MAA OMWATI DEGREE COLLEGE HASSANPUR (PALWAL)

Notes

B.COM 5th Sem

Financial Market Operations

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Overview of Indian Financial System

Introduction

The financial system consists of financial inputs, i.e., money and capital, while the real system consists of goods and services. The interaction between the financial system and the real system is necessary for the productive process. The financial system plays the role of intermediary between financial and real sectors, and savers and investors. It promotes capital formation and economic growth. The government and business sectors are the major borrowers while the household and foreign sectors are the net savers. The stock and capital markets are a part of the organised financial system in India and the functions of these include savings, mobilisation and promotion of investment in the country.

The provisions of liquidity and trading in liquidity are the major functions of the financial system. In addition to this, the mobilisation and channelisation of savings into productive activities are also the functions of financial system. Financial system facilitates the flow of funds from less productive to more productive activities through appropriate differentials in the rate of returns and other incentives.

Goldsmith has designated the various economic units into three categories:

(i) **Savings-surplus units** means those units whose savings are in excess of investments;

(ii) **Economic units** means those units whose investments exceed their savings;

(iii) **Neutral Units** means those units whose investments are equal to their savings.

If capital formation is to take place, the savings must be transferred from saving-surplus units to saving deficit units, therefore, the need of institutional arrangements arises to facilitate the transfer of resources. The various financial institutions act as the constituents of the financial system as the creation of cash is the function of RBI, credit creation of banks and claims on money or monetary assets are dealt in by all term lending institutions including RBI and banks. In the financial system, the money and monetary assets are traded.

When the financial system grows by providing inputs to productive activity, the savings and investments grow in the country. The financial system provides a mechanism by which savings are converted into investments.

The term financial system comprises of two words, i.e., finance and system. **Finance** refers to the monetary resources which comprise debt and equity of the state, company or an individual. Whereas, **system** refers to a set of interconnected institutions, markets, practices, agents, transactions, claims and liabilities in an economy. Thus, financial system refers to a system of borrowing and lending of funds to the state, companies, institutions and individuals.

Definition

Various authors have defined financial system as follows:

1. According to **H.R. Machiraju**, "A financial system may be defined as a set of institutions, instruments and markets which foster savings and channels them to most efficient use. The system consists of individuals (savers), intermediaries, markets and users of savings."
2. According to **L.M. Bhole**, "The financial system or the financial sector of any country consists of specialised and non-specialised financial institutions, of organised and unorganised financial markets, of financial instruments and services which facilitate transfer of funds. Procedures and practices adopted in the markets and financial interrelationships are also parts of the system."
3. According to **P.N. Varshney and D.K. Mittal**, "Financial systems facilitate expansion of financial markets over space and time and promote efficient allocation of financial resources for socially desirable and economically productive purposes."
4. According to **V.A. Avadhani**, "Financial system refers to the activity relating to the provisions of the services in terms of money and facilitates activity in real system."
5. According to **Shashik Gupta, Nishi Aggarwal** and **Neeti Gupta**, "Financial system comprises of a set of sub-systems of financial institutions, financial markets, financial instruments and services which help in the formation of capital. It provides a mechanism by which savings are transformed into investments."

Thus, after considering the above definitions, it may be said that financial system provides a system for the financial markets, institutions and instruments. It provides a mechanism through which savings are transformed into investments. Thus, a financial system helps in the capital formation of a country. The capital formation depends greatly on the efficiency of the financial system of the country.

Functions/Roles of the Financial System

A financial system performs the following functions/norms:

1. It promotes the process of capital formation by providing a mechanism for transformation of savings into investments.
2. It serves as a link between savers and investors. It mobilises the savings of the scattered savers into productive investments.
3. It provides an efficient mechanism of payment for the exchange of services and goods.
4. It ensures that the transactions are effected safely and swiftly on an ongoing basis.
5. It provides alternate forms of deposits according to the preferences and liquidity position of the savers.
6. It distributes the risk through diversification and thus reduce the risk of the savers, such as in the case of mutual funds.
7. It helps in lowering the cost of transactions and increase the returns through economies of scale in lending and borrowing.
8. It provides a mechanism for the transfer of resources beyond geographical boundaries.
9. It provides detailed information needed to the various players of the market such as individuals, intermediaries, businesshouses and government, etc.

10. It helps in managing such portfolios whose risk is less and return is more by providing better information.

Classification/Organisation Structure of the Financial System

The organisation structure of the Indian financial system comprises of three interdependent components, viz., Financial markets, Financial institutions/Intermediaries, and Financial assets/instruments/securities. The detailed organisation structure is given below:

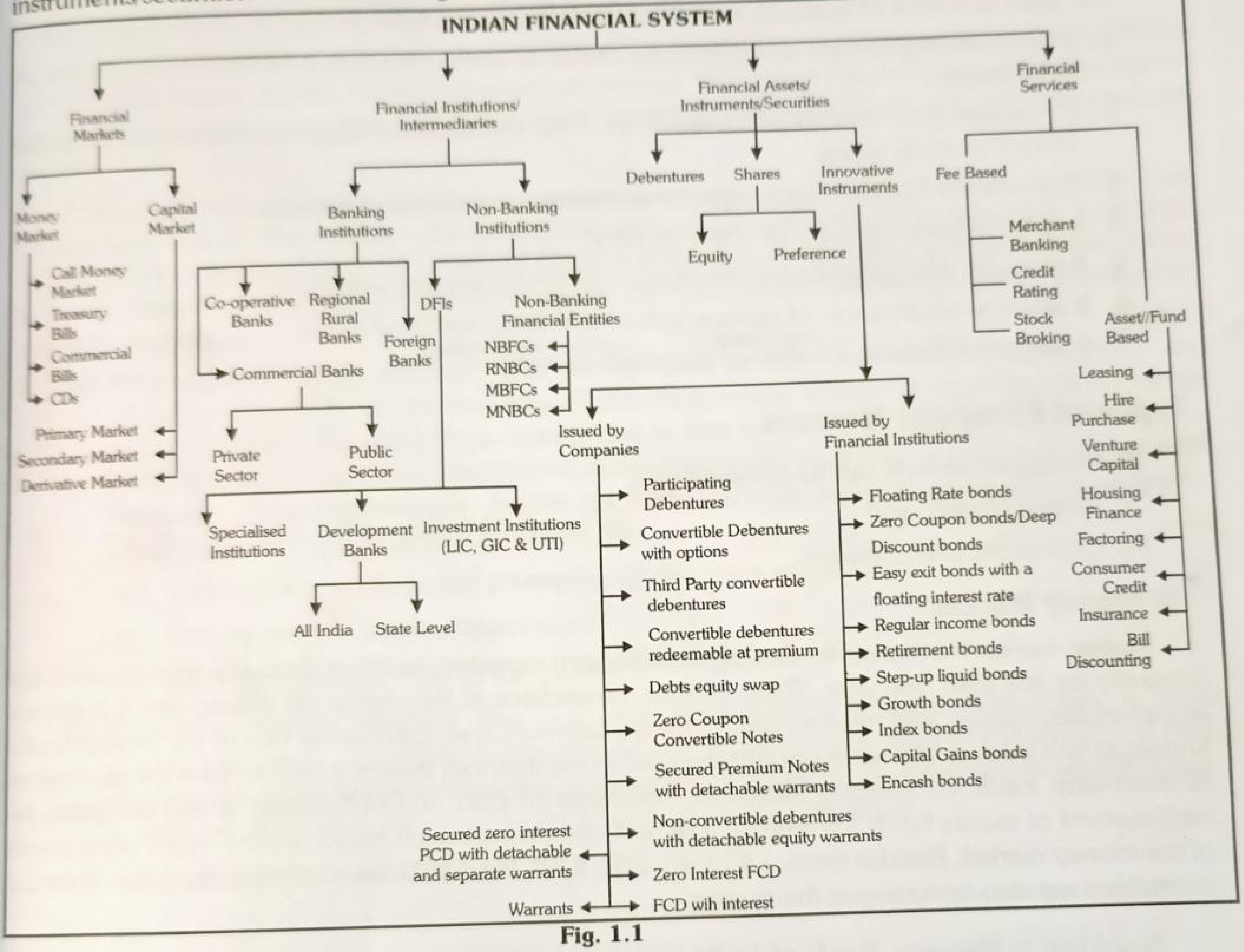


Fig. 1.1

I. Financial Markets

The important components of the organisation of financial system in India comprises of financial markets. Business finance is concerned with the provisions of funds for investment in business enterprise. The investor must provide the funds and it means that the investor must forego consumption and save to provide the funds. Savers and users of funds come together in a market which can be termed as financial market. Therefore, the activity in financial markets consists of trading in money and monetary assets and the operation of the financial markets may be referred to as the financial system.

The financial markets play a crucial function in the savings-investment process as facilitating organisations. Financial markets are not the source of finance and may or may not have a physical location. Financial markets can be referred to the institutional arrangements where dealing in financial assets and credit instruments takes place. Thus, it may also be said that financial markets are such markets which cater to the credit needs of various individuals, firms and institutions.

Functions

The main functions of financial markets are as follows:

1. It facilitates the transfer of funds from surplus sectors to the deficit sectors and thus work as intermediary.
2. It discovers price process which results from the interaction of buyers and sellers in the market when they trade assets.
3. It provides a liquidity mechanism for an investor to sell financial assets.
4. It helps in lowering the cost of transactions.
5. It provides adequate/needed information to the buyers and sellers.
6. It caters to credit needs of various individuals, firms and institutions.
7. It helps in achieving a balanced economic growth.

Types of Financial Markets

The financial markets can be classified into:

(i) Money Market, and

(ii) Capital/Securities Market

(i) Money Market

Money market is a market for dealing in short-term monetary assets or claims on money which are generally for less than one year. These include transactions in inter-bank call money which is known as call-money market and treasury bills of the government and commercial bills of the private sector known as bills market. It is an important segment of the financial system which enables the generation of short-term funds for meeting temporary shortages of cash and obligations. It also facilitates re-employment of excess funds for returns. RBI and other commercial banks are the major participants of the money market. Besides them, LIC, GIC, UTI, IDBI, NABARD, mutual funds and other financial institutions are also operating in the market.

According to **Reserve Bank of India**, the money market is "the centre for dealings, mainly of a short-term character, in monetary assets, it meets the short-term requirements of borrowers and provides liquidity or cash to the lenders."

The Indian money market is broadly divided into two parts, viz. the **organised** and the **unorganised**. The two markets differ from each other in terms of composition and rates of interest. The **organised sector** is composed of private and nationalised commercial banks, foreign banks, co-operative banks, RBI, the development financial institutions and the Discount and Finance House of India. Whereas the **unorganised sector** consists of the moneylenders and the indigenous bankers. RBI is the supreme controllable organisation of the Indian money market.

Objectives of Money Market

According to **M.Y. Khan**, the money market has the following objectives:

1. An equilibrating mechanism for evening out short-term surpluses and deficiencies.
2. A focal point of central bank intervention for influencing liquidity in the economy.
3. A reasonable access to the users of the short-term funds to meet their requirements at a reasonable price.

(ii) Capital/Securities Market

The institutional arrangements which facilitate the borrowing and lending of long-term funds is known as capital market. It transforms private savings to industrial and commercial investments through new capital issues and new public loans floated by the government and semi-government bodies.

The market for long-term funds is known as capital/securities market. Its main focus is on financing of fixed investments. The capital and securities market is now regulated by SEBI (Securities Exchange Board of India). Mutual Funds, LIC, GIC, FII (Foreign Institutional Investors), development and public financial institutions, corporates and individuals are the main participants of this market. This market has two segments:

(a) **Primary/New Issue Market:** This market deals in new securities. These securities are offered to the public for the first time. It directly provides additional funds to the corporate sector and hence the capital formation occurs in new issue market. This is a specialist service which is provided by various institutions at the time of any particular operation to the lenders/borrowers of the capital funds. It does not have any organisational set-up at any particular place. It performs three service functions, viz.;

- (i) Investigation, analysis and processing of new issue proposals;
- (ii) Underwriting in terms of guarantee;
- (iii) Distribution of securities to the investors.

(b) **Secondary/Stock Market:** The secondary market deals in existing securities. It has a physical existence, e.g., stock exchanges situated in the various parts of the country. It plays an indirect role in industrial financing as it provides liquidity to the investments already made. It performs three main functions in the growth of capital formation:

- (i) High returns to investors;
- (ii) Liquidity to investors;
- (iii) Continuous price formation.

Difference between Capital Market and Money Market

The main points of difference between the capital market and the money market are as follows:

Points of Difference	Money Market	Capital Market
. Term of Funds	It provides funds for long-term investment.	It provides funds for short-term investment.

2. Objective	Lending and borrowing to facilitate adjustment of liquidity position are the main objectives of this market.	Mobilisation and effective utilisation of the resources are the main objectives of this market.
3. Purpose of Utilisation	The funds provided by this market are generally utilised for working capital.	The funds provided by this market are used both for fixed and working capital.
4. Underwriting	Underwriting is a secondary function.	Underwriting is a primary function.
5. Middleman or Link	It works as a middleman between the depositor and the borrower.	It works as a middleman between the investor and the entrepreneur.
6. Opportunities	It provides opportunities to commercial banks, business corporates, non-bank financial concerns, etc. for making investment of their short-term surplus funds.	It provides opportunities to investment institutions to raise capital from the public and invest in the securities, so as to earn and give the highest possible return with the lowest risk.
7. Physical Location	It does not have any physical location.	It may have a physical location like stock exchange.
8. Form of Funds	It provides short-term funds in the form of treasury bills, commercial bills, CDs, MMMFs, etc.	It provides long-term funds in the form of debt and equity.

II. Financial Institutions/Intermediaries

It is the second constituent of the financial system. It provides institutional finance to the industry. It is a link between savers and investors and thus helps in the institutionalisation of personal savings. The main function of financial institutions or intermediaries is to convert direct assets or instruments or securities issued by corporate bodies into indirect securities. These indirect securities provide better investment alternatives to individual investors than direct or primary security, for example, units of mutual funds, UTI, and insurance policies and bank deposits, etc.

Financial institutions are the business organisations dealing in financial resources. They facilitate the meeting of the investors and borrowers. Financial institutions provide various services to investors and borrowers, like investment opportunities, housing finance, venture capital, factoring, restructuring, diversification, etc. They buy and sell financial instruments. However, brokers and financial institutions are different. A broker is an agent who facilitates transaction between buyer and seller of securities. But he does not borrow money himself. Instead financial institutions borrow money and thereafter lend it to the borrower at higher rate of interest.

Types of Financial Institutions

The financial institutions and intermediaries can be classified in two categories:

(1) Banking Institutions

Reserve Bank of India (RBI) is an apex institution which regulates, runs and supervises the bankin institutions in India. Banking Regulation Act, 1949 is the main legislation through which commerci banks in India are governed. Banking institutions provide various financial services. These institutior can broadly be divided in two categories:

A. Organised Sector

The organised banking sector in India is fairly developed and it is comprised of commercial banks, co-operative banks and regional rural banks.

(i) **Commercial Banks:** The commercial banks collect money from the public in the form of savings account, current accounts and term deposits and with this collection, they finance the working capital requirements of corporates. The banks have also started direct term lending since the early 90s. Public sector, private sector and foreign banks are operating in India.

The commercial banks include scheduled commercial banks and non-scheduled commercial banks. There are 26 public sector banks, 20 private sector banks and 43 foreign banks working in India. In 1969, nationalisation of banks was undertaken. 14 banks were nationalised. Prior to that, all banks, except State Bank of India were under private sector. In 1980, another six banks were nationalised. The total number of branches of scheduled banks in 1969 were 8045, which increased to 1,09,811on March 31, 2013. It includes 261 foreign bank branches as on March 31, 2013. The branches of non-scheduled banks were 28 as on that date. There are four non-scheduled commercial banks in India.

The commercial banks met the short-term funds requirements of the industry and accepted the deposits traditionally. But since the introduction of economic reforms in 1990, the banks are also meeting the long-term requirements of funds now. The private sector banks entered in the market in 1993, when the liberalisation measures were adopted in the Indian economy. This has increased the competition in the banking sector.

Functions of Commercial Banks: The major functions of commercial banks are:

1. To convert the bank deposits in cash and cash in bank deposits.
2. To transfer the funds among individuals and/or companies.
3. To underwrite capital issues.
4. To provide counselling on portfolio management or investment opportunities.
5. To invest funds in capital market.
6. To exchange deposits for bills of exchange, government bonds, etc.
7. To provide guarantee on behalf of its customers.
8. To provide advice on merges and acquisitions.

(ii) **Co-operative Banks:** Besides commercial banks, co-operative banks also exist in India. Co-operative banks are working in rural as well as urban areas of the country. These banks come under the purview of State Governments. State Governments have enacted their own Co-operative Societies Acts to protect the interest of the depositors. In addition to this, certain provisions of the Banking Regulation Act, 1949 were made applicable to these banks as well. These banks are eligible to be granted the status of scheduled banks by RBI. As on 31st March 2014, 57 state co-operative banks and 51 urban co-operative banks were in the list of scheduled banks. All co-operative banks are eligible for getting registered as insured banks. As on March 31st, 2014, there were 1,538 non-scheduled co-operative banks also.

The organisation structure of co-operative banks is as follows:

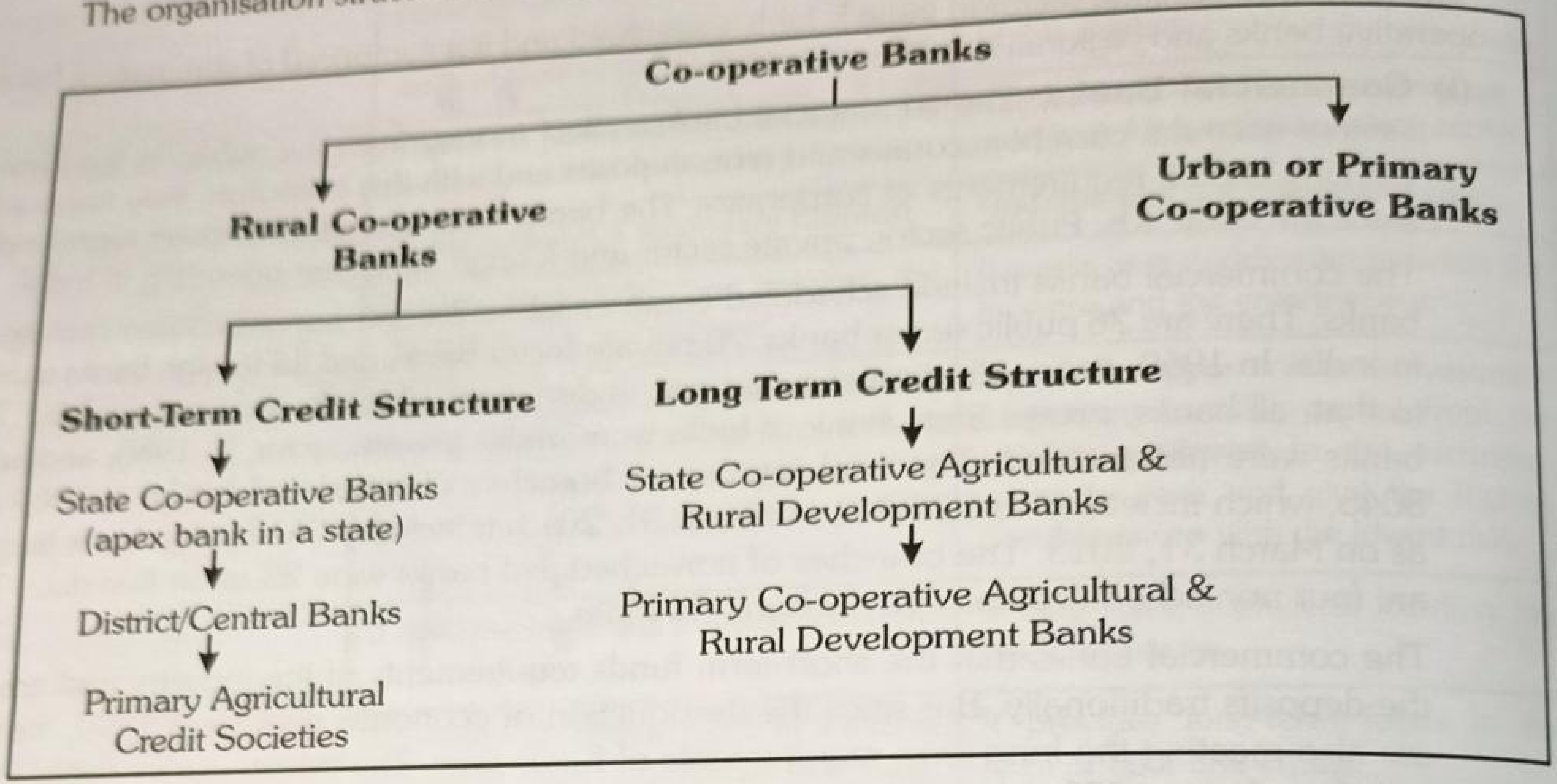


Fig. 1.2

Urban co-operative banks are required to maintain the entire 25% of statutory liquidity ratio only in government and other approved securities. Regarding the cash reserve ratio, the same percentage is applicable on all co-operative banks required for commercial banks. These banks are permitted to pay ½ per cent to 1 per cent interest rates on savings accounts, over the rates prescribed for commercial banks by RBI.

In November 2004, scheduled or licensed State Cooperative Banks and licensed DCBs with minimum net worth of ₹ 100 crore were permitted to undertake insurance business as corporate agent. In February 2005, this limit of net worth was reduced to ₹ 25 crore.

(iii) Regional Rural Banks: Regional Rural Banks are working in India since October 1975. These banks have been set up under the Regional Rural Banks Act, 1976. These banks were set up to supplement the commercial banks and co-operative banks in catering the credit requirements of the rural sector. It is a separate body corporate with perpetual succession and a common seal. These banks were set up by the State Governments and the sponsoring commercial banks.

Regional Rural Banks were set up with an objective to provide credit facilities to the weaker sections of the society. These banks provide credit and banking services to small farmers and small entrepreneurs in the rural areas. Regional Rural Banks undertake the following types of businesses:

(a) Granting of loans and advances to small and marginal farmers and agricultural labourers, and to co-operative societies for agricultural purposes or operations for other concerned purposes.

(b) Granting of loans and advances to artisans, small entrepreneurs and individuals of small means engaged in trade, commerce or industry within the notified areas of rural areas.

The RBI provides direct refinance assistance to RRB at a concessional rate of 3 per cent below the bank rate. In addition to this assistance, IDBI, NABARD and SIDBI also provide financial and managerial assistance to these banks. On the recommendation of **Bhandari Committee**, the government provided ₹ 360 crore for restructuring programme of these banks in 1994-95. Again the government provided ₹ 1867.65 crore for recapitalisation of RRBs between 1994-1998. During 2001-02, NABARD granted ₹ 38,255 crore as medium terms and long-term project loans. The RRBs have 17,586 branches as on March 31, 2013. The number of RRBs is 64 as on 31st March 2013.

(iv) Foreign Banks: Foreign banks are working in India since the British rule. The RBI has allowed the entry of foreign banks in India. Foreign equity in new Indian private sector banks is allowed. Foreign banks were permitted to enter the Indian banking sector with a ceiling of 49 per cent equity. Foreign banks were also permitted to enter in joint venture with local banks in non-banking financial services in accordance with the foreign investment policy. At present, 43 foreign banks with 293 branches are working in India. It has been stipulated that the minimum capital requirement for a foreign bank should be US $25 million, spread over 3 branches, i.e., US $10 million for the first branch, additional US $ 10 million for the second branch and further US $5 million for the third branch. Additional branches will be permitted after monitoring the performance of existing branches in India.

B. Unorganised Sector

The unorganised sector consists of indigenous bankers, moneylenders or *Sahukars or Seths, etc. These people are carry out the function of banking in an unorganised manner.*

(i) Indigenous Bankers: The activities of indigenous bankers are not at all regulated. These are the individuals or the private firms which act like a bank as they receive deposits and give loans to the public. These bankers were very active in the ancient and medieval periods. But with the growth of banking system in India, these bankers received a setback. But these bankers are still in operation in large numbers in the Western and Southern parts of the country. They charge high rate of interest and are not covered under the bank rate policy of RBI. Despite making attempts to regulate them, to restrict their operations and lately of liquidating them, they continue to keep their hold on small borrowers. Indigenous bankers provide finance for productive purposes directly to trade and industries. These bankers do not care the end-use of credit. Despite stiff competition, they are surviving due to various favourable factors like stringent conditions imposed by banks for granting credits, prompt and personalised services by these bankers to their customers, lower operational and establishment costs, etc. There is no certainty about the exact number of indigenous bankers operating all over India.

(ii) Moneylenders: Moneylenders are the people who give loans to small borrowers like small farmers, artisans, agricultural labourers, factory and mine workers, etc. They depend entirely on their own funds for the working capital. These are of three types (1) Professional moneylenders, (2) Inherent moneylenders and (3) Non-professional moneylenders. The methods and area of operation differ from moneylender to moneylender. Therefore, they do not constitute a homogeneous market. Generally, their business is confined to local limits. Although various measures have been introduced to control the activities of these lenders but still they are operating in India.

(2) Non-Banking Financial Companies (NBFCs)

The NBFCs raise most of the funds in the form of public deposits. They accept deposits for one to five years maturity period. They provide a variety of funds/asset based advisory services. These institutions can be divided into two parts:

(i) Development Financial Institutions (DFIs)

These development or financial companies have come into existence due to state ownership. These DFIs can be subdivided in three parts:

(a) **Specialised Financial Institutions:** The Government of India, soon after independence, set up various financial institutions to provide special help to the private sector industries in the matter of finance. These institutions have been doing wonderful work by subscribing to the shares and debentures of new and old companies, in giving loan assistance, in underwriting new issues, etc. The role assigned to them was that of a gap-filler which means that it was not expected from them to compete with the existing channels of industrial finance. Risk Capital and Technology Finance Corporation Ltd. (RCTC), Technology Development and Information Company of India Ltd. (TDICI Ltd.) and Tourism Finance Corporation of India Ltd. (TFCI) are the examples of these type of institutions.

(b) **All India Development Banks:** After independence, the Government of India though of increasing the industrial base of the country. At the same time, need for modernisation and replacement of old and obsolete machinery was also felt. To provide funds for all this, the usual agencies were found inadequate and hence the Government of India established a number of financial institutions to provide funds to industrial sector. These banks are of two types:

   (i) **All India Development Banks:** Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), Industrial Credit and Investment Bank of India Ltd. (ICICI), Small Industries Development Bank of India (SIDBI) and Industrial Investment Bank of India (IIBI), etc. are the examples of this type.

   (ii) **State Level Development Banks:** These banks provide industrial finance in a particular state. State Financial Corporations and State Industrial Development Corporations (SIDCs) are examples of it. In Haryana, HSIDC and HFC are working to provide finance to the industrial sector.

(c) **Investment Institutions:** The investment institutions mobilise the savings of the public to specifically invest in the industrial securities. UTI, LIC and GIC are major investment organisations. UTI collects funds from the public by issuing its units of various schemes and invests that fund in the corporate securities. LIC and GIC are insurance organisations. These organisations also act as investment institutions since these companies invest their excess money in corporate securities.

(3) Non-Banking Financial Entities

The Indian financial system has another part which comprises of a large number of privately owned, decentralised and relatively small-size intermediaries, which are engaged either in fund-based activities or in financial services. For the purpose of division, the former may be called non-banking financial companies and the latter non-banking financial services companies. This part is related to first type only. These are as follows:

(i) Non-Banking Financial Companies (NBFCs): The RBI (Amendment) Act, 1997 defines NBFC as an institution or company whose principal business is to accept deposits under any scheme or arrangement or in any other manner, and to lend in any manner. Therefore, a number of loan and investment companies registered under the Companies Act by established business houses for the purpose of making investments in group companies have become NBFCs due to the introduction of the new definition by RBI. NBFCs are providing finance to bridge the credit gaps in various sectors, which financial institutions are unable to fulfil. They are catering to specialised credit requirements of certain class of borrowers. They are also playing a positive role in assessing depositor segments of certain classes.

(ii) Residuary Non-Banking Company (RNBCs): Residuary non-banking company (RNBC) is a company which receives any deposit under any scheme or arrangement, either in one lump sum or in instalments by way of contributions or by sale of units or certificates or other instruments or in any other manner according to the definitions contained in the NBFC (RBI) Directions, 1977 or the Miscellaneous Non-Banking Companies (RBI) Directions, 1977. However, it is not an insurance company or equipment leasing company or hire purchase finance company or housing finance company or investment company or loan company or mutual benefit financial company or a miscellaneous non-banking company.

These companies generally tap the savings by operating deposit schemes which are similar to recurring deposit schemes of the banks. The collection is done at doorsteps of the depositors through field staff. These companies get funds at low cost for longer terms, and deploy these funds at relatively high yields. Many of these companies are operating with a very low capital. There is no restriction on the quantum of deposits they can raise from the market.

(iii) Mutual Benefit Financial Companies (MBFCs): Mutual benefit financial company is a company notified by the government under Section 620 A of the Companies Act, 1956. These are also known as *nidhis*. These are operating mainly in South India, particularly in Tamil Nadu.

The main function of these companies is to advance loans to their members for house construction or repairs, medical expenses repayment of old debts, marriage expenses, etc. Such loans are provided against some tangible assets like gold, jewellery, property, LIC policies, shares of companies, etc. These companies offer saving schemes with assurance to make credit available when required by investors. They also provide loans to individuals who are not able to get loans from commercial banks or to whom commercial banks are not able to reach. They give interest rates on deposits similar to that of commercial banks. These companies are incorporated under the Companies Act and hence governed by RBI rules.

(iv) Miscellaneous Non-Banking Companies (MNBCs): MNBC is such a type of company which carries all or any of the following types of business:

(a) Managing, conducting or supervising as a promoter, foreman or agent of any transaction or arrangement by which the company enters into an agreement with a specified number of subscribers that every one of them shall subscribe a certain sum of instalments over a definite period and that everyone of such subscribers shall in his turn, as determined by lot or by auction or by tender or in such other manner as may be provided for in the agreement by entitled to the prize amount.

(b) Conducting any other form of chit or Kuri which is different from the type of business referred above. Undertaking or carrying on or engaging in or executing any other business similar to the business referred above.

III. Financial Assets/Instruments/Securities

It is the third component of the financial system. These comprise of a variety of securities to suit investment requirements of various investors. The financial system also promotes financial product innovation. In the 90s, the Indian capital market witnessed a tremendous growth in financial information in the form of differentiated financial assets/instruments. The maturity and sophistication of financial system depends on the variety of securities. The different type of securities may be listed as below:

(1) Debentures

A debenture is a type of loan acknowledgment which is taken by the company from the public. Debentureholders are entitled to get interest at a specified rate on the face value of the debenture. A company can issue redeemable convertible debentures. The debentures can be secured or unsecured. It can be registered or bearer.

(2) Shares

The capital of the company can be divided in several parts with a definite value. Each part is called a share. Holders of these shares are called shareholders. There are two types of shares which a company may issue, i.e., preference shares and equity shares.

(i) **Preference Shares:** Preference shares are those shares on which shareholders enjoy namely two preferences over equity shareholders. These preferences are:

(a) Payment of dividend out of profits; and

(b) Repayment of capital in case of liquidation.

These shareholders do not have any right to participate in the management of the company. All preference shares are redeemable within 10 years. Preference shares are of different types, viz., cumulative or non-cumulative, convertible or non-convertible, participating or non-participating, etc.

(ii) **Equity Shares:** Equity or ordinary shareholders are the real owners of the company. It represents risk capital. The shareholders can participate in the management of the company. These shareholders have residual claims on the income and assets of the company. The rate of dividend is determined by directors on the basis of annual profits. It may exceed the rate of preference dividend. Such shareholders may also go without dividend if no profit is made by the company. The terms on which shares are to be issued by the company are given in the prospectus.

SEBI has issued various guidelines to safeguard the interest of equity shareholders, preference shareholders and debentureholders.

(3) Innovative Instruments

Innovative instruments are the new instruments issued by companies and financial institutions in recent years. For the purpose of study, these may be divided in two parts:

A. Issued by Companies

A variety of instruments have been issued by companies. These are:

(a) **Participating Debentures:** Participating debentures are eligible to participate in th excess profits of the company, after the payment of equity dividend. This is unsecure corporate debt security.

(b) **Convertible Debentures with Options:** These debentures have the option to exit either by the company or debentureholders from the terms of the issue. The coupon rate is specified at the time of issue.

(c) **Third Party Convertible Debentures:** These are the debts with a warrant which entitle the holders to subscribe to the equity of another firm at a preferential price instead of market price. The interest rate offered is generally lower in this type of debt in comparison with the simple debentures due to conversion option.

(d) **Secured Zero Interest Partly Convertible Debentures with Detachable and Separately Tradeable Warrants:** These debentures contain zero interest but are of secured nature. Such debentures have two parts: Part A and Part B. Part A is convertible into shares at a fixed rate on the date of allotment. Part B is non-convertible and is redeemable at par on the expiry of the specified period. It also contains a separately tradeable warrant which can be converted into equity shares.

(e) **Convertible Debentures Redeemable at Premium:** These debentures are issued at par but with an option to investor to sell the debentures to the issuer at a premium later on. They are basically similar to convertible debentures but carry less risk.

(f) **Debt Equity Swaps:** These are a type of convertible debentures. These provide offers to exchange debentures for equity. This type of instrument is quite risky for the investor because the anticipated capital appreciation may not materialise.

(g) **Zero-Coupon Convertible Notes:** These debentures have a right to be converted into shares. But on the date of conversion, they have to sacrifice accrued or unpaid interest. Zero-coupon convertible notes are quite sensitive to changes in the interest rates.

(h) **Secured Premium Notes (SPN) with Detachable Warrants:** These notes are repayable after a look-in period. The detachable warrants are to be converted into shares within specified period. No interest is payable during the lock-in period. No interest will be payable on SPN if the holder sells it back to the company after the lock-in period. However, he will be entitled to get additional interest in instalments if the redemption is made after the expiry of the firm of SPN.

The attached warrant assures the right to holder to apply and get equity shares allotted. This right is available only if the SPN is fully paid. The conversion of detachable warrant into equity shares will have to be done within the time limit allowed by the company.

(i) **Non-Convertible Debentures (NCD) with Detachable Equity Warrants:** These debentureholders have an option to buy a specified number of equity shares at a fixed rate on the expiry of certain period. There is lock-in period for NCD, after which the debentureholder can exercise his option for equity shares. If such an option is not exercised within the stipulated period, the company will be at liberty to dispose off the unapplied portion of shares in the market. The warrants attached to NCDs can be converted into shares only if they are fully paid.

(j) **Zero Interest Fully Convertible Debentures:** These debentures get automatically and compulsorily converted into shares after the specified time period. These type of debentures generally contain no interest. No interest will be paid during lock-in period. Fully Convertible Debentures (FCDs) can be converted into shares if they are fully paid. If the company goes for rights issue meanwhile, it shall only do so after the FCD holders are offered securities.

(k) **Fully Convertible Debentures (FCDs) with Interest:** These debentures do not yield any interest for a short period. After this period, the debentureholders get the option to apply for equities issued at premium without paying for the premium. Such option should be indicated in the application form itself. A specified rate of interest is payable on FCDs between the two conversion dates in lieu of which shares are issued.

(l) **Warrants:** A warrant is another type of convertible debenture which entitles the holders to purchase a specified number of shares at a specified rate before the specified period. These warrants may be issued with either debentures or equity shares. They are also called sweeteners. The number of shares entitled, the expiration date, along with the stated/exercise price, etc. are clearly specified in the warrants.

The warrants have a secondary market. They are generally issued by new/growing firms and venture capital firms. They do not contain any floatation cost and when they are exercised, the firm receives additional funds at a price lower than the current market, yet, higher than those prevailing at the time of issue. A few Indian companies have issued warrants since 1993.

B. Issued by Financial Institutions

Financial institutions in India have also issued innovative securities. These are listed as below:

(a) **Floating Rate Bonds (FRBs):** The interest rate on these bonds linked to some other rates, such as, bank rate, maximum interest on term deposits, prime lending rate, yield on treasury bills, etc. The floating rate is fixed in terms of margin above/below the benchmark rate. It ensures that neither the borrower nor the lender suffer from changes in interest rates. For example, the SBI's floating rate bond issue was linked to the maximum interest on term deposits which was 10 per cent at that time. The floor rate was 12 per cent in this case.

(b) **Zero-Coupon Bonds/Deep Discount Bonds:** No interest is payable on these bonds. These bonds are sold to customers at a discounted rate. They have long maturity period, generally of 20-25 years. The return to the investor is the difference between acquisition value and the redemption value. The example of it is the deep discount bonds of Sardar Sarvor Nigam Ltd., which were issued at a price of ₹ 3600 per bond and have the redemption value of ₹ 1,11,000 after 21 years.

(c) **Easy Exit Bonds with a Floating Interest Rate:** The rate of interest on these bonds is flexible. It means it is reset every six months. Small investors have been protected under this scheme with an option of exit up to a specified amount. But if a investor holds the bonds for more than 18 months from the date of allotment, he gets an additional interest. Call and put options are also available on these bonds. These bonds are targeted at the segment that is sensitive to inflation and wants an additional safety net in the form of exit.

(d) **Regular Income Bonds:** These are issued for a specified period of time. The interest is generally payable half-yearly on these bonds. The interest is paid at a pre-determined rate. The bonds also carry option for investors and call option for issuer and an early bird incentive. For example, the IDBI Regular Income Bonds were 10 year bonds issued in 1996, bearing a coupon of 16 per cent, payable half-yearly. The additional interest of 0.5 per cent was also paid in this scheme. It brings annualised yield equivalent to 18.2 per cent. The price of each bond was ₹ 5,000. Indian Finance Corporation of India (IFCI) has issued 5 year tenure bonds with a semi-annual yield of 16 per cent and an early bird incentive of 0.75 per cent.

e) **Retirement Bonds:** These bonds are issued for those who wish to get instalments of fixed amount after their retirement. The investor gets monthly fixed amount after the expiry of the wait period which is at the option of the investor. The investor can also choose the lump sum amount. Investor could also opt for a nil waiting period, in which he starts getting monthly income immediately, from next month only. These retirement bonds may also carry put and call options. For example, IDBI issued such type of bonds in 1996 with a maturity period of 10 years.

(f) **Step-up Liquidity Bonds:** The maturity period of these bonds is generally 5 years. The put option is available every year. The interest steps up every year. For example, IFCI issued these bonds in 1997. The interest rate offered was 16 per cent, 16.25 per cent, 16.5 per cent, 16.75 per cent and 17 per cent at the end of every consecutive year.

(g) **Growth Bonds:** These bonds generally have a redemption period of 10 years. However, some companies provide put options at the end of 5 or 7 years. For example, IFCI issued such types of bonds in 1996. The face value of each bond was ₹ 20,000 and the maturity value was ₹ 1,00,000 after 10 years. If the put option is exercised by the investor, he gets ₹ 43,500 after 5 years and ₹ 60,600 after 7 years.

(h) **Index Bonds:** These bonds provide both the security of money invested and the potential of appreciation in return to the investor. An index bond has two parts, a deep discount bond (Part A) and a detachable index warrant (Part B). Part A is deep discount bond whereas Part B gives return in proportion to the increase/decrease in the BSE SENSEX.

