listed company for more than a year, the capital gains are tax-free.

**Indian ESOP Statistics**

As per a survey, 43% of IT companies in India have given ESOPs to more than 90% of its employees but only 17% of Non-IT companies have done the same. More than 75% of non-IT companies offer ESOPs only to senior and middle management employees. A study in 2001 shows that within IT companies only 23% of the large companies offer ESOPs to more than 90% of their employees and only 60% in the case of small companies. A significant 54% of large IT companies offer ESOPs to less than 25% of their employees.

## How Indian ESOPs Works

The above shows the general outline of a stock option plan. An employee gets the grant and has to wait a minimum of one year until the shares vest. After which they can exercise and sell the option at any time depending on the market rates. There is no minimum or maximum limit for exercise and sale of shares. These ESOPs are not transferable and only the employee shall be entitled to exercise the options. The guidelines state, upon the death of the option holder, while he was an employee, all options granted to him including unvested options, shall vest in his legal heirs on the date of his death, and they shall be able to exercise it. This also holds if he was not an employee at the time of his death but had options. Buy-back of shares does not have clear regulations. The guidelines prohibit the transfer of stock options, buyback through negotiated deals, or private arrangements.

## COMPANIES OFFERING THESE SCHEMES IN INDIA :

- Aavin
- Adarsh Co-operative Bank
- Amul
- Banas Dairy
- Co-optex
- Dabbawala
- Horticultural Producers' Cooperative Marketing and Processing Society
- Indian Coffee House
- Indian Farmers Fertiliser Cooperative
- Indian Potash Limited
- J Thomas & Co. Pvt. Ltd.

- Kaira District Co-operative Milk Producers' Union
- Karnataka Milk Federation
- Kerala Co-operative Milk Marketing Federation
- Krishak Bharati Cooperative
- Larsen & Toubro
- Mother Dairy
- National Agricultural Cooperative Marketing Federation of India
- Orissa State Cooperative Milk Producers' Federation
- Pratibha Mahila Sahakari Bank
- Rehwa Society
- Sant Muktabai Sahakari Sakhar Karkhana
- Space Development Network
- The Totgars' Cooperative Sale Society Limited
- Working Women's Forum

## QUESTION BANK

## UNIT-III

## PART-A

1 What are Derivatives?

2 Recall any two demerits of listing

3 Why Listing of Shares is Important?

4 Give the meaning of convertible debentures

5 Define the term Employee stock Option Scheme.

6 Assess the provisions of Employee stock Option Scheme

7 What do you mean by Public Issue?

8 When can shares be Forfeited?

9 Recall the term employee stock purchase scheme

10 Give the meaning of Minimum Public Offer.

PART-B

1 Explain the conditions to be fulfilled by a company in order to list its securities.

2 Interpret the benefits of employee stock purchase plan

3 Classify the kinds of Shares.

4 Summarize the procedure for issuing of Shares.

5 Assess the procedure for issue of Employee Stock Option Plan(ESOP)

6 Determine the regulatory framework for ESOP.

7 Explain the different types of debentures.

8 Describe the Process of issue the Employee stock option plan

9 Examine the documents to be submitted by a company in order to list its securities.

10 Summarize the benefits of listing of securities.

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## UNIT 4 SEBI ACT 1992

**Securities and Exchange Board of India Act, 1992: Objective: Powers and functions of SEBI; Securities Appellate Tribunal Penalties and appeals - Appearance before SAT, SEBI (Buyback of Securities) Regulations, 1998, SEBI (Delisting of Equity Shares) Regulations, 2009.**

The Securities and Exchange Board of India Act, 1992 setup SEBI to promote & regulate the securities market and to protect the interests of investors.

The Securities and Exchange Board of India Act, 1992 was introduced with the aim of establishing a Board:

1. to protect the interests of investors in securities
2. to promote the development of the securities market
3. to regulate the securities market
4. for all connected and related matters.

**Brief History of the Act :**

The Securities and Exchange Board of India Act, 1992 was first introduced before the Lok Sabha as the Securities and Exchange Board of India Bill, 1992 on 03/03/1992 and was passed by the Lok Sabha on 30/03/1992. The Rajya Sabha passed this Bill on 01/04/1992 and it received Presidential assent on 04/04/1992.

**The Securities and Exchange Board of India Act, 1992** is an Act of the Parliament of India enacted for regulation and development of securities market in India. It was amended in the years 1995, 1999 and 2002 to meet the requirements of changing needs of the securities market. It is the 15th Act of 1992. The Act provides for the establishment of Securities and Exchange Board of India following the Harshad Mehta scam.

The Act contains 10 Chapters and 91 Sections.

**Preamble**

The Securities an Exchange Board of India is the sole regular of the Indian Securities Market. Its Preamble describes its basic function 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 incid thereto"

**Management of the Board** (1) The Board shall consist of the following members, namely:—

(a) a Chairman

(b) two members from amongst the officials of the 9[Ministry] of the Central Government dealing with Finance

(c) one member from amongst the officials of 11[the Reserve Bank];

[(d)five other members of whom at least three shall be the whole-time members,] to be appointed by the Central Government.

(2) The general superintendence, direction and management of the affairs of the Board shall vest in a Board of members, which may exercise all powers and do all acts and things which may be exercised or done by the Board.

(3) Save as otherwise determined by regulations, the Chairman shall also have powers of general superintendence and direction of the affairs of the Board and may also exercise all powers and do all acts and things which may be exercised or done by that Board.
(4) The Chairman and members referred to in clauses (a) and (d) of sub-section (1) shall be appointed by the Central Government and the members referred to in clauses (b) and (c) of that sub-section shall be nominated by the Central Government and the 13[Reserve Bank] respectively.
(5) The Chairman and the other members referred to in clauses (a) and (d) of sub-section (1) shall be persons of ability, integrity and standing who have shown capacity in dealing with problems relating to securities market or have special knowledge or experience of law, finance, economics, accountancy, administration or in any other discipline which, in the opinion of the Central Government, shall be useful to the Board.

**Purpose of SEBI Act**

The confidence of investors is eroded and the economic growth is impaired as a result of market abuse. Investors are lured into making investment decisions based on the incorrect or misleading information provided leading to the creation of artificial market and inflated results. Huge amounts of money were manipulated with the help of various financial scandals and security scams. Manipulators have a very vast knowledge about the working of the system and henceforth, they take advantage of this opportunity to manipulate the system as well as the investors.

Thus, the primary objective, which has to be achieved with the establishment of SEBI, is the creation of such an environment that helps in effective mobilization as well as the allocation of resources with the help of securities market of India. Such an environment is bundled with policy frameworks, rules and regulations, infrastructures and practices in order to meet the requirements of various class of people which are the main players of the market. Some of them are the investors, the market intermediaries and the companies, which are the issuers of securities.

1. **For the purpose of investors**

The credit for making market active goes to the investors. SEBI has the motive of providing accurate, authentic and adequate information on a regular basis in order to safeguard the interests and rights of the investors. This is done in order to restore the confidence of the investors or the general public, who is willing to invest their money in the market.

- **For the purpose of issuers of securities**

The demand of the various corporate fields, who are responsible for issuing securities, is a transparent and safe market place where they can look forward to raising the number of funds confidently in an efficient and easy manner. SEBI works with the aim of making such a safe as well as a healthy market place available to the issuers.

**For the purpose of intermediaries**

Intermediaries are those people who are entitled to act as middlemen for any transaction or agreement between the investors and the issuers. They are entrusted with the object of providing better services to the issuers and investors. For this purpose, SEBI is empowered to make an everexpanding, professionalized and competitive market with an efficient and adequate infrastructure available to the intermediaries. Financial transactions become safer and smoother because of the role of

**Securities and Exchange Board of India :**

The **Securities and Exchange Board of India** (**SEBI**) is the regulatory body for securities and commodity market in India under the jurisdiction of Ministry of Finance , Government of India. It was established on 12 April 1988 and given Statutory Powers on 30 January 1992 through the SEBI Act, 1992. Securities and Exchange Board of India (SEBI) was first established in 1988 as a non-statutory body for regulating the securities market. It became an autonomous body on 30 January 1992 and was accorded statutory powers with the passing of the SEBI Act 1992 by the Indian Parliament. 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 Ahmedabad respectively. It has opened local offices at Jaipur and Bangalore and has also opened offices at Guwahati, Bhubaneshwar, Patna, Kochi and Chandigarh in Financial Year 2013–2014.

Controller of Capital Issues was the regulatory authority before SEBI came into existence; it derived authority from the Capital Issues (Control) Act, 1947.

The SEBI is managed by its members, which consists of the following:

- The chairman is nominated by the Union Government of India.
- Two members, i.e., Officers from the Union Finance Ministry.

- One member from the Reserve Bank of India.
- The remaining five members are nominated by the Union Government of India, out of them at least three shall be whole-time members.

After the amendment of 1999, collective investment schemes were brought under SEBI except nidhis, chit funds and cooperatives.
The Government's avowed interest in regulating the capital market and safeguarding the retail investors lead to the creation of Securities and Exchange Board of India and subsequent reforms in the market. These significant events in the past decade have changed the course of the Indian capital market.

The IPOs in the primary market and several secondary market practices got changed affecting the prime constituent of the capital market, the individual investor. There cannot be two opinions on the fact that SEBI has, by its guidelines, regulations and directions, statutorily promoted disclosure of all relevant information and has strengthened the protection to investors in the securities market.

**Formation of SEBI:**

The Securities and Exchange Board of India (SEBI) was established by the Government of India through an executive resolution in 1988, and was subsequently upgraded as a fully autonomous body (a statutory Board) in the year 1992 with the passing of the Securities and Exchange Board of India Act (SEBI Act) on 30th January 1992.

Relatively a brief act containing 35 sections, the SEBI Act governs all the Stock Exchanges and the Securities Transactions in India. It has been set up as a statutory and autonomous regulatory board with independent powers and defined responsibilities, to cover both development & regulation of the Capital market. It may be said that this is a positive outcome of the Securities Scam of 1990-91.

### SEBI Act and SEBI Guidelines

SEBI was established as a non-statutory body in 1988, entrusted with observing the stock market activities. The SEBI Act of 1922 converted SEBI into a statutory authority with autonomous powers. The Act provided SEBI with the authority to regulate capital markets, not just observe but enforce guidelines.

The SEBI Act 1992 covers the following areas:

1. Composition and actions of the SEBI Board members
2. Powers and Functions of the Board
3. Fund sources of SEBI, as in grants made available by the Union Government
4. Rules on Penalties and legal pathways
5. Defines the judicial authority of SEBI
6. The extent of powers of the Union Government to supersede SEBI

SEBI also has to adhere to a list of SEBI guidelines, pertaining to areas such as:

- Employee Stock Option schemes
- Disclosure and Investor Protection norms
- Legal Proceedings
- Anti-money laundering norms
- Listing and delisting of securities
- Opening of trading terminals overseas

**Objectives of SEBI:**

SEBI was set up to assist and facilitate the mobilization of adequate resources through the securities market and its efficient allocation, keeping in mind the interest of issuers, investors and intermediaries.

**The primary-objectives of SEBI are:**

I. To protect the interests of investors in securities;

II. To promote the development of Securities Market;

III. To regulate the securities market; and

IV. For matters connected therewith or incidental thereto

**Protect the Interests of Investors:**

SEBI endeavours to restore and safeguard the trust of investors, especially the interest of small investors. This is achieved by meeting the needs of the players connected with securities market such as the investors, the corporate sector and the intermediaries. It works for creating proper investment climate to enable corporate sector to float industrial securities easily, efficiently and at affordable minimum cost.

It aims at educating investors so as to make them aware of their rights in clear and specific terms by providing them with information. A high degree of protection of investor rights and interests is made possible by providing adequate, accurate and authentic information on a continuous basis.

**Promote the Development of Securities Market:**

Since its inception SEBI has been working targeting the securities and is attending to the fulfillment of its objectives with commendable zeal and dexterity. The improvements in the securities markets like capitalization requirements, margining, establishment of clearing corporations etc. reduced the risk of credit.