The face value of the bond will appreciate the number of times the SENSEX has appreciated. The investors' returns will be treated as capital gains. For example, ICICI issued index bond in 1997 at a price of ₹ 6,000. Part A was a 12 year deep discount bond of face value of ₹ 22,000 (initial investment ₹ 4,000) and part B in the form of index warrant at ₹ 2,000 which gives return in proportion to the increase/decrease in BSE SENSEX after 12 years.

(i) **Capital Gain Bonds:** These bonds are issued with two options maturity – 3 years (option I) and 7 years (option II). 20% rebate in income tax is allowed on the investment in these bonds. Investment through stock-invest will not qualify for the rebate. IDBI, ICICI are issuing such type of bonds. These bonds are beneficial for individuals who are in high tax brackets. These bonds are also called tax-saving bonds.

(j) **Encash Bonds:** These bonds have a feature that interest is stepped up every year. These bonds can be redeemed after 1 year and 8 months. The encashing facility is available only to the original bondholders. These bonds not only offer higher return but also widen the banking facilities to investors. Improved yield maturity results in favourable secondary market price of the bonds.

IV. Financial Services

Financial services means the activities, benefits and satisfaction that are offered to users and customers. The variety of financial services in the country determines the efficiency of financial system. The main sectors which provide the financial services are banks, financial institutions and non-banking financial companies. The services provided by them can be broadly categorised into two parts:

A. *Assets/Fund Based Services*, and

B. *Fee Based/Advisory Services*

A. Assets/Fund Based Activities:

These activities include the following:

(i) Equipment Leasing/Lease Financing: A lease transaction is a commercial arrangement where an equipment owner or manufacturer gives the right to use the equipment in return for a rental. It may be of two types, namely, finance lease and operating lease. In **Finance Lease**, lessor transfers the risk and rewards incidental to the ownership of the asset to the lessee. Title remains with the owner. Rentals are paid in instalments which cover the cost of equipment plus a reasonable return on funds invested. In **operating lease,** the risk, rewards and the title remains with the lessor. Lessee has to pay rentals. It is a short-term lease agreement. First leasing company of India started leasing business in 1973. The leasing business has grown in India at a very fast speed because of its advantages to both lessor and lessee.

(ii) Hire Purchase and Consumer Credit: Hire purchase means a transaction where goods are sold to the buyer on the terms that he will make the payment in instalments. Hire purchase is different from leasing in a sense that in hire purchase the title of goods is transferred to buyer after the full payment is made by him. But in leasing, the rental is paid by lessee and no title is transferred to him. The characteristics of hire purchase are as follows:

(a) The possession of the goods is transferred to the buyer immediately.

(b) The payment is made in instalments by the buyer to the seller.

(c) The title of the goods remains with the vendor till the payment of last instalment.

(d) In case of default, the vendor can repossess the goods and the payment made by the purchaser is treated as rental.

(e) The instalments include the interest as well as the principal amount.

Consumer credit means the transactions through which consumer goods are sold to consumers on credit. Consumer pays a part of the total amount in cash and the balance in instalments over a specified period of time. It covers consumer goods, such as car, scooters, TVs, refrigerators, washing machines, DVDs, etc.

(iii) Venture Capital: A new type of professional investors emerged in late 1960s whose speciality was to combine risk capital with entrepreneurial management. They also used advanced technology to launch new products and companies in the market place. They are known as venture capitalists. It means the term venture capital is an investment in a highly risky project with the objective of earning a high rate of return. Venture capital is a risky money which is invested in risky enterprises either as equity or debt capital.

Venture capital originated in the USA in the late sixties. In India, a beginning was made in this direction by setting up of venture capital divisions in ICICI, IDBI and IFCI. ICICI together with UTI has established a separate company – Technology Development and Information Company of India – as a venture capital company. The company's activities include venture capital financing, technology information, consultancy as well as other services like marketing, business management, vendor development, etc.

(iv) Bill Discounting: Finance companies undertake this service. It is an attractive fund based activity. The development of bill discounting as a financial service depends upon the existence of a bill market. These bills are drawn by the drawer (seller) on the drawee (buyer) for the value of goods delivered to him. In India, banks mainly provide funds for working capital required in the business through discounting of commercial bills. In contrast, in other countries, bill finance is one of the major types of finance provided by banks.

According to the **Indian Negotiable Instrument Act, 1881,** "*It is a written instrument containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.*"

The bank purchases the bill payable on demand from the maker and credits his account with the amount of bill less discount. At maturity, the acceptor makes payment to the bank when the bill is presented for payment. In case of dishonour, the customer recovers the full amount from the maker. After the 1992 scam, RBI restricted the bill discounting services provided by banks. Now, RBI has permitted banks to rediscount bill amongst themselves and with other financial institutions and finance companies.

(v) **Housing Finance:** In India, there is scope and need for the development of arrangement for supplying loans for housing. This is because housing is considered as one of the basic necessities of man and the capital involved is so large that it is almost impossible and for middle and lower class to raise the required money from their own resources. Till the end of 1980s, it remained an underdeveloped sector. But in 1988, the RBI established National Housing Bank (NHB). It initiated housing finance as a fund based activity. NHB is an apex housing finance institution in India. Till now, many financial institutions and companies in public, private and joint sectors have entered this sector. Now the competition is so stiff that everyday we notice a new scheme launched to attract customers towards itself.

(vi) **Insurance Services:** Insurance is a contract between the insurer and the insured where the insurer gives an assurance to the person to pay him a certain sum of money in consideration of annual premium, against a specified risk such as fire or compensate the beneficiaries on specified events such as accident or death. The written document between the two is called policy. The insurance services are of two types:

(a) **Life and (b) General.** Until 1999, the LIC and GIC and its four subsidiaries were doing the insurance business in India. But after 1999, this sector was thrown open even for the private sector also. In 1999, Insurance Regulatory and Development Authority (IRDA) was also set up to monitor insurance business in India. The entrance of the private sector in this field has increased the competition and has forced two public sector giants to offer new attractive policies to customers.

(vii) **Factoring:** Generally, the business transactions at wholesale level are done on credit, while at retail level it, takes place partly on the basis of cash and partly on the basis of credit. Sellers allow time to buyers to make payments for the same. The dues which arise during the process of credit are known as trade receivables for sellers. Sometimes, sellers may require promissory notes or trade acceptances from buyers. The sellers may make their own arrangements to collect receivables or they may hand over this job of collecting receivables to a specialised collection agency. Such an agency is known as **factor**.

Thus, **factoring** is a fund based financial service which provides resources to finance receivables as well as the facility of collection receivables. Factoring may be on a recourse basis or without recourse basis. In a recourse basis, the risk of bad debts is borne by the client, whereas, in without recourse basis, the risk of credit is borne by the factor. In India, SBI Commercial and Factoring Services Ltd. was set up on 26th February 1991 as the first factoring company. At present, SBI Factors and Commercial Services Ltd. and CAN Bank Factors Ltd. are working as factoring organisations in the country.

B. Fee Based/Advisory Services

These services include the following:

(i) **Merchant Banking:** Merchant banks are known as "**accepting and issuing houses**" in England and as "**investment banks**" in America. They are the issue houses which provide various services related to the floatation of new ventures and new companies, preparation and execution of new projects, consultancy and advice on the matters related to technical, financial, managerial and organisational fields.

The notification of the **Ministry of Finance** defines a merchant banker as, "*any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities as manager, consultant, advisor or corporate advisory service in relation to issue management.*"

Merchant banking started in India in 1967 when Grindlays Bank received the licence from RBI. SBI started merchant banking in 1972 followed by a number of commercial banks. Development banks like ICICI started this activity in 1973, followed by IFCI in 1986 and IDBI in 1991.

(ii) **Stock Broking and Depository Services:** SEBI was set up by the government in 1991 to ensure that stock exchanges perform their self-regulatory role properly. Since then, stock broking became a professional advisory service. Stock broker is a member of stock exchange who deals in securities and purchases and sells the securities on behalf of customers. The stock-broker has to get himself registered with SEBI. SEBI has also issued various guidelines to regulate the working of the brokers. The brokers are allowed to charge commission on the buying and selling of securities.

The growth in the business of securities paved way for creating a new, modern infrastructure consisting of depositories, paperless trading and computer recording of transactions. A beginning in this direction was made by setting up Stock Holding Corporation of India Ltd. (SHCIL) in August 1988. The Government introduced the Ordinance for Depositories in September 1995, which was converted into Depositories Act, 1996. The depositories are the institutions which provide facility of dematerialisation of new and existing issues, implementation of delivery system, scrip hypothecation and implementation of beneficial owner record-keeping. The National Stock Depository Ltd. (NSDL) was the first depository in India which started in 1996.

(iii) **Credit Rating:** Credit rating is a grading service to investors which helps them in reducing their risk. Credit rating may be considered as a science as well as an art. It may be considered as a science because it involves a systematic approach to analyse the statistics with given formulas and as an art because there are too many variables to be judged.

It is a technique in which relative ranking is provided to different instruments of a company on the basis of systematic analysis of their strengths and weaknesses. This credit ranking i done on the basis of analysis of financial statements, project analysis, credit worthiness factor and future prospects of the concern project/company. Credit rating is not a recommendatio to purchase or sell or hold security. It is generally confined to debt instruments, but rating made for equity shares also. In India, CRISIL, CARE, ICRA, DPCR, Fitch Ratings India Lt are doing the credit rating of industrial instruments/securities.

B. Non-Banking Functions

The non-banking functions of indigenous bankers are as follows:

1. **Commission Agent:** They also function as commission agents in different markets (*mandi*).
2. **Speculative Trade:** Indigenous bankers also speculate in various consumable goods like wheat, gur, etc.
3. **Business and Shops:** Some indigenous bankers run their own shops of different nature, such as jewellery, etc. and perform the function of bankers simultaneously with the business.

2. Money lenders

Moneylenders are individuals who give loans to small borrowers, like small farmers, artisans, agricultural labourers, factory and mine workers, etc. Moneylenders are of three types: (1) *Professional moneylenders*, (2) *Itinerant moneylenders*, and (3) *Non-professional moneylenders*. Professional moneylenders are those whose main activity is moneylending. Itinerant moneylenders are those persons who lend money at exorbitant rates while wandering at different places, like Pathans and Kabulis. In contrast, the non-professional moneylenders are those persons whose main activity is not moneylending and nor is it their main source of income. Therefore, they do not constitute a homogeneous market and their methods of operation are not uniform. Generally, their business is confined to local limits. Although various measures have been introduced to control the activities of these lenders but still they are working due to political patronage.

Features

The main features are as follows:

(i) They generally do not accept deposits from the public.

(ii) They run their business with their own money rather than it borrowing from banks and financial institutions.

(iii) The interest rate charged by them is higher than the rate charged by banks and financial institutions.

(iv) They provide loan for productive purposes as well as for consumption purposes on the basis of certain security.

(v) They follow various malpractices, such as, false manipulation of loan records. They also use marshal methods to force debtors into their bondage.

3. Unregulated Non-Bank Financial Intermediaries

In India, there are different types of unregulated non-bank financial intermediaries such as finance companies, chit funds and nidhis. These finance companies accept deposits from public and also borrow from various sources for the purpose of granting loans to others. They charge high rate of interest. They normally provide loans to wholesale traders, retailers, artisans and self-employed persons. Nidhis are a type of mutual funds restricted to its members and they are mostly concentrated in Tamil Nadu and Kerala.

II. Organised Money Market

The Reserve Bank of India, the State Bank of India, commercial banks, co-operative banks, foreign banks, Discount and Finance House of India and the finance corporations collectively form the organised segment of the Indian money market. This segment of money market is well organised and integrated.

The principal centres of this segment of money market are Mumbai, Kolkata, Delhi, Chennai, Ahmedabad and Bangalore. Out of these, Mumbai is the most prominent. Mumbai occupies the same position in India as the London market in England. Mumbai has the head office of RBI and different commercial banks. It also has India's largest stock exchange, the bullion exchange and an organised market for government securities. The main constituents of the organised sector are as follows:

1. The Call Money Market

The call money market is that part of the national money market where the day-to-day surplus funds of banks are traded. The maturity of the loans made in this market varies between one day to a fortnight. The main purpose of the operation of this market is to adjust the reserves of banks and supply of funds to the market which arises out of the reserves of banks with the central banking system. In India, call loans are unsecured. The situation regarding these are subject to seasonal fluctuations. The seasonal fluctuations can be noticed in the volume of money at call and short-notice and call money rates at different times of the year.

Brokers play an important role in the call money market. As per RBI's Report on Currency and Finance issued in 1977-78, until March 1978, transactions in the call money market were usually affected through brokers. Each day, these brokers obtained information about money on offer and money demanded, and then effected transactions. Since then, RBI has prohibited banks paying brokerage on operations in the call money market as it has stopped payment of brokerage on deposits.

Scheduled commercial banks, non-scheduled commercial banks, foreign banks, co-operative banks, Discount and Finance House of India (DFHI) and Securities Trading Corporation of India (STCI) are the major participants in the call money market. Since 1970s, LIC, GIC and UTI and term lending institutions like IDBI, ICICI, and IFC have also started participating in it. As per the latest RBI policy, LIC, UTI, GIC, IDBI and NABARD are allowed to participate in the call market as lenders but not as borrowers. In April 1991, the RBI announced that access to call market as lenders would be provided to such entities as are able to provide evidence to the RBI about their bulk lendable resources, and which have no outstanding borrowings from banks. They will be required to observe a minimum size of operations of ₹ 20 crore per transaction. They can participate with the prior permission of the RBI out only through DFHI. Four Primary Dealers (PDs) were allowed to participate in the market by RBI in 1996-97 as both borrowers and lenders, and ten mutual funds were also allowed to participate as lenders.

Call money markets are located in big industrial and commercial places like Mumbai, Kolkata, Delhi, Ahmedabad and Chennai. These markets are also located at different places where stock exchanges are located. Although the average daily turnover in India increased from ₹ 23,221 crore in 1999-2000 to ₹ 35144 crore in 2002 and further increased to ₹ 129.39 billion in 2016-17.

The rate of interest paid on call loans is known as call rate. The call rate is highly variable. It varies from day to day. The weighted average rate for borrowing and for lending ranges between 4.00

(3) **Replacement of Public Debt Act, 1944:** The group suggested that the Public Debt Ac 1944 should be replaced by Government Securities Act to enable electronic transfer of g securities.

(4) **'Over the Counter' and 'Tripartite' Repos:** It recommended that the 'over the counte and 'tripartite' repos with proper and adequate checks should be introduced to expand th existing market.

(5) **Guidelines for Constituents SGL Account Operations:** The group also recommende certain guidelines for maintenance of constituents securities general ledger accounts.

(6) **Code of Conduct for Repo Transactions:** A code of conduct which is to be followed b the participants at the time of issue should also be introduced.

(7) **Master Repurchase Agreements for Repos:** It is felt that there should be master repurchas agreement which allows obligations under all outstanding repos to be set off against ead other upon default or insolvency of the party.

(8) **Roll-over of Repos:** Rollover on the prevailing market rates should be allowed since it i collateralised borrowing.

(9) **Maximum Eligibility Duration of Repos:** At present, there are no restrictions on th duration of repos. The maximum period of repos should be clarified by the Government.

(10) **Supervision and Monitoring by RBI:** Keeping in view the securities scam, the marke should be supervised and monitored by RBI.

(11) **Daylight Overdraft Facility for Current Account Holders:** It also recommended tha RBI should provide the daylight overdraft facility for current accountholders.

(12) **Contract Note should have Date of Deal and Settlement:** It recommended that it wi be desirable to stipulate deal date and settlement date in the contract note to avoid confusion i transactions.

nplementation

On the basis of the recommendations made by the study group, RBI has implemented certai ggestions. These are:

(1) **Amendment of SC(R) Act, 1956:** In March 2000, the Act was amended to give powers t RBI as per recommendation.

(2) **Introduction of Liquidity Adjustment Facility (LAF):** An Interim Liquidity Adjustme Facility (ILAF) was set up in April 1999 as a first step towards setting up of LAF. The LAF wi be implemented in stages on the basis of experience of ILAF. The first stage of LAF was starte from June 5, 2000. The LAF is a mechanism through which RBI reduces liquidity from th money market.

(3) **Debt Securities Clearing Corporation:** The Debt Securities Clearing Corporation is bein initiated. It will open up repo market for bonds of PSU and financial institutions.

(4) **Special Facility for Securities Settlement:** RBI has introduced a scheme for automa invocation by the SGL accountholder under refinance or liquidity support from it. This wi result in smooth settlement of transactions even if there is insufficient balance in the accoun

5) **Pure Inter-Bank Money Market:** As per the recommendations of the Narsimha Committe II, repo market has been widened to include non-bank entities having current SGL accou

with RBI. RBI is moving towards pure inter-bank call money market subsequent to amendment of SC (R) Act.

The Discount Market

1. SBI DFHI Ltd.

The Discount and Finance House of India (DFHI) was set up on April 25, 1988. The main objective of DFHI is to bring the entire financial system consisting of various constituents within the fold of the Indian money market. Actually, the Vaghul Committee had endorsed the recommendations of the Banking Commission (1972) and Chore Committee (1980) regarding the setting up of a specialised institution to develop the money market and provide liquidity to its instruments. As a result, the RBI with the help of public sector banks and the all-India financial institutions, set up the DFHI as an autonomous financial intermediary. Under the Companies Act, 1956 on March 8, 1988, DFHI became a subsidiary of SBI. From 31-03-2003, SBI became the major shareholder (67.01%) of the company.

Resources of SBI DFHI

The resources of the SBI DFHI are as follows:

(i) It is a joint stock company and is jointly owned by the RBI, public sector banks and all India financial institutions which have contributed its paid-up capital of ₹ 200 crore in the proportion of 5 : 3 : 2. The authorised capital of the company is ₹ 250 crore.

(ii) Refinance facility of different types from the RBI.

(iii) Line of credit from banks on a consortium basis of ₹ 100 crore from 28 public sector banks.

Functions of SBI DFHI

The functions of SBI DFHI are as follows:

(i) It shall be the sole depository of the surplus liquid funds of the banking system as well as the non-banking financial institutions.

(ii) It should use surplus funds to even out the imbalances in liquidity in the banking system subject to the RBI guidelines.

(iii) It should create ready market for commercial bills, treasury bills, and government/government-guaranteed securities by being ready to purchase from and sell to the banking system.

It was accredited as a Primary Dealer in February 1996. But over the years, SBI DFHI has undergone the role transformation. Primarily it concentrated on the money market and acted more as a broker giving two-way quotes on a daily basis. But now it has been playing a vital role in developing an active secondary market in money market instruments.

Objectives of SBI DFHI

The main objectives of SBI DFHI are as follows:

1. To balance the liquidity imbalances in the money market by matching the demand and supply of money.
2. To promote secondary market for short-term money market instruments, i.e., to be an active trader in money market instruments. These are the two main objectives of SBI DFHI. To achieve these objectives, the SBI DFHI has been striving to:

2

Indian Money Market

Introduction

Money market refers to a market for short-term funds, short-term money and financial asse which can be used as a substitute for money. It can also be termed as a mechanism or a system fro which the borrowers manage to obtain short-term funds and the creditors get borrowers for the money. The instruments of money market are characterised by liquidity, minimum transaction co and no loss in value. Commercial banks are the leading players in the money market.

Definitions

Different authors have defined the money market in different ways. These are:

1. According to **Geoffery Crowther,** "Money market is a collective name given to the vario forms and institutions that deal with various grades of near money."
2. According to **J.M. Culberston,** "A network of markets that are grouped together becaus they deal in financial instruments that have a similar function in the economy and are to som degree substitutes from the point of view of holders. The instruments of the money marke are liquid assets: interest bearing debts that mature within a short period of time or callable o demand."
3. **The Reserve Bank of India: 'Functions and Working'** has described the money marke as "the centre for dealings, mainly short-term character, in monetary assets; it meets the shor term requirements of borrowers and provides liquidity or cash to the lenders. It is the plac where short-term surplus investible funds at the disposal of financial and other institutions an individuals are bid by borrowers, again compromising institutions and individuals and als government itself."
4. According to **H.R. Machiraju,** "It is the market for dealing in monetary assets of short-ter nature. Short-term funds upto one year and for financial assets that are close substitution fo money are dealt in the money market."
5. According to **V. Avadhani,** "An important segment of the financial system is the mone market which refers to all transactions in near money such as short-term claims on bank financial institutions and corporate sector."
6. According to **L.M. Bhole,** "Money market is that part of the national money market whe day-to-day surplus funds, mostly of banks, are traded in."
7. According to **P.K. Dhar,** "By the term money market we mean, the establishment of a syste or a mechanism from which the borrowers usually get short-term loanable funds and also th lenders successfully get the credit worthy borrowers for their required money."

Thus, it may be said that money market is a system for dealing in short-term funds. Short-term refers to the period up to one year. Commercial bills issued by the corporate sector, treasury bills issued by government and the transactions in inter-bank call money are all part of it. The banks, financial institutions and the corporate sector are the players of this market who deals in money and near money items. Still the RBI occupies an important and strategic position as it influences the availability of the credit and decides the cost of the credit.

Characteristics of Money Market

The money market in India has the following characteristics:

(i) It establishes the link between the RBI and other banks.
(ii) It is a inter-bank market which matches the deficits and surplus of banks.
(iii) This market secures short-term requirements of banks and financial institutions.
(iv) It also provides a link between short-term and long-term capital market.
(v) Dealings in UTI bonds, PSU bonds, and bonds of government and semi-government sector are also covered under this market.
(vi) It is a wholesale market.
(vii) The volume of the business is found to be very large.
(viii) The settlement of transactions takes place on a daily basis.
(ix) The central bank occupies a strategic position in the money market.
(x) The developed money market contributes to an effective implementation of the monetary policy.

Objectives of the Money Market

As stated by **M.Y. Khan,** the money market has the following objectives:

(i) An equilibrating mechanism for balancing short-term surpluses and deficiencies;
(ii) A focal point of central bank intervention for influencing liquidity in the economy; and
(iii) A reasonable access to the users of short-term funds to meet their requirements at a reasonable price.

Pre-requisites for an Efficient Money Market

To meet the above said objectives, an efficient money market should satisfy the following requirements:

1. The money market should be deep and wide. Deep in the sense that there should be large number of participants, and wide in the sense that the flow of funds should not be restricted to the boundaries of a country only.
2. The money market instruments should be active and there should be a good mix of its instruments. These instruments should be able to meet the diversified requirements of lenders and borrowers.
3. The existence of active secondary market for these instruments is also necessary for an efficient money market.

4. A central bank for strong regulation, direction and facilitation is also necessary for developed and efficient money market.
5. The existence of developed banking system is also a pre-requisite for a developed money market. Commercial banks are the nucleus of the money market. The central bank can regulate the money market only with the help of commercial banks.
6. The demand and supply of funds should be large in money market. For this, there should be a developed capital market and the volumes of domestic and foreign trade should also be high.
7. Ready marketability and adequate liquidity in short-term are another pre-requisite for an efficient money market.
8. There should be a number of inter-related and integrated submarkets, such as, call money market, bills market, etc.
9. The demand and supply of funds and the rate of interest should be determined by market forces.
10. There should be proper and fair competition among submarkets and within each submarket.

Importance of Money Market

The importance of the money market is as follows:

1. It is an important source of financing trade and industry through bills, commercial papers, etc.
2. It influences the availability of funds both at domestic and international level.
3. It helps in the implementation of the monetary policy of the central bank of a country.
4. It helps central bank in controlling the inflation and deflation in the country.
5. It helps the government as a guide in formulating, revising and implementing the monetary policy.
6. It serves as an indicator of the monetary state of the economy. If the money market is strong, the monetary state of the economy will be sound.
7. It provides non-inflationary avenues to the government for raising short-term funds through treasury bills which are subscribed by commercial banks and the public.
8. It provides avenues to commercial banks for investing their short-term surplus funds and borrowing for short-term needs to meet statutory requirements, like cash reserve ratio and statutory liquidity ratio.
9. It affects resource mobilisation in the capital market. If the interest rates in the money market are lower, then the inflow of funds in the capital market will be more and if the interest rates in the money market are higher, the inflow of funds in the capital market will be lower.
10. It promotes liquidity and safety of financial assets. By doing so, it can help in encouraging savings and investments.

Institutions of Money Market

The institutions of money market means the market which deals in lending and borrowing of short-term funds. The institutions of money market differ from country to country. The major institutions of money market are as follows:

1. Commercial Banks

Commercial banks may be termed as the backbone of the money market. These banks collect the money from the public in the form of savings account, current accounts and term deposits and finance the working capital requirements of corporates. The commercial banks invest their funds in discounting bills of exchange to facilitate trade and commerce by mobilising the flow of money. They lend money through advances, allowing overdrafts in current accounts. They also lend money against promissory notes, *hundi*, etc. Call money to bill brokers and dealers in the stock exchange market is also provided by these banks. Surplus money is invested by them in those channels where the liquidity and profitability are optimum. In addition to commercial banks, co-operative banks, financial companies, etc. are also forms of money market.

2. Central Bank

The central bank is the apex institution and monetary authority. It plays a vital role in the money market. No money market can exist without central bank. The central banking functions are regulatory in nature. It is the lender of the last resort. It also functions as controller and guardian of the money market. During emergency, the central bank lends money to commercial banks. It raises or reduces the money supply and credit to bring stability in the economy. It does not enter into direct transactions. It regulates the money market by changing bank rates and through open market operations. A major point is that the performance of the central bank depends on the character and composition of the money market and vice versa.

3. Acceptance Houses

The acceptance houses and the bill brokers are another constituent of the money market. They work in the bill market. They function as an intermediary between lenders and borrowers, exporters and importers in the short-term. They accept the bills of those parties (buyers) whose position is unknown to sellers and thus facilitate the transactions between them. For this service, they charge commission. The discounting of such bills is done by another specialised agency. That specialised agency is known as discount houses. In India, Discount and Finance House of India (DFHI) is such an agency. As such, commercial banks are also functioning as acceptance houses and discount houses in India.

4. Bill Brokers

The bill brokers are intermediaries between the lender and the borrower who discount the bills of exchange at a small commission. Thus, they act like discount houses. These brokers are very important in underdeveloped money markets because the banking services may be underdeveloped or there may be absence of specialised houses for this purpose.

5. Non-Banking Financial Intermediaries

Besides commercial banks, these non-banking financial intermediaries also perform the function of lending and borrowing of short-term funds in the money market. These intermediaries include investment houses, insurance companies, chit funds, provident funds, building societies, etc.

In underdeveloped economies where banking facilities are not fully available, these non-banking financial intermediaries are very helpful in developing and running of money market.

The Indian Money Market

Till the late 80s, the Indian money market was highly regulated and was characterised by limited number of participants.The limited variety and instruments were available. The entry was regulated. Interest rate on the instruments was under the regulation of RBI. Sincere efforts for developing the money market were made since the early 90s when the financial sector reforms were started by the government.

The Indian money market cannot be considered as an integrated unit. It can be divided broadly into two parts viz., the unorganised and organised. The two markets differ from each other in terms of composition and rates of interest. The organised sector consists of private and nationalised commercial banks, the foreign banks, co-operative banks and the Reserve Bank of India (RBI), the development financial institutions, and the Discount and Finance House of India (DFHI), whereas the unorganised sector consists of the moneylenders and the indigenous bankers. Reserve Bank of India is the supreme controllable organisation of the Indian money market and therefore it shoulders the responsibility of smooth functioning of the financial system. For stabilising the money market, the RBI set up the Discount and Finance House of India (DFHI) in April 1988.

The Indian money market can be classified in two parts. These are:

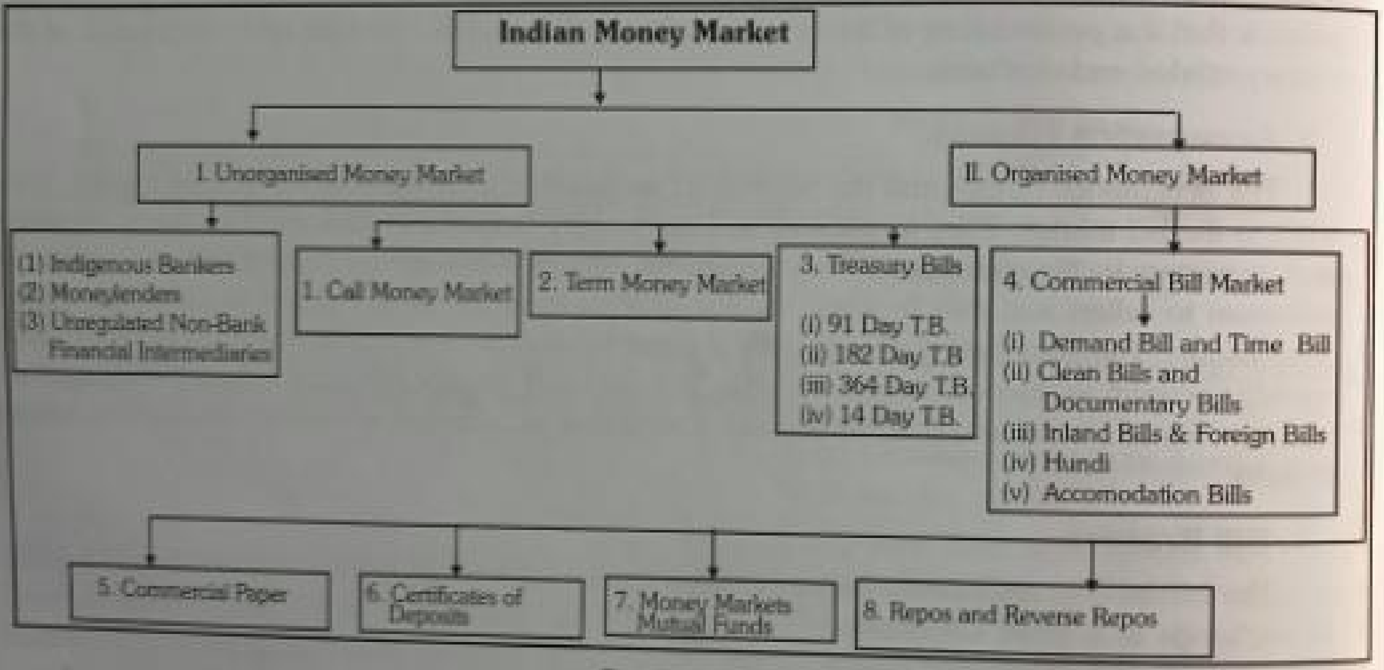


Fig. 2.1

I. Unorganised Money Market

This sector of money market is not homogeneous. It consists of indigenous bankers, moneylenders and non-bank financial intermediaries. They exist from villages to big cities, i.e, everywhere in India. Artisans, farmers, small traders and small producers are the main clients of the unorganised sector money market. Generally, these moneylenders lend small amount of money, but some indigenous bankers do a considerable amount of business. They pursue this business in combination with other businesses. The main constituents of this sector are:

1. Indigenous Bankers

The activities of indigenous bankers are not at all regulated. These are the individuals or private firms which act like a bank as they receive deposits and give loans to the public. These bankers were very active in the ancient and medieval periods. But with the growth of banking system in India, these bankers received a setback. With the growth of commercial and co-operative banks in the past two and a half decades, the business of indigenous bankers has further contracted. But these bankers are still in operation in large numbers in the Western and Southern parts of the country, e.g., Gujarati Shroffs, Multani or Shikarpuri Shroffs, Chettiars and Marwari Kayas. Banking and non-banking, both types of businesses are undertaken by these bankers. They charge high rate of interest and are not covered under the bank rate policy of RBI.

Since the nationalisation of banks, these indigenous bankers are facing stiff competition from commercial banks. Further, their position has worsened with the opening of private banks in the banking sector. But still they are surviving due to various favourable factors, like stringent conditions imposed by banks for granting credits, prompt and personalised services by these bankers to their customers, lower operational and establishment costs, etc. These bankers do not care for the end-use of credit. The RBI has no control over lending operations of these bankers and therefore, their activities remain completely unsupervised and unregulated.

There are three categories of indigenous bankers:

(a) those whose main business is banking;

(b) those who combine their banking business with trading and commission business; and

(c) those whose main business is trading and commission but do a little banking business too.

The majority of indigenous bankers belong to the second group.

Functions of Indigenous Bankers

The main functions of indigenous bankers can be classified in two parts:

A. Banking Functions

Banking functions of indigenous bankers are as follows:

1. **Accepting Deposits:** One of the main functions of the indigenous banker is to accept deposits. They accept deposits from the public and make payments of that after a certain period or on demand.
2. **Lending of Money:** Lending is another main function of these bankers. They give loan to the public against promissory notes, receipts and by keeping land, jewellery, house, etc. as mortgage. The rate of interest charged by them depends upon the nature of security provided against loans. Generally, farmers and small entrepreneurs borrow money for their agriculture and business.
3. **Dealing in *Hundi*:** *Hundi* is a credit instrument. Indigenous bankers deal in selling, purchasing and discounting of these hundies. Hundi may be of two types: Darshani and Muddati. Darshani hundi is payable on demand, whereas muddati hundi is payable on expiry of certain period.

per cent to 9.50 per cent in 2016-17. Among the three important centres of Kolkata, Chennai and Mumbai the call rate is usually the highest in Kolkata and the lowest in Mumbai.

2. Term Money Market

The term money market in India has been dormant. The term money market in India could not be developed due to statutory pre-emptions on interbank liabilities, regulated interest rate structure, high degree volatility in call money rates, availability of sector specific re-finance, cash-credit system of refinancing, absence of asset-liability management practices among banks and inadequate development. The interest rate ranged between 6.30 per cent to 9.50 per cent. The interest rate ranged between 5.80 per cent to 7.90 per cent. The average daily turnover in 2016-17 was of 4.63 billion.

3. Treasury Bills

A particular kind of finance bill or a promissory note issued by the government is known as the treasury bill. The market which deals in these bills is known as treasury bill market. Till 1950, the state governments also issued treasury bills. But after that, only the Central Government issues the treasury bills. It is a short-term instrument. The government issues these instruments for meeting temporary deficits occurred due to its excess of expenditure over income. In India, it has become a permanent source of funds for the central government as the government issues new bills every year to meet the repayment of retired bills. These are highly liquid but they are not self-liquidating like genuine bills. This segment has become more vibrant and responsive to policy changes since April 1, 1997 as wide range of changes have been made in respect of treasury bills.

Features of Treasury Bills

The features of treasury bills are as follows:

(1) **High Liquidity:** Treasury bills are highly liquid. Commercial banks, DFHI, STCI and other institutions provide ready market for these bills. RBI also provides ready market for it.

(2) **Low Transaction Cost:** DFHI offers two-way quotes, i.e., buying and selling rates daily. difference between the two rates is the transaction cost. The difference between the two is very low and thefore, the transaction cost is found to be very low.

(3) **Ready Availability:** These bills are readily available throughout the week as the rates are announced daily. On any day one can invest his surplus funds in it.

(4) **Assured Yield:** The fluctuation in the discount rate is found to be very low and thus it provides assured yield on investment.

(5) **Zero-Default Risk:** RBI issues these bonds on behalf of the Central Government. Therefore, there is no risk at all in these bills since they are guaranteed by the government.

(6) **Eligible Security for SLR:** The commercial banks have to satisfy the Statutory Liquidity Ratio (SLR). Treasury bills provide eligible security for the calculation of SLR. This gives an added advantage to commercial banks and makes them dominant dealers in the treasury bills.

RBI, SBI, commercial banks, state governments, DFHI, STCI, LIC, GIC, UTI, GIC, NABARD, IDBI, IFCI and ICICI, corporate sector, public and FIIs are permitted to purchase and sell off treasury bills.

At present, various types of treasury bills are:

(i) **91-Day Treasury Bill Market:** This is the oldest type of treasury bill. In India, there were two types of 91-day treasury bills–ordinary and ad hoc. The first type of bill, i.e., ordinary treasury bills are issued to the public and to the RBI. These bills enable the central government to meet the temporary requirement for funds. The other type of 91-day treasury bill, i.e., ad hoc treasury bill, was created in favour of RBI. The issuing of ad hoc treasury bills was introduced in India in 1937. The Government of India and RBI entered into an agreement in 1937 and 1955. It was decided in the agreement that the government shall maintain with the RBI, a cash balance of not less than ₹ 50 crore on Fridays and ₹ 4 crore on other days free of obligation to pay interest thereon and when the balance falls below these minimums, the government's account will be replenished by creating ad hocs in favour of RBI. But the Government of India and RBI entered into an agreement in 1994-95 to phase out adhocs in 3 years following the budget speech of the then Finance Minister. The limit for ad hocs was ₹ 5000 crore in 1994-95, 1995-96 and 1996-97. From 1997-98, the system of ad hocs was discontinued. A gross amount of ₹ 2372.6 billion crore was raised during 2016-17 as against ₹ 1470.5 billion in the year 2015-16. The average interest rate was 5.82% in 2016-17.

(ii) **182-Day Treasury Bill Market:** These bills were introduced in November 1986 to provide more outlets for temporary surplus funds. Again, 182-day treasury bills were issued by the Government of India, like 91-day treasury bill. This bill also provides an additional avenue to raise financial resources by the government for its budgetary expenditure. Initially, it was sold in the market by RBI at the beginning of every month. In July 1988, they were made fortnightly. No specific amount of funds was fixed to be raised through the auctions of these bills. This amount depended upon the funds available with the market participants and the amount they wish to invest in these bills. Thus, 182-day treasury bill, a new fiscal instrument, became an effective instrument for banks, corporate finance managers and financial institutions as it enabled them to invest their short-term funds. The bills of the minimum amount of ₹ 1,00,000 can be issued at discounted price. These bills can be purchased by any individual, firm, company, bank and financial institutions. The state governments and provident funds cannot purchase these bills. Foreign commercial bills, some of Indian scheduled banks, national co-operative development organisation, financial institutions, joint-stock companies, DFHI and others are the usual participants of this bill. The market for these bills was narrower than the market for 91-day bills. Issue and trading of these bills discontinued from 16th October, 1992.

However, in 1999-2000, these bills were re-introduced to enable the development of a market for government securities. These bills were not allowed to be rediscounted with RBI. They were offered for sale on an auction basis. The cut-off yield was 6.05 per cent in 2016-17. The total amount of ₹ 847.2 billion was owned by different stakeholders in 2016-17.

(iii) **364-Day Treasury Bills:** The authorities introduced 364-day treasury bills, w.e.f., April, 1992, when the 182-day treasury bills were discontinued. The first auction took place on 28th April, 1992 and since then auction is made every fortnight. These bills are also not purchased and rediscounted by RBI. The investors show moderate to good response for it. The response is evident from the number of bids and the amount tendered at the time of each auction. These bills offer short-term investment opportunity to financial institutions like banks. The total amount of ₹ 1416.8 billion was owned by different stakeholders in 2016-17.

(iv) **14-Day Treasury Bills:** These bills are of two types: one issued intermediate treasury bill (ITB) on April, 1, 1997; and the second was issue on May 20, 1997. The ITB has replaced the old treasury bill of 91-days. State governments, foreign central banks, and other specified bodies are entitled to buy these intermediate treasury bills as an alternate arrangement in place of 91-day treasury bills for investing their temporary cash surpluses. A scheme for the sale of a new category of 14-day treasury bills on an auction basis was announced on May 20,1997 to meet the cash management needs of various segments of the society. The first auction took place on June 6, 1997 and the amount outstanding at the end of March 2003, stood at ₹ 300 crore in 2000-03. No amount was outstanding in the years 2001-02 and 2002-03. These bills are discounted by RBI since 2002-03.