SEBI adopts two broad approaches to develop the securities market – to integrate the securities market at the national level and to diversify the trading products – so that there is an increase in number of traders including banks, financial institutions, insurance companies, mutual funds, and primary dealers etc. to transact through the exchanges.

In this context the introduction of derivatives trading through Indian Stock Exchanges permitted by SEBI in the year 2000 provided the much needed depth to the securities market.

**Regulation of the Securities Market:**

SEBI has introduced comprehensive regulatory measures, prescribed registration norms, eligibility criteria, code of obligations and the code of conduct for different intermediaries like, bankers to issue, merchant bankers, brokers and sub-brokers, registrars, portfolio managers, credit rating agencies, underwriters and others.

It has framed by-laws, risk identification and risk management systems for Clearing houses of stock exchanges, surveillance system etc. which has made dealing in securities both safe and transparent to the end investor.

**Organization of SEBI:**

The SEBI is a body corporate. Under Section 4 of the SEBI Act, the management of SEBI is entrusted with the Board of Directors.

**The Board consists of:**

(i) A Chairman appointed by the Government,

(ii) Two members from amongst officials of the Ministry of Government of India dealing with Finance and administration of the Companies appointed by the Government,

(iii) One member from amongst the officials of, and nominated by RBI,

(iv) Five members of whom at least two should be whole time members nominated by the Government. Its general superintendence, direction and management are vested in a Board of Members which may exercise all powers and do all acts/things which may be exercised/done by the SEBI.

The Chairman also has powers to general superintendence and direction of its affairs and may also exercise all powers and do all acts/things exercisable/done by it. The Chairman and other members of the SEBI should be persons of ability, integrity and standing who have shown capacity in dealing with problems relating to the securities market or have special knowledge/experience of law, finance, economics, accountancy, administration or in any other discipline which, in the opinion of the Government, would be useful to the SEBI.

The Central Government reserves the right to terminate the services of the Chairman or any member of the Board. SEBI has its head office in Mumbai and regional offices at Delhi, Calcutta and Chennai.

**Powers of SEBI:**

Section 11 of the SEBI Act provides that, it is the duty of the Board to protect the interest of investors in securities and to promote the development of and to regulate the securities market by such measures as required.

The Act has given power to the Board to regulate the business in Stock Exchanges, register and regulate the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers, etc., also to register and regulate the working of collective investment schemes including mutual funds, to prohibit fraudulent and unfair trade practices and insider trading, to regulate take-over, to conduct enquiries and audits of the stock exchanges, etc.

All the stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deed, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediary who may be associated with the Securities Markets are to register with the Board under the provisions of the Act, under Section 12 of the SEBI Act. The Board has the power to suspend or cancel such registration. The Board decides issues in its meetings by majority vote with the Chairman having a second or casting vote.

## Authority and Power of SEBI

SEBI possesses high authority and power as its primary purpose was to control the market systematically by preventing any fraudulent activity. It has three significant powers:

**1. Quasi-Judicial-** This includes drafting legislation with respect to the capital markets. With the help of this authority, it has the right to conduct hearing and pass judgments in case any fraudulent activity happens. The benefit of this authority is that it assures that there is fairness, reliability and accountability in the capital market.

**2. Quasi-Executive Functions-** Implementing legislation also comes under SEBI. This means that SEBI has the absolute authority to build rules and regulations to shield the interest of investors.

For example, there is legislation called SEBI Listing obligation and Disclosure requirements; this was made to consolidate and simplify provisions of the current listing agreements for various segments to financial markets such as equity shares. Such regulations are made to keep any sort of illegal practice at bay.

**3. Quasi-Legislative-** Under this segment, the role of SEBI is to create guidelines for the security of interest of investors. Few rules and regulations made by SEBI are disclosure requirements, trading regulation and listing obligation.

The primary goal is to methodize and fortify the provision of current listing agreements for various segments of the financial market. Although SEBI has a lot of powers, still, it has to go through the Securities Appellate Tribunal and the Supreme Court of India.

**Functions of SEBI:**

SEBI has three functions rolled into one body-legislative, judicial and executive. It drafts rules in its legislative capacity, it conducts enquiries and enforcement action in its executive function and it passes rulings and orders in its judicial capacity. Though this makes it exceedingly powerful, there is an appeal process to create accountability.

**Its main functions are:**

I. Helping the business in stock exchanges and any other securities markets,

II. Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner.

III. Registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf.

IV. Registering and regulating the working of venture capital funds and collective investment schemes including mutual funds;

V. Promoting and regulating self-regulatory organisations;

VI. Prohibiting fraudulent and unfair trade practices relating to securities markets;

VII. Promoting investors' education and training of intermediaries of securities markets;

VIII. Prohibiting insider trading in securities;

IX. Regulating substantial acquisition of shares and takeover of companies;

X. Calling for information from undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds and other persons associated with the securities market and intermediaries and self-regulatory organisations in the securities market;

XI. Calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any Central, State or Provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Board;

XII. Performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government;

XIII. Levying fees or other charges for carrying out the purpose of this section;

XIV. Conducting research for the above purposes;

XV. Calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions;

XVI. Performing such other functions as may be prescribed.

In addition, it may also take measures to undertake inspection of any book, register, or other document or record of any listed public company or public company which intends to get its securities listed on any recognised stock exchange where the SEBI has reasonable grounds to believe that such company has been indulging in insider trading and unfair trade practices relating to the securities market.

SEBI has had a mixed history in terms of its success as a regulator. Though it has pushed systemic reforms aggressively and successively (e.g., the quick movement towards making the markets electronic and paperless), it seems to lack the legal expertise needed to sustain prosecutions/enforcement actions. It has often received flak from the appellate body known as the Securities Appellate Tribunal (SAT). From the SAT, an appeal moves straight to the Supreme Court of India.

**Securities appellate tribunal :**

Securities Appellate Tribunal is a statutory body developed under the provisions of Section 15K of the Securities and Exchange Board of India Act. Securities Appellate Tribunal was mainly established to hear an appeal against the order passed by the **SEBI (Securities and Exchange Board of India)** or by an adjudicating officer under the SEBI Act. In this article, we look at the Securities Appellate Tribunal (SAT) in detail. Securities Appellate Tribunal is a statutory body established under the provisions of Section 15K of the Securities and Exchange Board of India Act, 1992 to hear and dispose of appeals against orders passed by the Securities and Exchange Board of India or by an adjudicating officer under the Act; and to exercise jurisdiction, powers and authority conferred on the Tribunal by or under this Act or any other law for the time being in force. Consequent to Government Notification No.DL-33004/99 dated 27th May, 2014, SAT hears and disposes of appeals against orders passed by the Pension Fund Regulatory and Development Authority (PFRDA) under the PFRDA Act, 2013. Further, in terms of Government Notification No.DL-(N)/04/0007/2003-15 dated 23rd March, 2015, SAT hears and disposes of appeals against orders passed by the Insurance Regulatory Development Authority of India (IRDAI) under the Insurance Act, 1938, the General Insurance Business (Nationalization) Act, 1972 and the Insurance Regulatory and Development Authority Act, 1999 and the Rules and Regulations framed thereunder

**Establishment of Securities Appellate Tribunals.**

(1) The Central Government shall, by notification, establish a Tribunal to be known as the Securities Appellate Tribunal to exercise the jurisdiction, powers and authority conferred on it by or under this Act or any other law for the time being in force.

(2) The Central Government shall also specify in the notification referred to in sub-section (1), the matters and places in relation to which the Securities Appellate Tribunal may exercise jurisdiction.]

**Composition of Securities Appellate Tribunal (SAT)**(1) The Securities Appellate Tribunal shall consist of a Presiding Officer and such number of Judicial Members and Technical Members as the Central Government may determine, by notification, to exercise the powers and discharge the functions conferred on the Securities Appellate Tribunal under this Act or any other law for the time being in force

(2)Subject to the provisions of this Act,—

(a) the jurisdiction of the Securities Appellate Tribunal may be exercised by Benches thereof;
(b) a Bench may be constituted by the Presiding Officer of the Securities Appellate Tribunal with two or more Judicial or Technical Members as he may deem fit:Provided that every Bench constituted shall include at least one Judicial Member and one Technical Member;

(c) the Benches of the Securities Appellate Tribunal shall ordinarily sit at Mumbai and may also sit at such other places as the Central Government may, in consultation with the Presiding Officer, notify.

(3) Notwithstanding anything contained in sub-section (2), the Presiding Officer may transfer a Judicial Member or a Technical Member of the Securities Appellate Tribunal from one Bench to another Bench Presiding Officer :

The Central Government will appoint the presiding Officer of Securities Appellate Tribunal in discussion with the chief justice of India or nominee. The person so appointed as the presiding Officer Officer should meet with the following requirements:

- The retired or sitting judge of the supreme **court**
- The retired or sitting judge of the high court
- The retired or sitting judge of the high court, who has completed at least seven years of service as a judge in a high court.

**Members :**

The Central Government will appoint the two members of the Securities Appellate Tribunal. The member so appointed should possess the following qualities:

- The member should be capable of dealing with problems related to the **securities market**.
- The member should possess qualification and experience related to corporate law, securities laws, economics, finance or accountancy.

**Tenure :**

**Presiding Officer:** The tenure for Presiding Officer will be five years from the date of appointment or re-appointment.

**Members:** The tenure for the member will be five years from the date of appointment or re-appointment.

**Procedure and powers of the Securities Appellate Tribunal.**

(1) The Securities Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 1908), but shall be guided by the principles of natural justice and, subject to the other provisions of this Act, and of any rules, the Securities Appellate Tribunal shall have powers to regulate their own procedure including the places at which they shall have their sittings

(2) The Securities Appellate Tribunal shall have, for the purposes of discharging their functions under this Act, the same powers as are vested in a civil court under

the Code of Civil Procedure, 1908 (5 of 1908), while trying a suit, in respect of the following matters, namely:

(a) summoning and enforcing the attendance of any person and examining him on oath;

(b) requiring the discovery and production of documents;

(c) receiving evidence on affidavits;

(d) issuing commissions for the examination of witnesses or documents;

(e) reviewing its decisions;

(f) dismissing an application for default or deciding it ex parte ;

(g) setting aside any order of dismissal of any application for default or any order passed by it exparte.

(h) any other matter which may be prescribed.

(3) Every proceeding before the Securities Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code (45 of 1860), and the Securities Appellate Tribunal shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973 (2 of 1974).

(4) Where Benches are constituted, the Presiding Officer of the Securities Appellate Tribunal may, from time to time make provisions as to the distribution of the business of the Securities Appellate Tribunal amongst the Benches and also provide for the matters which may be dealt with, by each Bench.

(5) On the application of any of the parties and after notice to the parties, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Presiding Officer of the Securities Appellate Tribunal may transfer any case pending before one Bench, for disposal, to any other Bench.

(6) If a Bench of the Securities Appellate Tribunal consisting of two members differ in opinion on any point, they shall state the point or points on which they differ, and make a reference to the Presiding Officer of the Securities Appellate Tribunal who shall either hear the point or points himself or refer the case for hearing only on such point or points by one or more of the other members of the Securities Appellate Tribunal and such point or points shall be decided according to the opinion of the majority of the members of the Securities Appellate Tribunal who have heard the case, including those who first heard it.

**Powers of SAT :**

For the following matters, Securities Appellate Tribunal will have the same powers that the Civil Court is vested with, under the Code of Civil Procedures, 1908.

- to summon and to enforce the attendance of any person; or
- to examine him on oath; or

- to order the discovery and production of documents; or
- to procure evidence on affidavits; or
- to issue commissions for the examination of witnesses or documents; or
- to review decisions passed by the Tribunal itself; or
- to dismiss an application for default; or
- to decide an application as ex-parte; or
- set any order aside or dismiss any application for default or any order passed by it ex-parte, or
- any other matter which may be prescribed.
- Enforce and summon the attendance of any person
- Require the discovery and production of documents
- Receive evidence on affidavits
- Issue commissions for the examination of the documents or witnesses
- Dismiss an application for default or deciding it ex-parte
- Set aside any order or dismissal of any application for default or any other order passed by it ex-parte
- Any other matter as and when prescribed.
-

**Appeal to SAT :**

**Section 15T of the Securities and Exchange Board of India Act, 1992**

Under this Section, an appeal can be preferred to a Securities Appellate Tribunal having jurisdiction in the matter,

- by an order or rules and regulations of the Board made under this Act which was made on and after the commencement of the Securities Laws (Second Amendment) Act, 1999;or

1. by an order made under this Act, by an adjudicating officer; or
2. by an order of the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority.

Now we will be dealing with the Securities Appellate Tribunal (Procedures) Rules, 2000.

Who can make an appeal?

Every person aggrieved by order of the Securities and Exchange Board of India or adjudicating officer is liable to make an appeal to the Securities Appellate Tribunal (SAT).

Note: No appeal can be made to the Securities Appellate Tribunal (SAT) against any order made with the consent of the parties.

**Time Limit :**

- Every appeal to the Securities Appellate Tribunal should be filed within 45 days from the day on which a copy of the order passed by the Securities and Exchange Board of India or adjudicating office is received.
- The Securities Appellate Tribunal may allow an appeal after the expiry of the specified period of 45 days if the reason for not filing the appeal with the said period is satisfied.
- The appeal should be made in three copies along with the additional copies for each additional appeal, and that should be signed by the authorised person.

- On receipt of the appeal, the Securities Appellate Tribunal may confirm, modify or set aside the order appealed against and such appeal should be disposed of within 6 months from the date of receipt of such appeal.

**Appear before SAT :**

As per the SEBI Act, any authorised person is a **Company Secretary**, Chartered Accountant (CA), Cost Accountant or Legal Practitioner can appear before Securities Appellate Tribunal (SAT).

Appeal against the orders of SAT

- Every person aggrieved by any order or decision of Securities Appellate Tribunal can file an appeal to the supreme court. Also, the appeal only can be made on any question of law.
- The appeal should be made within 60 days from the date of receiving a copy of the order or decision of Securities Appellate Tribunal. However, the supreme court may further allow a period of 60 days for making an appeal, if it satisfied that the applicant was prevented from filing the appeal within the first 60 days due to sufficient cause.

**Securities Appellate Tribunal (Procedure) Rules, 2000 :**

The Central Government issued the following guidelines, by exercising the powers conferred to it by Section 29 read with Sections 15T and 15U of the Securities and Exchange Board of India, 1992.

Let us discuss all the Sections contained in Securities Appellate Tribunal (Procedure) Rules, 2000 and the procedures to file an appeal in the Securities Appellate Tribunal.

**Limitation for filing the appeal :**

- The appeal should be filed before the Tribunal within a period of 45 days.
- The 45 days will start from the day when the appellant receives a copy of the order against which the appeal is filed.
- It is further provided that if the appeal is not filed within 45 days then the Appellate Tribunal may if it thinks that there exists a justified reason for not filing the appeal within 45 days, allow that appeal.

**Form and procedure of appeal :**

- Any aggrieved person in the registry of the Appellate Tribunal can present a memorandum of appeal which shall be presented in the Form.
- This memorandum of appeal has to be presented in the Appellate Tribunal within whose jurisdiction the concerned case falls or shall be sent by registered post addressed to the Registrar.
- In case, the memorandum of appeal is sent through the post by the aggrieved, then it shall be deemed to have been presented in the registry on the day it was received in the registry.

**Sittings of Appellate Tribunal :**

- The Appellate Tribunal will sit either at a place where its office is situated or at any other place where the jurisdiction of the Appellate Tribunal falls(whichever place the Appellate Tribunal finds suitable).

- When the Presiding Officer is temporarily absent, Government of India can authorize either of the two other members to preside over the sitting of the Tribunal either at a place where its office is situated or at such other place where the jurisdiction of the Appellate Tribunal falls.

**Language of Appellate Tribunal :**

- All the proceedings in the Appellate Tribunal are to be conducted in either English or Hindi.
- Any appeal, application, representation, document or other matters contained in any language other than English or Hindi, will not be accepted by the Appellate Tribunal unless the same is accompanied by a true copy of the translation of the following matter, which will be in English or Hindi.

**Appeal to be in writing :**

- Every appeal, application, reply, representation or any document filed before the Appellate Tribunal should be typewritten, cyclostyled or printed neatly and legibly.
- It should be typewritten on the side of a good quality paper of foolscap size in double space and separate sheets should be stitched together. Also, every page should be consecutively numbered and filed in the manner provided in sub-rule (2).
- The appeal under sub-rule (1) shall be presented in 5 sets in a paper book along with an empty file size envelope. This envelope should bear the full address of the particular respondent whereas the full address of each respondent, in case the respondents are more than one. It should be provided

along with a sufficient number of extra paper books together with an empty file size envelope.

**Presentation and scrutiny of the memorandum of appeal :**

1. The Registrar will endorse the date on every appeal and will sign the endorsement. The date mentioned will be the one on which the appeal was presented under rule 4 or deemed to have been presented under that rule.
2. The appeal will be duly registered and a serial number will be given provided that on scrutiny, the appeal is found to be in order.
3. The Registrar may allow the appellant to rectify the defect in his presence if on scrutiny, the appeal is found to be defective and the concerned defect is formal in nature, but if the said defect is not formal in nature, the Registrar may give the appellant some time to rectify the defect as he may deem fit.
4. If the appeal has been sent by post and found to be defective, the Registrar may communicate the defects to the appellant and give the appellant some time to rectify the defect as he may deem suitable.
5. If the appellant fails to rectify the defect within the time allotted by the Registrar (in sub-rule (3)), the Registrar will pass an order which will provide for reasons to be recorded in writing and may decline to register such memorandum of appeal and communicate the order to the appellant within seven days from declining.
6. An appeal against the order of the Registrar under sub-rule (4) can be made within 15 days of receiving such order which declined the appeal. The appeal will be made to the Presiding Officer or in his temporary absence, to the Member authorized under sub-rule (2) of rule 5, whose decision will be considered as final.

**Scheduled Fee :**

Every appeal should be made along with an application fee remitted in the form of Demand Draft drawn on any nationalised bank and such fee is payable at the place where the registry is located. The amount of fee payable for appeal against adjudication orders made are as follows:

| S.No | Amount of Penalty Imposed | Amount of Fees Payable |
|---|---|---|
| 1. | Less than Rs.10,000 | Rs.500 |
| 2. | Rs.10,000 or more | Rs.1,200 |
| 3. | Rs.1 lakh or more | Rs.1,200 inclusive of Rs.500 for every one lakh of penalty. |

Note: The fee payable for any other appeal against an order of the Board under the Securities and Exchange Board of India Act should be of Rs.5000.

**Buy Back :**

**Buy-Back is a corporate action in which a company buys back its shares from the existing shareholders usually at a price higher than market price.** When it buys back, the number of shares outstanding in the market reduces.

BREAKING DOWN 'Buyback'

A buyback allows companies to invest in themselves. By reducing the number of shares outstanding on the market, buybacks increase the proportion of shares a company owns. Buybacks can be carried out in two ways:

- Shareholders may be presented with a tender offer whereby they have the option to submit (or tender) a portion or all of their shares within a certain time frame and at a premium to the current market price. Thi s premium compensates investors for tendering their shares rather than holding on to them.
- Companies buy back shares on the open market over an extended period of time.

**Conditions & Requirements for Buyback of Shares and Other Securities**

According to new SEBI (Buy-back of Securities) Regulations, 2018, the applicant requires fulfilling the following conditions for buyback of shares and other specified securities:

1. The maximum limit of buy-back of shares/securities shall be 25% or less of the total paid-up capital and free reserves of the company
Note:The reference to 25% in this regulation, in respect of the buyback of shares/securities in any of the financial year, implies its total paid-up equity capital in that FY.

The ratio of the total secures and unsecured debts that the company owes after buyback shouldn't be more than twice the paid-up capital and free reserves
**Condition**: The Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies.

2.All shares and other securities for buy-back should be wholly paid-up
ompanies may buy back their shares or other securities by any of the following means:

The existing shares other specified security-holders on the basis of proportion through the tender offer;
Open market through-

- Book-building process
- Stock Exchange
- Odd-lot holder

A company could undertake a buy-back of its own shares or securities out of the following:

Its free reserves,

The securities premium account, or

The proceeds of the issue of any shares or securities as specified:

**Condition**: Any such buy-back shall not be made out of the proceeds of an earlier issue of the similar shares or other specified securities.

Note: For this regulation, “free reserves” comprises a securities premium account.

**Restrictions on Buyback**

Along with the above-described conditions, there are some restrictions on the companies opting for buy-back of shares. These are also a kind of condition that the applicant company must follow. They are as follows:

- ★ A company can’t buy-back its shares or other specified securities from any individual via negotiated deals, whether on or off the stock exchange or through any private arrangement or through spot transactions
- ★ Companies cannot buy-back their shares or other specified securities from the stock exchange for the purpose of delisting their shares or other specified securities
- ★ Companies can’t offer any buy-back within a period of one year reckoned from the expiry date of the buyback period of the preceding offer of the buyback if any

1. The company can’t let buyback of its shares unless the consequent reduction of its share capital is affected
2. A company can’t purchase its own shares or other specified securities either directly or indirectly
3. Through any subsidiary company consisting of its own subsidiary companies;Via any investment company or group of investment companies; or In case the company has made a default in the repayment of the deposits

accepted either before or after the commencement of the Companies Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company

**Condition**: The buyba ck isn't restricted, in case the company has resolved its default and it has lapsed a period of three years after such default.

**The reasons for buy-back:**

1. To improve earnings per share;
2. To improve return on capital, return on net worth and to enhance the long-term shareholder value;
3. To provide an additional exit route to shareholders when shares are under valued or are thinly traded;
4. To enhance consolidation of stake in the company;
5. To prevent unwelcome takeover bids;
6. To return surplus cash to shareholders;
7. To achieve optimum capital structure;
8. To support share price during periods of sluggish market conditions;
9. To service the equity more efficiently.

**Advantages of Buy Back:**

- It is an alternative mode of reduction in capital without requiring approval of the Court/CLB(NCLT),
- To improve the earnings per share;

- To improve return on capital, return on net worth and to enhance the long-term shareholders value;
- To provide an additional exit route to shareholders when shares are undervalued or thinly traded;
- To enhance consolidation of stake in the company.
- To prevent unwelcome takeover bids;
- To return surplus cash to shareholders;
- To achieve optimum capital structure;
- To support share price during periods of sluggish market condition;
- To serve the equity more efficiently.

**Statutory Provisions of Buy-Back of Shares as Per Companies Act 2013 and SEBI Act :**

**Procedure for Buyback of Shares**

Now that you are aware of the conditions and if you meet the requirements, then you can go for the process for buyback of shares in India:

**Step 1:** Convene the Board Meeting Firstly, the applicant needs to call a board meeting. For the same, a notice must be sent to the directors of the company at least 7 days prior to the date of the meeting

**Step 2:** Approval for EGM

In the board meeting, the applicant company needs to approve the buy-back, fix the date of the EGM (Extra-Ordinary Meeting), and approve the EGM's notice along with the explanatory statement under Section 102

**Step 3**: Send the notice for EGM Once the notice for EGM is approved, the applicant must send it at least 21 days before the date of the meeting

**Step 4:** Passing of Special Resolution for Buy-Back of Shares

In the EGM, a special resolution must be passed for the approval of the Buy-back of shares

**Step 5**: File SH-8 After the resolution has been passed, one must file the Letter of Offer in Form SH-8 with the Registrar. Furthermore, the form must contain the signature of two directors of the company

**Step 6:** Declaration of Solvency Along with the form SH-8, you need to annex form SH-9 which is the declaration of solvency. Again, the form must be signed by the two directors of the directors.

**Step 7**: Letter of Offer to the Shareholders Within 20 days of the filing of SH-8 with the Registrar, the applicant needs to dispatch the 'Letter of Offer' to the shareholders of the company. Moreover, the Letter of Offer needs to be kept open for at least 15 days and a maximum of 30 days.