Features

The salient features of 14-day treasury bills are as follows:

(a) The bills can be repaid or renewed at par on expiry of 14 days from the date of issue.

(b) It is rediscounted at 50 basis points higher than the discount rate.

(c) It is non-transferable.

(d) These would be sold for a minimum amount of ₹ 1,00,000 or in multiples thereof and would be issued only in book form.

(e) The discount rate be reset at quarterly intervals such that effective yields of this instrument would be equivalent to the interest rate on WMA chargeable to Central Government.

4. Commercial Bill Market or Acceptance Market

It is a sub-market in which the trade bills or the commercial bills are traded. These bills are drawn by the drawer (seller) on the drawee (buyer) for the value of goods delivered to him. In India, banks mainly provide funds for working capital required in the business through discounting of commercial bills. But in other countries, bill finance is one of the major types of finance provided by banks.

Pre-requisites of a Developed Bill Market

The following are the characteristics of a developed bill market:

(i) There should be large number of transactions supported by genuine bills.

(ii) Commercial banks, other financial institutions and acceptance houses should provide facility for acceptance at low cost.

(iii) Bills of exchange should be used by banks as an instrument for providing credit to their customers.

(iv) There should be abundant facilities for rediscounting of bills.

(v) Supply of bills in money market should be deep, wide and continuous.

(vi) The velocity of circulation of bills should be high.

(vii) The number of intermediaries in the market should be adequate.

(viii) The central bank should rediscount the bills throughout the year.

(ix) Both borrowers and lenders must follow strict financial discipline.

(x) There should be efficient credit investigation agencies to investigate the credit-worthiness of different parties.

Importance of Bill Market

The importance of bill market is as follows:

1. It is a prevalent method of meeting credit needs of trade and industry.
2. They have high level of liquidity because they can be discounted any time.
3. They are self-liquidating in nature because they are issued for fixed time period.
4. It enables financial institutions to invest their surplus funds at suitable maturities.
5. Banks and other financial institutions can meet their short-term liquidity requirements by getting these bills rediscounted.

According to the ***Indian Negotiable Instruments Act, 1881,*** *"It is a written instrument containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument."*

Various types of bills of exchange are in the market. They are:

(i) **Demand Bill and Usance or Time Bill:** A demand bill is payable immediately at sight or on presentation to the drawee. A bill which contains no time for payment is also considered as demand bill. On the other hand, usance or time bill is payable at a specified later date.

(ii) **Clean Bills and Documentary Bills:** Documentary bills are those bills which are accompanied by documents of title to goods, such as railway receipts or bills of lading.

(iii) **Inland Bills and Foreign Bills:** Inland bills are those bills which are to be drawn or made in India and must be payable in India. These bills can be drawn upon a person residing in India whereas, foreign bills are drawn outside India and these may be payable in India or outside India. These bills may be drawn on a person residing outside India or residing in India.

(iv) ***Hundi*:** Hundi is an indigenous variety of bill of exchange. Indigenous bankers used it to raise money or to remit funds or finance inland trade. These are of two types–*darshani* and *muddati*. **Darshani hundi** is very similar to modern bills of exchange. It is used for the payment of goods originating from the place of production and passing from party to party in different places. The place of origin and place of destination may be quite different. Whereas, the **muddati hundi** is payable after the expiry of fixed time period and is confined to local limits.

(v) **Accommodation Bills and Supply Bills:** An accommodation bill is such in which the accommodating person puts his signatures on the bill as acceptor to accommodate another party without receiving any consideration. The supply bill is a bill drawn by the supplier or the contractor on the government or semi-government department to get the advance amount against the goods or material supplied to them. These bills are not accepted by government departments. But the commercial banks give advances against these bills.

The RBI has taken the innovative steps of permitting scheduled commercial banks to rediscount genuine trade bills with other commercial banks, LIC, UTI, GIC and ICICI. This has increased the number and types of institutions participating in this market. The bills rediscounted by commercial banks amounted to ₹ 105 crore at the end of March 2003.

5. Commercial Paper

Commercial paper is a new instrument in money market. This was introduced in January 1990 in India. These were introduced to enable highly rated corporate borrowers to diversify their sources of short-term borrowings and also provide an additional instrument to the investor. RBI has issued guidelines to regulate the issue of commercial paper. These guidelines are applicable on all financial and non-financial companies. The main points of guidelines are as follows:

(i) **Eligibility Conditions:** Commercial paper can be issued only by that company whose:

(a) tangible net worth is not less than ₹ 4 crore.

(b) maximum permissible bank finance (MPBF) for working capital requirements is not less than ₹ 4 crore.

(c) current ratio is at least 1.33:1.

(d) shares of the company are listed on one or more stock exchanges.

(e) specified credit rating of P2 are obtained from Credit Rating Information Services of India (CRISIL) and A2 in the case of Investment Information and Credit Rating Agency of India Limited (ICRA).

(f) borrowal account is classified under health code No.1

(ii) **Period:** The maturity period ranges between 30 days to 1 year. No grace period is allowed for payment and even if the maturity date falls on a holiday, it should be paid on the previous working day.

(iii) **Denomination and Minimum Investment:** The issue should be for a minimum of ₹ 25 lakh and in multiples of ₹ 5 lakh. Total amount proposed to be issued should be raised within two weeks from the date on which the proposal taken on record by the bank. The paper may be issued as a whole on a single day or in parts on different dates but the maturity date of each paper should be the same.

(iv) **Ceiling:** The aggregate amount that can be raised by commercial paper by corporates is 100% of the working capital credit limit as announced in November 1996.

(v) **Mode of Issue and Discount Rate:** This paper should be issued in the form of usance promissory note and should be negotiable by endorsement and delivery. It can be issued at either discount or face value as may be decided by the issuing company.

(vi) **Issue Expenses:** Issue expenses include dealer's fees, rating agency fees and other relevant expenses. These are to be borne by the company.

(vii) **Procedure for Issue:** The commercial papers can be issued only through those bankers who have sanctioned working capital limits to the company. Every proposing company has to submit the proposal in the form prescribed by RBI along with credit rating to the bank which provides working capital to the company. The bank after scrutinising and making itself satisfied takes the proposal on record. The company has to privately place the issue either itself or through the merchant banker within two weeks. The initial investor pays the discounted value of the paper to the account of the issuing company with the bank in writing. The company has to send the advise of commercial paper issued within three days through the bank.

(viii) **Investors:** Any individual, bank, companies and other registered corporate bodies and unincorporated bodies can purchase this paper. This paper can also be issued to NRIs, but only on repatriable and non-transferable basis.

(ix) **Current Position:** The outstanding amount of commercial papers was ₹ 3979.7 billion as on March 31, 2017. The effective weighted average discount rate increased from 8.59 per cent in 2006 to 11.30 per cent in 2007 and decreased to 4.79 per cent as on 31st March, 2009 and again increased to a range between 5.90% to 14.92% in 2016-17.

6. Certificates of Deposits

A certificate of deposit (CDs) is a document of title to depositors of funds that remain in deposit at the bank for a specified period at a specified rate of interest. The CDs are bearer instruments and are readily negotiable and marketable. Both bankers and investors are benefitted by CDs as bankers need not make payment prematurely, while the investors can sell CDs in the secondary market before its maturity.

The **Tamble Working Group** in 1982 studied its feasibility of introducing it but did not recommended it for the following reasons:

(i) Absence of a secondary market;

(ii) Administered system of interest rates; and

(iii) The danger that CDs might give rise to fictitious transactions.

In 1987, the Vaghul Working Group studied the matter again and was in its favour, provided short-term deposits were aligned with other interest rates in the system. On the basis of the recommendations of Vaghul Committee, the RBI formulated a scheme for the issue of CDs by scheduled banks in June 1989.

According to the RBI scheme, the CDs can be issued only by scheduled banks at a discount rate from the face value, and the RBI puts no restrictions on the discount rate. It means there is no restriction on the rate of interest that can be paid to a depositor. The formula for the calculation of discount rate is:

$$D = \frac{F}{I + \frac{(I \times N)}{100 \times 365}}$$

Where, D = Discounted values of the CDs, I = Effective Interest per annum, F = Face value

N = Number of Days or Months.

The RBI has modified its original scheme in 1997-98. The broad points of the effective guidelines are as follows:

(i) The minimum denomination of CDs is ₹ 5 lakh.

(ii) The minimum size of the issue of a single depositor is ₹ 10 lakh and additional amounts can be issued in multiples of ₹ 5 lakh.

(iii) The maturity period of CDs varies from 3 months to 1 year.

(iv) The CDs are to be issued at a discount to face value.

(v) The CDs are transferable after a lock-in period of 30 days after the issue.

(vi) All scheduled banks other than RRBs are eligible to issue the certificates of deposits.

(vii) Term-lending institutions also can issue them but with the maturity period of 1 to 3 years.

(viii) The CDs are subject to cash reserve ratio and SLR requirements.

(ix) The CDs cannot be bought back by issuing institutions and they also cannot lend against CDs.

(x) The discount rate is determined by market and anyone can purchase CDs.

Initially, the CDs were highly popular instruments in the primary market in 1990 due to th higher interest rates in comparison to normal bank lending rates. But in 1993-94, there was a lack interest among banks in issuing fresh certificates of deposits. The stringent money market conditions 1995-96 induced banks to mobilise resources on a large scale through CDs. The outstanding amou of CDs issued by banks rose from ₹ 8,017 crore at the end of March 1995 to ₹ 21,053 crore as o June 1996. Thereafter, there was a steep fall in outstanding amount of CDs and it was as ₹ 4,4 crore as on March 2004. At the end of March 2017, there was a decline in amount of CDs as declined to ₹ 1557.4 billion. The weighted average discount rate of CDS ranged between 6.12% 6.71% in the year 2016-17.

7. Money Market Mutual Fund (MMMF)

Money Market Mutual Fund (MMMF) was intro-duced to enable small investors to particip in the money market. MMMF is a conduit through which they can earn the market-related yield. broad framework for setting up MMMFs was outlined by RBI in April 1991. As a follow-up, a ta force headed by **D. Bose** to work-out operating guidelines was appointed in September, 1991. Th RBI announced detailed guidelines in this regard in April 1992 based on the recommendations the task force. In December 1995, certain modifications to the existing scheme was introduced w a view to import greater liquidity and depth to the money market. The salient features of the schem are as follows:

(i) **Eligibility Criteria for Setting up MMMFs:** Scheduled commercial banks, public financ institutions or their existing mutual funds/subsidiaries engaged in funds management an mutual funds of private sector are eligible to set up MMMFs.

(ii) **Size:** There are no restrictions on the minimum size of a MMMF.

(iii) **Subscribers:** Individuals including NRIs are eligible to subscribe for the MMMF. The dividen income would be repatriable but the principal amount of subscription would not be allow to be repatriated abroad. During 1996-97, the MMMFs schemes were extended to corpora also.

(iv) **Minimum Size of Investment:** The MMMFs are free to determine the minimum size investment by a single investor.

(v) **Investment Objectives and Policies:** The investment objectives and policies of a MMM should be laid down by the sponsor bank/institution or concerned mutual fund. The objectives and policies should be clearly stated together with the terms and conditions of th scheme.

(vi) **Investment by MMMFs:** The MMMFs can invest the available resources in treasury bil call/notice money, commercial bills, commercial paper and certificates of deposit. The MMM were allowed to invest in rated corporate bonds/debentures with residual maturity period to 1 year with effect from October 22,1997.

(vii) **Minimum Lock-in Period and Redemptions/Repurchase:** The minimum lock-in perio for investments in MMMFs is 46 days. The minimum lock-in period was reduced to 30 days April 1998 and 15 days in October 1998.

(viii) **Accounts:** The MMMFs are required to keep distinct and separate accounts from their par institutions.

(ix) **Net Assets Value (NAV):** The MMMFs have to calculate the NAV of each scheme an disclose it periodically for the benefit of the investors.

(x) **Report to RBI:** The sponsor banks/FIs/subsidiary/mutual funds have to furnish quarterly report together with audited annual statement of accounts, scheme-wise details of the investment portfolio of the funds to the RBI. These reports should be furnished in duplicate to the RBI.

8. Repos and Reverse Repos

Repo is a money market instrument which helps in collateralised short-term borrowing and lending through sale/purchase operations in debt instruments. It is an agreement between a seller and a buyer in which securities are sold by their holder (seller) to the investor (purchaser) with an agreement to repurchase them at a predetermined rate and date whereas in a reverse repo, securities are purchased with a simultaneous commitment to resell at a predetermined rate and date.

Repos were initially allowed only in the central government treasury bills and dated securities, but gradually RBI allowed repo transactions in all government securities and treasury bills of all maturities, state government securities, public sector undertakings, bonds and private corporate securities.

Report on Currency and Finance, 1999-2000 has explained the usefulness of repos in the words that "repos help to manage liquidity conditions at the short-end of the market spectrum. Repos have been used to provide banks, an avenue to park funds generated by capital inflows to provide a floor to the call money market. During times of foreign exchange volatility, repos have been used to prevent speculative activity as the funds tend to flow from the money market to the foreign exchange market".

In continuation of the above, in Report on Currency and Finance 2001-02, it was stated that Reserve Bank has been emphasising expansion and diversification of the repo market under regulated conditions so that repos become very active in enabling smooth adjustment of liquidity in the system. To further develop and widen the repo market, the Reserve Bank introduced regulatory safeguards such as delivery versus payments system in April 1999. The operationalisation of the Negotiated Dealing System (NDS) and the Clearing Corporation of India Ltd. (CCIL) combined with placement of prudential limits of borrowing and lending in the call/notice market for banks are also expected to provide further boost to this market. The phase-out process of non-banks from the call/notice money market as also laying down of prudential restrictions on exposure limits of banks and PDs to this uncollateralised market segment is being followed up with the concomitant development of the repo market. The average daily turnover in the repo market (outside RBI) increased from ₹ 11,311 crore in April 2001 to ₹ 2334.7 billion in 2016-17. The repo auctions under liquidity adjustment facility (RBI) increased from ₹ 5,155 crore on 31 March, 2009 to ₹ 60.98 billion in March 2017. The interest rate was 4.75% on April 1, 2002 which increased to 6.25% on March 31, 2017. On the same day, the interest rate for reverse repo was 5.75%.

To examine various aspects of Repo, the RBI constituted a group which submitted its report in 1999. The recommendations of that group are as follows:

Recommendations

(1) **Withdraw Government Notification dated 27th June 1969:** The study group was of the opinion that the Government notification of 27th June, 1969 should be withdrawn. Otherwise the participation of most of the intending parties will not be possible.

(2) **Provide Powers to RBI under 29 A of SC(R) Act:** The study group also recommended that the Section 29 A of SC(R) Act should be amended to give regulatory powers to RBI to trade in Government securities.

(i) provide greater liquidity to money market instruments;

(ii) integrate markets at regional centres through its network with main market at Mumbai;

(iii) facilitate money market transactions for small and medium-sized irregular participating institutions;

(iv) provide safe and risk-free short-term investment avenues.

Importance of SBI DFHI

The importance of SBI DFHI is as follows:

(1) **Minimising Liquidity Imbalances:** SBI DFHI has significantly contributed in minimising liquidity imbalances in the money market. It is also providing higher liquidity to borrowing banks by readily buying and selling of money market instruments.

(2) **Two-Way Quotes:** It also gives two-way regular quotes in money market instruments which serves as a base to broaden the secondary market and provides an assured liquidity to the instruments.

(3) **Authorised Institution for Government Securities:** It is also an authorised institution to undertake REPO transactions in treasury bills and other Government securities. It provides greater liquidity to all the Government securities.

(4) **Deepening the Money Market:** It helped in deepening the money market and increasing the turnover manifold.

(5) **Facility for Deploying Short-term Surpluses:** It helped the banks and other financial institutions to deploy their short-term surpluses in suitable money market instruments by quoting two-way quotes regularly.

(6) **Constituent SGL Account Facility:** It provides the constituent SGL Account Facility to those entities which are otherwise not eligible to have SGL account facility with the RBI. This facility enables them to invest in Government securities.

(7) **REPO Facility:** DFHI has extended the REPO facility to IDBI, IRBI, IFCI, NABARD, LIC, GIC and its subsidiaries and the commercial banks. This helps these institutions in raising funds without divesting their holdings.

(8) **Extension of Money Market:** It also helped in extending the money market beyond the traditional metro centres. Now the co-operative banks and small private sector banks are using DFHI as a medium for money market activities.

(9) **Developing Primary and Secondary Market in Financial Instruments:** It is discharging the stabilising and developmental role in the money market. It is also contributing to develop the term money market. It is playing an important role in the development of primary and secondary market in financial instruments by increasing the number of participants and by providing various facilities.

Growth of SBI DFHI

The following table gives a brief picture of growth of SBI DFHI's business:

SBI DFHI– Operating Results (₹ in Lakhs) (2015-16)

Income	
Discount	12,723.54
Interest Income	23,358.04
Trading Profit	6,595.23
Other Income	319.87
Total Income	42,996.68
Expenditure	
Interest Expenses	27,399.96
Discount	1,779.00
Administrative Costs	2,931.50
Total Expenses	32,110.46
Profit Before Tax	10,886.22
Net Profit After Tax	7,219.21

Capital Resources

The company started its operation with an initial paid-up capital of ₹ 100 crore. However, in order to broad base the activity of the company, the paid-up capital was subsequently increased to ₹ 150 crore in 1989-90 and further to ₹ 200 crore during 1991-92. The sources and applications of funds on 31-03-2016 are as follows:

SBI DFHI–Balance Sheet
as on 31-03-16

(₹ in Lakhs)

Sources of Funds:		
Shareholders' Funds:		
Share Capital	21,818.19	
Reserves and Surplus	78,309.52	1,00,127.71
Loan Funds:		
Secured Loans		2,75,304.64
Unsecured Loans		2,06,280.00
Others: Deferred Tax Liability		74.74
Total		5,81,787.09

Applications of Funds:		
Fixed Assets:		538.70
Investments:		
Government Securities	4,13,175.48	
CP/CD	60.690.72	
Corporate Bonds	64,474.90	
Others	30,225.00	
	5,68,566.10	
Loans and Advances	13,625.28	
Cash and Bank Balances	639.03	
Less: Current Liabilities and Provisions	1,833.02	5,80,997.39
Non Current Assets		251.00
Total		5,81,787.09

(Source: Website of SBI DFHI Ltd.)

2. Securities Trading Corporation of India (STCI)

The STCI was set up in 1994 with the objective of promoting good secondary market for deb instruments. Its paid-up capital is ₹ 500 crore which is contributed by the banks, LIC and the RBI. The RBI holds 50.18% of the total capital. It functions as a primary dealer in government securities. It works as a market maker at the long end of this market. It means it takes up a part or whole o the auctions of the government securities, develop a market in them and pass them on to the fina investors. RBI provides refinance facility to STCI. RBI divested its equity in STCI in a gradual manne and completed full divestment in March 2002. The name of company is changed to STCI Finance Ltd. from October 24, 2011.

Currents Activities

The current activities of STCI are as follows:

(i) Underwriting of Government of India securities and treasury bills;

(ii) Participation in Government of India securities and treasury bills;

(iii) Market making and trading in Government of India securities and treasury bills by quoting two way quotes;

(iv) Trading in PSU bonds and other corporate debt instruments;

(v) Participation in REPO market of Government of India securities and treasury bills;

(vi) Participation in the inter-bank call/notice/term money market as a borrower and as a lende

(vii) Trading in equities;

(viii) Portfolio management services.

Capital Resources

STCI has authorised, issued, subscribed and paid-up capital of ₹ 500 crore, 29.95 per cen of this was contributed by Bank of India, 32.67 per cent by public sector banks, 10.50 per cent b SBI 10 per cent by IDFC and 16.88 per cent by financial institutions. Moreover, the reserves and surplus on March 31, 2016 amounted to ₹ 75,688.81 lakhs. The profit and loss A/c and sources and applications of funds of the company are as follows:

STCI– Profit and Loss A/c

as on 31-03-2017

Amount in (₹ in lakhs)

Income	₹
I. Revenue from Operations	
(a) Interest income	19,016.23
(b) Other financial services	472.56
(c) Profit/(Loss) on sale of securities	181.04
	19,669.83
II. Other Income	7,546.09
III. Total Revenue (I + II)	27,215.92
IV. Expenses	
Employee benefit expenses	477.42
Finance costs	9428.78
Depreciation and amortisation expenses	74.30
Other expenses	278.41
Provision against loans and advances	8,909.72
Total Expenses	19,168.63
V. Profit before exceptional and extraodinary items and tax (III-IV)	8,047.29
VI. Exceptional items	0.00
VII. Profit before tax (V + VI)	8,047.29
VIII. Tax expenses	
(i) Current Tax	(1774.80)
(ii) Deferred Tax	2006.84
(iii) Short/(Excess) provision for tax of earlier year (s)	0.00
IX. Profit for the year (VII-VIII)	7,815.25
X. Earning per equity share of per value of 100/- each	
(i) Basic earnings per share (EPS) in ₹	20.57
(ii) Diluted earnings per share (EPS) in ₹	20.57

(Source: Website of STCI)

Balance sheet
as on 31-03-2017

Amount in (₹ in lakhs)

Particulars	As at 31st March, 2017
I. EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share capital	38,000.00
(b) Reserves and surplus	75,688.81
(c) Money received against share warrants	—
(2) Share application money pending allotment	—
Total (1 + 2)	**1,13,688.81**
(3) Non Current Liabilities	
(a) Long term borrowings	1,03,333.33
(b) Defferred tax liability (Net)	0.00
(c) Long term provisions	672.49
Total (3)	**1,04,005.82**
(4) Current Liabilities	
(a) Short term borrowing	1,40,980.02
(b) Trade payables	34.30
(c) Other current liabilities	11,800.14
(d) Short term provisions	1,262.98
Total (4)	**1,54,077.44**
Total	**3,71,772.07**
II. ASSETS	
(I) Non Current Assets	
(a) Fixed Assets	
(i) Tangible Assets	2,223.04
(ii) Intangible Assets	13.99
(b) Non Current Assets	26,625.21
(c) Deferred tax assets (Net)	1,283.23
(d) Long term loans and advances	90,760.33
(e) Other non-current Assets	77.27
Total	**1,20,983.11**
2. Current Assets	
(a) Current Investments	0.00
(b) Inventories	35,240.18
(c) Trade Recivables	0.91
(d) Cash and Cash Equivalents	2919.79
(e) Short Term Loans and Advances	211309.92
(f) Other Current Assets	1,318.16
Total	**2,50,788.96**
Gross Total	**3,71,772.07**

(Source: Website of STCI)

Characteristics of Indian Money Market

The Indian money market suffers from a number of defects, the prominent of these are as follows:

(1) Lack of Integration

The Indian money market is not integrated one. It is divided in two sectors, i.e., organised sector and unorganised sector. The financial operations of both the sectors are independent to each other. The activities of both the sectors are also independent and have no impact on each other. Therefore, it is very difficult to establish a national money market. The constituents of the money market are competing with each other rather than co-operating with each other. The RBI has no control over indigenous bankers. Further, the monetary policy of the RBI has not been found sufficiently effective to maintain adequate integration among the various constituents of the Indian Money market.

(2) Shortage of Funds

The Indian money market also suffers from shortage of funds. The demand for funds is much more than the supply of funds. There are so many reasons for the shortage of funds such as, poverty, black money, parallel economy, inadequate banking facilities.

The development of banking facilities in the rural sector in the recent past and recently the lowering of cash reserve ratio by RBI has improved the mobilisation of funds.

(3) Lack of Rational Interest Rates Structure

The Indian money market suffered from the major defect of irrational interest rate structure for a long period of time. Recently, the RBI introduced the standardisation of interest rates for rationalisation, which made some improvement in this regard. But still the present system of administration is suffering from some defects, such as, too many concessional rates of interest, comparatively low yield of government securities and improper lending and deposit rates fixed by the commercial banks.

(4) Absence of Organised Bill Market

Although the commercial banks purchase and discount both inland and foreign bills to a limited extent, but still there is absence of organised bill market. Despite the introduction of limited bill market under its scheme of 1952 and 1970 the same scheme failed to popularise the bill market in India. The major reasons which may be assigned for the poor development of the bill market are lack of uniformity in commercial banks and the popularity of the cash credit system.

(5) Inadequate Banking Facilities

The Indian money market suffers also from inadequate banking facilities. Rural banking network in India is still underdeveloped. In India, we have a branch on an average for roughly 12000 persons. Due to this drawback, a huge amount of small savings is not mobilised which needs to be mobilised for its productive uses through the expansion of banking facilities.

(6) Seasonal Stringency of Funds and Fluctuations in Interest Rates

Indian money market faces seasonal stringency of funds. It is because of the reason that India being an agricultural country has to face huge demand for funds during the period of October to June so as to meet the increased requirement of agricultural operations. Due to the reason, the interest rates also increase. But in the slack season, the demand for funds falls down and ultimately the interest rates also falls down. These wide fluctuations in interest rates are not favourable to developmental activities of the country.

Measures to Reform and Strengthen the Indian Money Market

The RBI and the government have taken various measures to strengthen the Indian money market in the recent past. Some of these are as follows:

(1) Remission of Stamp Duty

The government removed the major administrative constraint in August 1989 by remitting the stamp duty on usance bill. However, this measure has not induced use of commercial bills. The experts feel that government's decision to remit the stamp duty alone cannot bring the required result till the cash credit system is discouraged in the country.

(2) Introduction of New Instruments

Since 1990s, a number of new money market instruments have been introduced. These include 182-day treasury bills, certificates of deposits, commercial paper, 364-day treasury bills and repos. These instruments have given a boost to the Indian money market.

(3) Deregulation of Interest Rates

The RBI has deregulated the money market interest rates since 1989. This was another step towards strengthening the money market. Again as per the recommendations of the Narsimhan Committee the interest rates were deregulated in 1991. The banks and financial institutions were asked to determine the interest rate as per market conditions. This has increased the flexibility in interest rates and transparency in lending transactions in the money market.

3

Primary Market

Introduction

A market for long-term funds is known as capital market. But in broader sense, it also includes market for short-term funds. For a common person, a capital market means "the market for all the financial instruments, short-term and long-term, as also commercial, industrial and government paper". It means, in a broad sense, it embraces the money market also. Because the commercial, industrial and government papers are the constituents of money market.

Definitions

1. According to **P.K. Dhar,** "This is not a market for capital goods, rather it is a market for raising and advancing money capital for investment purposes."
2. According to **Francis Cherunilam,** "The term capital market is used to refer to the market for long-term loanable funds as distinct from the money market which deals in short-term funds."
3. According to **M.Y. Khan,** "It is a market for long-term funds. Its focus is on financing of fixed investments in contrast to money market which is the institutional source of working capital finance."
4. According to **V.A. Avadhani,** "Capital market is a wide term used to comprise all operations in the new issues and stock market."
5. According to **H.R. Machiraju,** "The capital market is the market for long-term funds. Capital markets discharge the important function of transfer of savings, especially of the household sector to companies, governments and public sector bodies."

Nature of Capital Market

The nature of capital market is as follows:

1. It consists of a number of individuals and institutions that canalise the supply and demand for long-term capital and claims on capital.
2. It has three important components, namely, the suppliers of loanable funds, the borrowers and the intermediaries who deal with the lenders on the one hand and the borrowers on the other.

3. The individuals, corporates, institutional investors and the government are the main suppli of funds to the capital market. The demand for capital comes mostly from agriculture, indus trade and the government.
4. It not only deals with the issue of new claims on capital, but also deals in existing claims.
5. The efficient working of the capital market is the marketability of securities since investo would be reluctant to make loans if their claims are not easily disposed off.

portance of Capital Market

The importance of capital market is as follows:

1. The capital market serves a very useful purpose as it pools the capital resources of the count and makes them available to the enterprising investors.
2. The well-developed capital markets augment resources by attracting and lending funds on global scale.
3. A developed market can solve the problem of paucity of funds needed for developments, et
4. A developed capital market provides ample profitable investment opportunities.
5. A developed capital market became a necessary infrastructure for fast industrialisation.

nctions

The major functions performed by a capital market are:

1. To mobilise the financial resources at national level.
2. To secure the foreign capital and know-how to fill up the deficit in required resources fo economic growth at a faster speed.
3. To effectively allocate the financial resources.

e Indian Capital Market

The Indian capital market before independence was underdeveloped and was not in prope e. The growth of Indian capital market was very much limited as most of the companies in Indi British companies having their base in London market. After independence, the Indian capita et started to enlarge its base with increase in savings and investments. During the last thre des, there was a sharp increase in the volumes of capital market transactions.

he **Report on Currency and Finance, 1999-2000** disclosed about the Indian capital marke following words:

lthough the Indian market witnessed some significant changes during the eighties, both th ry and the secondary segments continued to suffer from some serious deficiencies. Many lthy practices prevailed in the primary market to attract the retail investors. Another disturbing was the high cost of new issues. Although over the years, a number of agencies came into ce offering different types of services in connection with the new issues of capital, their activitie ot overseen by any regulatory authority. The problems were even more serious in the secondary . The general functioning of the stock exchanges was not satisfactory." In the continuation of ve, the **Report on Currency and Finance, 2001-02** disclosed, "The reforms in the capital

market were aimed at enhancing the efficiency, safety, integrity and transparency of the market. The impact of various reform measures could be seen in the primary as well as secondary segments of the capital market."

Nature of the Indian Capital Market

The nature of the Indian capital market is as follows:

1. The Indian capital market consists of organised and unorganised sector.
2. The demand for funds in the organised sector is mostly for productive investment, a large part of the demand for funds in the unorganised market is for consumption purposes.
3. The demand for funds comes mostly from corporate enterprises, government and semi-government institutions.
4. The supply of funds comes from household savings and institutional investors, like banks, investment trusts, insurance companies, finance corporations, government and international financing agencies.
5. The Indian capital market is characterised by the existence of multiplicity of interest rates, exorbitant rates of interest and lack of uniformity in the business dealings.
6. The activities of the organised market are subject to a number of government controls, the unorganised sector is almost outside the government control.

Role of Capital Market in Industrial Growth

The capital market played a crucial and vital role in the Indian industrial growth. These are:

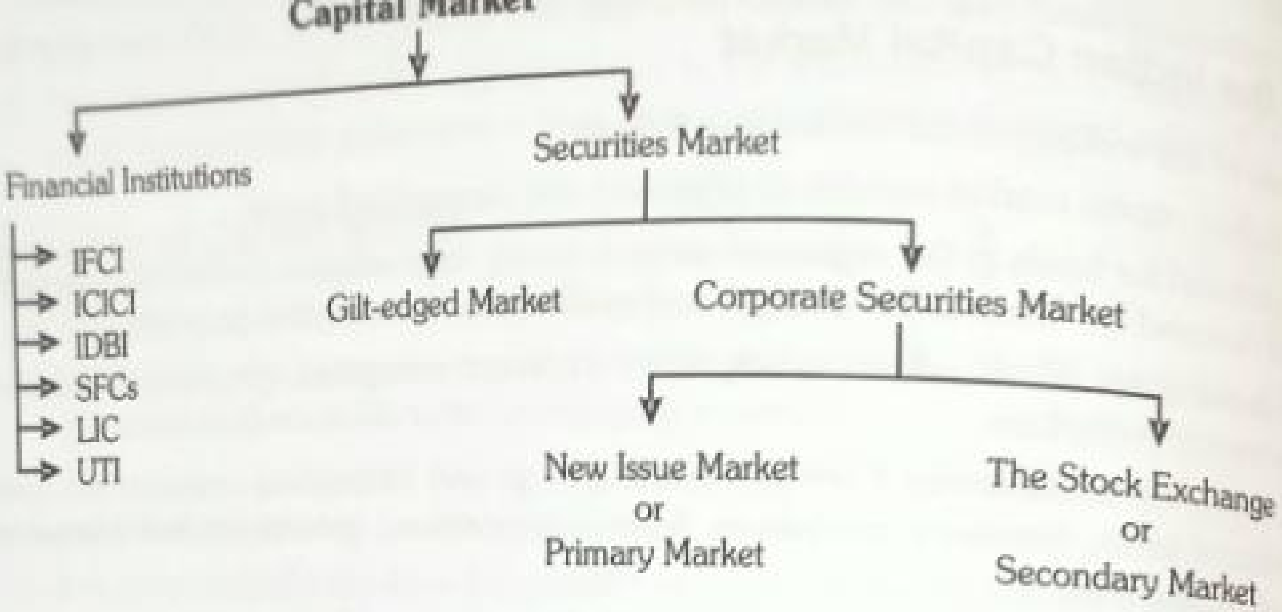
(1) **Promotion of Industrial Growth:** The capital market transfers the resources to the industrial sector of the economy. The existence of such an institution encourages people to invest in the securities of corporate. Thus, it helps in stimulating the industrial growth and economic development of the country.

(2) **Mobilisation of Savings and Acceleration of Capital Formation:** In the developing countries like India, the rate of savings is much lower than it should be. This market helps in the mobilisation of small savings from the various sections of the society. Thus it accelerates the capital formation in the country.

(3) **Raising Long-term Capital:** The existence of stock exchanges or secondary market enables the companies to raise long-term capital by issuing shares and debentures. These exchanges help in providing the new investors every time when the old investor wants to sell his investments.

(4) **For Financing Five Year Plans:** The government securities have gained the importance since the Second Five Year Plan as the government has had to depend on the sale of these securities to raise resources for financing public sector projects.

(5) **Ready and Continuous Market:** The stock exchange provides a place where the buyers and sellers can sell and purchase their securities easily and conveniently. This makes the investment in securities more liquid as compared to other assets.



As per the syllabus, we have to discuss only the securities market in general and primary secondary market in particular.

The securities market is divided into (i) the gilt-edged market, and (ii) the corporate secu market.

I. Gilt-edged Market or Government Securities Market

It is a market which deals in government securities or the securities guaranteed by the governm It is also known as gilt-edged market because the government securities are risk free as the govern cannot default on its payment. Central Government securities are the safest amongst all securi They may be dated securities or treasury bills. The state governments in India also issue their securi It is one of the oldest markets in India.

Need/Purpose for Issue of Government Securities

The Government securities are issued with the following purposes:

(i) for conversion or refinancing of maturing securities;

(ii) for raising fresh cash resources;

(iii) for advance refunding of securities which have not yet matured.

Characteristics of Gilt-edged Securities Market

Main characteristics of government securities market are as follows:

1. The central and state governments issue these securities.
2. The Reserve Bank of India uses these securities as an important instrument in monetary con
3. These securities bear a fixed rate of interest. But the interest rate is generally found to be lo in comparison to interest rate on other securities.
4. The government securities are generally issued in the denomination of ₹ 100 and ₹ 1000
5. The interest on these securities is payable half-yearly and these securities are completely as regards payment of interests and principal.

6. The government exempts the interest on these securities from income tax, subject to the limits under the Income Tax Act.
7. Investment in these securities is exempted from wealth tax subject to the limits specified in Wealth Tax Act.
8. Marketability of securities of state governments and semi-government organisations is found to be limited whereas the central government securities are the most liquid and are easily marketable.
9. Government securities have a fixed maturity period.
10. RBI purchases the unsubscribe portion of the securities.
11. This market is limited to institutional investors. In December 2001, the RBI allowed individuals also to buy government securities.
12. It is an over-the-counter market and each sale and purchase has to be negotiated separately.
13. RBI deals in these securities only through a very limited number of brokers approved by it.
14. On 26th December, 2002, the RBI proposed a system of retail trading in G-secs through SEBI registered brokers.
15. On January 19, 2007, the SEBI raised the FII limit in Government Securities and Treasury Bills to US $ 2.60bn from the existing limit of US $ 2.00bn. The present limit is US $30.0 bn.

Forms of Central and State Government Securities

These securities are of three types:

1. Stock Certificate
2. Promissory Note
3. Bearer Bond

Stock certificates are not very popular among investors and bearer bonds are generally not issued in India. Most of the government securities are in the form of promissory notes.

Participants in Gilt-edged Securities Market

The following are the participants in the gilt-edged securities market:

1. Central and State Governments.
2. Banking sector, consisting of RBI, SBI, other Commercial Banks, and Co-operative Banks.
3. Insurance companies including both LIC and GIC.
4. Provident funds, both statutory and non-statutory.
5. Other institutions including financial institutions, trusts, joint stock companies and local authorities.
6. Individuals.

Process of Issue

Public Debt Office (PDO) of RBI issues the Government Securities. The issue of these securities is notified a few days earlier before they become open for subscription. Generally, the subscription is kept open for two-three days. But it can be closed earlier also if the issue is fully subscribed. These securities are raised in a number of tranches in a year to avoid the flooding of these securities at a point of time. In case of oversubscription, the Government has a right to retain oversubscription up to a certain percentage. One can send the application to the office of RBI or branches of SBI. In case of State Government securities, the oversubscription to the securities of one State Government can be transferred to the securities of another State Government whose securities are still open for subscription, depending upon the desire of the investor.

If the issue is not fully subscribed, then that part is taken up by RBI. RBI also buys these securities from the secondary market and leaves a small portion of these securities in the market to be paid on maturity date. This process is known as **'grooming'**. **'Switches'** means the purchase of one security against the sale of another. This operation helps the investor to improve the yield on their investments. RBI fixes annual quota for the switch transactions of each bank.

The auction system has also been started in government securities since June 2, 1992. In this system, the bidder provides written quotations for a certain amount which is restricted to notified amounts. The unsubscribed portion of the notified amount devolves on the primary dealers or RBI either of which conducts the auction. Auction may be of two types, i.e., multiple price auction and uniform price auction. In **multiple price auction**, every bidder gets allocation according to his bid and the issuer collects a premium from all bidders quoting lower than the cut off yield. Under uniform price auction, competitive bids are accepted at the minimum discounted price determined at the auction, irrespective of the bid price.

Trading Procedure

Transactions in the gilt-edged securities are done in the following ways:

(i) Direct sales through vouchers,

(ii) Through securities general ledger (SGL) accounts, and

(iii) Through bank receipts.

(i) **Direct Sale:** Direct sale is done by Public Debt Office of RBI. It specifies the amount of loan and the days for subscription. In those days, the investor had to make an application in the office

(ii) **Sale through SGL Accounts:** In this method, the transactions are recorded as book entries by RBI only in the ledger on the date of transactions. The value of transaction is also entered in the ledger. Each bank maintains an SGL account with RBI on account of the Centra Government securities. Selling banker has to fill up a prescribed SGL form and has lodged i with RBI. This account facilitates REPO transactions.

(iii) **Sale through Bank Receipts:** Under this method, the selling bank issues a bank receipt instead of physical transfer of securities. This method is a hassle free method. This method is undertaken when REPO transaction is for a short time.

Retailing in Government Securities

In **June 1996**, the RBI issued guidelines for retailing of government securities to non-bank clients. These guidelines are:

(i) The condition of not selling to clients before the expiry of 30 days is removed on October 21 1997.

(ii) Retailing should be done on the basis of on-going market rates emerging out of secondary market transactions.

(iii) Sale should be effected by banks only if they have the securities in their portfolio either in physical form or in SGL account.