**Step 8:** Acceptance of Offer The Offer will be considered as accepted if there's no communication of rejection within 21 days of offer closure

**Step 9:** Opening of a Bank Account So, if the shareholders have accepted the offer, the applicant company has to open a separate bank account. Besides, the total consideration amount for the shares offered to be paid in Buy-back should be deposited in a separate bank account.

Furthermore, the consideration must be paid within seven days of verification. Moreover, shares that are to be bought back should be destroyed within seven days of the completion of buyback.

**Step 10:** Filing of SH-11 Lastly, the applicant needs to file form SH-11 within thirty days of the completion of the buyback return.

**DELISTING OF EQUITY SHARES :**

A company may delist its equity shares from one or more of the recognised stock exchanges on which it is listed without providing an exit opportunity to the public shareholders, if after the proposed delisting, the equity shares remain listed on any recognised stock exchange that has nationwide trading terminals.

On June 10, 2021, the Securities and Exchange Board of India (SEBI) has issued the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021.

**Applicability:** The Regulations apply to delisting of equity shares of a company including equity shares having superior voting rights from all or any of the recognised stock exchanges where such shares are listed.

(1) These regulations shall apply to delisting of equity shares of a company including equity shares having superior voting rights from all or any of the recognised stock exchanges where such shares are listed.

(2) Nothing contained in these regulations shall apply to the delisting of equity shares of a listed company—

(a) that have been listed and traded on the innovators growth platform of a recognised stock exchange without making a public issue;

(b) made pursuant to a resolution plan approved under section 31 of the Insolvency Code, if such plan provides for:

(i) delisting of such shares; or

(ii) an exit opportunity to the existing public shareholders at a specified price:

Provided that the existing public shareholders shall be provided the exit opportunity at a price which shall not be less than the price, by whatever name called, at which a promoter or any entity belonging to the promoter group or any other shareholder, directly or indirectly, is provided an exit opportunity:

Provided further that the details of delisting of such shares along with the justification for the exit price in respect of the proposed delisting shall be disclosed to the recognized stock exchange(s) where the shares are listed within one day of approval of the resolution plan under section 31 of the Insolvency Code.

**Conditions for delisting :**

(1) Neither any company shall apply for nor any recognised stock exchange shall permit delisting of equity shares of a company:-

(a) unless a period of three years has elapsed since the listing of that class of equity shares on any recognised stock exchange;

(b) if any instrument issued by the company, which is convertible into the same class of equity share(s) that is sought to be delisted, is outstanding;

(c) pursuant to a buyback of equity shares by the company, including a buyback pursuant to consolidation or division of all or part of the equity share capital of the company, unless a period of six months has elapsed from the date of completion of such buyback;

(d) pursuant to a preferential allotment made by the company unless a period of six months has elapsed from the date of such allotment:

Provided that nothing contained under clause (d) of sub-regulation (1) shall be applicable to the delisting of equity shares made by a new acquirer(s) who has made an offer under regulation 5A of the Takeover Regulations or a new promoter(s) pursuant to re-classification in terms of the provisions of the Securities and Exchange Board of India (Listing Obligations and Disclosures Requirements) Regulations, 2015.

(2) No acquirer shall propose delisting of equity shares of a company, if the acquirer had sold the equity shares of the company during the period of six months prior to the date of the initial public announcement made in terms of sub-regulation (1) of regulation 8 of these regulations.

(3) Nothing contained in clauses (a) and (b) of sub-regulation (1) shall apply to a delisting of equity shares falling under regulation 5 of these regulations.

(4) No acquirer shall, directly or indirectly, employ the funds of the company to finance an exit opportunity provided under Chapter IV of these regulations or an acquisition of sh ares made pursuant to sub-regulation (4) of regulation 33 of these regulations.

(5) No acquirer shall, directly or indirectly,–

(a) employ any device, scheme or artifice to defraud any shareholder or other person; or

(b) engage in any transaction or practice that operates as a fraud or deceit upon any shareholder or other person; or

(c) engage in any act or practice that is fraudulent, deceptive or manipulative – in connection with any delisting of equity shares sought or permitted or exit opportunity given or other acquisition of equity shares made under these regulations.

Neither any company shall apply for nor any recognised stock exchange shall permit delisting of equity shares of a company:-

(a) unless a period of three years has elapsed since the listing of that class of equity shares on any recognised stock exchange;

(b) if any instrument issued by the company, which is convertible into the same class of equity share(s) that is sought to be delisted, is outstanding;

(c) pursuant to a buyback of equity shares by the company, including a buyback pursuant to consolidation or division of all or part of the equity share capital of the company, unless a period of six months has elapsed from the date of completion of such buyback;

(d) pursuant to a preferential allotment made by the company unless a period of six months has elapsed from the date of such allotment.

2. No acquirer shall propose delisting of equity shares of a company, if the acquirer had sold the equity shares of the company during the period of six months prior to the date of the initial public announcement.

**Delisting from some of the recognised stock exchanges :**

A company may delist its equity shares from one or more of the recognised stock exchanges on which it is listed without providing an exit opportunity to the public shareholders, if after the proposed delisting, the equity shares remain listed on any recognised stock exchange that has nationwide trading terminals.

**Delisting from all the recognised stock exchanges :**

The equity shares of a company may be delisted from all the recognised stock exchanges having nationwide trading terminals on which they are listed, after an exit opportunity has been provided by the acquirer to all the public shareholders holding the equity shares sought to be delisted.

**Initial public announcement**

(1) On the date when the acquirer(s) decides to voluntarily delist the equity shares of the company, it shall make an initial public announcement to all the stock exchanges on which the shares of the company are listed and the stock exchanges shall forthwith disseminate the same to the public.

(2) A copy of the initial public announcement shall also be sent to the company at its registered office not later than one working day from the date of the initial public announcement.

(3) The initial public announcement shall contain such information as may be specified, including:—

(a) the reasons for delisting;

(b) an undertaking with respect to compliance with sub-regulations (2) and (5) of regulation 4 of these regulations.

(4) The initial public announcement shall not omit any relevant information or contain any misleading information.

**Appointment of the Manager to the offer**

(1) Prior to making an initial public announcement, the acquirer shall appoint a merchant banker registered with the Board as the Manager to the offer.

(2) The Manager to the offer appointed under sub-regulation (1) shall not be an associate of the acquirer.

(3) The initial public announcement and the subsequent activities as required under these regulations shall be undertaken by the acquirer through the Manager to the offer.

**Approval by the Board of Directors**

. (1) The company shall obtain the approval of its Board of Directors in respect of the proposal of the acquirer to delist the equity shares of the company, not later than twenty one days from the date of the initial public announcement.

(2) The Board of Directors of the company, before considering the proposal of delisting, shall appoint a Peer Review Company Secretary and provide the following information to such Company Secretary for carrying out duediligence:-

(a) the details of buying, selling and dealing in the equity shares of the company by the acquirer or its related entities during the period of two years prior to the date of board meeting held to consider the proposal for delisting, including the details of the top twenty five shareholders, for the said period;

(b) the details of off-market transactions of all the shareholders mentioned in clause (a) for a period of two years;

(c) any additional information, including the information mentioned in clauses (a) and (b) for a longer period of time, sought by the Company Secretary if the Company Secretary is of the opinion that the information provided under clauses (a) and (b) is not sufficient for providing the certification in terms of sub-regulation (3).

(3) After obtaining the information from the Board of Directors of the company under sub-regulation 2, the Company Secretary shall carry out the due-diligence and submit a report to the Board of Directors of the company certifying that the buying, selling and dealing in the equity shares of the company carried out by the acquirer or its related entities and the top twenty five shareholders is in compliance with the applicable provisions of securities laws including compliance with sub-regulation (5) of regulation 4 of these regulations.

(4) The Board of Directors of the company, while considering the proposal for delisting, shall certify that—

(a) the company is in compliance with the applicable provisions of securities laws;

(b) the acquirer and its related entities are in compliance with the applicable provisions of securities laws in terms of the report of the Company Secretary including compliance with sub-regulation (5) of regulation 4 of these regulations;

(c) the delisting, in their opinion, is in the interest of the shareholders of the company(5) While communicating the decision of the Board of Directors on the proposal for delisting of equity shares, the company shall also submit to the recognized stock exchanges on which the equity shares of the company are listed, the due – diligence report of the Company Secretary in terms of sub-regulation (3) and the audit report in terms of sub-regulation (2) of regulation 12 of these regulations.

(6) Upon receipt of the communication from the company under sub-regulation (5), the stock exchanges shall forthwith disseminate the same to the public.

**Approval by shareholders**

(1) The company shall obtain the approval of the shareholders through a special resolution, not later than forty five days from the date of obtaining the approval of Board of Directors.

(2) The special resolution shall be passed through postal ballot and / or e-voting as per the applicable provisions of the Companies Act, 2013 (18 of 2013) and the rules made thereunder.

(3) The company shall disclose all material facts in the explanatory statement sent to the shareholders in relation to such a resolution.

(4) The special resolution shall be acted upon only if the votes cast by the public shareholders in favour of the proposal are at least two times the number of votes cast by the public shareholders against it.

**In-principle approval of the stock exchange**

(1) The company shall make an application to the relevant recognised stock exchange for in-principle approval of the proposed delisting of its equity shares in the Form specified by the recognised stock exchange from time to time, not later than fifteen working days from the date of passing of the special resolution or receipt of any other statutory or regulatory approval, whichever is later.

(2) The application seeking in-principle approval for the delisting of equity shares shall be accompanied by an audit report as required under regulation 76 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 in respect of the equity shares sought to be delisted, covering a period of six months prior to the date of the application.

(3) Such application seeking in-principle approval for the delisting of the equity shares shall be disposed of by the recognised stock exchange within a period not exceeding, fifteen working days from the date of receipt of such application that is complete in all respects.

(4) The recognised stock exchange shall not unfairly withhold such an application, but may require the company to satisfy or inform it as regards –

(a) compliance with regulations 10 and 11 of these regulations;

(b) resolution of investor grievances by the company;

(c) payment of listing fees due to the recognised stock exchange;

(d) compliance with any provision of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 as amended from time to time, that has a material bearing on the interests of its equity shareholders;

(e) any litigation or action pending against the company pertaining to its activities in the securities market or any other matter having a material bearing on the interests of its equity shareholders;

(f) any other relevant matter as it may deem fit.

## QUESTION BANK

## UNIT IV

## PART-A

1 List out the primary objectives of SEBI.

2 How is the board of Management of SEBI constituted?

3 What is Securities appellate tribunal?

4 What do you mean by “Buy Back of Shares”?

5 Mention the qualifications of members of SAT

6 Who is a presiding officer in SAT?

7 List out the reasons for buy back of shares.

8 State any two benefits of Buy back of shares.

9 When did SEBI Act come to force?

10 State the tenure of various offices under SAT

PART-B

1 Discuss the powers and functions of SEBI Act.

2 Elaborate the Statutory provisions for buy back of Shares

3 Examine the conditions for Delisting of Shares.

4 Describe the objectives and guidelines of SEBI.

5 Explain the procedure and powers of Securities Appellate Tribunal

6 Explain the process of buying back through stock exchange

7 Outline the process for Delisting of shares of a Company

8 Summarize the functions of Securities Appellate Tribunal

9 Determine the powers of SAT in detail

10 Examine the statutory Provisions of Buy-Back of Shares as Per Companies Act 2013 and SEBI Act

## REFERENCE


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# UNIT 5

## DEPOSITORIES ACT, 1996

Depository System in India; Role & Functions of Depositories - Depository Participants - Admission of Securities - Dematerialization & Re-materialisation; Depository Process; Inspection and Penalties; Internal Audit and Concurrent Audit of Depository Participants.

## INTRODUCTION

A Depository is an organization like a Central Bank where the securities of a shareholder are held in the electronic form at the request of the shareholder through the medium of a Depository Participant. To utilize the services offered by a Depository, the investor has to open an account with the Depository through a Depository Participant.

According to Section 2(e) of the Depositories Act, 1996, Depository means a company formed and registered under the Companies Act, 2013 and which has been granted a certificate of registration under Section 12(1A) of the SEBI Act, 1992.