(iv) Bank has to deduct the corresponding amount from its investment account and Statutory Liquidity Ratio assets.

The RBI issues guidelines/instructions regarding retailing of securities on various dates. The master circular issued in July 2015 has consolidated instructions issued upto **30th June, 2015.** These are:

1. Banks are free to buy and sell Government Securities on an outright basis at prevailing market rates without any restrictions on the period between sale and purchase.
2. Banks shall not undertake ready forward transactions in Government Securities with non-bank clients.
3. The retailing of Government Securities should be on the basis of on going market rates/yields emerging out of secondary market transactions.
4. No sale of Government Securities should be affected by banks unless they hold the securities in their portfolio either in the form of physical scrips or in the SGL Account maintained with RBI.
5. Immediately on sale, the corresponding amount should be deducted by the bank from its investment account and also from its SLR assets.
6. Banks should put in place adequate internal control checks/mechanism in this regard.
7. These transactions should be subjected to concurrent audit as per RBI's extent instructions and should be looked into by the auditors at the time of bank's statutory audit.

Current Position

The secondary market transactions in government securities are outright transactions and repo transactions. The outright transactions in central government securities were of ₹ 3,07,645 billion, state government securities were of ₹ 12,740 billion and treasury bills were of ₹ 18,840 billion in 2016-17.

Primary Dealers and Government Securities Market

Primary Dealers are financial intermediaries that agree to perform specific obligations or functions in the market for Government Securities in exchange for specific privileges. The system of primary dealers was first established in the US in 1960. It was introduced in India in 1995. Some advanced countries like Australia, Germany and New Zealand have not yet established the PD system. The IMF survey also brings out the crucial role played by the supporting market segments and the infrastructure. This supporting system is still underdeveloped in many countries. With electronic trading of securities and auctions, which effectively expand investor base, the role of PDs in developed economies is losing importance. Primary dealers, however, play a critical role where the fiscal deficits and financing needs of the Government are large. In India, the PD system has contributed to the development of a deep and vibrant market for the Government Securities.

Pre-requisites for Establishing PD System

According to IMF's cross country survey in 2003, important prerequisites for establishing a PD System include:

3. The issue gets widely distributed and thus helps in reducing concentration of wealth and economic power.
4. The issue is allotted among the applicants on non-discriminatory basis.
5. Artificial scarcity of shares in the market is avoided, thus minimising the artificial jacking up of prices of new flotations.

Disadvantages

The main disadvantages of this method are:

1. The company has to bear the publicity costs.
2. The company has to incur floatation costs, like brokerage, underwriting expenses, etc.
3. The company also has to incur administrative costs, like cost of printing the prospectus and other documents, postage, other administration costs, bank charges, etc.
4. The company has to bear legal costs, like stamp duty, registration fees, etc.
5. This mode of issuing securities is beneficial only for large issues due to these high costs.

Current Position

Current position of the issue of capital through prospectus is evident from the following table:

Table 1. New Capital Issues by Non-Government Public Limited Cos. through Prospectus

Table 1

(₹ in billion)

Security and Type of Issues	2015-16		2016-17	
1. Equity Shares	87	240	116	303.6
2. Preference Shares	–	–	–	–
3. Debentures	09	27.1	15	293.3
(i) Convertible	–	–	–	–
(ii) Non-Convertible	09	27.1	15	293.3
4. Bonds	–	–	–	–
Total	96	267.2	131	596.9

(Source: RBI Bulletin, May 2016 & 2017, Appendix Table 30)

B. Offer for Sale

A company need not issue a prospectus in cases where it arranges money from private sources. As per Section 70 (i) of the Companies Act, a statement in lieu of prospectus is necessary to be filed with the Registrar of Companies at least 3 days before allotment of shares or debentures. Under the method, the company issues its shares through intermediaries, such as, issuing houses, stock-brokers etc. The issue may also be underwritten.

Under this method, the sale of securities is done in two stages. In the first stage, the company issues total number of securities to the issue houses or stockbrokers at an agreed price. In the second stage, the issue houses or stockbrokers resell these securities to the ultimate investors at a higher price. The difference between the purchase price and resale price is called 'turn' and is used by issue houses or stockbrokers to meet various expenses, such as, underwriting commission, advertisement expenses, etc.

Advantages

1. The issuing company saves itself from hassles involved in selling the shares.
2. The company is saved from various expenses, such as, advertisement, underwriting expenses, etc.
3. The company need not issue prospectus.

Disadvantages

The issue houses sell the shares to the public at a higher price and the difference goes in the pocket of intermediaries. The company does not get anything extra. Moreover, this method is comparatively expensive.

Current Position: The current position is give in Table 2.

Table 2

(₹ in Crore)

Stock Exchange	2014-15	2015-16
BSE	12,670	7,980
NSE	16,298	11,802
Total	28,968	19,702

(Source: SEBI, HBS-2016, T.15)

C. Private Placement

The private placement means the direct sale of securities by a company to institutional investors or the issuing houses directly acquire the securities from the issuing company at an agreed price and then they place the securities with their investor-clients (individual and institutional). The intermediaries play the vital role in preparing an offer memorandum and negotiating with investors.

Advantages

1. Private placement offers access to capital more quickly than the public issue.
2. The company does not incur costs relating to issue and thus company finds economy in issue expenses.
3. Private placement ensures confidentiality for private limited companies and closely held public limited companies which do not make public issue for fear of takeover, institutional interference, etc.
4. Those shares in which public shows no interest can be sold through private placement.
5. Some public companies may be too small to afford a public issue. In case, they need money, they can raise it through private placement of shares.

Disadvantages

1. The issue may be concentrated in fewer hands.
2. The intermediaries may create artificial scarcity of these securities for increasing their prices temporarily.
3. This method does not generate confidence in the minds of investing public.

(c) If the securities offered for sale were issued under a bonus issue on securities held for a period of at least one year prior to the filing of draft offer document with the Board and further subject to the following:

 (i) such securities are issued out of free reserves and share premium existing in the previous year of the financial year of filing the offer document with the Board; and

 (ii) such securities not being issued by utilisation of revaluation reserves or unrealised profits of the issuer.

(7) An Issuer making an IPO may obtain grading for such offer from one or more credit rating agencies registered with the Board.

Conditions for Further Public Offer

As per regulation 27 of SEBI (Issue of Capital & Disclosures) Regulations 2009, The conditions for further public offer are as follows:

(1) An Issuer may make a further public offer if it satisfies the conditions specified in clause (d) and (e) of sub-regulation (1) of regulation 26. If it does not satisfy those conditions, it may make a further public offer if it satisfies the conditions specified in regulation 26(2).

E. Right Issue

According to Section 81 of the Companies Act, 1956, if a company wants to increase its subscribed capital by allotment of further shares after two years from the date of its formation or one year from the date of first allotment, it has to offer shares at first to the existing shareholders in proportion to the shares already held by them. It is called as right issue. The shareholders have no legal binding to accept the offer. The shareholders have the right to renounce the offer in favour of any other person.

Rules of Right Issue

The rules regarding the right issue are as follows:

1. Only that company can make right issue whose shares are already in the market.
2. Rights should be issued on pro-rata basis.
3. A notice should be issued to the shareholders to specify the number of shares issued.
4. The time given to accept the right offer should not be less than 15 days.
5. Each shareholder should be given an option either to subscribe it or renounce it or surrender.
6. After the expiry of the time given in the notice, the board of directors has the right to depose the unsubscribed shares in such a manner, as they think beneficial to the company.

Merits

A right issue has a number of merits. These are:

1. It is an economical method of raising capital.
2. Existing shareholding pattern is not disturbed.
3. Raising of capital through right is more certain than the public issue.
4. Usually a company offers rights issue at a price which is lower than the market price of the shares. This gives monetary benefit to the existing shareholders of being associated with the company.

5. It provides an opportunity to the existing shareholders to invest in that company with which they are well conversant.

Demerits

This method suffers from various limitations also. These are:

1. This method can be used only by those companies whose shares are already in the market.
2. The issue remains limited up to existing shareholders only.
3. This concentrates the wealth and economic power in few hands.

Right Issue in India

The position of right issue in India is as follows:

Table 4. New Capital Issue by Non-Government Public Limited Companies through Rights

(₹ in billion)

Security and Type of Issue	2015-16		2016-17	
	No. of Issue	Amount	No. of Issue	Amount
1. Equity Shares	87	240.0	11	22.9
2. Preferences Shares	—	—	—	—
3. Debentures	—	—	—	—
(i) convertible	—	—	—	—
(ii) non-convertible	—	—	—	—
4. Bonds	—	—	—	—

(Source: RBI Bulletin, Appendix Table 30, May, 2017)

SEBI Regulations 2009 for Rights Issue

These regulations are as follows:

I. Record Date (Regulation 52)

(1) A listed issuer making a right issue shall announce a record date for the purpose of determining the shareholders eligible to apply for right shares.

(2) The issuer shall not withdraw right issue after announcement of the record date.

(3) If it withdraws the right issue after the announcement of record date, it shall not make an application for listing of its specified securities on any recognised stock exchange for a period of 12 months from the announced record date.

II. Restriction on Right Issue (Regulation 53)

(1) No issuer shall make a right issue of equity shares unless it has made reservation of equity shares of same class in favour of holders of outstanding compulsorily convertible debt instruments in proportion of convertible part.

(2) The reserved equity shares shall be issued to holders of debt instruments shall be issued at the time of conversion on the same terms at which the equity shares were offered in the rights issue were issued.

III. Letter of offer Abridged letter of Offer, Pricing and Period of Subscription (Regulation 54)

(1) The abridged letter of offer shall be dispatched through registered post or speed post to existing shareholders at least 3 days before the issue.

(2) The shareholders who have not received the application form may apply in writing on a pl paper along with required application money.

(3) The renunciation of rights can be done only on application form. They shall not utilise application form for any purpose including renunciation even if it is received subsequently

(4) Where the application is made on both plain paper and application form, the application liable to be rejected.

(5) The issue price shall be decided before determining the record date which shall be determin in consultation with designated stock exchange.

(6) A right issue shall be open for subscription for a minimum period of 15 days and for maximum period of 30 days.

(7) The issuer shall give only one payment option out of the following:

(a) Part payment on application. But it should not be less than 25% of issue price.

(b) Full payment on application.

IV. Pre-Issue Advertisement for Rights Issue (Regulation 55)

(1) The issuer shall issue an advertisement for rights issue disclosing the following:

(a) The date of completion of despatch of abridged letter of offer and the application form

(b) The centres other than registered office of the issuer where the shareholders or the persons entitled to receive the rights entitlements may obtain duplicate copies of the duplicate forms.

(c) A statement that if shareholders are entitled to receive right shares and they have no received the application forms, they may apply on plain paper for the same.

(d) A format to enable the shareholders entitled to apply on plain paper specifying necessa particulars such as name, address, ratio of rights issue, issue price, number of equi shares held, ledger folio numbers, depository participant ID, client ID, number of shar entitled and applied for, additional shares if any, amount paid, etc.

(e) A statement that the applications can be sent directly at the issuer's designated offi address alongwith application money through registered post.

(f) A statement to the effect that if shareholder makes application on plain paper and also o application form, both of his applications are liable to be rejected at the option of issu

(2) The advertisement shall be made in at least one English and one Hindi national daily newspap with wide circulation and on regional language daily newspaper where the registered office the issuer is situated. This advertisement should be published at least 3 days before the da of opening of the issue.

V. Reservation for Employees alongwith Right Issue (Regulation 55 A)

The issuer may make reservation for employees along with rights issue. But it cannot mak allotment of shares of more than ₹ 2 lakhs to any employee.

VI. Utilisastion of Funds Raised in Right Issue (Regulation 56)

The issuer shall utilise funds collected through rights issue after the finalisation of the basis of allotment.

F. Bonus Shares

Bonus shares are those shares which are issued by a company without any charges to the existing shareholders. When a company have large accumulated reserves but it is not in a position to pay cash dividends due to inadequate cash, then it may issue additional equity shares to the existing shareholders in proportion of their existing shareholding without charging any payment. It represents just a book entry subject to certain rules and regulations. Total resource base of the company does not change due to issue of bonus shares.

There are two ways of issuing bonus shares to the shareholders. These may be:

1. By way of making existing partly paid shares as fully paid without charging any cash from shareholders.
2. By the issue of fresh fully paid bonus shares.

SEBI Regulations 2009 for Bonus Issue

These are as follows:

I. Conditions for Bonus Issue (Regulation 92)

Subject to the provisions of Sec. 23 (1) (c) of companies Act, 2013, a listed issuer may issue bonus shares to its shareholders, if

(a) It is authorised by the articles of association for issue of bonus shares, capitalisation of reserves, etc. If no provision is present in articles of association, then a special resolution is to be passed in the general body meeting to include provisions in the articles of association for capitalisation of reserves.

(b) It has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it.

(c) It has not defaulted in payment of statutory dues of the employees, such as contribution to provident fund, gratuity and bonus.

(d) The partly paid up shares are made fully paid-up.

II. Restrictions on Bonus Issue (Regulation 93)

(1) Before making a bonus issue, it is necessary to make reservation of equity shares of the same class in the favour of outstanding compulsorily convertible debt instruments in proportion to the convertible part.

(2) The equity shares so reserved shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion at which the bonus shares were issued.

III. Bonus Shares only Against Reserves, etc. if Capitalised in Cash (Regulation 94)

(1) The Bonus issue shall be made out of free reserves built out of the genuine profits or securities premium collected in cash only. Reserves created by revaluation of fixed assets shall not be capitalised for the purpose of issuing bonus shares.

(2) The bonus shares cannot be issued in lieu of dividend.

IV. Completion of Bonus Issue (Regulation 95)

(1) The bonus shares should be issued within 15 days from the date of approval of issue b Board of Directors if shareholders' approval for capitalisation of profits or reserves for mak the bonus issue. If such approval of shareholders is necessary, then the bonus issue mus implemented within 2 months from the date of meeting of its board of directors.

(2) The issue cannot be withdrawn once the decision to make a bonus issue is announced.

Advantages

(i) As the bonus issue does not involve any cash payment, liquidity or working capital of company is not adversely affected;

(ii) Because of the bonus issue, the share capital of the company is increased and as such company can reduce its abnormally high rate of dividend and still distribute the same amo as dividend.

(iii) Shareholders can dispose off the bonus shares for fulfilling their cash needs.

(iv) The shareholder's income in future will increase because of increased shareholding.

(v) Bonus shares are particularly beneficial for shareholders in tax brackets, since on sale of the shares there may be only Capital Gain Tax which is at a rate lower than the tax rate on ot incomes.

Disadvantages

The major disadvantages are as follows:

(i) The market price of the shares falls in the market due to increased supply of the shar Therefore, the advantage gained by the shareholders in the form of bonus shares someti neutralises because of fall in the market price of the shares.

(ii) The rate of dividend in future decreases as the capital of the company increases due to is of bonus shares but not the profits of the company.

(iii) The speculation in the shares of the company increases due to issue of bonus shares.

G. Book-Building

Book-building is relatively a new option for issue of securities. The first guidelines regarding were issued on October 12, 1995 and after that these guidelines were revised from time to time. Bo building is a method of issue of shares based on floor price which is indicated before the open of the bidding process. The issue price is fixed after the bid closing date. Book-building invol firm allotment of the instrument to a syndicate or a merchant banker. That lead merchant banke the syndicate member of the issue will be nominated as a book runner by the issuer company. T book runner has to circulate the copy of the draft prospectus to be field with SEBI and among institutional buyers who are eligible for firm allotment. The draft prospectus should indicate the p band within which the securities are being offered for subscription.

The offers are sent to the book runners. The record of names and number of securities offered the institutional buyer is maintained by the book runner within the placement portion. The underw should also intimate the orders received by him within the placement portion and the price for wh the order is received to the book runners. The price is finalised by book runner and issuer comp and the issue price for the placement portion and offer to the public should be the same. The bo

runner collects the application forms along with application money one day earlier to the opening of the issue to the public from the institutional buyers and the underwriters. Proper records should be maintained by the book runner and other intermediaries involved in the book building process. These records can be inspected by the SEBI at any time.

The book building is compulsory for companies for IPOs which do not have specified track record of profits. These companies have also to allot 60% of offer to Qualified Institutional Buyers(QIBs), such as, financial institutions, banks, mutual funds, etc. The SEBI introduced the modified rules on September 5, 1997 for book-building exercise. The process of book-building has been made applicable to 100% of the issue size in case of issue of ₹100 crore or more.

Guidelines for the Process of Book-Building

(1) **Lead Book Runner:** The issuer shall appoint one or more merchant banker(s) as book runner(s) and their name(s) shall be disclosed in the draft red herring prospectus. There shall be only one lead book runner and other merchant bankers appointed, if any, shall either be co-book runners or syndicate members.

(2) **Syndicate Members:** The book runner(s) may appoint syndicate members.

(3) **Underwriting:** The lead book runner and co-book runners shall compulsorily underwrite the issue and the syndicate members shall sub-underwrite with the lead book runner/co-book runners. The details of final underwriting arrangement indicating actual numbers of shares underwritten shall be disclosed and printed in the Prospectus before it is registered with the Registrar of Companies.

(4) **Agreement with the Stock Exchange:** The issuer shall enter into an agreement with one or more of the stock exchange(s) which have the system of on-line offer of securities.

(5) **Appointment of Stock Brokers as Bidding/Collection Centres:** The book runner(s) syndicate members shall appoint stock brokers who are members of the recognised stock exchange and registered with the Board. They will be appointed for the purpose of accepting bids, applications and placing orders with the issuer and ensure that the stock brokers so appointed are financially capable of honouring their commitments arising out of defaults of their clients/investors.

(6) **Price Not to be Disclosed in Red Herring Prospectus:** Where the issue size is specified the red herring prospectus may not contain the price and the number of specified securities.

(7) **Floor Price and Price Band:** The issuer may mention the floor price or price band in the red-herring prospectus.

(a) Where the issuer opts not to make the disclosure of the price band or floor price in the red-herring prospectus, the following shall also be disclosed in the red-herring prospectus:

(i) A statement that the floor price or price band, as the case may be, shall be disclosed at least two working days (in case of an initial public offer) and at least one working day (in case of a further public offer) before the opening of the bid;

(b) Where the issuer decides to opt for price band instead of floor price, the issuer shall also ensure compliance with the following conditions:

(i) The cap of the price band should not be more than 20% of the floor of the band.

(ii) The price band can be revised during the bidding period in which case the maximum revision on either side shall not exceed 20.

(8) The manner and contents of Applications-cum-Bidding form and Revision Application-c Bidding form shall be as specified by the Board through Circular.

(9) **Anchor Investors:** An Anchor Investor shall make an application of a value of at least ₹ crore in the public issue. Allocation to Anchor Investors shall be on a discretionary basis a subject to the following:

- (i) Maximum of 2 such investors shall be permitted for allocation up to ₹ 10 crore;
- (ii) Minimum of 2 and maximum of 15 such investors shall be permitted for allocation abo ₹ 10 crore and upto ₹ 250 crore, subject to minimum allotment of ₹ 5 crore per su investor;
- (iii) In case of allocation above ₹ 250 crore; a minimum of 5 such investors and a maxim of 15 such investors for allocation upto ₹ 250 crore and an additional 10 such investo for every additional ₹ 250 crore or part thereof, shall be permitted, subject to a minim allotment of ₹ 5 crore per such investor.
- (iv) Upto sixty per cent of the portion available for allocation to qualified institutional buye shall be available to anchor investors for allocation/allotment.
- (v) One-third of the anchor investor portion shall be reserved for domestic mutual funds.
- (vi) The bidding for Anchor Investors shall open one day before the issue opening date.
- (vii) Anchor Investor shall pay on application the same margin which is payable by oth categories of investors. The balance, if any, shall be paid within two days of the date closure of the issue.
- (viii) Allocation to Anchor Investors shall be completed on the day of bidding by Anch Investors.
- (ix) If the price fixed as a result of book building is higher than the price at which the allocatio is made to Anchor Investor, the Anchor Investor shall bring in the additional amoun However, if the price fixed as a result of book building is lower than the price at whi the allocation is made to Anchor Investor, the excess amount shall not be refunded.
- (x) The number of shares allocated to Anchor Investors and the price at which the allocatio is made, shall be made available in public domain by the merchant banker befo opening of the issue.
- (xi) There shall be a lock-in of 30 days on the shares allotted to the Anchor Investor from th date of allotment in the public issue.
- (xii) Neither the merchant bankers nor any person related to the promoter/promoter grou merchant bankers in the concerned public issue can apply under Anchor Invest category.

(10) **Margin Money:** The margin collected shall be uniform across all categories of investors. A amount to the extent of entire application money as margin money may be collected from th applicants before they place an order on their behalf.

(11) **Bidding Process:** Bidding process shall be only through an electronically linked transpare bidding facility provided by recognised stock exchanges. During the period the issue is open t the public for bidding, the applicants may approach the stock brokers of the stock exchang through which the securities are offered under on-line system, Self Certified Syndicate Ban Registrar to Issue and Share Transfer Agents or Depository Participants. Applicants who are qualified institutional buyers shall place their bids only through the stock brokers who shall have the right to vet the bids. The bidding terminals shall contain an online graphical display of demand and bid prices updated at periodic intervals, not exceeding thirty minutes. The retail individual investors may either withdraw or revise their bids until closure of the issue. Bidding shall be kept open for a minimum of three days for all categories of applicants.

(12) **Determination of Price:** The issuer shall, in consultation with lead book runner, determine the issue price based on the bids received. On determination of the price, the number of specified securities to be offered shall be determined. Once the final price (cut-off price) is determined, all those bidders whose bids have been found to be successful shall be entitled for allotment of specified securities. Retail individual investors may bid at "cut off" price instead of their writing the specific bid price in the bid forms.

(13) **Registering of Prospectus with Registrar of Companies:** The final prospectus containing all disclosures in accordance with the provisions of these regulations including the price and the number of specified securities proposed to be issued shall be registered with the Registrar of Companies.

(14) **Manner of Allotment/Allocation:** Allotment to non-institutional investors and qualified institutional buyers other than anchor investors shall be made proportionately. The allotment to retail individual investors shall be made as referred to in sub-regulation (1A) of regulation 50 of SEBI Regulations, 2009. In case of under subscription in any category, the under subscribed portion in that category shall be allocated to the bidders as per disclosures made in the red herring prospectus.

(15) **Application for Listing:** The issuer may apply for listing of specified securities on a stock exchange other than the stock exchange through which it offers its specified securities to public through the on-line system.

(16) **Maintenance of Books and Records:** A final book of demand showing the result of the allocation process shall be maintained by the lead book runner. The book runners and other intermediaries associated in the book building process shall maintain records of the book building prices.

Advantages

The advantages of the book-building process are:

1. It is one of the ways of curtailing grey market operations.
2. It reduces the duration between allotment and listing.
3. There is a very little chance for manipulating the price before listing as the price is fixed on the basis of the bids received.
4. It also curtails the lengthy allotment procedure.

Current Position

As per economic Survey, 2004-05, "The resource mobilisation through book building rose steadily from 25 per cent of public equity offerings in 2001 to 53 per cent in 2002, 64 per cent in 2003 and 99 per cent in 2004." After 2005-06, all the issues were made through book-building process.

H. Stock Option

Employees Stock Option Scheme (ESOP) or stock option is a voluntary scheme which encourages employees' participation in the company. This scheme is particularly beneficial for those companies whose activities are dominantly based on the talent of the employees such as, software companies.

Guidelines Regarding Employees Stock Options in India (ESOP)

Every company whose securities are listed on any stock exchange may offer securities to the employees through ESOP, but subject to the following specified conditions. These conditions are:

1. The issue size under ESOP should not exceed 1% of the paid-up capital of the company in any one year.
2. The company cannot allot securities to promoters and the part-time directors under ESOP even if they are employees of the company.
3. The companies are free to devise the ESOP including the terms of payment.
4. Issue of shares under ESOP on a preferential basis can be made at a price not less than the higher of the following:
   - (a) The weekly average of high and low of the closing prices of the related shares quoted on the stock exchange during the previous 6 months;
   - (b) The weekly average of high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.
5. The Board of Directors shall disclose the details either in Directors Reports or in annexure to Directors' Report.

Guidelines for a special stock option scheme for Indian software companies were announced on June 22, 1998. This scheme is available to non-resident and resident permanent employees. The Indian and overseas working directors are also eligible under the scheme. This scheme enabled the software companies to offer comparable terms with international companies. The issuing company is entitled to issue stock options not exceeding 10% of its paid-up capital. On June 16, 2000, the government expanded the scope of the scheme for issue of foreign currency convertible bonds and ordinary shares.

The **J.R. Verma Panel** submitted its report in June, 2002. On the basis of the report, the SEBI on October 4, 2002 put a lock-in period of 3 years on sweat equity shares to employees and directors. A new pricing formula on the line of preferential allotments was also given by the SEBI.

I. Bought Out Deals (BODs)

A mutual agreement between the merchant banker or sponsor is called as bought out deal. Under bought out deal, no party can take unilateral action. It is a deal in which entire equity or related security is bought in full or in lots with an intention of off-loading it later in the market. The shares are to be held by the sponsor until they are ready for public participation.

The Indian primary market for the first time witnessed the emergence of bought out deals. Co nick Alloys (India) was the first which offered for sale at a premium sponsored by ICICI in June 1992

A fee-based activity into a fund-based activity of merchant bankers through bought out deals. The SEBI in 1994 issued the guidelines for reservation of issues without lock in as follows:

1. 20% for mutual funds;
2. 24% for FIIs;
3. 20% for financial institutions; and
4. 10% for employees.

Advantages

The advantages of BODs are as follows:

1. It saves time and cost of the issuing company as it eliminates retailing.
2. They are cheapest and quickest source of finance for small and medium companies.
3. It also helps the entrepreneurs who are not confident enough to raise the funds directly.
4. The investor is also benefitted because the merchant banker would not risk his capital unless a proper appraisal of the project has been done.
5. The gains for the merchant banker would be handsome, if he selects proper issue and prices attractively.

J. Grey Market

The trading in security before it is officially listed is popularly known as grey market. In this, the promoters of the company sell the shares 6 to 8 months before the actual public issue. Such sales are actually illegal.

K. Qualified Institutional Placement

It has been decided to introduce an additional mode for listed companies to raise funds from domestic market to make Indian markets more competitive and efficient. This mode is known as Qualified Institutions Placement.

(i) **Issuer:** A company whose equity shares are listed on a stock exchange for not less than 1 year, having nationwide trading terminals and which is complying with the prescribed requirements of minimum public shareholding of the listing agreement will be eligible to raise funds in domestic market by placing securities with Qualified Institutional Buyers (QIBs).

(ii) **Securities:** Securities which can be issued through QIP are equity shares or any securities other than warrants, which are convertible into or exchangeable with equity shares (hereinafter referred to as "specified securities"). A security which is convertible into or exchangeable with equity shares at a later date, may be converted or exchanged into equity shares at any time after allotment of security but not later than sixty months from the date of allotment. The specified securities shall be made fully paid up at the time of allotment.

(iii) **Investors/Allottees:** The specified securities can be issued only to Qualified Institutional Buyers (QIBs). Such QIBs shall not be promoters or related to promoters of the issuer, either directly or indirectly. Each placement of the specified securities issued through QIP shall be on private placement basis. A minimum of 10% of the securities in each placement shall be allotted to Mutual Funds. For each placement, there shall be at least two allottees for an issue of size upto ₹ 250 crore and at least five allottees for an issue size in excess of ₹ 250 crore. Further, no single allottee shall be allotted in excess of 50 per cent of the issue size. Investors shall not be allowed to withdraw their bids/applications after closure of the issue.

(i) **Cumulative and Non-cumulative Preference Shares:** Under cumulative preference shares, the shareholders have the right to recover the arrears of dividend in the years in which the company has the sufficient profits. On the other hand, the holders for non-cumulative preference shares do not have any right to recover the arrears of dividend in next years. It must be made clear in the terms and conditions of the issue or in the articles of the company that these shares are cumulative or non-cumulative. If nothing is stated, then these shares are said to be cumulative.

(ii) **Redeemable and Non-redeemable Preference Shares:** If the preference shares can be redeemed at the option of the company after a fixed period of time, then these shares are called as redeemable preference shares. On the opposite side, if the amount of preference shares is not to be paid back to the shareholders in the lifetime of the company, such shares are called as non-redeemable preference shares.

(iii) **Participating and Non-participating Preference Shares:** If the shareholders of preference shares have the right to participate in the additional profits in addition to the fixed rate dividend, such shares are called as participating preference shares. In such case, firstly the dividend to preference shareholders will be paid at a fixed rate and then the equity shareholders will be paid at a reasonable rate. If still any balance of profit remains, then these shareholders will get some more part of profits as dividend. The rate of the additional dividend is determined at the time of issuing the preference shares. But in other case, if the preference shareholders do not have any right to participate in the additional profits, such shares are known as non-participating preference shares.

(iv) **Convertible and Non-convertible Preference Shares:** If the shareholders have the right to get their shares converted into equity shares after a certain period of time, then these shares are called as convertible preference shares. The period and conversion ratio must be made clear in the Articles of Association or under the terms of issue. On the other hand, if the preference shares are not to be converted into equity shares, then those shares are called as non-convertible preference shares.

(v) **Guaranteed and Non-guaranteed Preference Shares:** The preference shares on which the fixed rate of dividend is guaranteed, those are called as guaranteed preference shares. The shares on which such guarantee is given, are called as non-guaranteed preference shares.

(vi) **Cumulative Convertible Preference Shares:** The Government of India allowed public limited companies to issue such shares in 1985. These shares can be issued for the establishment of new projects, expansion of existing projects, modernisation, diversification and management of working capital. The face value of such shares will normally be ₹100 each and the rate of dividend will be 10 per cent. These shares will be converted into equity shares in three years or five years at the option of the company.

Characteristics of Preference Shares

The main characteristics of preference shares are as follows:

(i) **Maturity:** The company gets fixed capital from the preference shares like the equity shares and is not to repay it in case of non-redeemable preference shares. Redeemable preference shares are redeemed at the option of the company but as per the terms of the issue, the company may also issue convertible preference shares. These shares are converted into equity shares after a stipulated period.

(ii) **Claims on Income:** Preference shareholders have the preference in relation to dividend over the equity shareholders. They get fixed rate of dividend. There is no statutory obligation to pay dividend to non-cumulative preference shareholders. Even in the case of income, they cannot compel the company to pay dividends. But in the case of cumulative preference shares, it becomes obligatory to pay dividends on such shares. If the company does not have sufficient profits in any year, then the company will pay all such dividends in the year in which it has sufficient profits.

(iii) **Claims on Assets:** The preference shareholders have prior claims on the assets of the company in comparison of equity shares in case of liquidation. But the company does not keep any asset as security with the preference shareholders. It means that the preference shareholders will be paid prior to equity shareholders, if the assets remain after paying off the debentureholders.

(iv) **Controlling Power:** The preference shareholders do not have any right to participate in the management of the company normally because they don't have voting rights for the appointment of directors and in other matters. But they have the right to vote under Section 87 on some specified issues which directly affect them.

C. Deferred Shares

These shares are also called as founder shares. These shares are issued to promoters or founders of the company for the services they provided to the company. These shares are issued in small denomination. These shares carry voting rights and therefore, the management of the company remains in the hands of promoters. The payment of dividend on these shares is made in the last. Companies Act, 1956 has put restriction on the issue of such type of shares by a public limited company.

D. Sweat Equity Shares

Under Section 54 of the Companies Act, 2013, a public limited company can issue sweat equity shares to its employees or directors at discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, etc., on the following conditions:

(a) The company should pass a special resolution in the general meeting in this behalf.

(b) The resolution must specify the number of shares, current market price and consideration, if any, and the class or classes of directors or employees to whom such shares are to be issued.

(c) The company can issue such shares only after the completion of one year from the date of commencement of business.

(d) The equity shares of the company must be listed on a recognised stock exchange.

(e) The issue of sweat equity shares must be in accordance with the regulations made by SEBI in this behalf.

(f) The issue of sweat equity shares by an unlisted company must be in accordance with the prescribed guidelines made for this purpose.

(g) All the limitations, restrictions and provisions relating to equity shares shall be applicable to sweat equity shares also.

(h) The lock-in-period for sweat equity shares will be 3 years.

(i) The price of sweat equity shares shall not be less than the higher of average weekly high an low of closing prices during last six months and two weeks preceding the relevant date.

The idea behind the issue of sweat equity is that an employee or a director will work at his be when he has a 'sense of belongingness'. It is one of the ways of rewarding him. These shares a called as sweat equity shares because they earned it by hardwork (sweat) and in another sense, th employees feel happy on the issue of such shares. These shares are also issued with an objective o ensuring more loyalty and participation of employees.

E. Shares with Differential Rights

Section 43 of the Companies Act, 2013 allows public limited companies to have two kinds o shares, i.e., equity and preference. Section 43 states that the share capital of a company limited b shares shall be of two kinds only, namely:

(a) Equity Share Capital

(i) With voting rights; or

(ii) With differential rights as to dividend, voting or otherwise in accordance with such rul and subject to such conditions as may be prescribed.

(b) Preference Share Capital

Amendments were made to the Companies Act, 1956 in 2000 regarding the issue of shares wi differential rights by the companies. Consequently, Section 88 of the Companies Act was omitte which prohibited issue of equity shares with disproportionate rights. For the issue of such shares, th Central Government notified the Companies (Issue of shares with Differential Voting Rights) Rules, 2001. It imposed certain conditions to be fulfilled by the companies for issue of such shares.

Conditions

1. The company has distributable profits in terms of Section 205 of the Companies Act fo proceeding 3 financial years preceding the year in which it decided to issue such shares.
2. The company has not defaulted in filing annual accounts and annual returns for the 3 financi years immediately preceding the financial year of the year in which it decided to issue su shares.
3. The company has not failed to repay its deposits or interest thereon on due date or redeem it debentures on due date or pay dividend.
4. The Articles of Association of the company authorises the issue of shares with differenti voting rights.
5. The company has not been convicted of any offence arising under SEBI Act, 1992, Securiti Contracts (Regulation) Act, 1956, Foreign Exchange Management Act, 1999.
6. The company has not defaulted in meeting investors' grievances.
7. The company has obtained the approval of shareholders in General Meeting by passi resolution under Section 94.
8. The listed public company obtained approval of shareholders through Postal Ballot.

Disclosure: In the notice of the meeting at which resolution is proposed to be passed, th explanatory statement shall contain details relating to:

1. The rate of voting right which the equity share capital with differential voting right shall carry;
2. The scale or in proportion to which the voting rights of such class or type of shares will vary;
3. The shares with differential voting rights shall not exceed 26% of the share capital issued;
4. The company shall not convert its equity capital with voting rights into equity share capital with differential voting rights and the shares with differential voting rights into equity shares capital with voting rights.
5. That a member of the company holding any equity shares with differential voting rights shall be entitled to bonus shares, rights shares of the same class;
6. The holders of the equity with differential rights, shall enjoy all other rights to which the holder is entitled except to right to vote.

2. Debt Securities

These securities are also known as creditorship securities. It includes debentures and bonds. The debt instrument of corporates, financial institutions and banks constitute a tiny proportion of the entire debt market. The predominant security in the debt market is government security. The details of corporate debt securities are as follows:

A. Debentures

A debenture is a type of loan acknowledgement which is taken by the company from the public. The debentureholders are entitled to get the interest at a specified rate on the face value of the debenture. A company can issue various types of debentures. A debenture issued by a company is usually in the form of a Certificate, given under the seal of the company. Thus, a debenture is a written acknowledgment of a debt taken by the company as these are issued under the seal of the company.

A debenture certificate contains the terms of the repayment of the principal sum at a specified date and the terms of payment of interest at a fixed per cent.

According to Section 2(30) of the Companies Act, 2013, "Debenture includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not."

Characteristics or Features of Debentures

1. A debenture is issued by a company in the form of a certificate, which is a written acknowledgement of debt taken by the company.
2. A debenture is issued under the seal of the company.
3. It contains a contract for the repayment of principal sum at a specified date.
4. A debentureholder receives interest on his debentures at a fixed rate, as mentioned in the certificate, payment of interest is made, normally after every six months, whether the company makes a profit or not.
5. A debentureholder is generally secured by a charge on the assets of the company. This means that if the company is unable to repay the debentures as per the terms of issue, the debentureholders can move the court and realise their money by getting the assets of company sold.
6. Funds raised by the issue of debentures are of long-term nature and usually the debentures are repaid after a long period, such as seven years, ten years or twelve years. As such, the loan raised by the issue of debentures is also called as 'Loan Capital'.

Types or Kinds of Debentures

A company may issue the following types of debentures:

(1) **Secured or Mortgage Debentures:** These debentures are those which are secured eith on particular assets of the company called fixed charge or on all assets of the company i general, called a floating charge. In India, debentures have necessarily to be secured.

(2) **Unsecured or Naked Debentures:** These debentures are those which are not given a security. The holders of such debentures are treated as unsecured creditors at the time liquidation of the company.

(3) **Registered Debentures:** Registered debentures are those which are payable only to tho holders whose names and addresses are recorded in a register of the company called, "Regis of Debentureholders".

(4) **Bearer Debentures:** Bearer debentures are those which are payable to the bearer or hold of the debenture. These are transferable by mere delivery and the company does not keep a record of names and addresses of debentureholders.

(5) **Redeemable Debentures:** Redeemable debentures are those debentures which will b repaid by the Company at the end of a specified period or by instalments during the lifetim of the Company.

(6) **Irredeemable or Perpetual Debentures:** Irredeemable debentures are those debentur which are not repayable by the company during its lifetime. These debentures are repayab only at the time of liquidation of the company.

(7) **Convertible Debentures:** Holders of these debentures are given an option to convert the into equity or preference shares at a stated rate of exchange after a certain period.

B. Innovative Instruments

It has become imperative for the corporate sector to device new debt instruments for raising fund from the market, keeping in view the fast changing financial scenario. A discussion about these made in chapter 1.

Pricing of New Issues

Prior to May 27, 1992, the issue of capital was governed by the Controller of Capital Issues Ac 1947. SEBI removed these restrictions and introduced an element of flexibility and liberalisatio Companies can raise fresh capital by freely pricing their capital issues in consultation with le managers as per the SEBI guidelines. However, the issuer company has to justify for the price in th offer documents. The guidelines are as follows:

1. At Premium

Companies are permitted to price their issues at premium in the following cases:

1. First issue of new companies set up by existing companies with proven track record.
2. First issue of existing private/closely held or other existing unlisted companies with 3 year tra record of consistent profitability.
3. First public issue by existing private/closely held or other existing unlisted companies without year track record but promoted by existing companies with a 5 year track record of consist profitability.

4. Existing private/closely held or other existing unlisted companies with 3 year track record of consistent profitability, seeking disinvestment by offer to public without issuing fresh capital.
5. Public issue by existing listed companies with the last 3 years of dividend paying track record.

2. At par Value

In certain cases, the companies are not permitted to fix their issue prices at premium. These companies have to issue the shares at par. They are for

1. First public issue by existing private/closely held or other existing unlisted companies without 3 year track record of consistent profitability, and
2. Existing private/closely held and other unlisted companies without 3 year track record of consistent profitability seeking disinvestment offer to public without issuing fresh capital.