A depository cannot act as a depository unless it obtains a certificate of commencement of business from the SEBI. There are two Depositories functioning in India, namely the National Securities Depository Limited (NSDL) and the Central Depository Services (India) Limited (CDSL).Under the provisions of the Depositories Act, these Depositories provide various services to investors and other Participants in the capital market, such as, clearing members, stock exchanges, investment institutions, banks and issuing corporates. These include basic facilities like account opening, dematerialization, settlement of trades and advanced facilities like pledging, distribution of non-cash corporate actions, distribution of securities to allottees in case of public issues, etc.

All the securities held by a depository shall be dematerialized and shall be in a fungible form. To utilize the services offered by a depository, the investor has to open an account with the depository through a participant, similar to the opening of an account with any of the bank branches to utilize services of that bank. Registration of the depository is required under the SEBI (Depositories and Participants) Regulations, 2018 and is a pre-condition to the functioning of the depository. Depository and depository participant both are regulated by the SEBI.

**Definition**

The Depository Act was enacted by the Indian Parliament to provide a legal framework for the establishment of depositories. The term "Depository" is **a registered organization which helps an investor to buy or sell securities such as shares, debentures and bonds in an electronic form.**

**Certificate of commencement of business by depositories.**

(1) No depository shall act as a depository unless it obtains a certificate of commencement of business from the Board.

(2) A certificate granted under sub-section (1) shall be in such form as may be specified by the regulations

(3) The Board shall not grant it certificate under sub-section (1) unless it is satisfied that the depository has adequate systems and safeguards to prevent manipulation of records and transactions: Provided that no certificate shall be

refused under this section unless the depository concerned has been given a reasonable opportunity of being heard.

**Agreement between depository and participant.**

(1) A depository shall enter into an agreement with one or more participants as its agent.

(2) Every agreement under sub-section (1) shall be in such form as may be specified by the bye-laws.

**Services of depository.**

Any person, through a participant, may enter into an agreement, in such form as may be specified by the bye-laws, with any depository for availing its services.

**Rights of depositories and beneficial owner.**

(1) Notwithstanding anything contained in any other law for the time being in force, a depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner.

(2) Save as otherwise provided in sub-section (1), the depository as a registered owner shall not have any voting rights or any other rights in respect of securities held by it.

(3) The beneficial owner shall be entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository

**DEPOSITORY FUNCTION**

– Account opening

– Dematerialisation

– Rematerialisation

– Settlement

– Initial Public Offers (IPO’s), corporate benefits

– Creation of encumbrance

**ROLE AND FUNCTIONS OF DEPOSITORIES**

In the depository system, the ownership and transfer of securities takes place by means of electronic book entries. At the outset, this system rids the capital market of the dangers related to handling of paper. The system provides numerous direct and indirect benefits, like:

**Elimination of bad deliveries**

In the depository environment, once the holdings of an investor are dematerialised, the question of bad delivery does not arise i.e. they cannot be held “under objection”. Inthe physical environment, buyer of shares was required to take the risk of transfer and face uncertainty of the quality of assets purchased, while in a depository environment good money certainly begets good quality of assets.

**Elimination of all risks associated with physical certificates**

Dealing in physical securities have associated security risks of theft, mutilation of certificates, loss of certificates during movements through and from the registrars, thus exposing the investors to the cost of obtaining duplicate certificates, loss of certficates and advertisements, etc. This problem does not arise in the depository environment.

**Immediate transfer and registration of securities**

In the depository environment, once the securities are credited to the investor's account on pay out, he becomes the legal owner of the securities. There is no further need to send it to the company's registrar for registration. If securities are purchased in the physical environment, the investor has to send it to the company's Share Transfer Agent so that the change of ownership can be registered. This process usually takes around three to four months and is rarely completed within the statutory framework of two months thus exposing the investor to opportunity cost of delay in transfer and to risk of loss in transit. To overcome this, the normally accepted practice is to hold the securities in street names i.e. not to register the change of ownership. However, if the investors miss a book closure the securities are not good for delivery and the investor would also stand to loose their corporate entitlements.

**Faster disbursement of non-cash corporate benefits like rights, bonus, etc.**
Depository system provides for direct credit of non-cash corporate entitlements to an investors account, thereby ensuring faster disbursement and avoiding risk of loss of certificates in transit.

**Reduction in brokerage by many brokers for trading in dematerialized securities**

Brokers provide this benefit to investors as dealing in dematerialized securities reduces their back office cost of handling paper and also eliminates the risk of being the introducing broker.Reduction in handling of huge volumes of paper and periodic status reports to investors on their holdings and transactions, leading to better controls.

**Elimination of problems related to change of address of investor, transmission, etc.**

In case of change of address or transmission of demat shares, investors are saved from undergoing the entire change procedure with each company or registrar. Investors have to only inform their DP with all relevant documents and the required changes are effected in the database of all the companies, where the investor is a registered holder of securities.

**Elimination of problems related to selling securities on behalf of a minor**

A natural guardian is not required to take court approval for selling demat securities on behalf of a minor.

**Other roles of Depositories**

The role of depositories can vary from country to country and the range of services offered in each country may differ. Nowadays depositories continue to expan d and offer new services on a continual basis. Some of the other roles of depositories are;

- Removing or minimising problems associated with a change of address of an investor
- Removal of problems associated with the transfer or selling of shares of a minor
- Ease in portfolio monitoring
- The role of depositories in other countries includes underwriting new securities
- Processing dividend and interest payments

- Announcing, reporting and facilitating tender offers and reorganisations in addition to the deposit and withdrawal of securities

Depositories offer their services through depository participants. All of the functions including the various roles of depositories are performed by depository participants. Depository participants are a bridge between depositories and investors. This means that any investor who wishes to make use of the services provided by depositories does so through the depository participants. Depository participants can be banks or other financial institutions, brokers, custodian participants, registrars, share transfer agents or non-banking financial companies. There can be one or various organisations offering depository services in a country. Depositories are regulated by the securities exchange board.

Following services are provided by a depository to the beneficial owners but of course, through a depository participant:

- Opening a demat account;
- Dematerialization, i.e. converting physical securities into electronic form,
- Rematerialization, i.e. converting electronic securities balances held in a BO account into physical form;
- Maintaining record of securities held by the beneficial owners in the electronic form;
- Settlement of trades by delivery or receipt of securities from / in BO accounts;

● Settlement of off-market transactions between BOs;

● Receiving electronic credit in respect of securities allotted by issuers under IPO or otherwise on behalf of demat account holders;

● Receiving non cash corporate benefits such as allotment of bonus and rights shares or any other non-cash corporate benefits given by the issuers in electronic form on behalf of its demat account holders,

● Pledging of dematerialized securities & facilitating loans against shares,

● Freezing of the demat account for debits, credits, or both

**Difference between Depository and Custodian**

Both depository and custodian services are responsible for safe keeping of securities but they are different in the sense that the Depository can legal maintains securities' account balances and intimates the status of holding to the account holder from time to time. According to the SEBI guidelines, Financial Institutions like banks, custodians, stock-brokers etc. can become participants in the depository.

**Characteristics of a DP:**

– Transmission requests/nomination

– Acts as an Agent of Depository

– Customer interface of Depository

– Functions like Securities Bank

– Account opening

– Facilitates dematerialisation/rematerialisation

– Instant transfer on pay-out

– Enables off market transfers

– Settles trades in electronic segment

– Pledge/enforcement of pledge etc.

A DP is one with whom an investor needs to open an account to deal in shares in electronic form. While the Depository can be compared to a Bank, DP is like a branch of that bank with which an account can be opened.

**The SEBI (Depositories and Participants) Regulations, 1996**

SEBI had circulated a consultative paper on the framework of the draft regulations for depositories and participants in October 1995. Extensive discussion were then held with the stock exchanges, market participants and investors on this issue. In addition to the views expressed at these meetings, SEBI also had the benefit of written comments on the Consultative Paper submitted by chambers of commerce and industry, market participants and investors. Based on the above, the SEBI (Depositories and Participants) Regulations, 1996 were notified in May 1996.

These regulations provide for the following:

- registration of depositories and participants under the SEBI Act

- grant of certificate of commencement of business upon satisfaction that adequate safeguards and systems to prevent manipulation of records and transactions have been put in place, as required by the Depositories Act
- the eligibility criteria for admission of securities to a depository
- the specific rights and obligations of depositories, participants and issuers in addition to those specified in the Depositories Act
- periodic reports to and inspections and enquiries by SEBI
- penal action and procedure in case of default

In addition, the regulations contain the following provisions:

- the minimum capital of the company that is to be registered as depository, has been set at Rs. 100 crore
- the eligibility criteria for the sponsors of a depository, who have been restricted to financial institutions, custodians, non-banking finance companies and stock brokers with a minimum net worth of Rs. 50 lakh and subject to a ceiling of 25 times their net worth on the value of the portfolios for which they act as participant
- provisions for the indemnification of beneficial owners including insurance cover for the depository and participants
- the adequacy of safeguards and procedures that are to be put in place before commencement of business is allowed to the depository
- the internal and external controls and audit mechanisms that are to be instituted by the depository in order to ensure the integrity of data processing systems and the adequacy of systems and procedures to prevent systemic failure, manipulation or loss of records

**The SEBI(Depositories and Participants)(Amendment) Regulations, 1997**

In February 1997, the SEBI (Depositories and Participants) Regulations, 1997 were amended to restrict foreign ownership of a depository, whether as sponsors or participants to 20% of its equity. The regulations were also amended to permit non-banking finance companies with a minimum net worth of Rs. 50 crore in addition to the net worth specified by any other authority to act as participants in a depository on behalf of other beneficial owners.

**The National Securities Depository Limited Following the notification of the SEBI (Depositories and Participants) Regulations, 1996**,

NSDL, a company sponsored by the IDBI, the UTI and the NSE was granted a certificate of registration as a depository on June 7, 1996. NSDL was granted a certificate of commencement of business on October 31, 1996. NSDL began the process of dematerialisation of securities with three participants and three securities eligible for dematerialisation.

As of March 31, 1997, 28 participants had been registered by SEBI as participants in NSDL. Of these 10 were banks, 2 were financial institutions, 3 non bank custodians, 11 were stock brokers and 2 other non bank finance companies. All the major custodians of securities who act on behalf of FIIs, mutual funds and financial institutions had become participants in NSDL. For a security to be declared eligible for dematerialisation in NSDL, the issuer (and his registrar and transfer agent in case there is one) has to sign an agreement with NSDL. This agreement lays down the obligations and responsibilities of the issuer and NSDL with respect to each other, in addition to those prescribed in the Depositories Act and the SEBI regulations. As the Depositories Act permits investors to hold securities which are eligible for dematerialisation in a depository in physical form outside the depository, it is important that the issuer or the issuer's registrar and transfer agent have been required to reconcile the holdings of a security in physical form with those held in dematerialised form on a daily basis.

As of March 31, 1997, issuers had signed agreements with NSDL in respect of 43 securities. The market capitalisation of securities for which issuers had established electronic connectivity with NSDL at the end of 1996-97 stood at Rs. 44,973 crore. As of March 31, 1997, the market value of dematerialised securities stood at Rs. 502 crore. These were held on behalf of 1,957 beneficial owners.

At present, only the capital market segment of the NSE and the National Securities Clearing Corporation Limited (NSCCL), which acts as the clearing corporation for securities traded on the capital market segment of the NSE are integrated with the depository. Only trades which are executed on the dematerialised securities trading segment on the NSE can be cleared by NSCCL for settlement by electronic book entry within NSDL. The Depositories Act, 1996 amended the Indian Stamp Act, 1899, to exempt transfers of equity shares through electronic book entry from payment of stamp duty.