Allotment of Shares

SEBI regulations clarify that the allocation of shares should be made under proportionate allotment method. The allotment for each category is inversely proportional to the over-subscription ratio. The category will be made according to the number of shares applied for. The allocation will be made on proportionate basis and will be rounded off to the nearest multiple of 100. If the shares allocated on a proportionate basis to any category are more than the shares allotted to applicants in that category, the balance shall be first adjusted against any other category where the allotment of shares is not sufficient for proportionate allotment in that category. The remaining shares after adjustment will be added to the category comprising of applicants applying for minimum number of shares.

Intermediaries in NIM

A number of agencies and institutions play a critical role in the process of issue of new securities. The major intermediaries of the new issue market are as follows:

1. Merchant Bankers/Lead Managers

The merchant banks are known as "accepting and issuing houses" in the England and as "investment banks" in the America. Merchant banks in other countries undertake a large number of activities. They operate in the money market and capital market both and undertake direct and indirect lending portfolio management for institutions, trusts, charities, etc. They also undertake the funds management for existing companies, underwriting for new and old companies, etc. It is now obligatory that all the public issues should be managed by merchant bankers functioning as lead managers except the rights issue not exceeding ₹50 lakh. This has been explained in detail in chapter 10 of the book.

2. Underwriters

Underwriting is an agreement between the issuing company and a person or an institution in which the latter gives the guarantee to former that if the issue is not fully subscribed by the public then the balance shares will be taken by them. The person or institution is known as underwriter. They render this service for a commission agreed upon between the issuing company and them, subject to the ceiling under Companies Act. Brokers, investment companies, commercial banks and term lending institutions are providing this service. Issuing company appoints underwriters in consultation with merchant bankers/lead managers. Lead managers have to certify that the underwriters have adequate assets to meet their obligations in their opinion. This statement should also be included in the prospectus.

(ii) The controlling branch of the banker to an issue has to submit a daily statement to the company/registrar to an issue.

(iii) The banker has to submit the needed information to SEBI as and when required by it.

(iv) A banker to an issue is duty bound to inform SEBI about any RBI action taken agai regarding issue payment.

(v) A banker to an issue has to maintain books of accounts, records and documents pertai all matters.

4. Registrars to an Issue and Transfer Agent

The company registrarship is a highly professional service involving minute attention to The functions to be performed by them are as follows:

(i) Maintenance of registrar of members and index of members.

(ii) Preparation and issue of share certificates.

(iii) Attending routine enquiries from shareholders, stock brokers and others.

(iv) Preparation and despatch of all dividend and interest warrants.

(v) Despatch of notices of meetings, annual reports and other company communication shareholders concerned.

(vi) Assisting in preparation of statutory annual returns to be filed with the registrar of comp every year.

(vii) Assisting the company secretary in company general meeting in matters of voting and pr and attendance slips.

Appointment of a registrar for rights issue has been made mandatory.

Share Transfer Agent

Transfer agents perform the following functions:

(i) Maintain records of holders of securities of the company for and on behalf of the compa

(ii) Handle all matters related to transfer and redemption of securities of the company, and

(iii) They can also function as Depository Participants.

Categories of Registrars and Share Transfer Agents: The categories are as follow

Category I: Those who carry on activities of both registrars to an issue and also of share tra agents.

Category II: Those who carry on activities either of a registrar to an issue or as a share tra agent.

Capital adequacy requirement is net worth of ₹50 lakh for category I and ₹ 25 lakh for cate II registrars and share transfer agents. Every registrar and transfer agent shall pay the initial regist fees. It is ₹ 4 lakh for category I and ₹ 2 lakhs for category II. The initial registration shall be val 5 years. Thereafter they have to pay renewal fees for every 3 years. It is ₹2.70 lakh for category I ₹ 90,000 for category II registrars and transfer agents.

5. Debenture Trustees

A debenture trustee is a trustee for trust deed required before issue of debentures by a company. SEBI made compulsory to appoint debenture trustees to safeguard the interest of debentureholders in the company.

For protecting the interest of debentureholders, the reforms in the direction of creating debenture trustees, vesting them with more powers, etc., have been made. The requirements in respect of debenture trustee are as follows:

1. In case of issue of debentures with maturity of more than 18 months, the issuer shall appoint a debenture trustee.
2. The names of the debenture trustees must be stated in the offer document.
3. A trust deed shall be executed by the issuer company in favour of the debenture trustees within 6 months of the closure of the issue.
4. Trustees to the debenture issue shall be vested with the requisite powers for protecting the interest of debentureholders including a right to appoint a nominee director on the Board of the Company in consultation with institutional debentureholders.
5. The merchant banker shall file certificates alongwith draft offer document from their bankers to the SEBI that the assets on which security is to be created are free securities and the necessary permissions to mortgage assets have been obtained.
6. The debenture trustee shall ensure compliance with the following:
   (i) The lead financial institution/investment institution shall monitor the progress in respect of debentures raised for project finance/modernisation/expansion/diversification /normal capital expenditure.
   (ii) The lead bank for the company shall monitor debentures raised for working capital funds.
   (iii) The trustees shall obtain a certificate from the company's auditors.
      (a) In respect of utilisation of funds during the implementation period of projects.
      (b) In the case of debentures for working capital, certificate shall be obtained at the end of each accounting year.
   (iv) Debenture issues by companies belonging to groups for financing, replenishing funds or acquiring shareholding in other companies shall not be permitted.
   (v) The debenture trustees shall supervise the implementation of the conditions regarding creation of security for the debentures and debenture redemption reserve.
7. The capital adequacy requirement is the minimum net worth of ₹ 1 crore.

Registration with SEBI

A person can act as debenture trustee only when he has obtained a certificate of registration from SEBI for this purpose. Before granting the certificate, the SEBI takes into account all relevant matters. SEBI considers whether the applicant:

(i) Has the necessary infrastructure,

(ii) Has any past experience as a debenture trustee or has minimum 2 persons in his employment who have the experience in the matters which are relevant to a debenture trustee,

(iii) Or any other person, connected with the applicant has not been granted registration by SEBI directly or indirectly under the Act.

(iv) Has at least 1 person in his employment who possesses the professional qualification,

(v) Or any of its director or principal officer is or has not been convicted any time for any offe involving moral turpitude or has not been found guilty of any economic offence.

Conditions of Registration

The following conditions would apply on the debenture trustees:

1. The applicant has to pay a registration fee of ₹20 lakh at the time of registration and on p rata basis for 2 years and thereafter he has to pay ₹9 lakh after every three years for rene of registration starting from 6th year.
2. The debenture trustee has to obtain the prior approval of the Board for continuing to ac before if it proposes to change its status or constitution.
3. The debenture trustee would take adequate steps for redressal of grievances of the inves within 1 month of the date of receipt of the complaint.
4. It shall maintain capital adequacy requirements.

Eligibility

The following persons are entitled to act as debenture trustee:

(i) A scheduled commercial bank carrying on commercial activity; or

(ii) A public financial institution within the meaning of Section 4-A of the Companies Act, 1956

(iii) An insurance company, and

(iv) A body corporate.

Duties of a Debenture Trustee

The debenture trustee has to perform the following duties:

(i) To ensure that provisions of the laws are adhered to by the company.

(ii) To call for periodic reports from the company.

(iii) To carry out inspection of books of accounts/records/documents and registers and t property.

(iv) To take possession of the property as per provisions of deed.

(v) To exercise due diligence to ensure that the property secured is sufficient to pay the dues

(vi) To resolve grievances of debentureholders with respect to receipt of certificates, interest other dues.

(vii) To carry out other functions for the protection of interest of debentureholders.

6. Brokers to Issue

Stockbrokers are the members of the stock exchange. These are the persons who buy, sell, dea procure subscriptions from prospective investors spread over large area. For the issue of its secu in the public, a company can appoint as many brokers as it wants. Members of the stock excha are to take prior approval from their respective stock exchanges to act as broker to an issue. T brokerage rate applicable to all types of public issues is fixed at 1.5%. The maximum rate of brok on private placement of capital is 0.5%. Brokerage will not be allowed in respect of promoter's q including the securities subscribed by directors, their friends and the employees.

Fees to be Paid by the Stock Broker

Every stockbroker shall pay registration fees in the manner set out below:

(a) Where the annual turnover does not exceed ₹ 1 crore during any financial year, a sum of ₹ 5 thousand for each financial year;

(b) Where the annual turnover of the stock-broker exceeds ₹ 1 crore during any financial year, a sum of ₹ 5000 plus one hundredth of one per cent of the turnover in excess of rupees one crore for each financial year.

Conditions of Registration

Any registration granted by the Board under regulation 6 shall be subject to the following conditions:

(a) The stockbroker holds the membership of any stock exchange.

(b) He shall abide by the rules, regulations and bye-laws of the stock exchange which are applicable to him.

(c) Where the stockbroker proposes change in control, he shall obtain prior approval of the Board for continuing to act as such after the change.

(d) He shall pay fees charged by the Board in the manner provided in these regulations.

(e) He shall take adequate steps for redressal of grievances, of the investors within one month of the date of receipt of the complaint.

(f) He shall at all times abide by the Code of Conduct.

(g) He shall at all times maintain the minimum net worth.

Fees to be paid by Sub-Brokers

Every sub-broker shall pay fees in the manner set out below:

(a) Where a sub-broker was granted certificate of registration by the Board before August 1, 2006:
   - (i) He shall pay a sum of 10,000 rupees for the block of 5 financial years commencing from April 1, 2007.
   - (ii) After the expiry of the said block of 5 financial years, he shall pay a sum of 5000 rupees for every subsequent block of 5 financial years.

(b) Where a sub-broker is granted certificate of registration by the Board on or after August 1, 2006:
   - (i) He shall pay a sum of 10,000 rupees for the block of 5 financial years commencing from the financial year in which registration has been granted;
   - (ii) After the expiry of the said block of 5 financial years, he shall pay a sum of 5000 rupees for every subsequent block of 5 financial years.

Conditions of Registration

Any registration granted by the Board shall be subject to the following conditions:

(a) He shall abide by the rules, regulations and bye-laws of the stock exchange which are applicable to him;

(b) He shall pay fees charged by the Board in the manner provided in these regulations;

(c) He shall take adequate steps for redressal of grievances, of the investors within 1 month of date of receipt of the complaint and keep the Board informed about the number, nature other particulars of the complaints received from such investors.

(d) He is authorised in writing by a stock-broker being a member of a stock exchange for affil himself in buying, selling or dealing in securities.

The capital adequacy requirement shall not be less than the net worth of two crore rupees. T certificate of registration shall be valid for a period of three years from the date of its issu the applicant. Every portfolio manager shall pay a non-refundable fee of 1 lakh rupees al with the application for grant or renewal of certificate of registration. Every portfolio mana shall pay a sum of ₹ 10 lakh as registration fees at the time of the grant of certificate by Board. Every portfolio manager shall pay a renewal fee of ₹ 5 lakh upon grant of renewal

Conditions for Portfolio Managers

(a) Where the portfolio manager proposes to change its status or constitutions, it shall obtain p approval of the Board for continuing to act as such after the change.

(b) It shall pay the fees for registration or renewal, as the case may be, in the manner provide these regulations.

(c) It shall take adequate steps for redessal of grievances of the investors within one month of date of the receipt of the complaint and keep the Board informed about the number, na and other particulars of the complaints received.

(d) It shall maintain capital adequacy requirements at all times during the period of the certific or renewal thereof.

(e) It shall abide by the regulations made under the Act in respect of the activities carried on b as portfolio manager.

7. Portfolio Consultants

A combination of securities such as stocks, bonds and money market instruments is calle portfolio. Whereas the portfolio consultants are the persons or firms or companies who advise or di or undertake the management of funds on behalf of their clients. The portfolio manager deals with process of securities from the number of opportunities available with different expected returns carrying different levels of risk. The selection of securities is made with a view to provide the maxim yield to the investors with minimum risk.

Investors Protection in the Primary Market

To ensure healthy growth of primary market, SEBI considered on priority basis recommendations made by the **"Informal Group on Primary Market"** and accepted most of recommendations for immediate implementation. These include the following:

1. Primary issues to be made compulsory through the depository mode after a specified da
2. 100 per cent book building in respect of issues of ₹25 crore and above.
3. Reduction in the minimum number of mandatory collection centres in respect of issues ab ₹ 10 crore to 4 metropolitan cities plus the place having the regional stock exchange.

A committee under the chairmanship of Dr. N.L. Mitra submitted its study report on Inv Protection to SEBI and Government. The main recommendations are as follows:

1. A judicial forum is required to redress investor's grievance concerning award of compen

2. SEBI should be the only regulator of capital market.
3. Provisions relating to Investor Education and Protection Fund (IEPF) should be included in the SEBI Act, 1992 in place of Companies Act.
4. SEBI Act should be amended to provide for statutory standing committees on investor's protection, market operation and standard setting.
5. All IPOs be insured on the principle of third party insurance with differential premium based on the risk study by insurance companies.
6. The SC(R)A be amended to facilitate corporatisation of exchanges and to ensure good governance of stock exchanges.

Rights of Investors

Rights of investors can be divided in two parts:

(1) Rights as a Shareholder

A shareholder of a company enjoys the following rights:

1. To receive the share certificates on allotment or transfer in due time.
2. To receive the copies of Annual Report, Balance sheet, P & L A/c and the Auditors Report.
3. To receive dividends in due time.
4. To receive corporate benefits like rights shares and bonus shares, etc.
5. To participate and vote in General Meetings either personally or through proxies.
6. To inspect the minutes of the General Meetings and to receive the copies thereof.
7. To apply to the Company Law Board to call or direct the AGM.
8. To proceed against the company by way of civil or criminal proceedings.
9. To apply for the winding-up of the company.
10. To receive the residual proceeds.

Rights as a Group

In addition to the above rights as an individual, they also enjoy certain rights as a group. These rights are:

1. To demand a poll on any resolution.
2. To requisition an extraordinary general meeting.
3. To apply to Company Law Board (CLB) to investigate into the affairs of the company.
4. To apply to CLB for relief in case of oppression and mismanagement.

(2) Rights as a Debentureholder

The debentureholder of a company enjoys the following rights:

1. To receive interest and redemption in due time.
2. To approach the trustees with their grievance.
3. To receive a copy of the trust deed on request.
4. To apply for winding up of the company if the company fails to pay its debt on due date.

Problems of New Issue Market

The main problems of the new issue market are as follows:

(1) **Inadequate Mobilisation of Savings:** The new issue market could not mobilise the adequate savings from the public. It has mobilised less than 10% financial savings of the household sector for investment in securities market. A large portion of capital requirements of corporates are fulfilled by financial institutions or through private placements.

(2) **Underdevelopment of Merchant Banking:** The wholesale market for new issues is underdeveloped in India and merchant banking is in its infant stage. Therefore, the new market suffers from institutional and functional gaps particularly in terms of the new issue instrument Adequate attention has not been given to the technical, managerial and entrepreneurial aspects. Therefore, it may be said that merchant banks are not playing a developmental role and SEBI has not asked the merchant bankers regarding this.

(3) **Diversion of Funds:** The equity capital is more risky and with a risk aversion in the new issue market, funds were diverted from the risky market to less risky debentures as well as deposits with the companies. Companies have themselves shifted away equity financing to debt financing in the eighties.

(4) **Problems of Investors of Semi-urban and Rural Areas:** The investors have to send application forms to centres where banks are authorised to accept them and to incur huge amount as bank-drafts, postal charges, loss of interest and collection charges for refund orders. All these problems would amount to considerable hardship to the probable investors particularly of semi-urban and rural areas.

Recommendations of Committee on Fuller Capital Account Convertibility (Tarapore Committee II)

Government Securities Market

(i) Over time, it would be preferable to progressively increase the share of mark-to-market category.

(ii) Promoting a two-way market movement would require permitting participants to freely undertake short-selling. Currently, only intra-day short-selling is permitted. This would need to be extended to short-selling across settlement cycles; this would, however, require adequate regulatory/supervisory safeguards.

(iii) To stimulate retail investments in gilts, either directly or through gilt mutual funds, the gilt funds should be exempted from the dividend distribution tax, and income up to a limit from direct investment in gilts could be exempted from tax.

(iv) In line with advanced financial markets, the introduction of Separate Trading of Registered Interest and Principal of Securities (STRIPS) in G-secs should be expedited.

(v) Expanding investor base would be strengthened by allowing, inter alia, entry to non-resident investors, especially longer term investors like foreign central banks, endowment funds, retirement funds, etc.

(vi) To impart liquidity to government stocks, the class of holders of G-secs needs to be widened and repo facility allowed to all market players without any restrictions on the minimum duration of the repo; this would, however, necessitate adequate regulatory/supervisory safeguards. This

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Secondary Market

Introduction

The market where the outstanding securities are traded is known as secondary market. This market is popularly known as stock market or stock exchange. In this market, the investors can sell and buy shares or debentures of companies. Stock markets deal in equity shares primarily, but the debt instruments like bonds and debentures are also traded in the stock market. The growth of primary market depends on the secondary market. It also promotes capital formation.

History of Stock Exchanges in India

The emergence of stock market can be traced back to 1830. In Bombay, business passed in the shares of banks like the Commercial Bank, The Chartered Mercantile Bank, The Chartered Bank, The Oriental Bank and The Old Bank of Bombay and Shares of Cotton Presses. In Calcutta, an Englishman reported the quotations of 4%, 5% and 6% loans of East India Company as well as the shares of The Bank of Bengal in 1836. This list was further broadened in 1839 when the Calcutta newspaper printed the quotations of banks like Union Bank and Agra Bank. It also quoted the prices of business ventures like the Bengal Bonded Warehouse, the Docking Company and the Stoam Tug Company.

Between 1840 and 1850, only half a dozen brokers existed for the limited business. But during the share mania of 1861–65, the number of brokers increased considerably. By 1860, the number of brokers was about 60 and during the exciting period of the American Civil War, their number increased to about 200 to 250. The end of the American Civil War brought disillusionment and many failures and the brokers decreased in number and prosperity. It was in those troublesome times between 1868 and 1875 that brokers organised an informal association and finally as recited in the indenture constituting the "Articles of Association of the Exchange". On or about the ninth day of July, one thousand and eight hundred and seventy-five, a few native brokers doing brokerage business in shares and stocks resolved upon forming in Bombay an association for protecting the character, status and interest of native share and stockbrokers and providing a hall or building for the use of the members of such association.

As a meeting held in the Brokers' Hall on the 5th day of February, 1887, it was resolved to execute a formal deal of Association and to constitute the first Managing Committee and to appoint the first Trustees. Accordingly, the Articles of Association of the Exchange and the Stock Exchange was formally established in Bombay on 3rd day of December, 1887. The Association is now known as "The Stock Exchange".

The entrance fee for new members was ₹ 1 and there were 318 members on the list, whe exchange was constituted. The number of members increased to 333 in 1896, 362 in 1916 and 47 1920 and the entrance fee was raised to ₹ 5 in 1877, ₹ 1000 in 1896, ₹ 2500 in 1916 and ₹ 48 in 1920. At present, there are 16 recognised stock exchanges with 9,411 stockbrokers.

Definitions

The definitions of stock exchange are as follows:

1. As per the **Stock Exchange Official Directory.** "The stock market provides a market pl for the purchase and sale of securities evidencing the ownership of business property or public or business debt. The origin of the stock market, therefore, goes back to the time wh securities representing this property provided debt. The origin of the stock market, therefo goes back to the time when securities representing this property or promises to pay were issued and made transferable from one person to another."
2. According to **Husband** and **Dockeray,** "Securities or stock exchanges are privately organi markets which are used to facilitate trading in securities."
3. According to **Pyle,** "Security exchanges are market places where securities that have be listed thereon may be bought and sold for either investment or speculation."
4. According to **Hartley Withers,** "A stock exchange is something like a vast warehouse whe securities are taken away from the shelves and sold across the countries at a fixed price catalogue which is called the official list."
5. According to **P. N. Varshney** and **D.K. Mittal,** "Stock exchange means any body individuals, whether incorporated or not constituted for the purpose of assisting, regulating controlling the business of buying, selling or dealing in securities."
6. According to **P. K. Dhar,** "By the term stock exchange we mean a market where stoc shares and other kind of securities are bought and sold. In this market owners can dispose their securities as per their likings."
7. The **Securities Contracts (Regulation) Act, 1956** defines a stock exchange as 'a association, organisation or body of individuals, whether incorporated or not, established the purpose of assisting, regulating and controlling business in buying, selling and dealing securities."

Characteristics of Stock Exchanges

The characteristics or features of stock exchanges are as follows:

1. It is a place where securities are purchased and sold.
2. Buying and selling of shares is done by both genuine investors and speculators.
3. It is an association of persons whether incorporated or not.
4. SEBI controls and regulates the trading of various transactions at stock exchanges.
5. All types of securities, whether government or industrial, are allowed to be dealt at stoc exchanges.

Functions of Stock Exchanges

Main functions of the stock exchanges are as follows:

(1) Maintains Active Trading: Shares are traded on stock exchanges. It enables the investors to buy or sell securities. The basic function of a stock market is the creation of a continuous market. The continuous market creates marketable liquid investments and facilitates collateral lending. Frequency of sales, prompt execution of orders, little gap between bids and offers, etc., are the major indicators of an active trading or continuous market.

(2) Fixation of Prices: Prices are determined on the basis of demand and supply of securities. The demand and supply of securities depend upon investors' demand and suppliers' preferences. The traded prices are made known to the public. Now one can sell and purchase securities on terminals. This helps the investors take better decisions. But there is an exception to the fair fixation of prices, i.e., Manipulation of prices. The bulls increase the prices abnormally high, whereas bears bring down the prices abnormally.

(3) Ensures Safe and Fair Dealing: The stock exchanges ensure safe and fair dealing through various rules, regulations and bye-laws. Transactions are conducted under competitive conditions enabling the investors to get a fair deal. The government has also notified guidelines for institutional transactions in shares. The operation department of the stock exchange supervises the operations, fixes the different types of margins and making up of prices, etc. The monitoring department of the exchange keeps a watch on the price movements and the trading volume of the members, and takes such action as is necessary to control excessive and speculative trading.

(4) Provides Adequate Liquidity: Stock exchanges provide liquidity to the listed companies. Liquidity occupies a central place in evaluating the efficiency of an exchange. The characteristics of a liquid market are depth, breadth and resilience. Public loans and joint stock enterprises are able to fetch money from small investors because of their unequalled marketability and liquidity. Investors will be willing to subscribe the initial public offerings only when it is easy to trade the securities. Thus, it simulates the capital formation.

(5) Dissemination of Information: Stock exchanges provide necessary information to various interested parties through various publications. They publish the share prices traded on daily basis along with the volume traded. Directory of Corporate Information is useful for the investors' assessment regarding the corporate. Functioning of the stock exchanges are also provided through handbooks, handouts and pamphlets.

(6) Performance Inducer: The quoted stock prices on stock exchanges reflect the performance of the traded companies. This makes the corporate more concerned with its public image and tries to maintain good performance.

Role of Stock Exchanges

Stock exchanges in India played a vital role in the capital formation in the country. The role of stock exchange may be explained with the help of following:

1. **Self-regulatory Organisation:** Stock exchanges in India are the self-regulatory organisations as the stock exchange is an association of member brokers for the purpose of facilitating and trading in securities as per the existing law. The traditional emphasis was on regulation by the SRO (self-regulatory organisation) in the interest of members.
2. **Public Interest:** Another role of the stock exchanges is the movement in the direction of public interest. For the growth of capital market, it is necessary to protect the interest of the

investors. Therefore, the government and the SROs are moving in this direction. This has to a greater emphasis on the developmental role of the stock exchanges. The representati of public on the Board of Directors, the establishment of the grievances cell in the sto exchanges and the nationwide electronic trading system are the steps in this direction.

3. **Enforcement of a Code of Conduct:** The SROs are playing self-regulation under supervisory role of the government. The role of SROs has increased in the direction of sto enforcement of a code of conduct and the rules in the regular conduct of the business.
4. **As Public Service Institution:** The stock exchanges are providing a variety of servic to the investors and therefore, growing as public service institutions. It is providing vario services, like publication of share prices, investors education and training programme settlement of disputes between brokers and clients, etc.

Reasons for Transactions on Secondary Market

There are two reasons for transactions in the secondary market:

1. **Information Motivated Reasons:** The investors, who are motivated through information believe that they have better information about a particular security than other investors have This information leads them to believe that the security is underpriced or overpriced and therefore, they wish to buy or sell the security.
2. **Liquidity Motivated Reasons:** Liquidity motivated investors are those who transact in the secondary market because either they have excess money or they are facing paucity of funds The investors of second category, i.e., paucity of funds will sell securities to improve their liquidity position and on the other hand, the investors with surplus cash will try to buy the securities to earn more returns in the future.

Difference between Primary and Secondary Market

The difference between primary and secondary market is as follows:

Basis of Difference	**Primary Market**	**Secondary Market**
1. Types of Securities	It is a market for new securities.	It is a market for existing securities.
2. Location	It has no fixed geographical location.	It is located at a fixed place.
3. Permission	All companies can enter primary market.	Securities of only listed companies can be traded at stock exchanges.
4. Administrative Set-up	It has no tangible form or administrative set-up. It is recognised only by the services it renders.	It has a definite administrative set-up and a tangible form.
5. Facility	It provides the facility to the corporate sector in raising fresh resources.	It provides the facility for transfer of securities from one corporate investor to another.
6. Control	It is subjected to outside control by SEBI, Stock Exchanges and The Companies Act.	It is subjected to control both from within and outside.

Regulation of Stock Exchanges

All stock exchanges were subject to self-regulation from their own management bodies till 1956. Since 1956, the Securities Contracts (Regulation) Act, 1956 administers the operation and the recognition of stock exchanges through its stock exchange division.

The SEBI (Securities and Exchange Board of India) also tries to promote orderly and healthy development of the securities market and to provide adequate investor protection. The SEBI would seek to create an environment to facilitate mobilisation of adequate resources. This environment includes rules and regulations, infrastructure and policy framework. The regulation of stock exchanges can be divided in the following three parts:

I. Securities Contracts (Regulation) Act, 1956

In 1952, a draft bill on stock exchanges regulation was prepared by the government and this Bill was referred to an expert committee under the chairmanship of **A.D. Gorwala.** A **Bill** called the Securities Contracts (Regulation) Bill was prepared on the same lines and was introduced in the Parliament in 1954. With some amendments, Securities Contracts (Regulation) Act, 1956 was passed. This Act along with the Securities Contracts (Regulation) Rules of 1957 and 1996 have been the main laws regulating securities markets in India.

II. Securities and Exchange Board of India (SEBI)

The SEBI was given a statutory status on 30th January, 1992 by an ordinance to provide for the establishment of SEBI. A Bill to replace the ordinance was introduced in Parliament on 3rd March, 1992, and was passed by both houses of Parliament on 1st April, 1992. The Bill became an Act on 4th April, 1992 when it received the President's assent. Under Section 11 of the SEBI Act is provided that it shall be 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. The SEBI will do the following functions:

1. Regulating the business in stock exchanges and any other securities markets.
2. 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 market in any manner.
3. Registering and regulating the working of the depositories, participants, custodian of securities, foreign institutional investors, credit rating agencies and other intermediaries as Board may specify in this regard.
4. Registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds.
5. Promoting and regulating self-regulatory organisations.
6. Prohibiting fraudulent and unfair trade practices relating to securities markets.
7. Promoting investors education and training of intermediaries of securities markets.
8. Prohibiting insider trading in securities.
9. Regulating substantial acquisition of shares and takeover of companies.
10. Calling for information from, undertaking inspection, conducting inquiries and audit of the stock exchanges and intermediaries and self-regulatory organisations in the securities market.

11. Calling for information and record from any bank or any other authority or board, corporation established or constituted by any Central State or Provincial Act in respect of a transaction in securities which is under investigation or inquiry by the Board.
12. Performing such functions and exercising such powers under the provisions of the Cap Issue (Control) Act, 1947 and the Securities Contracts (Regulation) Act, 1956, as may delegated to it by the Central Government.
13. Levying fees or other charges for carrying out the purpose of this section.
14. Conducting research for the above purpose.
15. Calling from or furnishing to any agencies as may be specified by the Board, such informat as may be considered necessary by it for the efficient discharge of its functions.
16. Performing such other functions as may be prescribed.

Functions as Developmental Role

The Board plays a dual role by adopting regulatory functions as well as playing a developmen role. Its developmental function includes:

1. To deal with all matters relating to development and regulation of the securities market.
2. To administer various legislations affecting securities market.
3. Regulation of the market intermediaries, viz., stock exchanges, stock brokers, merch bankers, mutual funds, etc.
4. To provide adequate investor protection.

III. Self-Regulatory Organisations

The spirit of self-regulation had been prevalent in the Indian securities market as well. Just t elaborate this, we can refer to Section 9 of the SC(R) Act, 1956, which states the following:

Any recognised stock exchange may, subject to the previous approval of the Central Governme (till 1991) and Securities and Exchange Board of India (since 1992), make bye-laws for the regulati and control of contracts. The powers granted to stock exchanges are given in the heading of Provisio Related to Stock Exchanges of this chapter.

The Self-Regulatory Organisations Regulation came into force from 2004. These are:

1. Recognition of Self-Regulatory Organisation

Any group or association of intermediaries, which is desirous of being recognised as a S Regulatory Organisation, may form a company registered under Section 25 of the Companies A 1956 and such company may make an application along with application fee of ₹ 25,000 to t Board for grant of certificate of recognition as a Self-Regulatory Organisation. Every application m shall be accompanied by a copy of the governing norms of Self-Regulatory Organisation and als copy of the memorandum and articles of associations. It must contain the following:

(a) Board of Directors of Self-Regulatory Organisation, its constitution and powers of managem and the manner in which its business would be transacted;

(b) the powers and duties of the office bearers of Self-Regulatory Organisation;

(c) the admission into the Self-Regulatory Organisation of members, agents, their qualificatio for membership, and the exclusion, suspension, expulsion and readmission of members th from or there into.

2. Eligibility Criteria

The Board shall not consider an application for grant of a certificate unless the applicant satisfies the following conditions, namely:

(a) the applicant is a company which has been granted license under Section 8 of Companies Act, 2013;

(b) the applicant has, in its memorandum of association, specified admission of members and discharging the functions of Self-Regulatory Organisation as one of its main objects;

(c) the applicant has minimum net worth of 1 crore rupees;

(d) the applicant has adequate infrastructure, to enable it to discharge its functions as a Self-Regulatory Organisation in accordance with the provisions of the Act and these regulations;

(e) the applicant and its directors have the professional competence, financial soundness and general reputation of fairness and integrity to the satisfaction of the Board;

(f) neither the applicant, nor any director of the applicant is involved in any legal proceeding connected with the securities market, which may have an adverse impact on the interests of the investors;

(g) neither the applicant, nor any director has at any time in the past been convicted of any offence involving moral turpitude or any economic offence;

(h) the applicant has, in its employment, persons having adequate professional and other relevant experience to the satisfaction of the Board;

(i) the applicant is a fit and proper person based on the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008;

(j) grant of certificate to the applicant is in the interest of investors and the securities market;

3. Grant of recognition as a Self-Regulatory Organisation

If the Board 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 articles and governing norms of the applicant applying for recognition are in conformity with such conditions as may be specified by the Board;

(b) that the applicant is willing to comply with any other conditions which the Board may impose for the purpose of carrying out the objects of these Regulations; and

(c) that it would be in the interest of the trade and also in the public interest to grant recognition to the applicant as a Self-Regulatory Organisation;

4. Conditions for Grant of Recognition

The recognition fee is ₹ 5 Lacs. The SEBI can specify the following conditions for recognition:

(i) the qualification for membership of the Self Regulatory Organisation;

(ii) the representation of the Board in the Board of Directors of the Self-Regulatory Organisation by such number of directors not exceeding 4 as the Board may nominate;

(iii) the maintenance of accounts of members and their audit by chartered accountants whenever such audit is required by the Board.

(7) The order made under sub-section (6) shall be published in the Official Gazette and o publication thereof, the order shall, notwithstanding anything to the contrary contained i Companies Act, 1956 (1 of 1956), or any other law for the time being in force, have full e

(8) Every recognised stock exchange, in respect of which the scheme for corporatisation demutualisation has been approved under sub-section (2), shall ensure that at least 51 cent of its equity share capital is held by the public other than shareholders having tra rights, either by fresh issue of equity shares to the public or in any other manner as ma specified by the regulations made by the Securities and Exchange Board of India within t months from the date of publication of the order Sub-section (7).

Securities Contracts (Regulation) (Manner of Increasing and Maintainin Public Shareholding in Recognised Stock Exchanges) Regulations, 200

On 13th November, 2006, SEBI enacted the new regulations for recognised stock exchange India. These regulations shall be applicable to all recognised stock exchanges in respect of which scheme for corporatisation or demutualisation has been approved by the Board. The major poi these regulations are as follows:

1. Manner of Increasing the Public Shareholding

The recognised stock exchange has to ensure that at least 51 per cent of its equity share ca should be in the hands of the public. For increasing the public share, the stock exchange can e issue fresh equity shares through prospectus or in the following manner:

(a) Offer for sale of the shares held by shareholders having trading rights therein;

(b) Placement of shares held by shareholders having trading rights to such persons or institu as may be short listed by the recognised stock exchange with the approval of the board;

(c) Issue of equity shares on private placement basis by the recognised stock exchange to person or group of persons not being shareholders having trading rights or their asso subject to the approval of the board; or

(d) Any combination of the above.

2. Procedure for Fresh Issue of Equity Shares or Offer for Sale to the Public

(a) The fresh shares should be issued in compliance with the provisions of the Companies 1956 and Guidelines or Regulations of the Board.

(b) Where any fresh issue of equity shares or offer for sale to the public is made under sub- (a) of the point 1 (Manner of Increasing the Public Shareholding), an application for l shall be made to the same recognised stock exchange.

(c) Listing of equity shares or other securities of a recognised stock exchange on the recognised stock exchange shall be in compliance with such conditions as may be speci the Board.

3. Private Placement

(a) Where the shares of a recognised stock exchange are not listed on any recognised exchange will make a private placement.

(b) Where the shares of a recognised stock exchange are listed on any recognised stock ex and still makes a private placement, then such placement shall be in accordance w provision's of the Companies Act, 1956 and Guidelines or Regulations of the Board.

(c) The Board will issue a confirmation letter to the recognised stock exchange, when it is satisfied that the recognised stock exchange has complianced with the provisions.

4. Shareholding and Transferability Restrictions

(a) After the commencement of these regulations, no person can acquire or hold more than 5 per cent in the paid-up equity share capital of a recognised stock exchange.

(b) A stock exchange, a depository, a clearing corporation, a banking company, an insurance company and a public financial institution may hold either individually or jointly upto 15 per cent of the paid up equity capital of the recognised stock exchange.

(c) The combined holding of all persons outside India shall not exceed 49 per cent of the capital of recognised stock exchange.

5. Eligibility Criteria

(A) No person shall acquire or hold more than 5 per cent of the paid-up equity capital of the recognised stock exchange, unless he is a fit and proper person, and has taken the prior approval of the Board for doing so.

(B) A person will be fit and proper, if:

(i) such person has good general reputation and record of fairness and integrity;

(ii) such person has not incurred any of the following disqualifications:

- (a) The person or any of his whole time directors or managing partners have been convicted by the court for any offence involving moral turpitude or any economic offence or any offence against the securities laws;
- (b) An order for winding up has been passed against the person;
- (c) The person or any of its whole time directors or managing partners have been declared insolvent and have not been discharged;
- (d) An order, restraining or prohibiting or debarring the person or any of his whole-time directors or managing partners from dealing in securities in the capital market or from accessing the capital market has been passed by the Board or any other regulatory authority and a period of 3 years, from the date of order, has not elapsed;
- (e) Any other order against the person or any of his whole-time directors or managing partners has a bearing on the capital market, has been passed by the Board or any other regulatory authority and a period of 3 years from the date of order has not elapsed.
- (f) The person has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force; and
- (g) The person is financially unsound.

6. Dematerialisation

(a) The recognised stock exchange shall enter into an agreement with the depositories for dematerialisation of the equity shares proposed to be issued or sold; and

(b) It shall give an option to the subscribers or transferees to receive the share certificate or hold the shares in the dematerialised form with a depository.

7. Obligations of Stock Exchange

(i) A recognised stock exchanges shall monitor and ensure:

(a) that no transfer or issue of equity shares is made in contradiction with these regulati

(b) that at least 51 per cent of its equity share capital is held by the public continuously,

(c) that the restrictions imposed under these regulations are complied with.

(ii) The recognised stock exchange shall submit a report to the Board within 15 days from the of each quarter, containing:

(a) the names of 10 largest shareholders along with the number of shares held by them;

(b) the names of the shareholders who had acquired shares in that quarter; and

(c) the shareholding pattern in the recognised stock exchange.

Procedure for Dealing at Stock Exchanges

The buying and selling of securities in stock exchanges can be done only through regist brokers. Investors are not allowed to transact directly. The following procedure is followed for deal at stock exchanges.

1. **Selection of a Broker:** First of all, an investor has to select a broker for dealing in securi The interested investor may directly or through his bank approach a broker. After satisf himself with the financial position of the investor, the broker opens his account.
2. **Placing an Order:** After the opening of the account with the broker, the client can place orders for selling and purchasing of securities. The investor can take the help of his br regarding the type of securities to be purchased and the proper time for it. After being sati himself about the securities, the client tells to his broker to purchase shares, their number the price at which the transaction should be done. If a tentative price is told to the broker, the broker will try to make purchases or sales at the nearest price offered by the client. I definite price is told to the broker by the client, then he will have to stick with that price o
3. **Making the Contract:** The broker enters the rate and the number for buying or sellin securities in his computer and forwards it to the exchange. That rate and number is flashe the screens of the computers of all the brokers. If the rate matches with the rates of the c client of another broker, then the transaction is struck. Otherwise the first or second clien to modify his rates so that the transaction could take place. Second method is that the c can see the offered rates at the screen of the computer of his broker and can buy or sel securities at that rates.
4. **Contract Note:** If the transaction has taken place, then the broker will issue a contract to his client mentioning the details of security traded, its number and prices, etc.
5. **Settlement:** The securities can be in two forms, i.e., physical and dematerialised. There the settlement procedure in both is different.

    (a) **Settlement of Securities in Physical Form:** The investor or the client give securities in physical form along with the signed transfer deed to his broker o same day. The selling broker hands over the transfer deed and share certificates concerned stock exchange. On the other hand, the buying broker has to depos money with the clearing bank of the exchange. This process is completed on the day specified by the stock exchange. After examining and processing the drafts, ch

and securities certificates, the clearing house makes the payment to the selling broker and delivers the security certificates to the buying broker on the pay-out day.

(b) **Dematerialised Securities:** The procedure for transactions of securities which are in dematerialised form is as follows:

(i) In case of sale, the investor instructs his DP (Depository Participant) to debit his demat account with the number of securities sold and credit the broker's account. In case of purchase, the investor has to issue the cheque to his broker for payment of such security.

(ii) Before the pay-in day, broker of the selling client transfers the securities to the clearing house of the stock exchange.

(iii) On the pay-out day, the clearing house makes the payment to the selling broker and the purchasing broker receives credit of securities in his account.

(iv) The investor receives payment from the broker for the selling of securities. Purchasing broker gives instructions to DP to debit clearing account and credit client's account.

6. **Rolling Statement:** It is an important measure to enhance the efficiency and integrity of the security market. It has changed the traditional account period settlement which marks an important change in the market design and age old practices. In January, 1998, SEBI had introduced rolling settlement on a voluntary basis. Due to less response to the voluntary scheme, SEBI introduced compulsory rolling statement in January 2000. Rolling statement has been introduced in the form of T + 5 settlement initially but now it is T + 2 settlement system. Here T is the trade and two day is given for delivery of securities and cash payments.

Factors Influencing Prices on Stock Exchange

The factors which influence the prices of shares on stock exchange are as follows:

1. **Financial Position of the Company:** The prices of the shares are influenced by the financial position of the company. Good financial results increase the rate of security in the market. The rate of dividend also affects the market price of the share. Higher dividends attract more customers and thereby increase the market rates. On the other hand, if a company fails to pay dividends or pays the dividend at lower rates, the shareholders sell their holdings and the prices of shares will come down.
2. **Demand and Supply Position:** Demand and supply of a particular share directly influences the rates of security at a stock exchange. If the demand is more and supply is less, the market rates will increase. On the other hand, if the demand is less and supply is more, the prices of security will decline.
3. **Role of Financial Institutions:** The financial institutions directly affect the prices of securities at a stock exchange because they deal in bulk quantity. When they purchase a security, it reduces the supply of shares and hence the price increases. On the contrary, when institutions start selling their holdings, the supply in the market increases and as a consequence, the prices decline in the market.
4. **Speculative Activities:** The market prices are also affected by the speculative activities of operators and investors. The speculators may create artificial scarcity in a particular security by purchasing the available shares. Once they control the demand and supply of shares, they start dictating the prices. Harshad Mehta scam is the example of it.

(2) Powers of Recognised Stock Exchanges: These powers may be divided into two pa

(A) Powers to Make Rules Regarding Voting Rights: A recognised stock exchange m make rules or amend any rules made by it related to the following matters: only in respect of any matter placed be

(i) the restriction of voting rights to members the stock exchange at any meeting.

(ii) the regulation of voting rights at any meeting so that each member may be enti to have one vote only irrespective of his share of the paid-up equity share capita the stock exchange.

(iii) the restrictions on the right of a member to appoint another person as his proxy

(iv) such incidental, consequential and supplementary matters as may be necessary give effect to any of the matters specified above.

(B) Power to Make bye-laws: Any stock exchange may make bye-laws for the regula and control of contracts subject to prior approval of the SEBI. These bye-laws m provide for:

(i) the opening and closing of markets and the regulation of the hours of trade.

(ii) a clearing house for periodical settlement of contracts and differences thereund the delivery of and payment of securities, the passing on of delivery order and t regulation and maintenance of such clearing house.

(iii) the submission of periodical statement to the SEBI by the clearing house as soon possible after each periodical settlement of all or any of the particulars which SE requires from time to time.

(iv) the publication of the particulars by the clearing house of all or any of the particula submitted to the SEBI as per directions issued by SEBI in this behalf.

(v) the regulation or prohibition of blank transfers.

(vi) the number and classes of contracts in respect of which settlements shall be made differences paid through the clearing house.

(vii) the regulation or prohibition of badlas or carry over facilities.

(viii) the fixing, altering or postponing of days for settlements.

(ix) the determination and declaration of market rates, including the opening, clo highest and lowest rates for securities.

(x) the terms, conditions and incidents of contracts.

(xi) the regulation of entering into, making performance, recession and termina of contracts, including contracts between members or between a member and constituents or between a member and a person who is not a member.

(xii) the regulation of taravani business including the placing of limitations thereon.

(xiii) the listing of securities on the stock exchange, the inclusion of any securities for purpose of dealings and the suspension or withdrawal of any such securities.

(xiv) the method and procedure for the settlement of claims or disputes inclu settlement by arbitration.

(xv) the levy and recovery of fees, fines and penalties.

(xvi) the regulation of the course of business between parties to contract in any capacity.

(xvii) the fixing of a scale of brokerage and other charges.

(xviii) the making, comparing, settling and closing of bargains.

(xix) the emergencies in trade which may rise, including the power to fix maximum and minimum prices for securities.

(xx) the regulation of dealing by members for their own account.

(xxi) the separation of the functions of jobbers and brokers.

(xxii) The limitations on the volume of trade done by any individual member in exceptional circumstances.

(xxiii) The obligation of members to supply such information or explanation or documents which governing body may require.

(C) Consequences of Violation of bye-laws: The contracts entered in contravention of the bye-laws shall be void and the members shall be liable to one or more of the following punishments:

(i) Fine,

(ii) Expulsion from membership,

(iii) Suspension from membership for a specified period,

(iv) Any other penalty of a like-nature not involving the payment of money.

(3) Power of Central Government to Direct to Stock Exchange Regarding Rules to be Made or to Amend Rules: After consultation with the governing bodies of stock exchanges generally or with the governing body of any particular stock exchange, if the Central Government is of opinion that it is necessary to make or amend rules, it may direct to stock exchanges within a period of 2 months from the date of order.

If the recognised stock exchange fails to comply the orders within the specified time period, the Central Government may make or amend rules.

(4) Clearing Corporation: A recognised stock exchange may transfer the duties and functions of a clearing house to clearing corporations with the prior approval of the SEBI. The clearing corporation is established as a company incorporated under the Companies Act for the purpose of:

(a) the periodical settlement of contracts and differences there under;

(b) the delivery of and payment for securities;

(c) any other matter incidental to or connected with such transfer.

(5) Power of SEBI to Make or Amend Bye Laws of Stock Exchanges: The SEBI may make or amend bye laws of recongnised stock exchanges.

(6) Power of Central Government to Supersede Governing Body of Recognised Stock Exchange: The Central Government may supersede the governing body of any recognised stock exchange after giving a written notice to the governing body.

(7) Qualifications for Membership of a Recognised Stock Exchange: The qualifications for membership of a recognised stock exchange may be divided in two parts:

(A) For Individuals: The individuals who satisfy the following conditions are eligible become a member of recognised stock exchange if:

(i) he is not less than twenty-one years of age;

(ii) he is a citizen of India;

(iii) he has not been adjudged bankrupt;

(iv) he is not engaged as principal or employee in any business other than tha securities except as a broker or agent not involving any personal financial liabili

(v) he has not been compounded with his creditors unless he has paid them fully; he has not been convicted for an offence involving fraud or dishonesty;

(vi) he has not been expelled or declared a defaulter by any other stock exchange

(vii) he has never been previously refused admission to membership unless a period of

(viii) he has not been previously refused admission to membership unless a period of year has elapsed since the date of such rejection. In addition to the above, a pers is not eligible for admission unless he satisfies the following conditions also;

(viii) he has worked for not less than two years as a partner with, or an authorised assis or authorised clerk or remisier or apprentice to a member; or

(ix) he agrees to work for a minimum period of 2 years as a partner or representat member with another member; or

(x) he succeeds to the established business of a deceased or retiring member who is father, uncle, brother or any other person who is a close relative in the opinion of t governing body.

(B) For Companies and Corporations: A company as defined in the Companies A 1956 is eligible to be elected as a member of a stock exchange if:

(i) such company is formed in compliance with the provisions of Section 332 of t Companies Act;

(ii) a majority of the directors of such company are shareholders of such company a also members of that stock exchange; and

(iii) the directors of such company, who are the members of stock exchange, h unlimited liability in such company.

A company is also eligible if:

(i) that company is formed in compliance with the provisions of Section 12 of the SEBI A

(ii) such company undertakes to comply with such financial requirements and norm may be specified by SEBI;

(iii) the directors of company are not disqualified for being members of a stock exch

(iv) the directors of the company had not held the offices of the directors in any comp which had been a member of the stock exchange and had been declared de or expelled by the stock exchange; and

(v) not less than 2 directors of the company are persons who possess a minim years' experience in dealing in securities or as portfolio managers or as inves consultants.

(vi) The minimum paid-up equity capital is ₹ 30 Lacs.

(vii) At least two directors are identified as designated directors who would be managing day to day operation and they should have minimum HSC or equivalent qualification. In addition to the above, other corporations, companies or institutions can also be admitted as member like IFCI, IDBI, LIC, GIC, UTI, ICICI, subsidiary of all these and subsidiary of SBI.

(8) Maintenance of Books and Documents: The maintenance of books and documents can also be studied under the following two parts as per SEBI rules:

(A) By Every Recognised Stock Exchange: Every recognised stock exchange has to maintain and preserve the following books of account and documents for a period of 5 years:

(i) Minute Books of the Meeting of:

(a) Members

(b) Governing body

(c) Any standing committee or committee of the governing body or the general body of members.

(ii) Register of clearing members showing their full names and addresses

(iii) Register of authorised clerks

(iv) Register of remisiers of authorised assistants

(v) Record of security deposits

(vi) Margin deposits book

(vii) Bank passbook

(viii) Journals

(ix) Cash Book

(B) By Every Member of Recognised Stock Exchange: Every member of a recognised stock exchange has to maintain and preserve the following books of account and documents:

(i) For a period of 5 years:

(a) Sauda Book (register of transactions).

(b) Journals.

(c) Client's ledger.

(d) General ledger.

(e) Cash Book.

(f) Bank passbook.

(g) Documents register showing full particulars of shares and securities received and delivered.

(ii) For a period of 2 years:

(a) Members' contract books showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other members.

4. Companies would be required to make their party paid-up shares fully paid-up or forfei same before making a public/rights issue.
5. The promoter's contribution has now been made uniform at 20% irrespective of the issue
6. Only such securities can be offered for promoters' contribution for which a specific wr consent has been obtained from the shareholders for lock-in.
7. Appointment of a 'Registrar to Issue' for rights issue is now mandatory.
8. A provision has been made regarding disclosure of the shareholding of the promoters wh name figures in the paragraph on promoters and their background.

Listing Procedure

The listing procedure involves the following steps:

(1) Preliminary Discussion: The officers of such company who are interested in getting securities listed on the stock exchange should have the detailed discussion with the author of the exchange. This discussion enables them to understand the legal requirements to complied for the listing of securities.

(2) Approval of Article of Association: The articles of association will be approved on it fulfils the requirements of SC(R) Act, like, free dealing in shares, common form of tran shares should be free from lien, interest payment on calls in advance, etc. But if the ab requirements are not met by the company then it has to give an undertaking that it will am the articles of association in next annual general meeting.

(3) Draft Prospectus Approval: Draft prospectus should be approved prior to the listing securities. Company authorities should hold discussions with the stock exchange author before the finalisation of the prospectus. The conditions put by the stock exchange shoul the part of the approval. Following should be clearly stated in the prospectus:

(i) The name of regional stock exchange and other exchanges where it intends to enl securities.

(ii) The date of opening and closing of the subscription should also be mentioned.

(4) Application for Listing: A public company should apply to the stock exchange on prescribed application form along with the following documents for getting its securities li on a recognised stock exchange:

(i) Memorandum and Articles of Association and, in the case of a debenture issue, a c of the trust deed.

(ii) Copies of all prospectuses or statements in lieu of prospectuses issued by the compan any time.

(iii) Copies of offer for sale or circulars or advertisements offering any securities for subscri or sale during the last five years.

(iv) Copies of balance sheets and audited accounts for the last five years, or in the ca new companies, for such shorter period for which accounts have been made up.

(v) A statement showing:

  (a) dividends and cash bonuses, if any paid during the last ten years;

  (b) dividends or interest arrears, if any.

(vi) Certified copies of agreements with:

  (a) managing agents and secretaries and treasurers;

  (b) selling agents;

  (c) managing directors and technical directors; and

  (d) general manager, sales manager, manager or secretary.

(vii) A statement containing particulars of the dates of, and parties to all material contracts, agreements, concessions and similar other documents together with a brief description of the terms, subject matter and general nature of the documents.

(viii) Certified copies of agreements or other documents relating to arrangements with or between:

  (a) vendors and/or promoters,

  (b) underwriters and sub-underwriters, and

  (c) brokers and sub-brokers.

(ix) Certified copy of every letter, report, balance sheet, valuation contract, court order or other documents, part of which is reproduced or referred to in any prospectus, offer for sale, circular or advertisement offering securities for subscription or sale, during the last five years.

(x) A brief history of the company since its incorporation, giving details of its activities including any reorganisation, reconstruction or amalgamation, changes in its capital structure, and debenture borrowings, if any.

(xi) Particulars of shares forfeited.

(xii) Particulars of shares or debentures for which permission to deal is applied for.

(xiii) A list of highest ten holders of each class or kind of securities of company.

(xiv) Particulars of shares and debentures issued:

  (a) for consideration other than cash, whether in whole or part,

  (b) at a premium or discount, or

  (c) in pursuance of an option.

(xv) A statement containing particulars of any commission, brokerage, discount or other special terms including an option for the issue of any kind of the securities granted to any person.

(5) Listing Fee: The stock exchange charges a fee from the company for permitting the company's scrip to be traded. The fee varies from major exchange to regional exchange. The fees charged by the regional exchanges are comparatively less than the major stock exchanges.

(6) Listing Agreement Regarding Projection of Profitability: SEBI amended the listing agreement by inserting a new clause 43 to provide protection to the investors. Accordingly, the company has to submit the yearly statement showing the variation between the projection given in the prospectus and the actual achieved. The reasons for variation should also be mentioned.

(7) Listing Agreement and Cash Flow Statement: Inclusion of cash flow statement in annual report has been imposed as a part of listing agreement to comply with the international standards. The cash flow statement has to be prepared according to the instructions given b the SEBI.

Listing of Right Shares

The formalities regarding the listing of right shares are as follows:

1. The company should notify the stock exchange, the date of meeting of Board of Directors which the proposal of right shares or debenture is to be considered.
2. The company should inform the decision taken regarding the right issue to the stock exchang immediately.
3. As per Section 81 of the Companies Act, 1956, the company should obtain the consent of th shareholders by way of a special resolution in general body meeting.
4. The record date for closure of register of members should be intimated to the stock exchang
5. The letter of offer should give financial information before one month of the date of company last balance sheet.
6. The applications are accepted at all centres where recognised stock exchanges are situated the company is not able to make such arrangements at all centres, it can have the centres its own choice.
7. The letter of offer should be made within six weeks after the closure of the transfer books
8. The shareholders should be given reasonable time to record their interest or exercise th rights. It should not be less than four weeks.
9. The renunciation forms should be made available to the shareholders freely on request.
10. The company should inform the stock exchange the last date fixed for submission of righ application split/renunciation application and consolidated coupons.
11. The company should forward a specimen copy of the letter of offer and application form the rights issue to the stock exchange.
12. After despatching the allotment letters or share certificates, the company should apply listing in the prescribed form.
13. After receiving the application form along with the required documents, the stock exchang would permit the shares to be listed for official dealing by its members.

Evaluation of Listing

Evaluation of listing can be studied under two heads:

(A) Merits

The Merits or benefits of listing are as follows:

1. **Liquidity:** The shares listed on stock exchanges have high liquidity as they can be sold and converted into cash quickly.
2. **Fair Trading:** Investors are assured of fair trading practices as the trading is now screen b and the investor can himself see the prevailing rates.
3. **Best Prices:** The price of shares is determined on the basis of demand and supply. The quotations and the traded volume appear in the newspapers. Thus, the investors are a realise their securities at best prices.

4. **Transferability:** Section 22 of Securities Contracts (Regulation) Act ensures free transfer of listed securities. Thus, the listing provides free transferability of securities.
5. **Periodic Reports:** Listed companies have to provide periodic report to the public, such as, it is obligatory for each company to publish its quarterly results in the newspaper.
6. **Income Tax Benefit:** Income Tax Act treats the listed companies as widely held companies. The advantages available to a widely held company are applicable to the listed company. The quotations for listed companies appear in newspaper which is useful for the computation of income tax and gift tax, etc. Thus, the listing is necessary both for shareholders and company.
7. **Better Status and Goodwill:** The listed company enjoys a better status in the corporate world and the society. It facilitates the flow of public savings into the company. This helps the company to expand its activities.
8. **Fiscal Benefits to Company:** Certain fiscal benefits can be enjoyed by the companies including borrowing from financial institutions and the government.

(B) Demerits

Listed companies suffer from the following demerits:

1. Stock exchanges and SEBI have imposed several regulatory measures on the listed companies. Therefore, the listing of companies is subject to those measures.
2. The listed companies have to submit the essential informations to the stock exchange.
3. Listed companies are required to send the annual reports to all the shareholders and also have to convene annual general meetings. Therefore, the company has to bear the additional wasteful expenditure.
4. Offer to public for purchase of its securities is itself an expensive exercise. But, this is a pre-requisite for the company's shares to be listed.

Consequences of Non-Listing

If a company has not applied for listing on the one or more recognised stock exchange within 10 weeks from the date of closure of subscription list, then the following consequences follow:

1. Any allotment of shares or debentures shall be void.
2. Application money received is to be refunded without interest within 8 days of the closure of the subscription.
3. After the expiry of the aforesaid 8 days, the company and its every director shall be jointly and severally liable to repay the amount with interest at prescribed rate.

Delisting of Securities

A recognised stock exchange may suspend or withdraw admission to dealings in the securities of a company or body corporate either for a breach of or non-compliance with provisions of the conditions of dealings.

Insider Trading

Insider means any person who is or was connected with the company or is deemed to have been connected with the company and is reasonably expected to have access, by virtue of such connection, to unpublished price sensitive information in respect of securities of the company, or who

Recommendations of Committee on Fuller Capital Account Convertibility (Tarapore Committee)

Corporate Bond and Securitised Debt Market

(i) GOI, RBI and SEBI should be able to evolve a concerted approach to deal with the complex issues identified by the High Level Committee on Corporate Bond Market.

(ii) Institutional trading and settlement arrangements need to be put in place and investors should have the freedom to join any of the trading and settlement platforms they find to be convenient.

(iii) The issuance guidelines have to be changed so as to recognise the institutional character of the market. Since issuers may like to tap the bond market more frequently than the equity market and since subscribers are mainly institutional investors, issuance and listing mechanisms in respect of instruments being placed with institutional investors should be simplified by relying more on the assessment of a recognised rating agency rather than on voluminous and tedious disclosures as required by the public issues of equities.

(iv) Until transparent trading platforms become more popular, reliable trade reporting systems should be made mandatory. Clearing and settlement arrangements like those offered by CCIL in the case of G-secs should be in place to ensure guaranteed settlement.

(v) Stamp duty at the time of bond issues as also on securitised debt should be abolished by all the state governments.

(vi) The FII ceiling for investments in corporate bonds of US $1.5 billion should in future be linked to fresh issuances and the present absolute limit should be retained for the year 2006-07 and be fixed at 15 per cent of fresh issuances between 2007-08 and 2008-09 and at 25 per cent between 2009-10 and 2010-11. The allocation by SEBI of the limits between 100 per cent debt funds and other FIIs should be discontinued.

(vii) Corporate bonds may be permitted as eligible securities for repo transactions subject to strengthening of regulatory and supervisory policies.

(viii) In the case of the securitised debt market, the tax treatment of special vehicles that float the securitised debt has to be materially different. Government should provide an explicit tax pass-through treatment to securitisation of Special Purpose Vehicles (SPVs) on par with ta pass-through treatment granted to SEBI registered venture capital funds.

(viii) Securitised debt should be recognised under the Securities Contract and Regulation Ac (SCRA), 1956 as a tradable debt. The limitations on FIIs to invest in securities issued by Ass Reconstruction Companies should be on par with their investments in listed debt securities

Current Position

There are several facets to the secondary market for securities. Trading, clearance and settlem are one part and others include exchange management, product innovation, risk management, e SEBI has been continuously improving functioning of secondary securities market. Trading, clear and settlement in equity shares was contracted to T+3 from April, 2002 and further contracted to T+ from April, 2003. In order to make markets more efficient and provide more investment opportun to the investors, trading in government securities on stock exchange was permitted. Due to th initiatives, the business on all stock exchanges has increased. It is evident from Table 2:

(i) A debt issuance strategy

(ii) Interest rate liberalisation in the Government Securities Market to ensure efficient pri discovery;

(iii) An adequate number of end investors;

(iv) A diversified maturity spectrum in Government Securities;

(v) Policy impetus for developing the secondary market for the Government Securities witho direct intervention; and

(vi) A competitive market environment.

To promote the secondary market in government securities, the Reserve Bank of India announce the detailed guidelines in March 1995 for enlistment of Primary Dealers. The salient features of thes are:

Objectives of Primary Dealers

The objectives of primary dealers are:

(i) Strengthening the infrastructure in the government securities market in order to make vibrant, liquid and broad based.

(ii) Ensuring development of underwriting and market making capabilities for governme securities outside the RBI.

(iii) Improving secondary market trading system which would contribute to price discover enhance liquidity and turnover and encourage voluntary holding of government securitie amongst a wider investor base.

(iv) Making Primary Dealers an effective conduit for conducting open market operations.

Eligibility Conditions

All India financial institutions, foreign subsidiaries of scheduled commercial banks and a compan incorporated under Companies Act, 1956 are eligible to apply for primary dealership. The subsidiar of scheduled commercial bank or banks and All India Financial Institution should be registered as a NBFC at least one year prior to date of application. They should have minimum Net Owned Funds o ₹ 150 crore for core activities and ₹ 250 crore for diversified activities.

The banks should have minimum capital to risk weighted assets ratio (CRAR) of 9 per cent. Thei non-performing assets (NPA) should be less than 3 per cent and they should have profit making reco of last 3 years. The banks which do not have a subsidiary undertaking PD business and intending t undertake PD business departmentally should have minimum Net Owned Funds of ₹ 1000 crore.

Primary Dealer's Role and Obligation

1. PDs are expected to play an active role in the G-Sec market, both in its primary and seconda market segments through various obligation like participating in Primary auction, mark making in G-Secs, predominance of investment in G-Secs, achieving minimum seconda market turnover ratio, maintaining efficient internal control system for fair conduct of busines etc.
2. A PD is required to have a standing arrangement with RBI based on the execution of a undertaking and the authorisation letter issued by RBI every three years. Undertaking will b based on passing of a fresh Board resolution by the PD every three years.

3. The underwriting commitment on dated securities of Central Government will be divided into two parts – a) minimum Underwriting Commitment (MUC), and (b) Additional Competitive Underwriting (ACU).
4. The MUC of each PD will be computed to ensure that at least 50 per cent of the notified amount of each issue is mandatorily underwritten equally by all the PDs.
5. RBI will announce the MUC of each PD. In the ACU auction, each PD would be required to bid for a an amount at least equal to its share of MUC. A PD cannot bid for more than 30 per cent of the notified amount in the ACU auction.
6. The auction could be either uniform price-based or multiple price-based depending upon the market conditions and other relevant factors.
7. Bids will be tendered by the PDs within the stipulated time, indicating both the amount of the underwriting commitment and underwriting commission rates.
8. On announcement of an auction of State Development Loans (SDLs), which are dated securities of the State Governments, RBI may invite PDs to collectively bid to underwrite upto 100 per cent of the notified amount.
9. A PD can bid to underwrite upto 30 per cent of the notified amount of the issue. If two or more issues are floated on the same day, the limit of 30% is applied by taking the notified amounts separately.
10. Depending upon the bids submitted for underwriting, the RBI will decide the cut-off rate of commission and the underwriting amount upto which bids would be accepted and inform the PDs.

Underwriting Commission

1. All successful bidders in the ACU auction will be paid underwriting commission on the ACU segment as per the auction rules. Those PDs who succeed in the ACU for 4 per cent and above of the notified amount of the issue, will be paid commission on the MUC at the weighted average of all the accepted bids in the ACU. Others will get commission on the MUC at the weighted average rate of the three lowest accepted bids in the ACU.
2. In the GOI securities auction, a PD should bid for an amount not less than its total underwriting obligation. If two or more issues are floated on the same day, the minimum bid amount will be applied to each issue separately.
3. Underwriting commission will be paid on the amount accepted for underwriting by the RBI, irrespective of the actual amount of devolvement, by credit to the current account of the respective, PD at the RBI, Fort, Mumbai, on the date of issue of security.
4. In case of devolvement, PDs would be allowed to set-off the accepted bids in the auction against their shortfall in underwriting commitment accepted by the RBI. Devolvement of securities, if any, on PDs will take place on pro-rata basis, depending upon the amount of underwriting obligation of each PD after setting off the successful bids in the auction.
5. RBI reserves the right to accept any amount of underwriting upto 100 per cent of the notified amount or even reject all the bids tendered by PDs for underwriting, without assigning any reason.

Facilities from RBI

The RBI currently extends the following facilities to the PDs to enable them to fulfill their obligations effectively:

1. access to Current Account facility with RBI;
2. access to Subsidiary General Ledger (SGL) Account facility with RBI;
3. access to e-Kuber facility for primary auction;
4. permission to borrow and lend in the money market including call money market and to trade in all money market instruments;
5. memberships of electronic dealing, trading and settlement systems;
6. access to the Liquidity Adjustment Facility (LAF) of RBI;
7. access to liquidity support from RBI under a scheme separately notified for standalone PDs; and
8. access to open market operations by RBI.

Current Status

The selected indicators of PDs are as follows:

		(₹ in Billions)
	2016	**2015**
Number of PDs	08	08
Profit After Tax	3,455.1	6,099.1

II. Corporate Securities Market

Corporate securities market is a market where the securities issued by industrial firms are sold and purchased. It consists of new issues market, i.e., primary market and stock exchange, i.e., the secondary market.

1. The New Issues Market (Primary Market)

Primary market is the market for long-term funds. This market is comprised of individuals, institutions, methods/mechanism, service and practices involved in raising fresh capital for both new and existing companies. Individuals or households with surplus money invest their savings in exchange for shares, debentures and securities of such companies and governments. Primary market deals in only new securities which are acquired for the first time. The issuer may be a new company or an existing company. These may be in the form of new floatation either publicly or privately or in the form of a rights offer to the existing shareholders.

Characteristics of NIM

The new issue market has the following characteristics:

1. It is market for new securities.
2. It does not have any fixed geographical location.
3. The corporate sector raises fresh resources through this market.
4. This market has no tangible form or administrative set-up.

5. It has the recognition only by the services it renders.
6. SEBI, stock exchanges and the Companies Act establish control over this market by making various rules and regulations.

Functions of New Issue Market (NIM)

The main function of NIM are as follows:

(1) Origination: The sponsors of issue perform the work of investigation, analysis and review of the issue and render the consultative services, authenticating and processing services to the investors. All this work and service are called as origination. This helps the issuing company in fixing the price, size of the issue, time of issue, terms and conditions of the issue and methods of floatation, etc.

(2) Underwriting: Underwriting is a contract by means of which a person gives an assurance to the issuer to the effect that the former would subscribe to the securities offered in the event of non-subscription by the persons to whom they are offered. The person who assures is called an underwriter. The company or the promoters get the issue underwritten to ensure the success of the issue. Underwriting guarantees success of the issue and benefits the issuing company and the investing public.

(3) Distribution: Sale of securities to ultimate investors is called distribution. It is a specialised activity which is rendered by brokers, subbrokers and dealers in securities. They maintain regular and direct contact with the present and prospective ultimate investors.

These three service functions are basically done to perform the following three main functions:

(i) It facilitates transfer of resources from savers to entrepreneurs.

(ii) It helps in raising resources for expansion and diversification activities of existing companies.

(iii) It also helps in the conversion of existing proprietorship/partnership or private limited companies into public limited companies.

Issue Mechanism

The various methods of new issues are as follows:

A. Public Issue through Prospectus

This is the most common and popular method of raising capital from the general public. The company invites the public to subscribe the shares through the prospectus. The company gives the direct offer to the investing public to subscribe to the securities of the company at a given price. Prospectus contains the various information like, company's name and address, names and addresses of directors, promoters, auditors, bankers and brokers. The date of opening and closing of subscription list, credit rating obtained from CRISIL, or any other organisation details regarding the project, past performance (if any) of the company, etc.

Advantages

The advantages of public issue through prospectus are as follows:

1. The company and the issue get full publicity.
2. The entire issue process becomes transparent to the public and the authorities.

Private Placement in India

The position of private placement in India is witnessed from the following table.

(₹ in billion)

Table 3

Sector	2014-15		2015-16	
	No. of Issues	Amount	No. of Issues	Amount
1. Private Sector	2436	2,770.18	2488	2,578.05
(a) Financial	1901	1,838.42	1991	1,842.10
(b) Non-Financial	535	931.76	497	737.95
2. Public Sector	220	1,694.66	185	1,505.92
(a) Financial	135	1,349.84	111	1,146.75
(b) Non-Financial	85	344.82	74	359.17
Total	2,656	4,464.84	26273	4,083.97

(Source: Handbook of Statistics, RBI, 2015-16 Table 75)

The RBI report disclosed that although the public issue market for last few years witnessed depressed conditions, corporates were able to mobilise sizeable funds from the private placement market.

D. Initial Public Offers (IPOs) through Secondary Market

The proposal for marketing IPOs through the secondary market was accepted by SEBI in October, 1999. It means SEBI allowed to use the existing infrastructure of stock exchanges for the initial public offers (IPOs).

This system would reduce the time taken to complete an IPO to two weeks. Under the system, brokers are advised to ask to successful allottees to submit the application form after the basis of allocation is finalised. The amount payable is paid through the broker to the clearing house. After that, the clearing house credits the depository account of the investor.

Features

1. The broker will open a separate escrow account for the primary market issue.
2. The broker would place orders on behalf of his clients.
3. After finalisation of share allocation, the broker will advise successful allottees to submit the application form and the amount payable for shares.
4. The clearing house of the exchange will debit the primary issue account of the broker and credit the issuer's account.
5. The certificate will be delivered to investors or their depository account will be credited.

Conditions for Initial Public Offer

The regulation 26 of the SEBI (Issue of Capital and Disclosures) Regulation, 2009 describes the conditions for the IPO. These regulations were amended in 2014. As per these regulations the following conditions apply on IPOs:

(1) An issues can make initial public offer, if

  (a) It has net tangible asset of at least 3 crore rupees in each of the preceding 3 full years. Out of this, more than 50 per cent should be in monetary assets. This conditions of 50 per cent shall not apply if issue is made entirely through an offer for sale.

  (b) It has a minimum average pre-tax operating profit of ₹ 15 crore during the 3 most profitable years out of immediately preceding 5 years.

  (c) It has a net worth of at least 1 crore rupees in each of preceding 3 full years.

  (d) The aggregate of proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed 5 times its pre-issue net worth as per audited balance-sheet of previous year.

  (e) If it has changed its name within the last one year, then at least 50 per cent of revenue for the preceding one full year has been earned by it from the activity indicated by new name.

(2) An issuer not satisfying above conditions may make IPO if issue is made through book building process and issuer undertakes to allot at least 75 per cent of the net offer to public and qualified institutional buyer. He should also undertake to refund full subscription money if he fails to make said minimum allotment to qualified institutional buyers.

(3) An issuer may make an IPO of convertible debt instruments without making a prior public issue of its equity shares and listing thereof.

(4) An issuer shall not make an allotment if the number of prospective allottees is less than 1000.

(5) The issuer shall not make an IPO if there are any outstanding convertible securities or any other right which would entitle any person with any option to receive equity shares. The above sub-regulation shall not apply to:

  (a) a public issue made during the currency of convertible debt instruments which were issued through an IPO and the conversion price of such convertible debt instruments was determined and disclosed in the prospectus.

  (b) outstanding options granted to employees pursuant an ESOP scheme framed in accordance with accounting standards issued by ICAI.

  (c) fully paid-up outstanding convertible securities which are required to be converted on or before the date of filing of the red herring prospectus or the prospectus.

(6) Equity shares may be offered for sale to public if such equity shares have been held by the sellers for a period of at least 1 year prior to filing of draft offer document with the Board. This condition of holding equity shares for 1 year shall not apply in the following cases:

  (a) In case of offer for sale of specified securities of a government company or statutory authority or corporation or any special purpose vehicle set up and controlled by anyone or more of them which is engaged in infrastructure sector.

  (b) If the specified securities offered for sale were acquired under any scheme approved by a High Court under sections 391-394 of the Companies Act, 1956 in lieu of business and invested capital which had been in existence for a period of more than 1 year to such approval;

(iv) **Issue Size:** The aggregate funds that can be raised through QIPs in one financial year sha not exceed five times of the net worth of the issuer at the end of its previous financial year.

(v) **Placement Document:** Issuer shall prepare a placement document containing all th relevant and material disclosures. There will be no pre-issue filing of the placement docume with SEBI. The placement document will be placed on the websites of the Stock Exchange and the issuer, with appropriate disclaimer to the effect that the placement is meant only to QIBs on private placement basis and is not an offer to the public.

(vi) **Pricing:** The floor price of the specified securities shall be determined on a basis similar t that for GDR/FCCB issues and shall be subject to adjustment in case of corporate actions such as stock splits, rights issue, bonus issue, etc.

(vii) **Other procedural requirements:** The resolution approving QIP, passed under sub-sectio (1A) of Section 81 of the Companies Act, 1956 or any other applicable provision, will remai valid for a period of twelve months from the date of passing of the resolution. There shall be a gap of at least six months between each placement in case of multiple placements of specifie securities pursuant to authority of the same shareholders' resolution. Issuer and Mercha Banker shall submit documents/undertakings, if any, specified in this regard in the listing agreement, for the purpose of seeking in principle approval and final permission from Stoc Exchanges for listing of the specified securities.

(viii) **Involvement of Merchant Banker:** QIP shall be managed by a SEBI registered mercha banker who shall exercise due diligence and furnish a due diligence certificate to Stoc Exchanges stating that the issue complies with all the relevant requirements. The mercha banker shall file a copy of the document and post issue details with SEBI within 30 days of the allotment.

Capital Market Instruments

The company raises the long-term sources of finance by issuing new securities in the primary market. These securities can be classified in two categories:

1. Ownership Securities; and
2. Debt Securities

1. Ownership Securities

The shareholders of the company are known as the owners of the company and therefore, the shares (both equity and preference) represent the ownership securities. The details of these are as follows:

A. Equity Shares

The capital of the company can be divided in several parts with a definite value. Each such part is called a share. Upto 1956, the companies used to issue three types of shares, i.e., preference shares, ordinary shares and deferred shares. The Companies Act, 1956 has limited the types of shares only to preference and equity. The various types of shares may be as follows:

(i) **Equity Shares:** Equity or ordinary shareholders are the real owners of the company. It represents risk capital. These shareholders can participate in the management of the company. They also have residual claim on the income and assets of the company. The rate of dividend is determined by directors on the basis of annual profits. If the profits are higher, they will get dividend at higher rates and if profits are less, then they will get dividend at lower rates or they may not get anything. These shares cannot be redeemed during the lifetime of the company. As per amendment made in Companies Act in 1999, the companies have now been allowed to buy back their own shares subject to the regulations laid down by SEBI.

Characteristics of Equity Shares: The characteristics of equity shares are as follows:

(a) **Residual Claim on Income:** Equity shareholders have a residual claim on the income of the company. They have the claim on income only after the payment of preference dividend. If the profits are insufficient to pay the dividends, the directors may skip the equity dividend. Even in the case of sufficient profits, the shareholders cannot legally force the directors to pay dividend. Board of Directors have the right to decide that how much part of the profit is to be distributed as dividends and how much is to be retained in the business.

(b) **Residual Claim on Assets:** The claim of the equity shareholders on the assets of the company is also residual. In case of liquidation, the preference shareholders will be repaid first after paying debts and in the last, the equity shareholders are to be paid off. It may happen that they even do not get anything in case of liquidation.

(c) **Limited Liability:** The liability of the equity shareholders is limited to the amount of shares they have purchased. In case of liquidation, they have the liability to pay if the shares are partly paid-up. If the shares are fully paid-up, they are not liable to pay anything. This provides them a facility to enjoy ownership without unlimited liability.

(d) **Pre-emptive Rights:** Equity shareholders are provided with pre-emptive rights. This right protects their interest in the company. Pre-emptive right means the right to purchase new shares issued by the company. As per Section 81 of the Companies Act, 1956, whenever a company proposes to increase its capital by issue of further shares, it must offer such shares to holders of existing equity shares in proportion of existing shareholdings. Such shares are called as right shares and such right of shareholders is known as pre-emptive right. It protects shareholders from dilution of their financial interest in the company.

(e) **Right to Control:** The equity shareholders have full right to control the company as owners of the company. They enjoy voting rights in the meetings of the company. As such, the company is run by Board of Directors. But they are elected by the equity shareholders. Hence, equity shareholders exercise an indirect control over the working of the company.

B. Preference Shares:

Preference shares are those shares on which shareholders enjoy two preferences over the equity shareholders. These preferences are:

(i) Payment of dividend out of profits; and

(ii) Repayment of capital in case of liquidation.

The preference shareholders do not have any right to participate in the management of the company. All preference shares are redeemable within 10 years. A fixed rate of dividend is paid on these shares. These shareholders do not have any voting right. However, they get the right to vote if their interest is affected by any decision of the company.

Types of Preference Shares

Different types of preference shares are as follows:

An individual, firm or a company can act as underwriter who has obtained certificate of regist from SEBI. Those merchant bankers and stock brokers do not require a separate registration w already registered with SEBI.

Conditions for Registration

SEBI satisfies itself before granting certificate of registration that an applicant:

(i) Has the necessary infrastructure like adequate space and manpower,

(ii) Has past experience in underwriting or has in employment at least 2 persons with expe in underwriting.

(iii) Meets capital adequacy requirement of net worth specified by Stock Exchange in ca broker, and SEBI (Merchant Banker) Regulation 1992 in case of merchant banker, and lakh in case of a body corporate.

(iv) The applicant has not been convicted of an offence involving moral turpitude or found of any economic offence,

(v) Undertakes to fulfil obligations under the SEBI Act, rules and regulations,

(vi) Undertakes to abide by the prescribed code of conduct, and

(vii) Pays the prescribed fee for grant of registration certificate and for its renewal. The fee is 13 33 thousand and 03 hundred rupees and will pay ₹ 5 lakh every 3 years from the 6th from the date of registration.

General Responsibilities of an Underwriter

The major responsibilities of an underwriter are as follows:

(i) Every underwriter shall abide by the code of conduct at all times.

(ii) The underwriter shall not derive any direct or indirect benefit from underwriting the i other than the commission or brokerage payable under the agreement.

(iii) The total underwriting obligations shall not exceed 20 times of the net worth under al agreements.

(iv) Every underwriter shall subscribe the securities within 45 days of the date of information the body corporate, if the issue is not fully subscribed.

(v) Every underwriter will maintain the proper books and records, etc., for a minimum peri 5 years.

Forms of Underwriting

The underwriting may be of following types:

(i) **Full Underwriting:** It is an agreement under which the underwriter gives the guaran buying the whole of shares or debentures issued to the public in the event of non-subscri

(ii) **Partial Underwriting:** If the underwriter undertakes the guarantee for only a part of issue and his liability is limited to that extent, then it is called as partial underwriting.

(iii) **Joint Underwriting:** In case of large issue, the issuing company may enter into an agre with more than one underwriter. Each underwriter undertakes the guarantee for a co portion of the issue. This is known as joint underwriting.

(iv) **Sub-underwriting:** If the underwriter enters into an agreement with some other underwriters to undertake guarantee for the issue of whole or part of the issue underwritten by him, then it is called as sub-underwriting.