**Admission of securities**

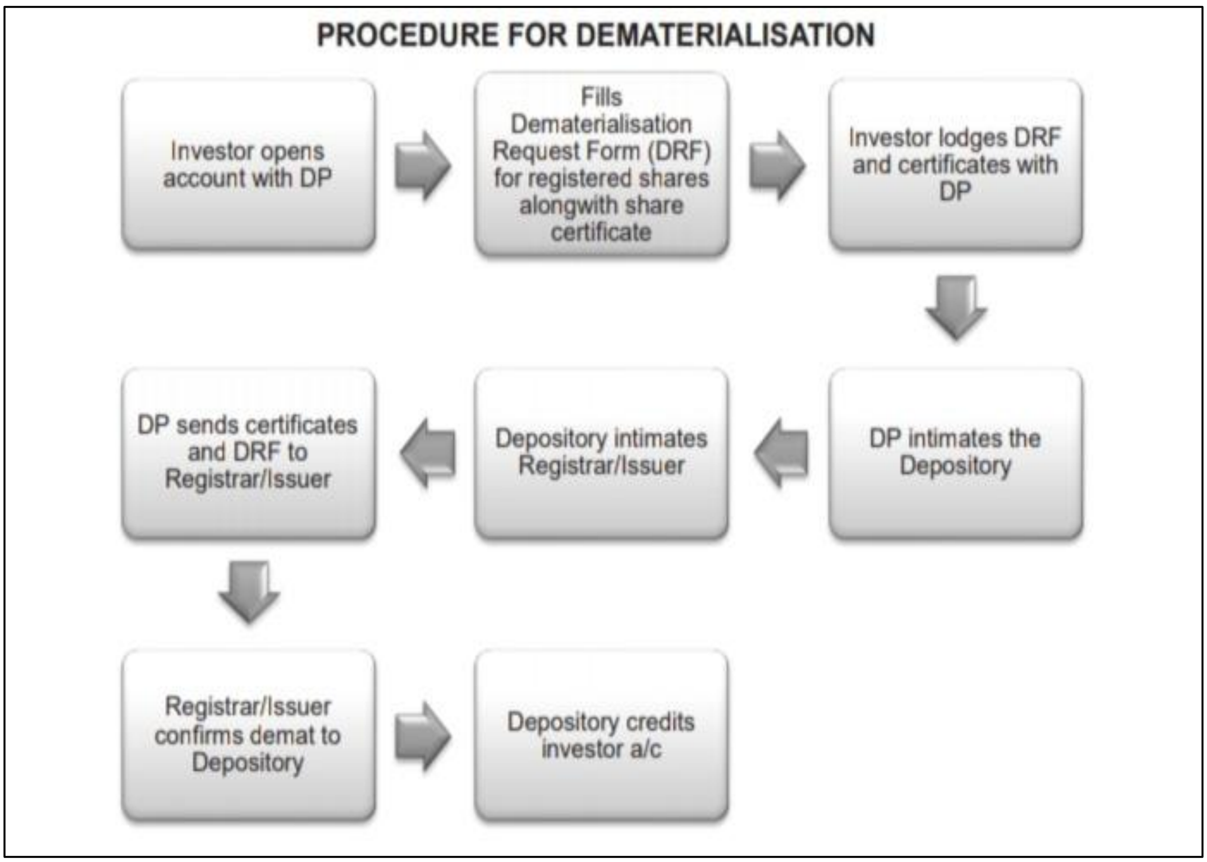
The registration of securities ensures the enforceability of shareholders’ ownership rights, a higher degree of circulation safety and greater trust by investors, partners and financial institutions.

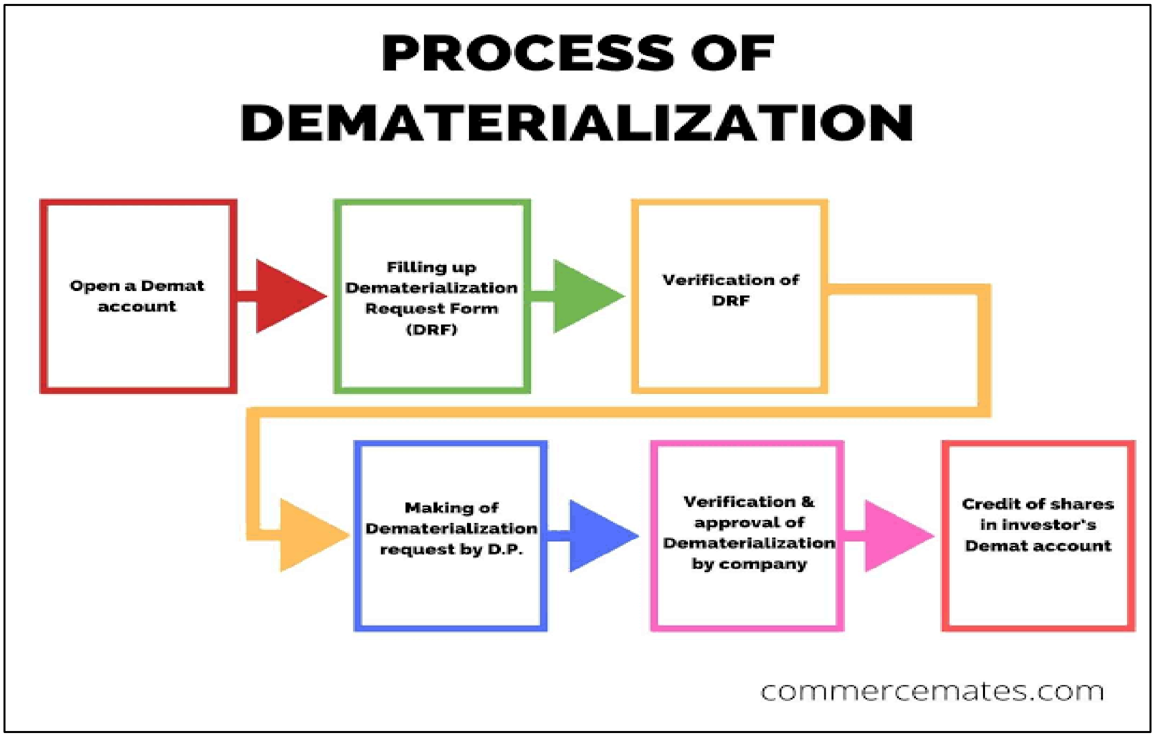
- Law under which the securities are constituted allows securities to be represented in book-entry form subsequent to a direct issuance in dematerialized form;
- Law under which the securities are constituted does not prohibit securities to be validly issued and transferred in the Settlement System to which admission is requested;
- All securities of the same issue are fungible,
- Admission of securities complies with the requirements of the law applicable to the Settlement System to which the admission is requested.
- Shares of companies registered in the Estonia and other securities constituted under Estonian law are admitted to Estonian Settlement System;
- Shares of companies registered in the Iceland and other securities constituted under Icelandic law are admitted to Icelandic Settlement System;
- Shares of companies registered in the Latvia and other securities constituted under Latvian law are admitted to Latvian Settlement System;
- Shares of companies registered in the Lithuania and other securities constituted under Lithuanian law are admitted to Lithuanian Settlement System.

**DEMATERIALIZATION**

Dematerialization is a process by which the physical share certificates of an investor are taken back by the Company and an equivalent number of securities are credited his account in electronic form at the request of the investor. An investor will have to first open an account with a Depository Participant and then request for the dematerialization of his share certificates through the Depository Participant so that the dematerialized holdings can be credited into that account. This is very similar to opening a Bank Account.

Dematerialization of shares is optional and an investor can still hold shares in physical form. However, he/she has to demat the shares if he/she wishes to sell the same through the Stock Exchanges, as physical shares are to be sold through a separate session and are sold at a big discount to the market prices. Similarly, if an investor purchases shares from the Stock Exchange, he/she will get delivery of the shares in demat form. Odd lot share certificates can also be dematerialized. Similarly, in Public Issues/Right Issues, shares are issued only in demat form.






In order to dematerialise physical securities one has to fill in a DRF (Demat Request Form) which is available with the DP and submit the same along with physical certificates that are to be dematerialised. Separate DRF has to be filled for each ISIN. The complete process of dematerialisation is outlined below:

1.Surrender certificates for dematerialisation to your DP.

2.DP intimates to the Depository regarding the request through the system.

3.DP submits the certificates to the registrar of the Issuer Company.

4,Registrar confirms the dematerialisation request from depository.

5.After dematerialising the certificates, Registrar updates accounts and informs depository regarding completion of dematerialisation.

6.Depository updates its accounts and informs the DP.

7.DP updates the demat account of the investor.

**Procedure for selling dematerialised securities**

The procedure for buying and selling dematerialised securities is similar to the procedure for buying and selling physical securities. The difference lies in the process of delivery (in case of sale) and receipt (in case of purchase) of securities.

**In case of purchase:-**

- The broker will receive the securities in his account on the payout day.
- The broker will give instruction to its DP to debit his account and credit BO's account.
- BO will give 'Receipt Instruction' to DP for receiving credit by filling appropriate form. However BO can give standing instruction for credit to his account that will obviate the need of giving Receipt Instruction every time.

**In case of sale**

BO will give delivery instruction through Delivery Instruction Slip (DIS) to DP to debit his account and credit the broker's account. Such instruction should reach the DP's office at least 24 hours before the pay-in, failing which, DP will accept the instruction only at the BO's risk.

## REMATERIALISATION

Rematerialisation is the process of converting securities held in electronic form in a demat account back in physical certificate form. For the purpose of rematerialisation, the client has to submit the rematerialisation request to the DP with whom he has an account. A client can rematerialise his dematerialised holdings at any point of time. The securities sent for rematerialisation cannot be traded.

### Features

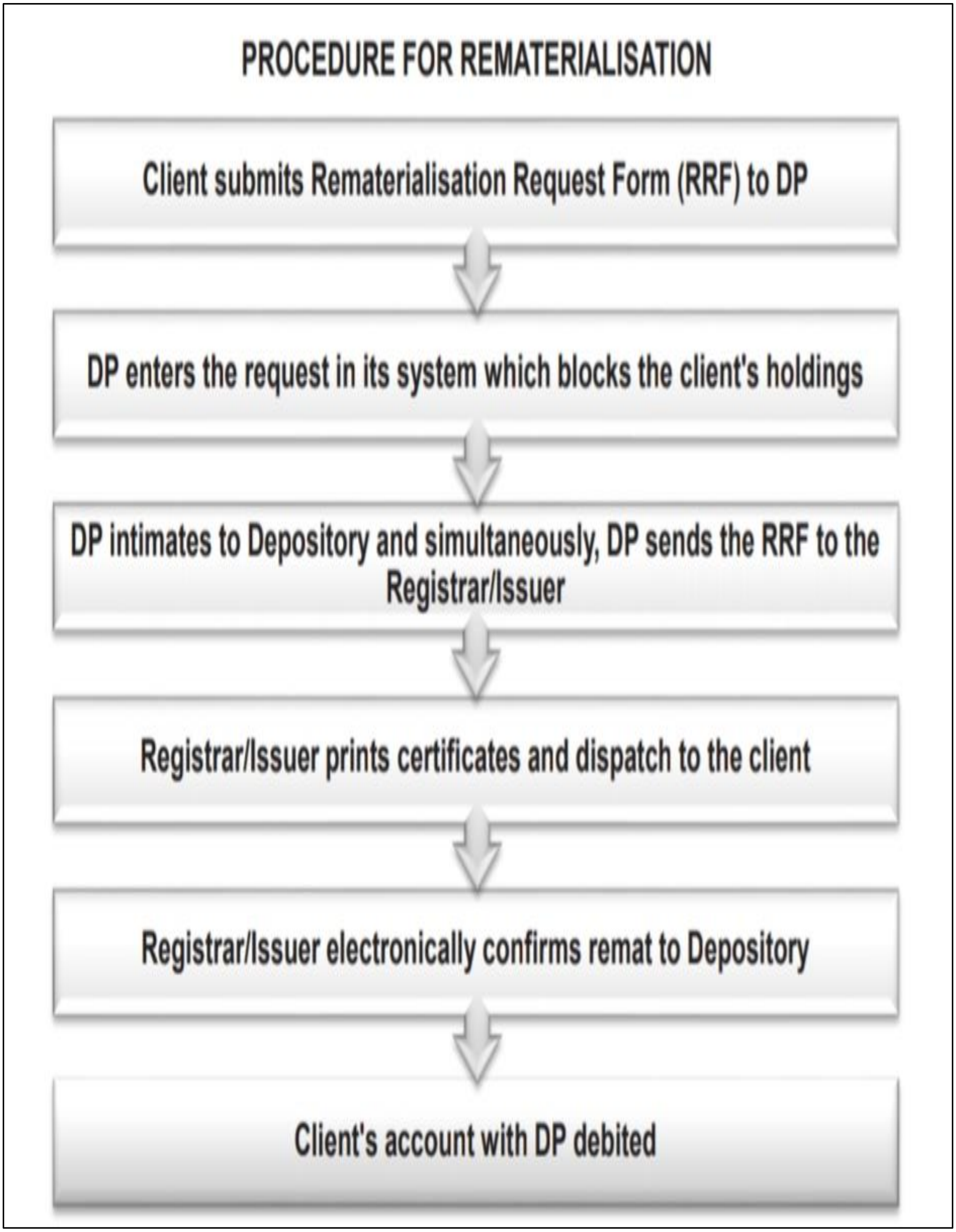
- A client can rematerialise his dematerialised holdings at any point of time.
- The rematerialisation process is completed within 30 days.
- The securities sent for rematerialisation cannot be traded.

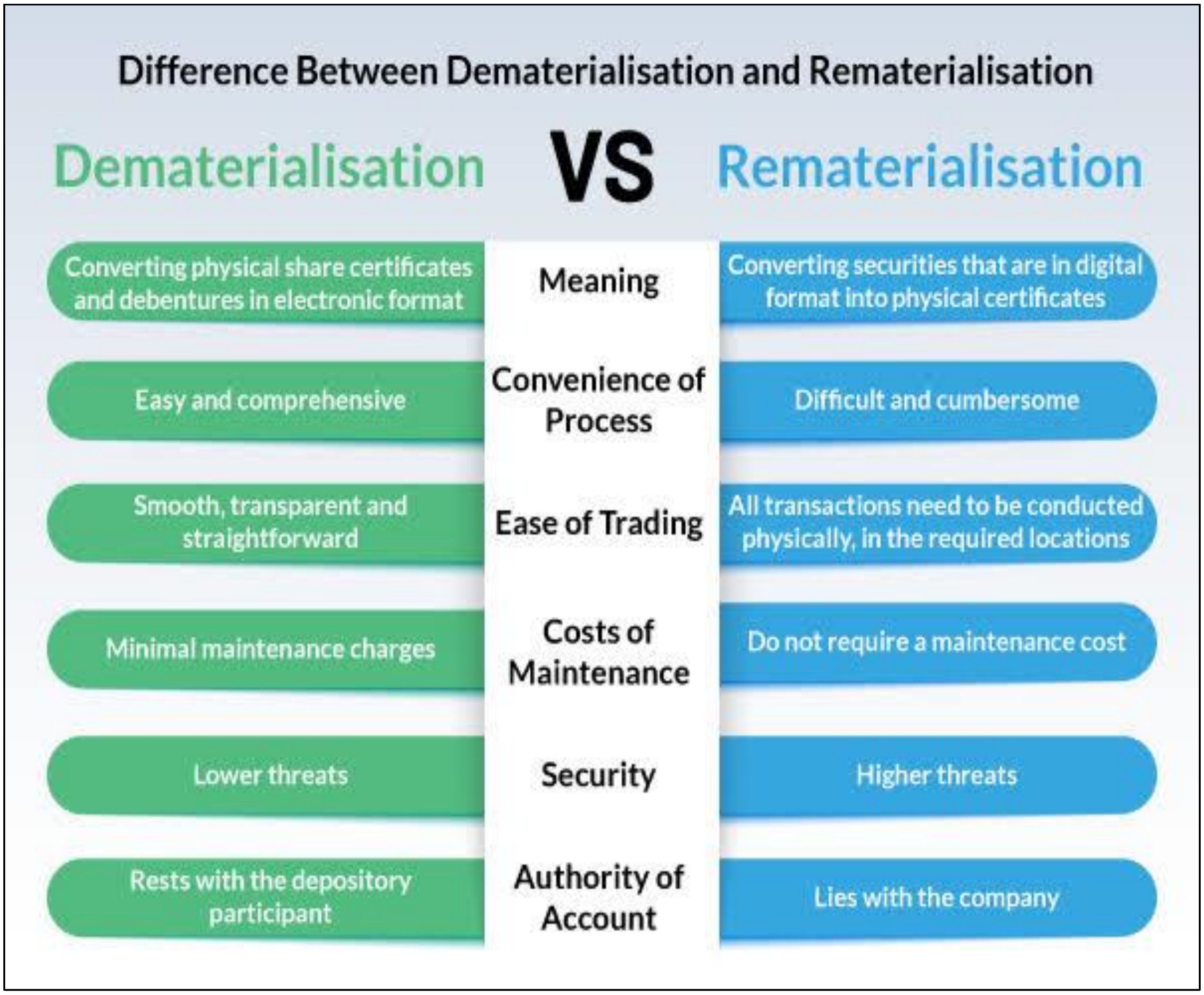
### Process

The process is called rematerialisation. If one wishes to get back his securities in the physical form he has to fill in the RRF (Remat Request Form) and request his DP for rematerialisation of the balances in his securities account. The process of rematerialisation is outlined below:

- Make a request for rematerialisation.
- Depository participant intimates depository regarding the request through the system.
- Depository confirms rematerialisation request to the registrar.

- Registrar updates accounts and prints certificates.
- Depository updates accounts and downloads details to depository participant.
- Registrar dispatches certificates to investor.


PROCEDURE FOR REMATERIALISATION
Client submits Rematerialisation Request Form (RRF) to DP
DP enters the request in its system which blocks the client's holdings
DP intimates to Depository and simultaneously, DP sends the RRF to the Registrar/Issuer
Registrar/Issuer prints certificates and dispatch to the client
Registrar/Issuer electronically confirms remat to Depository
Client's account with DP debited




**Depository process**

When the shares are handed over to the depository system, the shares get immobilized as they are no more with the shareholder in physical form.

**Notification by Stock Exchange**

The stock exchange concerned where the shares are listed will come out with a notification for the dematerialization of shares.

**Dematerialization Form**

The shareholder will obtain the Dematerialisation request form from the Depository Participant. This form will contain details about the name of the company, folio number and the distinctive number of the shares which are given for dematerialization. The form will be signed by either the single owner if it is held so or by joint owners, when they are held jointly.

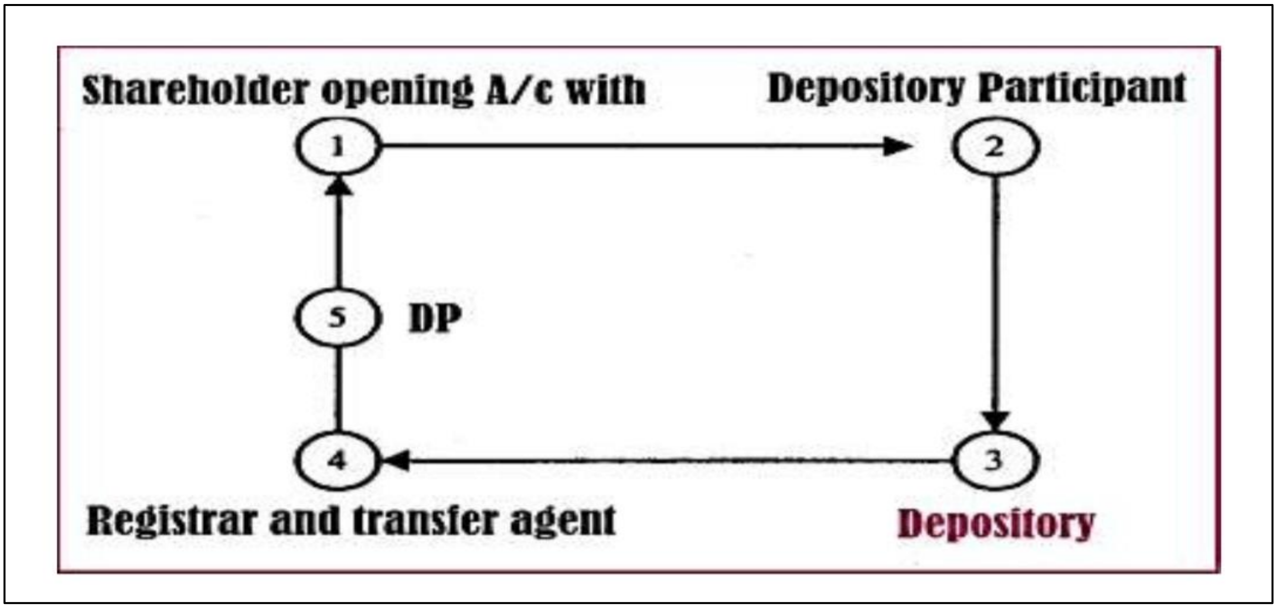
**Registering of shares**

When the D.P hands over the securities to the depository, the securities will be sent to Share Registrar who will register the depository name and the particulars of shares. But, before doing this, the ownership of the securities should be verified with the company and hence, this procedure will take some time.

In case the signature in the requisition form does not tally with the specimen signature held by the company, then the request for dematerialization will be rejected as it amounts to bad delivery.

**Crediting the investor account**

In the last stage, the Depository will inform the D.P the details of shares registered in the name of the shareholder concerned. On this basis, the D.P will send the Statement of Account, to the customer shareholder.




**Objectives of Depository**

The introduction of depository system will result in the elimination of all the problems connected with ownership, trading and transfer of securities. It plays a crucial role in Indian capital market. Depository system enables the capital market to achieve the following objectives:

1. It eliminates the occurrence of bad deliveries, forgery and duplicate share certificates.

2. It avoids delay in transfer of securities.

3. It enhances liquidity of securities by facilitating their easy transfer.

4. It substantially reduces the cost of transactions for the investor.

5.It enables surrender and withdrawal of securities from it with ease.

6. It maintains an accurate record of investors' holdings by keeping the details in electronic form.

7. It attracts foreign investors by complying with global standards.

8. It provides service infrastructure in a capital market.

**POWER OF THE SEBI:**

Section 18 of the Act provides that the SEBI in the public interest or in the interest of investors may by order in writing to call upon any issuer, depository, participant or beneficial owner to furnish in writing such information relating to the securities held in a depository as it may require; or authorise any person to make an enquiry or inspection in relation to the affairs of the issuer, beneficial owner, depository or participant, who shall submit a report of such enquiry or inspection to it within such period as may be specified in the order.

Sub-section (2) to Section 18 provides that every director, manager, partner, secretary, officer or employee of the depository or issuer or the participant or beneficial owner shall on demand produce before the person making the enquiry or inspection all information or such records and other documents in his custody having a bearing on the subject matter of such enquiry or inspection.