(v) **Syndicate Underwriting:** Under this, a number of underwriters enter into an agreement among themselves to undertake the guarantee of buying shares or debentures jointly. In syndicate underwriting, the agreement between the issuing company and the syndicate takes place.

(vi) **Firm Underwriting:** When an underwriter undertakes to buy or subscribe a certain number of shares or debentures irrespective of subscription from the public, it is called firm underwriting. The liability of underwriters in case of firm underwriting is both for shares underwritten and firm underwriting.

3. Banker to an Issue

Bankers to an issue help functioning in primary market by accepting the applications for shares/debentures alongwith application money from investors and also refund of application money to the applicants to whom securities could not be allotted.

A bank can operate as a banker to an issue only after obtaining a certificate of registration from SEBI. It considers the past experience, nature and size of the bank and its overall activities and other conditions for granting such certificate.

Conditions for Registration

For getting the certificate of registration, the following requirements are to be satisfied:

(i) The applicant has the necessary infrastructure, such as, manpower, adequate space, data processing facilities and communication facilities, etc.,

(ii) The applicant or any of its directors is not involved in any litigation connected with securities market,

(iii) Neither applicant nor any of its directors have been convicted of any economic offence,

(iv) The applicant is a scheduled bank,

(v) The grant of certificate of registration is in the interest of investors,

(vi) The applicant pays the registration fee.

SEBI charges an annual fee of ₹ 20 lakh for the first 5 years from the date of initial registration. The renewal fee is ₹ 9 lakh for 3 years.

(vii) If any banker to an issue proposes to change its status or constitution, it shall obtain prior approval of the board.

(viii) It shall enter into a legally binding agreement with the body corporate for or on whose behalf it is acting as banker to an issue.

(ix) It shall take adequate steps for redressal of grievances of the investors within one month of the date of receipt of the complaint.

General Responsibilities

The major obligations of a banker to an issue are as follows:

(i) Each banker to an issue has to enter into an agreement with the issuing company.

5. Conditions of Certificate and Validity Period

(1) The certificate granted shall be subject to the following conditions, namely:

(a) the applicant shall comply with the provisions of the Act, applicable regulations guidelines, directions or circulars issued by the Board from time to time.

(b) any information or particulars furnished to the Board by the applicant shall not be or misleading in any material respect;

(c) where any material information or particulars furnished to the Board by the applicant or in connection with the application for recognition, has undergone change subseque to its furnishing, the applicant shall forthwith inform the fact to the Board in writing

(2) The certificate of recognition shall be valid for a period of 5 years.

6. Renewal of Certificate

(1) Any Self-Regulatory Organisation desirous of obtaining renewal of the recognition granted it, shall make to the Board an application for the renewal of the certificate.

(2) Such application shall be made not less than 3 months before expiry of the period of vali of the certificate.

(3) The application for renewal made shall be accompanied by a renewal fee of ₹ 3 Lacs.

Governing Body

All stock exchanges have their own separate 'Governing Boards'. The governing body of recognised stock exchange has wide governmental and administrative powers. It has the po to make, amend and suspend the operation of the rules, bye-laws, and regulations of the st exchange. It also has complete jurisdiction over all members and in practice it has absolute powe management and control.

These governing boards consist of elected members-directors, public representatives government/SEBI nominees. The government/SEBI has powers to nominate Presidents Vice Presidents of stock exchanges and to approve appointment of chief executive and pu representatives to the governing board. The chief executive exercises control on members inclu their admission, expulsion, adjudication of disputes, imposition of penalties, regulation of market investor protection, etc.

Corporatisation and Demutualisation of Stock Exchanges

Kania Committee submitted a report on corporatisation of stock exchanges on 29th Novem 2002. SEBI approved and accepted the report. A uniform model of corporatisation and demutualis has been approved and adopted for all exchanges. As a result, all the exchanges converted companies and changed their character from a non-profit entity into a profit-one.

Now the brokers have no say in the administration of an exchange in the new arrangem broker now gets only trading rights after paying the fees fixed by the exchange. The shareholde the corporatised exchange have the ownership rights. The shares of an exchange can also be l on other exchanges. SEBI approves the name of all directors including the broker directors. The s exchanges are to have equal representation of brokers, shareholders and the investors.

Corporatisation and demutualisation of stock exchanges have been defined under Section 2 (aa) and Section 2 (ab) Securities Contract (Regulation) Act, 1956 as follows:

"Corporatisation" means the succession of a recognised stock exchange, being a body of individuals or a society registered under the Societies Registration Act, 1860 (21 of 1860), by another stock exchange, being a company incorporated for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities carried on by such individuals or society;

"Demutualisation" means the segregation of ownership and management from the trading rights of the members of a recognised stock exchange in accordance with a scheme approved by the Securities and Exchange Board of India.

As per Section 4A, on and from the appointed date, all recognised stock exchanges shall be corporatised and demutualised in accordance with the provisions contained in Section 4B.

Procedure for Corporatisation and Demutualisation (Section 4B)

(1) All recognised stock exchanges shall, submit a scheme for corporatisation and demutualisation for its approval within such time as may be specified by the Securities and Exchange Board of India.

(2) On receipt of the scheme, the Securities and Exchange Board of India may, after making such enquiry as may be necessary in this behalf and obtaining such further information, if any, as it may require and if it is satisfied that it would be in the interest of the trade and also in the public interest may approve the scheme with or without modification.

(3) No scheme under sub-section (2) shall be approved by the Securities and Exchange Board of India if the issue of shares for a lawful consideration or provision of trading rights in lieu of membership card of the members of a recognised stock exchange or payment of dividends to members have been proposed out of any reserves or assets of that stock exchange.

(4) Where the scheme is approved under sub-section (2), the scheme so approved shall be published immediately by—

(a) the Securities and Exchange Board of India in the Official Gazette;

(b) the recognised stock exchange in such two daily newspapers circulating in India, as may be specified by the Securities and Exchange Board of India.

(5) Where the Securities and Exchange Board of India is satisfied that it would not be in the interest of the trade and also in the public interest to approve the scheme under Sub-section (2) it may, by an order, reject the scheme and such order of rejection shall be published by it in the Official Gazette.

(6) The securities and Exchange Board of India may, while approving the scheme under Sub-section (2), by an order in writing, restrict—

(a) the voting rights of the shareholders who are also stock brokers of the recognised stock exchange;

(b) the right of shareholders or a stock broker of the recognised stock exchange to appoint the representatives on the governing board of the stock exchange;

(c) the maximum number of representatives of the stock brokers of the recognised stock exchange to be appointed on the governing board of the recognised stock exchange, which shall not exceed one-fourth of the total strength of the governing board.

5. **Government Policy:** The government policy also influence the prices on stock exchang If government adopts a favourable policy, the market will be bullish and if the governme policies are adverse, then the market will be in the grip of bears. The recent example of t the exemption of dividend from the tax liability of the investor.

6. **Interest Rates:** Prevailing interest rates in the country also affects the prices of shares. T high interest rates attracts the money towards money market and therefore, the prices o capital market will fall down due to low demand of securities. On the other hand, the lo interest rates increases the flow of money in the capital market. Due to increased sources o money, the demand of securities increases and as a result, the prices increase.

7. **Trade Cycle:** The trade cycle also operates in the capital market. The various stages a influence share prices like other industries. The increase in prices could be seen in the boo period. The depression stage brings stagnation in growth and prices of shares go down. The tra cycle stages in the capital market are called as bull stage (boom) and bear stage (depression

Types of Speculators

Four types of speculators could be witnessed on the Indian bourses. They are bull, bear, sta and lame duck. These names are chosen from the animal world denoting the nature and working speculators. A brief description of these is as follows:

1. **Bull:** Bull's are also known as Tejiwala. He is an operator who expects a rise in prices securities in the future. He makes purchases in anticipation of a price rise and with the intenti to sell at higher prices. He has no intentions to take delivery of shares as he is the speculat He buys only for reselling and earning profits by way of difference in prices. His behavio matches with the behaviour of a bull that throws its victims up in the air. Here Tejiwala thro prices up in the market by purchasing securities in bulk quantity. This type of market is kno as bullish and optimism prevails in the market. Entry of new investors is a prominent featu of it because of expectation of earning higher profits.

2. **Bear:** A bear presses its victims down to the ground. Likewise, the bear in the capital ma brings down the prices of the securities. These speculators are also famous as Mandiwa They expect the prices to fall in the future and therefore, start selling at current prices wit view to repurchase them at lower rates. In this case, the pessimism prevails in the market. If t prices come down as per the expectations of the bear, he earns profits by way of differen On the other hand, if the prices increase in the future, he has to pay the difference. He is c a speculator and not the investor, therefore, he does not take the delivery of shares. A bear c also sell the securities without owning them. This is known as short selling. In case, the pr do not fall as per expectation, they may float negative rumours in the market to bring pr down. The market where prices are falling down is known as bearish market.

3. **Stag:** The nature of a Stag is cowardice. It tries to move cautiously and safely. Likewise stag speculator remains cautious in the stock exchange. He does not involve himself in sel and purchasing of securities in the market like bull and bear. He relies only in applying for n shares and sells them at a premium if he gets an allotment. He sells the shares before b called to pay the allotment money.

   He applies for large number of shares so that he could get some shares even in the case of subscription. Generally, he selects those companies whose shares are in more demand and likely to be sold at higher rates in the market.

4. **Lame Duck:** It is the second form of a bear. When a bear is unable or feels difficulty in fulfilling his commitment, he is called struggling like a lame duck. As mentioned above, a bear sells the securities at current levels for repurchasing at lower levels. But sometimes it happens that prices do not fall. In that situation he is not able to get the securities from the market and on the other hand the buyer refuses to carry over the transaction.

Provisions Related to Stock Exchanges

(1) Recognition of Stock Exchanges: A stock exchange, which is desirous to be recognised under SC (R) Act and SEBI, has to meet certain requirements regarding procedure for application, constitution, laws and bye-laws, rules and regulations, filing of periodical returns, etc.

- **(i) Application for Recognition of Stock Exchanges:** A stock exchange willing to be recognised under SC(R) Act has to make an application in the prescribed manner to the Central Government. The application should be accompanied by a copy of bye-laws and a copy of the constitution, powers of management, powers and duties of office bearers, admission of various classes of members, qualification of membership, exclusion, suspension, expulsion and readmission of members, etc.

- **(ii) Grant of Recognition to Stock Exchanges:** The Central Government may grant recognition if it is satisfied:
  - (a) that the rules and bye-laws of the stock exchange ensure fair dealing and protect investors.
  - (b) that the recognition would be in the favour of the trade and also in the public interest, and
  - (c) that the stock exchange is willing to comply with the conditions which the Central Government imposes for the purpose of carrying out the object of the Act.

  Conditions: The Central Government may also impose certain conditions for the grant of stock exchanges. These may be:
  - (a) the qualifications for membership of stock exchanges.
  - (b) the manner in which contracts shall be entered into and enforced as between members.
  - (c) the representation of the Central Government on the stock exchange by such number of persons not exceeding 3.
  - (d) the maintenance of duly audited accounts of members.

- **(iii) Corporatisation and Demutualisation of Stock exchanges:** All the stock exchanges shall be corporatised and Demutualised in accordance with the provisions contained in Sec 4B of SC (R) Act.

- **(iv) Withdrawal of Recognition:** The Central Government may withdraw the recognition of a stock exchange if it is of the opinion that such recognition is against the interest of the trade or investors. But the government will give the opportunity to the governing body of the exchange to explain its position before the withdrawal of the recognition.

(b) Counterfoils or duplicates or contract notes issued to clients.

(c) Written consent of clients in respect of contracts entered into as principals.

(9) **Submission of Reports and Returns:**

(A) **Every recognised stock exchange** has to furnish the Central Government annual a report about its activities during the preceding year by 30th September each year. Th report must contain the detailed information about the following:

- (i) changes in rules and bye-laws (if any).
- (ii) changes in the composition of the governing body.
- (iii) any new sub-committees set-up and changes in the composition of existing one
- (iv) admissions, re-admissions, deaths or resignation of members.
- (v) securities listed and delisted.
- (vi) securities brought on or removed from the forward list.
- (vii) defaults.
- (viii) action taken to combat any emergency in trade.
- (ix) disciplinary action against members.
- (x) arbitration of disputes between members and non-members.

(B) **Every recognised stock exchange** also has to furnish the following returns periodical

- (i) the official rates for the listed securities.
- (ii) the number of shares delivered through the clearing house.
- (iii) the making up prices.
- (iv) the clearing house programmes.
- (v) the number of listed and delisted securities in the previous quarter.
- (vi) the number of securities brought on or removed from the forward list during t previous quarter.

(10) **Regulatory Fees:** As per SEBI (Regulatory Fee on Stock Exchanges) Regulations, 20 every stock exchange in India has to pay the regulatory fee to SEBI with effect from, Janu 1, 2007.

A recognised stock exchange having an annual turnover mentioned in column 2 of t following table shall pay the amount mentioned in the corresponding entry in column 3 of t table within 30 days of the conclusion of the relevant financial year.

Table 1

S.No. (1)	Annual Turnover (₹ in Crore) (2)	Amount of Fee (₹) (3)
1.	Less than or equal to 10,000	1,00,0
2.	More than 10,000 but less than or equal to 1,00,000	10,00,0
3.	More than 1,00,000 but less than or equal to 5,00,000	50,00,0
4.	More than 5,00,000 but less than or equal to 10,00,000	1,00,00
5.	More than 10,00,000	1,00,00,000 plus .00006% of an turnover in excess of ₹ 1,00,00,000 sub to maximum of ₹ 2,00,0

(Source: SEBI Website)

Listing of Securities

Listing of Securities on a recognised stock exchange means that they are admitted by the exchanges for its purchase and sale. According to Section 40 of the Companies Act, 2013, every company which intends to offer shares or debentures to the public for subscription, has to make an application to the recognised stock exchange for their listing. However, it is not obligatory for companies to make public issue of its securities.

The SEBI in March, 2001 has allowed all the companies to issue debt securities to the public without listing equity. Prior to the amendment, this facility was available only to the infrastructure companies and municipal corporations. However, this has been allowed only for investment grade securities.

Central Listing Authority (CLA) is being set up in November 2002. It has the representatives of regional exchanges. The authority lays down the standard listing process and carries out the due diligence of a company to be listed. The responsibility of updating the listing norms also lies with the CLA. The CLA updates the list after taking into consideration the internal and external developments.

Objectives of Listing

The main objectives of listing are as follows:

1. To protect the interest of shareholders and the investors.
2. To ensure proper supervision and control of dealings in securities.
3. To ensure liquidity of securities.
4. To regulate dealings in securities.
5. To provide marketing facilities for the securities.
6. To avoid concentration of economic power in few hands.

Central Listing Authority

The listing requirements differ from exchange to exchange. SEBI has initiated steps for setting-up of a central listing authority which would accord approval. This approval would enable all the stock exchanges to list the securities at an early date. The Central Listing Authority (CLA) is acting as a check on the fly by night operators who float public issues. Central Listing Authority has two primary roles–Laying down standard listing processes and Carrying out the due-diligence of a company to be listed. CLA has also the responsibility to update the listing norms depending upon the internal and external environmental developments. SEBI has made Central Listing Authority Regulations, 2003 for bringing CLA into effect. The CLA is repealed by the SEBI by issuing notifications in this regard on 2nd January, 2007.

Listing Requirements or Norms for Qualifying for Listing

(1) **Listing Requirements:** The Securities Contracts (Regulation) Act has made listing of companies compulsory. As per bye-laws and regulations of SC (R) Rules, 1957 and guidelines issued by Securities and Exchange Rules, a company must comply with the following in order to get its shares listed on any recognised stock exchange:

- (i) The Memorandum and Articles of Association must not contain any provisions that restrict free transfer of shares.
- (ii) The company must offer for public subscription at least 25 per cent of its issued capital.

(iii) The minimum issued capital of the company should be at least ₹ 10 crore in case of and NSE and ₹ 5 crore in case of other exchanges.

(iv) No previous track record is necessary.

(2) Listing Norms: Following are the norms for qualifying for listing:

(i) **Minimum Issued Capital and Minimum Public Offer:** The minimum pos paid-up capital of the company shall be ₹ 10 crore for IPOs & ₹ 3 crore for FPOs an minimum size shall be ₹ 10 crore and the minimum market capitalisation of com shall be ₹ 25 crore.

(ii) **Minimum Public Shareholding:** The minimum public shareholding 25 per cent be maintained.

(iii) **Listing on More Than one Exchange and on Regional Exchanges:** E company has to get itself listed on more than one stock exchange including comp listing on regional stock exchange.

(iv) **Cost of Public Issue of Capital:** The listing of old companies will continue an new companies will be considered for listing only if they adhere to the norms and c in expenditure of public issues.

(v) **Undertaking Regarding Restriction on Transfer of Shares from Promo Quota:** The auditors or practising company secretary of the company applying for l have to certify that the share certificates have been stamped and the restrictions years have been imposed on the transfer or hypothecation of shares from prom quota.

(vi) **Corporate Governance Must for Listing:** The new companies have to enter in agreement with the stock exchange regarding corporate governance, if they wish t listed on stock exchange. All existing listing companies will also have to adhere to the code, otherwise they will be delisted.

(vii) **Compulsory Provisions in Articles of Association:** The Articles of Assoc of a company must have the following provisions, if it wishes to be listed on the s exchange:

(a) that the company shall use a common form of transfer.

(b) the fully paid shares will be free from all lien.

(c) that option or right to call of shares shall not be given to any person except wi anction of the company in general meeting.

(d) that any amount paid-up in advance of call on any share may carry intere shall not entitle the holder of the share to participate in respect thereof in a div subsequently declared.

(e) that there will be no forfeiture of unclaimed dividends before the claim be barred by law.

(3) Other Conditions: In addition to the above, an existing company has to satisfy the follo conditions also prior to listing:

(i)(a) that letters of allotment, acceptance and letters of regret will be issued simultan at same time.

(b) that letters of allotment, acceptance or rights will be serially numbered, printed on good quality paper and signed by a responsible officer of the company.

(c) that letters of rights will be issued simultaneously.

(d) that letters of allotment and renounce able letters of rights will contain a provision for splitting and the form of renunciation will be printed on the back of letters.

(ii) To issue certificates in respect of shares or debentures lodged for transfer within a period of one month of the date of lodgement of transfer.

(iii) To advise the stock exchange of the date of the board meeting at which the declaration or recommendation of a dividend or the issue of right or bonus share will be considered.

(iv) To notify the stock exchange of any material change in the general character or nature of the company's business.

(v) To forward to the stock exchange copies of statutory and annual reports and audited accounts as soon as issued including director's report.

(vi) To forward to the stock exchange copies of all other notices and circulars sent to the shareholders.

(vii) To notify the stock exchange prior to intimating the shareholders of any new issue of securities whether by way of right, privilege, bonus or otherwise.

(viii) To notify the stock exchange in the event of re-issue of any forfeited securities or the issue of securities held in reserve for future issue.

(ix) To notify the stock exchange of any other alteration of capital including calls.

(x) To close the transfer books only for the purpose of declaration of dividend or issue of right or bonus shares or for such other purposes as the stock exchange may agree and after due notice and sanction.

(xi) To forward to the stock exchange an annual return immediately after each annual general meeting of ten principal holders of each class of securities of the company.

(xii) To grant to shareholders the right of renunciation in all cases of issue of rights, privileges and benefits and to allow them reasonable time for exercise of such right.

(xiii) To intimate the stock exchange any other information necessary to enable the shareholders to appraise the position of the company.

(xiv) That in the event of the application for listing being granted, such listing shall be subject to the rules and bye-laws of the exchange in force from time to time.

Listing Norms for Unlisted Companies

On August 12, 1997 SEBI issued the following entry norms for unlisted companies:

1. Unlisted companies should have paid dividend in immediately preceding three years before public issue.
2. An unlisted company can freely price its securities provided it has shown net profits in the immediately preceding three years.
3. A listed company would be required to meet the entry norms only if the post-issue net worth becomes more than five times the pre-issue net worth.

has received or has had access to such unpublished price sensitive information. Unpublished p sensitive information means any information which relates to the following matter:

(i) financial results of the company;
(ii) intended declaration of dividends;
(iii) issue of shares by way of public rights, bonus, etc.;
(iv) any major expansion plans or execution of new projects;
(v) amalgamation, mergers and takeovers;
(vi) disposal of the whole or substantially the whole of the undertaking;
(vii) such other information as may affect the earnings of the company;
(viii) any change in policies, plans or operations of the company.

Connected persons may be the director, officer or employee of the company or a person dee to be director of the company or a person having business or professional relationship wit company.

Objectives of Insider Trading

Insider trading may be attempted to:

(i) benefit the company through unethical purchase and sale of the company's shar withholding price sensitive information, and/or
(ii) benefit the individual indulging in this unethical practice.

Categories of Insiders

Broadly, the investors can be divided in the following categories:

1. **Primary Insiders:** They are directors, stock exchanges, merchant bankers, registrars, in of the company, top executives, auditors, banks, etc.
2. **Secondary Insiders:** These are dealers, agents, other employees, etc.
3. **Other Insiders:** These are the persons which are having access to price sensitive informa due to their proximity with the company.

Prohibition

It has been laid down that no insider shall:

1. deal in securities of a company listed on any stock exchange on the basis of any unpubli price sensitive information either on his own behalf or on behalf of any other person;
2. communicate any unpublished price sensitive information to any person, except as ap in the ordinary course of business or under any law; or
3. counsel or procure any other person to deal in securities of any company on the ba unpublished price sensitive information.

Action by SEBI

SEBI can order for investigation and inspection of the books of accounts, other record cuments of an insider. After receiving the investigation report, communicating with the insid ing him an opportunity for explanation, SEBI may:

1. initiate criminal prosecution against the insider, and/or

2. give necessary directions to insiders for protecting the interest of investors and the securities market, and for due compliance with the provisions of the SEBI Act, Rules and Regulations. These may relate to:
   (i) directing the insider not to deal in securities in any particular manner;
   (ii) prohibiting the insider from disposing of any of the securities acquired in violation of these regulations;
   (iii) restraining the insider to communicate or counsel any person to deal in securities.

Trading Regulations 2015

These regulations are called the SEBI (Prohibition of Insider Trading) Regulations, 2015. The main regulations are:

1. **Connected Persons:** The persons falling within the following categories shall be deemed to be connected persons:
   (a) an immediate relative of connected persons; or
   (b) a holding company or associate company or subsidiary company; or
   (c) an intermediary or an employee or director thereof; or
   (d) an investment company, trustee company, asset management company or an employee or director thereof; or
   (e) an official of a stock exchange or of clearing house or corporation; or
   (f) a member of board of trustees of a mutual fund or a member of the board of directors of the asset management company of a mutual fund or is an employee thereof; or
   (g) a member of the board of directors or an employee, of a public financial institution as defined in section 2 (72) of the Companies Act, 2013; or
   (h) an official or an employee of a self-regulatory organization recognised or authorized by the Board; or
   (i) a banker of the company; or
   (g) a concern, firm, trust, Hindu undivided family, company or association of persons wherein a director of a company or his immediate relative or banker of the company, has more than ten per cent of the holding or interest;
2. **Communication Or Procurement Of Unpublished Price Sensitive Information:** No insider shall communicate, provide, or allow access to any unpublished price sensitive information, relating to a company or securities listed or proposed to be listed to any person.
3. **Trading When In Possession Of Unpublished Price Sensitive Information:** No insider shall trade in securities that are listed or proposed to be listed on a stock exchange when in possession of unpublished price sensitive information:
4. **Trading Plans:** An insider shall be entitled to formulate a trading plan and present it to the compliance officer for approval and public disclosure pursuant to which trades may be carried out on his behalf in accordance with such plan. Such trading plan shall:
   (i) not entail commencement of trading on behalf of the insider earlier than six months from the public disclosure of the plan;

(ii) not entail trading for the period between the twentieth trading day prior to the last day o any financial period for which results are required to be announced by the issuer of th securities and the second trading day after the disclosure of such financial results;

(iii) entail trading for a ,period of not less than twelve months;

(iv) not entail overlap of any period for which another trading plan is already in existence;

(v) set out either the value of trades to be effected or the number of securities to be trade along with the nature of the ,trade and the intervals at, or dates on which such trade shall be effected.

(vi) not entail trading in securities for market abuse.

5. **Code of Fair Disclosure:** The board of directors of every company, whose securitie are listed on a stock exchange, shall formulate and publish on its official website, a code o practices and procedures for fair disclosure of unpublished price sensitive information that would follow in order to adhere to each of the principles set out in these regulations, withou diluting the provisions of these regulations in any manner.

Factors Contributing to the Growth of Capital Market in India

Following factors contributed to the growth of secondary market in India:

(1) **Establishment of Development Banks and Industrial Financing Institutions:** Th government has established various development banks and industrial financing institutio like IFCI, IDBI, IRCI, SFCs, SIDCs, LIC and UTI, etc. These financial institutions a development banks have contributed to the growth of capital market in India by advanc finance for the establishment of industrial units.

(2) **Legislative Measures:** The government also enacted various Acts and made several ru and regulations for the protection of investors. The protection of the investors through vari measures has led to the healthy growth of the capital market in India.

(3) **Growth of Underwriting Business:** The underwriting business in India has been grow rapidly mainly due to the growth of financial institutions and commercial banks. Th underwriting provides guarantee to the enterprises regarding subscription of shares. Th ensured the increase of NIM in India.

(4) **Setting up of SEBI:** The Securities and Exchange Board of India (SEBI) was set-up 1988 and was given statutory recognition in 1992. The board was established to creat environment which would facilitate mobilisation of adequate resources through the securi market and its efficient allocation.

(5) **Growing Public Confidence:** Thanks to the reforms initiated by the government in 199 which have increased the interest of small investors in the stock markets. The small investo who earlier shed away from the securities market and trusted traditional modes of investm showed increased preference in favour of shares and debentures. The cheerful performa of many companies has further boosted their confidence.

(6) **Credit Rating Agencies:** At present, 4 credit rating agencies are operating in India. Th are CRISIL (The Credit Rating Information Services of India Ltd.) which was set up in 19 ICRA Ltd. (The Investment Information and Credit Rating Agency of India Ltd.) was set u 1991 and CARE (Credit Analysis and Research Limited) was set up in 1993 and Fitch Ra Agency Ltd. These agencies have been providing guidance to investors for determini

credit risk associated with a debt instrument by rating them. This is likely to help in the healthy development of the capital market in future.

(7) **Increasing Awareness of Investment Opportunities:** The last few years have witnessed increasing awareness of investment opportunities among the general public. Business newspapers and journals, like The Economic Times, The Financial Express, Business World, Business Today and Fortune India, etc., have made the people increasingly aware of new long-term investment, opportunities in the primary and secondary markets.

Major Problems or Defects of Secondary Market

The Indian Secondary Market is suffering from certain defects. These are:

(1) **Weak Management of Stock Exchanges:** The management of stock exchanges is weak and deficient in India. The Indian stock exchanges are governed by the member-brokers for their own benefit. The Executive Director has also failed to perform his regulatory functions freely as he is also responsible to the governing body.

(2) **Lack of Integration:** There are 23 stock exchanges in India which are scattered throughout the country. But these exchanges lack in integration. Due to lack of integration among the stock exchanges, the prices of securities vary considerably between different markets at the same time.

(3) **Arbitrary Classification of Specified and Non-specified Shares:** The Indian stock exchanges have been following an arbitrary practice of classifying listed shares into specified and unspecified groups. This type of arbitrary categorisation favours artificial encouragement to a few large companies and promotes speculation in it.

(4) **Ignoring Investors' Interest:** The Indian stock exchanges are ignoring the genuine interests of investors. Complaints made by investors remain uncared and unattended.

(5) **Domination of Financial Institution:** Indian capital market is dominated by financial institutions and big operators. UTI, LIC, GIC, ICICI and 3-4 big operators are the main players in Indian stock markets. Transactions done by these institutions set the trend in the market. If these institutions buy the stocks, the market gets bullish and on the reverse side, the market becomes bearish because of selling by them. Individual investor has no say in the stock market.

(6) **Poor Liquidity:** The Indian stock exchanges suffer from poor liquidity. A small number of stocks are traded everyday and most of the times, thin volumes can be seen at the stock exchanges. Now the volumes increasing due to more and more foreign financial institutions are investing in India.

(7) **Less Floating Stocks:** Scarcity of floating stocks in the Indian stock exchanges is another reason of their weaknesses. The shares and debentures offered for sale are a small portion of total stock. Financial institutions do not offer the scrips they have purchased for sale. It creates shortage of floating stocks.

Reforms in Capital Market

1. The Depositories Act, 1996 was enacted in July 1996 and SEBI (Depositories and Participants) Regulations, 1996 were notified.
2. Stock exchanges asked to modify the listing agreement to provide for payment of interest by companies to investors from the 30th day after the closure of a public issue.

3. The promoter's contribution for public issues has been made uniform at 20 per cent irrespec of the issue size.
4. Only the body corporates are allowed to act as merchant bankers.
5. Companies are allowed to buy-back the shares.
6. Rolling settlement in respect of demat shares was started.
7. Trading of specified shares in dematerialised form was started.
8. SEBI (Acquisition of Shares and Takeovers) Regulations, 1997 issued.
9. Derivatives trading was started in June 2000.
10. Compulsory trading of shares of all companies listed in stock exchanges in demat form w effect from 2nd January, 2002.
11. Derivatives trading was extended to trading in equity to index options, stock options and st futures.
12. Investor Education and Protection Fund was established with effect from 1 October, 2001
13. All scrips included in the ALBM/BLESS or MCFS in any stock exchange or in BSE 200 were brought under rolling statement with effect from July 2, 2001.
14. Restriction on short selling have been withdrawn with effect from July 2, 2001.
15. Stock exchanges were allowed to use the Settlement Guarantee Funds (SGFs) for mee shortfalls caused by non-fulfilment/partial fulfilment of obligations by members.

Recommendations of R.H. Patil Committee Report on Corporate Bonds and Securitisation

Corporate debt in India suffers from certain shortcomings: investment cult is confined to b cities; corporate debt market is lesser developed as compared to G-sec market; small issuer b major issuance of corporate papers is through private placements with scanty disclosures; corp debt market does not have a structured clearing and settlement mechanism in place. Addressing above mentioned issues, a high-level committee headed by Shri R.H. Patil gave the following r recommendations:

- The stamp duty on partly secured (including partly secured by registered mortgage) unsecured debentures should be made uniform across all States and be linked to the ten the securities, with an overall cap;
- TDS rules for corporate bonds should be similar to the ones applicable to Governm Securities;
- In order to incentives corporates to raise a part of their requirements through bonds, the and cost for public issuance and the disclosure and listing requirements for private plac should be reduced and made simpler;
- Banks should be allowed to issue bonds of maturities of over 5 years for Asset-Lia Management (ALM) purpose and not only for the infrastructure sector as at present;
- A suitable framework needs to be put in place that incentives efficient market-making considers support mechanisms that market-makers need for this purpose, including pe to undertake repos in corporate bonds;

- For unlisted companies issuing bonds to institutional investors/Qualified Institutional Buyers (QIB), rating rationale should form the basis of listing;
- SEBI should issue suitable guidelines for providing wide dissemination of information/reports including compliance reports filed by companies and debenture trustees, defaults, if any, and all other relevant information that are required to be brought to the knowledge of the investors;
- The scope of investment by provident/pension/gratuity funds and insurance companies in corporate bonds should be enhanced and rating should form the basis of such investments rather than the category of issuers;
- Retail investors should be encouraged to participate in the market through stock exchanges. Such investors should also be encouraged to participate in the corporate bond market through mutual funds;
- There should be a guideline limiting the number of fresh issuances that would include re-issuance of the existing bonds by a corporate in a given time period (say over a quarter);
- The immediate creation of a centralised database of all bonds issued by corporates is an absolute necessity. This database should also track rating migrants;
- There is a need to develop a transparent and efficient secondary market for corporate bonds, incorporating the global best practices and systems to the extent they are relevant and consistent with the Indian securities market. SEBI, being charged with the responsibility of development and regulation of corporate bonds market, should provide the necessary regulatory framework;
- Steps should be taken to immediately establish a system to capture all information related to trading in corporate bonds as accurately and as close to execution as possible, and disseminate it to the entire market in real time;
- The clearing and settlement of trades in this market must follow the International Organisation of Securities Commission (IOSCO) standards and the global best practices by way of well established clearing and settlement procedures through recognised clearing and settlement agencies;
- In order to improve secondary market trading, repos in corporate bonds may be permitted by RBI to be operated by the proposed clearing entities for corporate bonds;
- As market participants gain experience with trade reporting and the first phase of clearing and settlement systems, efforts should be made to develop online order matching platforms for corporate bonds. Such trading platforms can be set-up by the stock exchanges or jointly by regulated institutions like banks, financial institutions, mutual funds, insurance companies, etc. SEBI would frame specific guidelines for setting up such trading platforms. Any platform, other than the one offered by a stock exchange would effectively be performing the functions of an exchange to a limited extent and as such would need the specific approval of SEBI;
- Currently, the interest rate derivatives market is confined to the over-the-counter (OTC) market with only a handful of participants. Large corporates are active participants in this market. There is no mechanism for dissemination of trades and prices. Steps may be taken to introduce reporting system in the market and ensure real time dissemination of information. Simultaneously steps may be taken to immediately introduce the revised and approved exchange traded derivative products which have been pending for a long time.

5

OTCEI and NSE

Introduction

There are 23 recognised stock exchanges in India. Setting up of OTCEI and NSE is a signific step in the direction of promoting secondary market by spreading securities dealings in every cit the country. Stock exchange operations started from Bombay and for a long time remained limite metropolitan cities only. But now these 23 exchanges are situated in different states. Thus, securi trading is coming closer to the investors. By the setting up of OTCEI and NSE, the investors acr the country have now better access to securities market. The stock exchanges in India played a v role in capital formation in the country. The stock exchanges are providing a variety of services to t investors and therefore, growing as public service institutions.

OTCEI

Over the Counter Exchange of India (OTCEI) was incorporated in October, 1990 under t Companies Act, 1956. It became operational in 1992. It was promoted by consortium of prem financial institutions like, IDBI, ICICI, IFCI, LIC, GIC and its subsidiaries, UTI, etc. It is a recogni stock exchange under the Securities Control (Regulation) Act, 1956. It was the first stock exchang India which started screen-based trading system. The companies listed on OTCEI cannot be listed any other recognised stock exchanges in India. But those securities will enjoy the same listing statu available to companies listed on any other recognised stock exchange in India.

OTCEI has opened 25 representative offices in all major cities of the country. It entered int Memorandum of Understanding (MoU) with the National Association of Securities Dealers Autom Quotation (NASDAQ) for enhanced co-operation between the two exchanges in February, 19 OTCEI aimed at creating a fully decentralised and transparent market. The OTCEI was started w the objective of providing a market for the smaller companies who could not afford the listing fe large exchanges.

Over the counter means trading across the counter in scrips. The location of member or d where the deal or trade takes place refers to counter. Every counter is treated as a trading floor f OTCEI where the investors can buy or sell the securities. The trading takes place by putting bu sell orders by telephone, telex, letter, oral message, etc.

Objectives of OTCEI

The objectives of OTCEI are as follows:

1. To provide quicker liquidity to investors;
2. To make available the securities at fixed and fair prices to small investors;
3. To provide liquidity to a less traded security or that of a smaller company;
4. To simplify the process of buying and selling;
5. To create the public interest in risky but viable ventures;
6. To make available the easy and cheaper means of making public sale of new issues;
7. To list the securities of those companies who could not afford the listing fees of the large exchanges and did not fulfil the minimum requirement for listing.

Features of OTCEI

The salient features of OTCEI are as follows:

(1) **Nationwide Trading:** OTCEI has nationwide network. The securities listed on OTCEI can be traded across the country through centres in different cities.

(2) **Ringless Trading:** The OTCEI has no trading ring or hall. The dealers or brokers transact through a computer connected with the central OTC computer.

(3) **Compulsory Investor Registration:** An investor has to get registered himself by submitting an application at any counter of the OTCEI. Only after getting the 'INVESTOTC Card,' the investor can buy or sell shares on OTCEI.

(4) **Transparent Trading:** The trading on OTCEI is done in a transparent manner through computers. The investor can see the buy and sell rates with his own eyes on computers.

(5) **Transfer by Counter-receipt:** The investors have to submit a counter-receipt for transfer of shares at any of the OTCEI counters. If the consolidated holding of an investor is within the limit of 0.5 per cent of the issued capital of the company, then the shares will be automatically transferred in his name.

(6) **Exclusive Listing:** Initially, the companies listed on OTCEI were not allowed to be listed on any other exchange. But later on, this provision was relaxed.

(7) **Only Authorised Dealers:** Only the dealers authorised and approved by OTCEI can deal on it.

(8) **Trading in Unlisted Equity Shares:** The SEBI has allowed trading of equity shares of all unlisted companies on the OTCEI in pursuance of Dave Committee's recommendations to boost the business volume of OTCEI. Such trading provides an opportunity to make the stocks liquid and tradeable.

(9) **Trading in Futures and Options and Forward Contract on Stock, etc.:** On the basis of recommendations of Dave committee's report, the SEBI allowed the trading of instruments, like futures and options, forward contracts on stocks, other forms of forward transactions and stock lending.

(10) **Sponsorship:** The companies sponsored by members of OTCEI are listed on the exchange. The companies that seek listing on the OTCEI have to approach one of the members appointed by OTCEI for acting as the sponsor to the issue. The sponsor appraises the project. Investors are benefited by this as it enhances the liquidity of the scrips listed on the OTCEI.

Listing at OTCEI

Listing Requirements

(a) A company should have a minimum paid-up capital of ₹ 30 lakh and the minimum offe the public should be 25 per cent of the issued capital or ₹ 20 lakh worth of shares in fac value, whichever is higher. Guidelines on Disclosure and Investor Protection will be applicab to all OTCEI issues.

(b) Every company that intends to get listed has to be sponsored by a merchant banker (membe sponsor) of the exchange. The sponsor of the issue must arrange for market makers to gi buy and sell quotes in the securities for an initial period of 18 months.

(c) Relaxation in Listing Norms as Compared to Other Stock Exchanges.

These are:

Companies that do not fulfil the following conditions are also eligible for listing on OTCEI:

1. 3 year dividend paying record in the last 5 years, and;
2. Appraisal and funding by financial institutions, will be allowed to raise funds by listing o OTCEI, provided they are:
   - (i) Sponsored by a Member/Sponsor of OTCEI.
   - (ii) Appoint at least 2 market makers for continuous liquidity to their shares.
   - (iii) Bought out deals undertaken earlier and all future bought out deals - which may not fu the 3 year dividend record/Financial Institution appraisal and funding criteria.