**To Give Directions**

Section 19 provides that the SEBI, if after making or causing to be made an enquiry or inspection, the SEBI is satisfied that it is necessary in the interest of investors or the securities market or to prevent the affairs of any

depository or participant being conducted in the manner detrimental to the interests of investors or the securities market, it may issue such directions, –

(a) to any depository or participant or any person associated with the securities market; or

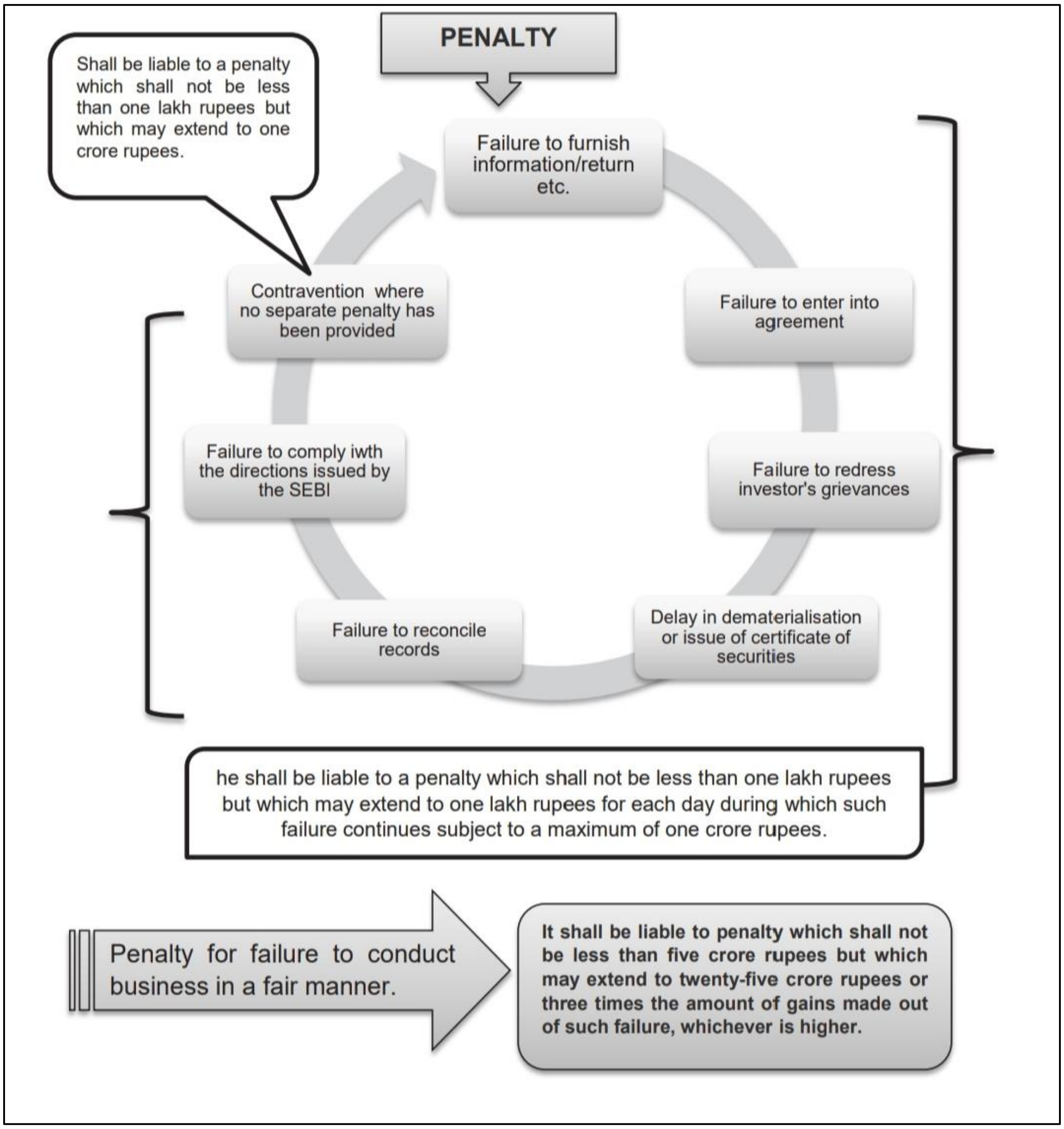
(b) to any issuer, as may be appropriate in the interest of investors or the securities market.

**INSPECTION AND PENALTIES**

**PENALTIES AND ADJUDICATION**

| S.No | Section | Section Particulars |
|---|---|---|
| 1. | Section 19A | Failure to furnish information, return, etc. |
| 2. | Section 19B | Failure to enter into an agreement |
| 3. | Section 19C | Failure to redress investors' grievances |
| 4. | Section 19D | Delay in dematerialisation or issue of certificate of securities |
| 5. | Section 19E | Failure to reconcile records |
| 6. | Section 19F | Failure to comply with directions issued by the SEBI under section 19 of the Act |
| 7. | Section 19G | Contravention where no separate penalty has been provided |
| 8. | Section 19H | Power to adjudicate |
| 9. | Section 19I | Factors to be taken into account by adjudicating officer |
| 10. | Section 19-IA | Settlement of Administrative Civil Proceedings |

| | | |
|---|---|---|
| 11. | Section 19-IB | Recovery of amounts |
| 12. | Section 19J | Crediting sums realised by way of penalties to Consolidated Fund of India |




## Adjudication

The adjudication procedure as mentioned under Section 19H to 19J of the Depositories Act, 1996 is same as the adjudication procedure prescribed under the SEBI Act, 1992. Hence, student may refer the same.

**AUDIT UNDER SEBI (DEPOSITORIES AND PARTICIPANTS) REGULATIONS, 2018:**

Regulation 76 of SEBI (Depositories and Participants) Regulations, 2018 provides that every issuer shall submit audit report on a quarterly basis to the concerned stock exchanges audited by a practising Company Secretary or a qualified Chartered Accountant, for the purposes of reconciliation of the total issued capital, listed capital and capital held by depositories in dematerialized form, the details of changes in share capital during the quarter and the in-principle approval obtained by the issuer from all the stock exchanges where it is listed in respect of such further issued capital.

The audit report is required to give the updated status of the register of members of the issuer and confirm that securities have been dematerialized as per requests within 21 days from the date of receipt of requests by the issuer and where the dematerialization has not been effected within the said stipulated period, the report would disclose the reasons for such delay.The issuer is under an obligation to immediately bring to the notice of the depositories and the stock exchanges, any difference observed in its issued, listed, and the capital held by depositories in dematerialized form.

**INTERNAL AUDIT OF OPERATIONS OF DEPOSITORY PARTICIPANTS:**

The two Depository service providers in India, viz., National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Limited (CDSL) have allowed Company Secretaries in Whole-time Practice to undertake internal audit of the operations of Depository Participants (DPs).

NSDL has vide its circular No. NSDL/SG/II/010/99 dated 26th March 1999 notified amendment of its Bye Law "Every Participant shall ensure that an internal audit in respect of the operations of the Depository is conducted at intervals of not more than three months by a qualified Chartered Accountant or a Company Secretary holding a certificate of Practice and a copy of the internal audit report shall be furnished to the Depository."

CDSL has vide its letter dated September 28, 1999 notified amendment of its Bye Laws "Every Participant shall ensure that an internal audit shall be conducted in respect of the participant's operations relating to CDSL by a qualified Chartered Accountant in accordance with the provisions of the Chartered Accountants Act, 1949 or by a Company Secretary in practice in accordance with the provisions of the Company Secretaries Act, 1980, at such intervals as may be specified by CDSL from time to time. A copy of Internal Audit report shall be furnished to CDSL."

**Checklist of Internal Audit of Operations of Depository Participants**

– Account opening

– Reporting to BOs

– Dematerialisation of Securities

– Rematerialisation of Securities

– Market Trades

– Off Market Trades

– Transmission

– Returns to Depository

– Grievance Redressal Mechanism

– Collateral Security

– Assignment of Business

– Freezing of Account

– Closure of Account

– Pledge and Hypothecation

– Invocation of Pledge/Hypothecation by Pledgee

– Lending and Borrowing of Securities

– Records to be Maintained by DPs

– Disclosure and Publication of Information

– Supervision by DP

– Code of Ethics for DPs

– Branch of Depository Participants

**CONCURRENT AUDIT**

National Securities Depository Limited vide its Circular No. NSDL/POLICY/ 2006/0021 dated June 24, 2006 provides for concurrent audit of the Depository Participants. The Circular provides that w.e.f. August 1, 2006, the process of demat account opening, control and verification of Delivery Instruction Slips (DIS) is subject to Concurrent Audit.

Depository Participants have been advised to appoint a firm of qualified Chartered Accountant(s) or Company Secretary(ies) holding a certificate of practice for conducting the concurrent audit. However, the participants in case they so desire, may entrust the concurrent audit to their Internal Auditors. In respect of account opening, the auditor should verify all the documents including KYC documents furnished by the Clients and verified by the officials of the Participants. The scope of concurrent audit with respect to control and verification of DIS cover the areas given below:

**(I) Issuance of DIS**

The procedure followed by the Participants with respect to:

(a) Issuance of DIS booklets including loose slips.

(b) Existence of controls on DIS issued to Clients including pre-stamping of Client ID and unique pre-

printed serial numbers.

(c) Record maintenance for issuance of DIS booklets (including loose slips) in the back office.

**(II) Verification of DIS**

The procedure followed by the Participants with respect to:

(a) Date and time stamping (including late stamping) on instruction slips.

(b) Blocking of used/reported lost/stolen instruction slips in back office system/ manual record.

(c) Blocking of slips in the back office system/manual record which are executed in DPM directly.

(d) Two step verification for a transaction for more than Rs. 5 lakh, especially in case of off-market transactions.

(e) Instructions received from dormant accounts.

The Concurrent Auditor should conduct the audit in respect of all accounts opened, DIS issued and controls on DIS as mentioned above, during the day, by the next working day. In case the audit could not be completed within the next working day due to large volume, the auditor should ensure that the audit is completed within a week’s time.

Any deviation and/or non-compliance observed in the aforesaid areas should be mentioned in the audit report of the Concurrent Auditor. The Management of the Participant should comment on the observations made by the Concurrent Auditor. The Concurrent Audit Report should be submitted to NSDL, on a quarterly basis, in a hard copy form. If the Auditor for Internal and Concurrent Audit is the same, consolidated report may be submitted.

**ELECTRONIC CREDIT IN NEW ISSUES**

– Investor opens account with DP

– Submits application with option to hold securities in depository giving DP-Id and Client-Id

– Registrar uploads list of allottees to Depository

– Depository credits allottee’s account with DP

– Refunds sent by Registrar as usual.

**TRADING SYSTEM**

– Separate quotes in Book Entry

– Trading Member to have Clearing Account with DP

– Settlement as per Settlement Calendar of Stock Exchange

– Trading can be introduced in any Stock exchange if settlement is guaranteed.

**CORPORATE ACTIONS**

– Dividends/cash benefits, these benefits are directly forwarded to the investors by the company or its registrar and transfer agent.

– Non-cash benefits, viz. Bonus, Rights Issue, etc. these benefits are electronically credited to the beneficial owner’s account through Depository.

**LEGAL FRAMEWORK**

The legal framework for a depository system has been laid down by the Depositories Act, 1996 and is regulated by SEBI. The depository business in India is regulated by –

– The Depositories Act, 1996

– The SEBI (Depositories and Participants) Regulations, 2018

– Bye-laws of Depository

– Business Rules of Depository.

Apart from the above, Depositories are also governed by certain provisions of:

– The Companies Act, 2013

– The Indian Stamp Act, 1899

– Securities and Exchange Board of India Act, 1992

– Securities Contracts (Regulation) Act, 1956

– Benami Transaction (Prohibition) Act, 1988

– Income Tax Act, 1961

– Bankers' Books Evidence Act, 1891

The legal framework for depository system in the Depositories Act, 1996 provides for the establishment of multiple depositories. Anybody to be eligible for providing depository services must be formed and registered as a company under the Companies Act, 2013 and seek registration with SEBI and obtain a Certificate of Commencement of Business from the SEBI on fulfillment of the prescribed conditions. The investors opting to join depository mode are required to enter into an agreement with depository through a participant who acts as an agent of the depository. The agencies such as custodians, banks, financial institutions, large corporate brokerage firms, non-banking financial companies etc. act as participants of depositories. The companies issuing securities are also required to enter into an agreement with the Depository.

# QUESTION BANK

## UNIT-V

## PART-A

1.Define a Depository

2.State the functions of Depository.

3.List out the characteristics of a Depository.

4.What is meant by Dematerialization?

5.Mention the objectives of Depository system

6.Expand the term DIS.

7.Differentiate Depository from a Custodian.

8.State the meaning of Re-materialization.

9.Write down any four differences between Dematerialization and Re-materialization.

10.What is meant by Adjudication?

## PART-B

1.Summarize the roles and functions of Depository.

2.Explain the process of Dematerialization of securities with the help of an illustration.

3.Explain the procedure for Re-materialization of securities Illustrate with the help of a flow chart.

4.Differentiate Dematerialization from Re-materialization.

5.Examine the Penalties and Adjudication of Depository under SEBI Act 1992.

6.Explain the Internal Audit process for Depositories under SEBI Act.

7.Describe Depository participants in detail.

8.Explain the Concurrent Audit process for Depositories under SEBI Act.

9.Summarize in detail about Depository system in India.

10.Analyze the process for Admission of Securities.

## REFERENCE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