Qualifying Norms

Along with the above norms, all Public Limited Companies fulfilling the following criteria a eligible to get themselves listed on the OTCEI:

1. Company Valuation

Net Tangible Assets (or)	₹ 1 crore (or)
Market capitalisation (or)	₹ 5 crore (or)
Net Income (in latest fiscal year or 2 of last 3 fiscal years).	₹ 0.25 crore

2. Shareholding

Minimum Total Float (shares)	11,00,000
Minimum Public Float (shares)	5,00,000
Minimum Value of Public Float	₹ 2.50 crore
Minimum Offer to the Public	25 per cent of total paid-up capi
Minimum No. of Shareholders	1,000

3. Market Making

No. of Market Makers	Minimum 2
Duration of Market Making	18 months
Obligation	Mandatory
Market Making Inventory (at the time of public issues)	Graded

4. Company Fact File

Operating History (or)	1 year (or)
Minimum Market Capitalisation	₹ 5 crore
Corporate Governance	Yes
Compliance Standards	No Defaults

5. It is also desirable for the company to have a website.

Additional Requirements for Finance Companies:

For finance companies these additional conditions will also apply:

Registration with RBI as NBFC	Compulsory
Investment Grade Rating	In case of FD or Debenture Issues
Continuous Profitability	Past 3 years
Market Making Inventory	
Principal and Additional Market Maker	10 per cent minimum together
Debt-Equity Ratio	As per RBI guidelines

Continuous Listing Requirements for All

The trading in the equity shares of the company will commence 3 days after the company is listed. Post listing, the company is required to provide a Bank Guarantee of 1 per cent of the issue amount in favour of OTCEI, for complying with continuous requirements.

Bank Guarantee to be valid for a period of 3 years and to be provided prior to refund of security deposit. Once listed, the company would have to continuously fulfil the following criteria after a period of 18 months:

1. Company Valuation

Net Tangible Assets, or	₹ 0.75 crore, or
Market Capitalisation, or	₹ 3.75 crore, or
Net Income (in last fiscal year or 2 of last 3 fiscal years)	₹ 0.15 crore

2. Shareholding

Minimum Total Float (Shares)	8,25,000
Minimum Public Float (Shares)	3,75,000
Market Value of Public Float	₹ 1.90 crore
Minimum Public Offer to the Public	25 per cent of total paid-up capital
Minimum No. of Shareholders	1,000

3. Company Fact File	Not Applicable, or
Operating History	₹ 3.75 crore
Minimum Market Capitalisation	Yes
Corporate Governance	No Defaults
Compliance Standards	

Procedure for Listing

The procedure adopted for the listing of shares at OTCEI is as follows:

1. OTCEI appoints a member as a sponsor for the company's issue. The sponsor appraises the project or company on various aspects, such as technical, managerial, commercial, economical and financial. After appraisal, the sponsor certifies the OTCEI regarding its appraisal.
2. The Sponsor appoints market makers.
3. The sponsor determines the price of shares to be offered to the public, members and dealers of OTCEI.
4. The sponsor after compliance with all SEBI guidelines gets all statutory consents.
5. The sponsor registers the issue with OTCEI for approval and makes the listing application the OTCEI as per rules and regulations.
6. The sponsor submits the notice of issue/offer.
7. After getting the approval, the allotment is made.
8. Once the allotment is over, the equity is listed and trading commences.

Application for Listing

After the completion of the entire process of allotment and refund, the company or the sponsor makes the application for the listing of scrips at OTCEI. The following documents are to be attached with the application for listing:

1. Listing agreement;
2. Certificate from auditor that the allotment letters, counter receipts and advice-cum-refund orders have been mailed;
3. A certificate from the auditor that the allotment has been made as per the basis approved by OTCEI;
4. Company's confirmation that all cheques for brokerage and underwriting commission have directly been posted to members and dealers;
5. A copy of the newspaper announcement giving the basis of allotment as approved by OTCEI and
6. A cheque/demand draft for the listing fee.

Listing Fee

The fee structure for listing is as follows:

Initial Listing Fees	:	₹ 7,500
Annual Listing Fees	:	

Paid-up capital	:	**Amount of Annual Fees**
Up to ₹ 3 crore	:	₹ 7,500/-
₹ 3 crore – ₹ 10 crore	:	₹ 15,000/-
₹ 10 crore – ₹ 20 crore	:	₹ 25,000/-
₹ 20 crore – ₹ 50 crore	:	₹ 40,000/-
₹ 50 crore – ₹ 100 crore	:	₹ 85,000/-
Above ₹ 100 crore	:	₹ 1,000 for every ₹ 10 crore or part thereof the capital

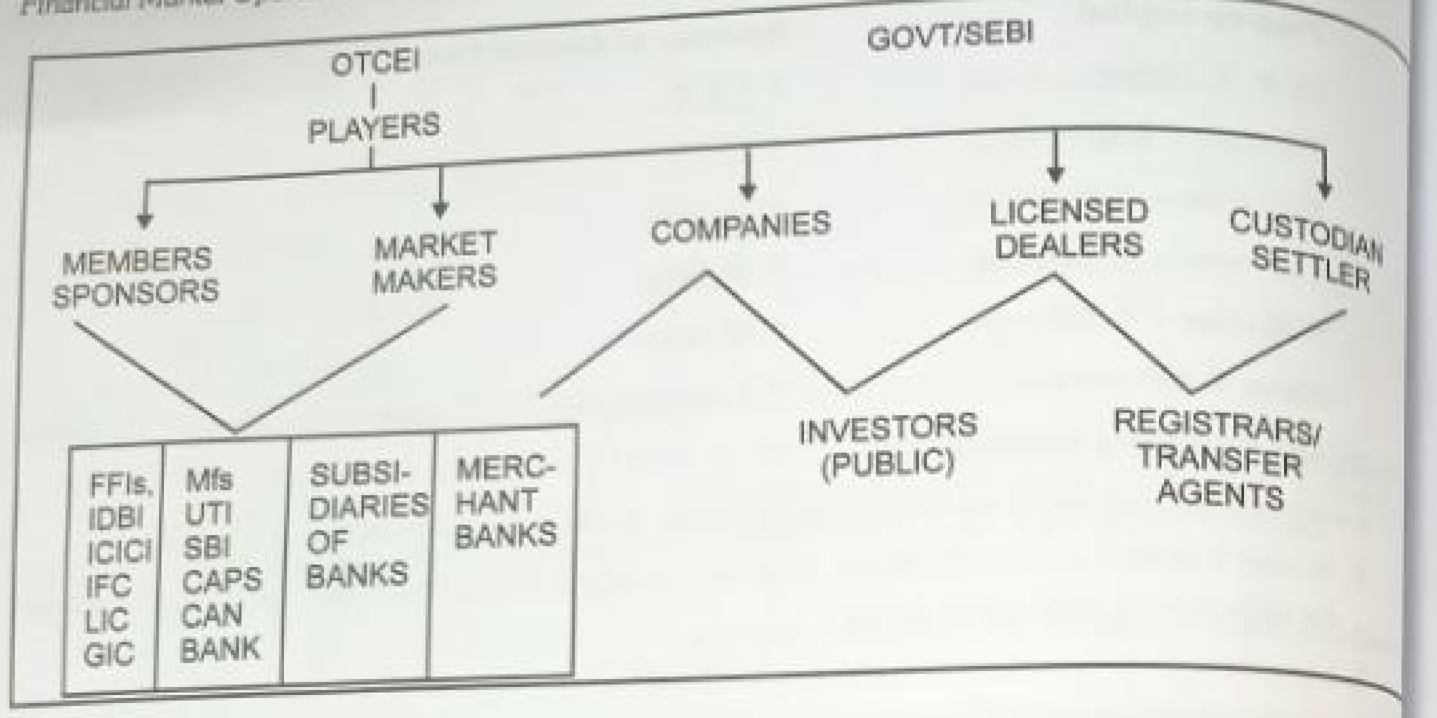
Obligations on the Companies

A company seeking listing on OTCEI has to satisfy the following additional conditions:

1. At least 4 centers each in Northern, Western, Southern and Eastern regions should be opened for collection of application forms.
2. Securities are to be issued in a market lot of 100.
3. A company listed on OTCEI can issue partly paid-up securities only with the special permission of OTCEI.
4. The securities to be issued by the company should be in conformity with the provisions of SC(R) Act, SEBI Act, rules, regulations, etc.
5. The audited accounts for the last 5 years or for a shorter period for which they are available in case of a new company, are to be submitted with OTCEI.
6. In case of a change in the management recently, OTCEI has to be satisfied regarding the requisite expertise of the current management.
7. If the company is not interested in the trading of certain portion of its share capital, then the company has to declare it to the OTCEI.
8. The company has to undertake to process applications for transfer of shares lodged with it or its nominee or agents within 18 days from the date of lodgement including holidays.
9. The company has to authorise OTCEI or any of its nominees or agents to transfer shares called 'small deal'.
10. Listing on OTCEI is permitted only if the company has obtained necessary statutory approvals under MRTP, FERA, etc.
11. Publicity to an issue of security to the public has to be subject to approval by OTCEI.

Players in the OTCEI

Members/dealers, registrars and custodians, clear bank settler and the entire set of regulatory and monitoring mechanism, etc., facilitates the smooth functioning of OTCEI. Market players in the OTC market are as follows:



(I) Investor

Investors are the most important players in the market who buy and sell the shares. Actually other activities are carried for investors' operations and all other players work for smooth, effici and fault-free investors' operations. An investor can buy or sell shares through 'INVESTOTC Ca through OTCEI. Investor may be an individual, company, firm, FIIs, FIs, FMs or commercial banks

(II) Issuer Companies

Issuer company means the company whose securities are bought and sold on OTCEI. Th securities of the companies are as follows:

(i) **Listed Securities:** Listed securities are those which are allowed to be traded at any coun of OTCEI and cannot be traded on any other stock exchange.

(ii) **Permitted Securities:** Permitted securities are the securities which are listed on oth exchanges but are allowed to be traded as permitted securities on the counters of OTCEI

(iii) **Equity Shares of Unlisted Companies:** The shares of those companies which are n listed on any exchange can now be traded on OTCEI.

(iv) **Initiated Debentures:** Any entity holding a minimum of ₹ 1 lakh debentures of a particu company can offer them for trading on OTCEI by appointing a member or a dealer a compulsory market maker in these debentures. These are called as initiated debentures.

(III) Members

The functions of members and dealers are almost the same. But the status of members is super to dealers as members can be sponsors while dealers cannot. The main functions of members OTCEI are as under:

(a) Appraisal and evaluation of proposal;

(b) Valuation of shares for companies appraised;

(c) Participation in bought out deals;

(d) Offer of shares to public;

(e) Stock broking activities;

(f) Market making;

(g) Investor Services.

Market Making

Quoting buy and sell rates for a particular scrip is called market making. Each quotation must specify the value, quantity and the time for which it is valid. The market making at OTCEI can be of following three types:

(a) **Compulsory Market Making:** This type of market making has to be undertaken by the sponsor of that scrip for a period of 18 months from the date of commencement of public trading of that scrip. The sponsor can delegate the function of market making to dealer but the responsibility remains with members.

(b) **Additional Market Making:** It is a market making which is undertaken by a dealer member appointed by a sponsor at least for 3 months from the date of commencement of public trading or commencement of market making whichever is earlier. The sponsor and the additional market maker must hold between themselves up to 5% of the public offer.

(c) **Voluntary Market Making:** As the name suggests, it is a market making which is voluntarily undertaken at least for a period of 3 months from the date of entrance in market making. The market maker offers two-way quotes for the same scrip. But if they do not have adequate saleable stock of at least one market lot or any other quantity specified by OTCEI, then they should abstain from offering sale quote for the time being.

Members can perform any of the above market making, but dealers cannot perform the compulsory market making unless this function has been assigned to them by the sponsor.

Norms for Members

(1) **Eligibility:** Only the corporate entities are eligible for membership.

(2) **Networth Criteria:** ₹ 1 crore comprising of the minimum paid-up capital (₹ 30 lakh) plus free reserves (excluding revaluation reserves, capital reserves and specified reserves and value of membership/dealership/deposit with OTCEI/other stock exchange) less accumulated losses, if any. Minimum funds committed for OTC operations should be ₹ 1 crore.

(3) **Minimum Educational Qualifications:** At least 2 whole time directors of the corporate should be graduates.

(4) **Citizenship:** The company should be incorporated Under Companies Act, 1956.

(5) **Experience:** Minimum of 2 directors should possess a minimum of 2 years experience in capital market/stock broking/portfolio management/investment consultancy.

Trading Infrastructure: The company should have the following infrastructure:

(i) Members should have office space of at least 200 sq. ft. This building should either be owned or on lease of at least 5 years.

(ii) The company should have at least two direct telephones.

(iii) The company should also have the telex/fax at the designated OTC counter.

The entity should not be engaged in any fund based activity.

Selection Procedure

(i) Prospective members to submit an application in prescribed form.

(ii) Selection will be at the sole discretion of the Board of OTCEI.

(IV) Dealers

Norms for Dealers

(I) Individuals

1. **Age:** Minimum 21 years and not more than 60 years.
2. **Net Worth Requirements:** Minimum ₹ 15 lakh excluding the value of membership/dealership/deposits with OTCEI/other stock exchanges.
3. **Minimum Educational Qualification:** Graduate.
4. **Experience:** Minimum 2 years experience in Capital Markets/Stock Broking/Portfolio Management/ Investment Consultancy.
5. **Citizenship:** Indian Citizenship.

(ii) Corporate Entity

1. **Net Worth Requirements:** ₹ 20 lakh excluding the value of membership/dealership/deposits with OTCEI/Other Stock Exchanges.
2. **Capital:** The minimum paid-up capital should be ₹ 10 lakh plus free reserves (excluding revaluation reserves, capital reserves and specified reserves, cost of dealership and net worth of other exchanges) less accumulated losses, if any.
3. **Minimum Educational Qualifications:** At least 2 whole time directors of the corporate should be graduate.
4. **Experience:** Minimum of 2 whole time Directors should possess a minimum of 2 years experience in either capital market/stockbroking/portfolio management/investment consultancy.
5. **Citizenship:** The company should be incorporated under Companies Act, 1956.

Trading Infrastructure for Dealers

(i) Dealers must have the office space of at least 200 sq.ft. This office space should either be owned or on long term lease of at least 5 years.

(ii) They should also have two direct telephones.

(iii) They should also have telex/fax facility at the designated OTC counter.

The company should not be engaged in any fund based activity.

Dealership Selection Procedure:

(i) Prospective dealers to submit an application in the prescribed form.

(ii) Criteria for selection at all stages will be as decided by OTCEI at its sole discretion and the decision of OTCEI in the selection process is final.

Functions of Dealers:

(i) Stock broking activities

(ii) Market making

(iii) Investor services.

(iv) Participation in bought-out deals as co-investors.

(V) Sponsors

The sponsors are the members who buy wholesale and sell in the market through a network of licensed dealers. Sponsorship of scrips is the process through which the companies and their projects are screened before listing of scrips at OTCEI , so that the investors get better scrips. Following are the functions performed by a spousor.

1. To appraise the company and its projects for ensuring that the company's projects are technologically and financially viable.
2. To participate in bought-out deals.
3. To sponsor companies for listing and, to lead and manage those issues.
4. To appoint market makes for all issues sponsored.

Eligibility Norms

1. **Eligibility:** Only SEBI recognised merchant bankers (Corporate entities only) are eligible to become sponsors.
2. **Net Worth Requirements:** ₹ 1 crore comprising of the minimum paid-up capital plus free reserves (excluding revaluation reserves, capital reserves, specified reserves & cost of sponsorship) less accumulated losses, if any. Minimum funds committed for OTC operations should be ₹ 1 crore.
3. **Minimum Educational Qualifications:** Minimum 2 whole time directors should be graduates.
4. **Citizenship:** Company should be incorporated under Companies Act, 1956.
5. **Experience:** Minimum of 2 directors should possess a minimum of 2 years experience in either of capital market/stock broking/portfolio management/investment consultancy.

Selection Procedure for Sponsors

1. Prospective sponsors to submit the application in prescribed form.
2. The selection will be at the sole discretion of the Board of OTCEI.

(VI) Registrar and Custodian

Registrar and custodian are also the part and parcel of OTCEI. They carry out the following functions:

1. To transfer shares not exceeding 0.5 per cent of equity portfolio.
2. To maintain a register of members.
3. To keep in custody share certificates of the company.
4. To update the list of members.
5. To register power of attorney, transmission and transposition of shares.
6. To maintain a record of signatures and to check them at the time of receiving counter receipts (CR) and transfer deed (TD) for transferring securities.
7. To register nominations, etc.

(VII) Central Clearing Bank

All inter-counter deals and settlements are done through a central bank which is known as central clearing bank.

(VIII) Settler

The following functions are performed by settler:

1. Record keeping of documents generated by counters.
2. Checking of applications for splitting of sharers.
3. Keeping a record of signatures of all investors at the counters.
4. Monitoring the movement of documents.
5. Verification of signatures on counter receipts.
6. Checking genuineness of counter receipts.
7. Sending confirmations to the counters regarding receipts of counter receipts.
8. Exchange of counter receipts for shares before sending them to registrar.

(IX) Monitoring Agencies

OTCEI has a committee which monitors the activities of sponsors, members and the overall trading at OTCEI. Ministry of Finance and Government of India also keep an eye on the working of OTCEI. SEBI monitors the activities at OTCEI and frames rules and regulations for the smooth and proper working of the exchange.

Trading Mechanism

Listed securities and permitted securities have different trading mechanism at OTCEI. Therefore it is divided in the following two parts:

(I) For Listed Securities

Trading in listed securities starts 3 days after the listing. Trading commences with the compulsory market maker, additional market maker and voluntary market maker offering quotes for the minimum depth which depends on the issue price of the security. The market makers have to give quotes for at least 10 market lots in case the issue price is ₹ 50 and 5 market lots in other cases. Share certificates of listed securities are not traded on OTCEI. An investor has to first convert share certificates into counter receipts before trading which are tradeable documents. Following steps are followed in trading process at OTCEI:

1. Counter receipt is issued in lieu of share certificate.
2. A counter receipt is also issued every time when a scrip is purchased at OTCEI counter.
3. The counter fills up seller's details and obtains his signature.
4. Triple copies of counter receipts, one each for buyer, custodian and counter are prepared.
5. An Application Acknowledgement Slip (AAS) in triplicate is also generated for the transfer of security in the name of investor. In addition to this, the investor gives a duly stamped and attested transfer deed to the counter.
6. All transfer deeds with relevant counter receipts and AAS are sent to the custodian at the end of each day.

7. Registrar affects the transfer and issues actual certificate in lieu of counter receipts.
8. An investor interested in selling securities, submits the counter receipts at the counter. After verification of the particulars on the CR and settlement of price, a sale confirmation slip is issued to the investor and the deal is put through. If the shares are already transferred in the seller's name, then he has to submit a transfer deed before he gets Sale Confirmation Slip (SCS) and a cheque.
9. The counters send those transfer deeds to the registrar for the necessary action.

(II) For Permitted Securities

The trading of permitted securities was initiated in 1994-95. The securities which are listed on other stock exchanges can now be permitted to be traded under this category. OTCEI issued guidelines for listing of finance, investment, leasing and hire purchase companies on April 7,1995 after obtaining SEBI's approval in this regard. The trading mechanism is as follows:

1. Trading document is the share certificate with a valid transfer deed.
2. The counters give two-way quotes voluntarily. They are free to modify or withdraw their quotes before the deal is struck.
3. Selling and purchasing investors are issued with Purchase Confirmation Slips (PCS) and Sale Confirmation Slips (SCS) respectively by the counters.
4. The counters have to ensure that the share certificates are accompanied by valid transfer deeds.
5. All delivering brokers have to affix their rubber stamp on the reverse of the transfer deed.

Settlement System

The OTCEI has five days trading cycle at present. Forward trading is not permitted on OTCEI. OTCEI does not permit short selling in listed securities. Whereas short selling and squaring up in permitted securities is to be completed within the trading cycle. All deals in listed securities get completed after the counter receipts, sale confirmation slips and application acknowledgment slips are confirmed, matched and issued. The settlement process is based on a rolling T+3 settlement system. SEBI has allowed shifting of settlement system on the recommendation of Dave Committee from the T+3 system to T+1 system where the pay-in takes place on the next day and pay-out on second day.

Methods of Offering New Issues

Companies can offer new issues OTCEI in any of the following ways:

1. Primary Issues

The issuing company may offer its shares directly to the public. The sponsor performs the functions of issue management and as a single underwriter. He may also go for sub-underwriting with a syndicate of members/dealers.

2. Secondary Issues

The issuer company offloads the shares to the sponsor and receives the cash from him. The sponsor holds these shares till the conditions are favourable for public issue. The sponsor acts as a manager to the issue at the time of public issue. The sponsor may appoint additional sponsors. He may offload these shares to the public either directly or through members/dealers. Thus, this method provides the capital to the company at an early stage and can take up speedy commencement of the project.

3. Book-building

The company can also issue the shares through book-building process at OTCEI.

4. Bought Out Deals

Dave Committee suggested that Bought Out Deals should be allowed as a facility of offer for sale, listing and trading only on OTCEI. This facility should be available to those who do not fulfi the criteria of three year dividend, financial institutional appraisal and funding. This suggestion was approved and accepted. The detailed scheme for off-loading shares acquired under BOD was chalked out. These companies when listed on OTCEI were to be listed only at OTCEI for minimum of 3 years.

Growth Equity Market (GEM)

The Growth Equity Market (GEM) is the OTC Exchange of India's new market for start-up enterprises. The 'GEM' enables businesses to seek proper valuation and see their shares more widely traded without formally listing their shares on a stock exchange through the traditional listing mechanism. The 'GEM' provides a new and significant opportunity to a dynamic company for further growth as well as valuation of their equity.

Features of GEM

With the introduction of the 'GEM', the market for trading in securities that are not listed, the OTCEI would:

(i) provide an exit route/opportunity for investments of venture capital and private equity funds;

(ii) promote organised trading in unlisted securities by bringing scattered investors on to a common trading platform introducing greater level of transparency in utilised securities market;

(iii) broad-base the existing informal market in order to make it more liquid;

(iv) provide benchmark rates for security prices;

(v) act as a preparatory ground prior to an IPO issue;

(vi) provide companies the protection of institutional investment, and at the same time the visibility and the benefits of exchange trading;

(vii) encourage companies to adopt transparency and corporate governance in their dealings.

Intermediaries

There are three key entities in the 'GEM' of the OTCEI:

(i) Companies

The 'GEM' is suitable for trading among a broad range of companies, from young businesses to management buy-outs and family concerns. Be it a company that is operating in an emerging technology sector or a traditional manufacturing or service industry, the 'GEM' could be a market for such companies.

(ii) Introducers

A company wanting to trade on the 'GEM' would need to appoint advisors to assist in the admission procedure and compliance with ongoing requirements. The advisors are called 'Introducers' and are either OTCEI's sponsor/member or a SEBI registered Category 1 Merchant Banker. The introducer communicates between the company and the market to ensure that investors are able to reach fully informed investment decisions.

(iii) Qualified Participants

A qualified participant is the investor on the 'GEM'. It has been determined that a QP should have a net worth of at least ₹ 2.5 crore. The QP can buy/sell securities and participate in book building of a company's security. Corporates including scheduled banks, venture capital funds, private equity funds or mutual funds, UTI, development financial institutions, state level institutions created by an Act of Parliament/legislation and high net worth individuals can become qualified participants.

Current Position

During the year 2009-10, 704 brokers were active. Margin trading and securities lending have been introduced. The debt market which was thrown open to the non-institutional investors through the launch of Retail Debt Market on OTCEI, NSE and BSE could not attract much participation as familiarity with such debt products and trading techniques is low in this segment. The OTCEI has earned a net profit ₹ 80.02 during the year 2008-09.

Benefits of OTCEI

(I) Benefits to Listed Companies

The listed companies are benefited in the following ways:

1. Shares of all unlisted companies can now be traded on OTCEI.
2. The company can negotiate the issue price with sponsors.
3. The company can fix an optimum level of premium on issue with minimum risk of non-subscription in consultation with sponsors.
4. The cost of raising funds with public issue is saved.
5. The scrips of a company offering only 40 per cent of its equity for trading can be listed on OTCEI. This limit is 20 per cent in case of closely held securities.

(II) Benefits to Investors

The investors are benefited in the following ways:

1. Investors can settle the deal across the counter.
2. Two-way quotes (purchase and sale) of scrips are available on screen. Therefore, the investors are benefited with transparent dealings.
3. Futures and options, forward contracts on stock and other forms of forward transactions and stock lending are allowed on OTCEI.
4. The process of investigation of the company and its projects impart greater security to investors.
5. The deals and settlements are taking place at a fast speed.

(III) Benefits to Stock Market Environment

OTCEI has improved the stock market environment as follows:

1. OTCEI has a nationwide network and through its network it is spreading the stock market operations. Thus, it facilitates the integration of capital market in the country.
2. OTCEI has encouraged closely held companies to go to public. Now the scrips of these companies can be listed even if only 20 per cent of capital is offered to the public.
3. Those members of the OTCEI who did not have multiple membership can now have an opportunity to trade in some of the large capital indices.
4. It promotes savings and investment by offering easier avenues for raising capital.
5. It facilitates dispersal of economic activities by encouraging small companies and small investors.

Exit: As per SEBI order, OTCEI is no longer a recognised stock exchange under the provisions of SEBI Act 1992 and Securities Contracts (Regulation) Act, 1956 with effect from March 31, 2015.

National Stock Exchange (NSE)

The National Stock Exchange was incorporated in November 1992 and became operational in capital market segment on 3rd November, 1994 in Mumbai. Its genesis lies in the recommendations of the Pherwani Committee. This study group submitted its report on June 1991 and recommended some criteria for setting up of model national stock exchange at Navi Mumbai. It also recommended for the **'National Market'** to be set-up by NSE.

Objectives of NSE

The objectives of NSE are as follows:

1. To establish a nationwide trading facility for all types of securities.
2. To ensure equal access to all investors all over the country through an appropriate communication network.
3. To provide a fair, efficient and transparent securities market using electronic trading system.
4. To enable shorter settlement cycles and book entry settlements.
5. To meet the international benchmark and standards.

Features of NSE

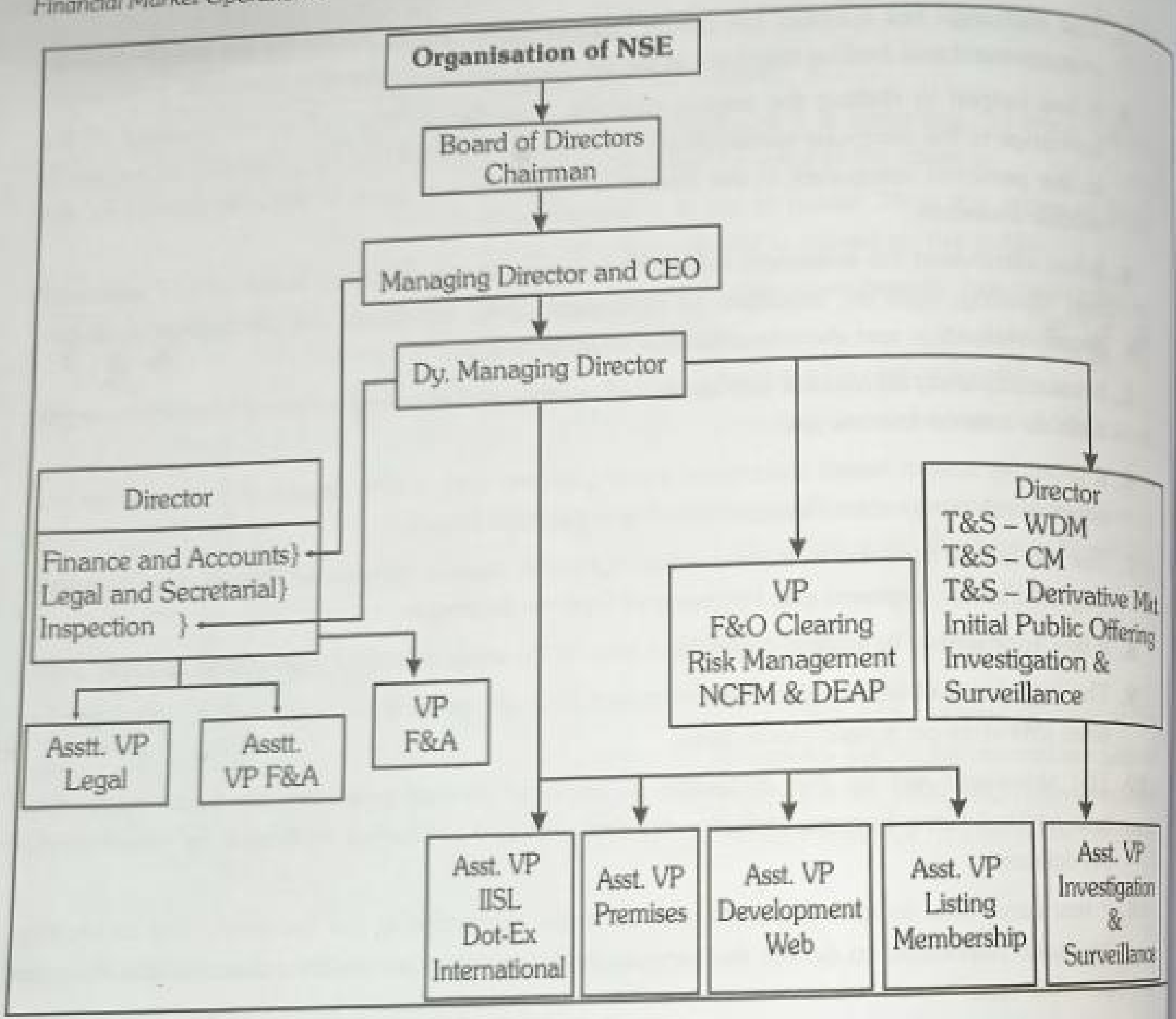
The features of NSE are as follows:

1. It has been playing the role of a catalytic agent in reforming the market in terms of micro structure and market practices.

2. The exchange has adopted the purest form of demutualised set-up where the ownership, management and trading rights are in the hands of three different sets of people.
3. It has helped in shifting the trading platform from the trading hall in the premises of the exchange to the computer terminals at the premises of the trading members and subsequently to the personal computers in the homes of investors and even to portable devices for the mobile investors .
4. It has eliminated the settlement risks with its innovative endeavours in the area of settlement and clearing, such as, reduction of settlement cycle, fine-tuned risk management system, dematerialisation and electronic transfer of securities, etc.
5. It has completely eliminated any conflict of interest and pursuing policies and practices within a public interest framework.
6. It provides screen based automated trading system with a high degree of transparency and equal access to investors irrespective of geographical location.
7. The exchange operates in three market segments, namely Wholesale Debt Market Segment, Capital Market Segment and Futures and Options Segments.
8. It has augmented its system capabilities to provide services in IPO market and mutual funds.
9. The high level of information dissemination through online system has helped in integrating retail investors on a nationwide basis.
10. The standards set by the exchange in terms of market practices, products, technology and service have become industry benchmarks and are being replicated by other market participants.
11. It has been able to take the stock market to the doorsteps of the investors. The technology has been harnessed to deliver the services to the investors across the country at the cheapest possible cost.

Organisation of NSE

NSE is owned by a set of leading financial institutions, banks, insurance companies and other financial intermediaries and is managed by professionals who do not directly or indirectly trade on the exchange. Its board comprises of senior executives from promoters, institutions, eminent professionals and a full time executive. Its organisation can be depicted from the following diagram:



The board deals with the broad policy issues. The day-to-day management of the exchang delegated to the Managing Director and Chief Executive Officer (CEO) who is supported by a team professional staff. The Executive Committees which are formed under the Articles of Associatio include trading members manage the day-to-day affairs of the Exchange. The Executive Committe have constituted several committees to receive regulatory inputs from the market and it is compris mostly of trading.

Capital and Present Position

NSE is a for-profit and tax paying company. It depends on business income for its susten and growth. It had a net worth of ₹ 1,908.66 crore as on March 31, 2009. NSE is the first exch in the world to use satellite communication technology for trading. It uses satellite communic technology to energise participation from about 2,648 VSATs from nearly 201 cities spread all o the country.

On its recognition as a stock exchange under the Securities Contracts (Regulation) Act, 1956

April 1993, it commenced operations in the Wholesale Debt Market (WDM) segment in June 1994, in the Capital Market (CM) segment in November 1994 and in Futures and Options (F&O) segment in June 2000. The exchange started providing trading in retail debt of Government Securities in January 2003. During the year 2008-09, it accounted for over 65.94% of total trading volume in the stock exchanges and 67.61% in equities and more than 99.5% in derivatives. The dimensions of these segments are as follows:

Table. 5.1. Dimensions of NSE

(at the end of March 2016)

Segment	No. of Members	No. of Securities Available	Market Capitalisation (₹ crore)	Trading Volume (₹ crore)
CM	89	1613	93,10,471	42,36,983
F&O	1247	—	—	6,48,25,834
CDS	59	—	—	45,01,886
WDM	07	7089	59,65,056	5,26,425
Int. Rate Futures	—	—	—	5,26,425

(Source: NSE Website)

Listing of Securities

The Exchange has laid down criteria for listing of new issues by companies. IPOs by knowledge-based issuers, companies listed on other exchanges and companies formed by amalgamation/restructuring, etc., in conformity with the Securities Contracts(Regulation) Rules, 1957 and directions of the Central Government and the Securities and Exchange Board of India (SEBI).

Criteria for Listing

The criteria for listing include minimum paid-up capital, market capitalisation, project appraisal, company/promoter's track record, etc. The listing criteria for companies in CM segment is presented in the Table 5.2.

Table 5.2. Criteria for Listing of Companies (CM segment)

Criteria	Initial Public Offerings (IPOs)	Companies Listed on Other Exchanges
(1) Paid-up Equity Capital (PUEC) and Market Capitalisation (MC)	PUEC ≥ ₹ 10 crore MC ≥ ₹ 25 crore	PUEC ≥ ₹ 10 crore and MC ≥ ₹ 50 crore OR PUEC ≥ ₹ 25 crore OR MC ≥ ₹ 100 crore
(2) Company/Promoter's Track Record	3 years of existence of applicant/ promoting agency	3 years of existence of applicant/ promoting company
(3) Dividend Record or Net worth	—	Dividend paid in at least 2 out of the last 3 years or Net worth ₹ 50 crore
(4) Listing	—	Listed on any other stock exchange for at least last 3 years.

(5) Other Requirements	(a) No disciplinary action by other stock exchanges/ regulatory authority in past 3 years. (b) Satisfactory redressal mechanism for investor grievances, distribution of shareholding and litigation record of the promoting company.	(a) Same as for IPOs. (b) No negative networth, no winding-up petition and no reference to BIFR.

In the WDM segment, all government securities, state development loans and treasury bills are 'deemed' listed as and when they are issued. The other categories of securities are traded either under the 'permitted to trade' category or under the 'listed' category. Amongst other requirements, privately placed debt paper of banks, institutions and corporates require an investment grade credit rating to be eligible for listing. The listing requirements for securities on the WDM segment are presented in the Table 5.3.

Table 5.3. Listing Criteria for Companies(WDM Segment)

Issuer	Public Issue	Listing Criteria	Private Placement
(a) PSUs/Statutory Corporations			
– Min. 51% holding by Govt.	————	As Applicable to Corporates	————
– Less than 51% holding by Govt.	————	As Applicable to Corporates	————
(b) Statutory Corporation/Local/ Bodies/Authorities			
– Min. 51% holding by Govt.	– As Applicable to PSUs		– As Applicable to Corporates
– Less than 51% holding by Govt.	As Applicable to Corporates		————
(c) Financial Institutions	Eligible		Investment Grade Credit Rating
(d) Scheduled Commercial Banks	Net worth of ₹ 50 crore or above		Net worth of ₹ 50 crore or above and Investment Grade Credit Rating
(e) Infrastructure Companies	————	Investment Grade Credit Rating	————
(f) Corporates	Minimum Paid-up capital of ₹ 10 crore, Or Market Capitalisation of ₹ 25 crore		Same as Public Issue and Investment Grade Credit Rating
(g) Mutual Funds		SEBI registered Mutual Fund/Scheme having an investment objective to invest predominantly in debt instruments	
(h) Securitised Debt	————	Minimum tranche of ₹ 20 crore	————
	————	Investment Grade Credit Rating	————

Listing Fees

The Exchange does not levy any listing fee in respect of 'permitted to trade' securities. Half of the prescribed annual fee is levied in respect of listed securities for which the Exchange is not the regional stock exchange. The listing fee levied by the Exchange is shown in the Table 5.4.

Table 5.4. Listing Fees

(₹ in crore)

Listing Fees	Amount (₹)
Initial Fees	50,000
Annual Fees	
Paid-up share capital/Debentures (₹ crore)	
Up to 50	2,00,000
50–100	2,55,000
100–200	3,30,000
200–300	4,15,000
300–400	5,10,000
400–500	6,70,000
Above 500	6,75,000 + ₹ 4,150 for every additional 5 crore or part above 1,000 crore
Above 1000 crore	11,00,000 + ₹ 4,625 for every increase of ₹ 5 crore or part above 1,000 crore
Above 2000 crore	11,25,000 + ₹ 5,025 for every increase of ₹ 5 crore above 1,000 crore
Above 3000 crore	12,00,000 + ₹ 4,600 for every increase above 1,000 crore

Compliance of Listing Conditions

NSE has institutionalised a process of verifying compliance of various conditions of the listing agreement. It conducts a periodic review for compliance on account of announcement of book closure/record date, announcement of quarterly results, submission of distribution schedule and annual reports, appointment of compliance officer, investor grievances, various disclosures, etc.

Benefits of Listing

The benefits of listing on NSE are:

1. NSE being the largest stock exchange in terms of reach, listing on NSE enables issuers to reach and service investors across the country.
2. The securities trade at low impact cost and are highly liquid as it is the largest stock exchange in terms of trading volume.
3. The NSE network disseminates information and company announcements across the country, thus reducing scope for price manipulation or misuse.

4. The facility of making Initial Public Offers (IPOs), using NSE's network and software, results in significant reduction in cost and time of issues.
5. The listing fee is nominal.
6. Listing companies are provided with monthly trade statistics for the securities of the company listed on the Exchange.
7. NSE's website provides a link to the websites of the companies that are listed on NSE, so that visitors interested in any company can visit that company's website from the NSE site.

Delisting of Companies from NSE

The securities listed on NSE can be de-listed from the exchange as per the SEBI (Delisting of Securities) Guidelines, 2003 in the following manner:

(1) **Voluntary Delisting of Companies:** Any promoter or acquirer desirous of delisting securities of the company under the provisions of these guidelines shall obtain the prior approval of shareholders of the company by a special resolution passed in its general meeting and should also make a public announcement in the prescribed manner. After that they should make an application to the delisting exchange in the form specified by the concerned exchange from where the companies are to be de-listed. Any promoter of a company desirous to be de-listed from the stock exchange shall also determine an exit price for delisting of securities in accordance with the book building process. The stock exchanges shall display the delisting price at the terminals of trading members to enable the investors to access the price on the screen to bring transparency to the delisting process.

(2) **Compulsory Delisting of Companies:** The stock exchanges may delist companies which have been suspended for a minimum period of 6 months for non-compliance with the listing agreement. The stock exchanges have to give adequate and wide public notice through newspapers. The exchange should also give a show cause notice to the company. The exchange shall provide a time period of 15 days within which representation may be made to the exchange by the aggrieved person. When the securities of the company are de-listed by an exchange, the promoter of the company shall be liable to compensate the securityholders by paying them fair value of the securities.

Membership

Any person can become a member by complying with the prescribed eligibility criteria and can exit by surrendering trading membership without any hidden/over cost. There are no entry/exit barriers to trading membership.

The standards for admission of members as laid down by the Exchange stress on factors such as corporate structure, capital adequacy, track record, education, experience, etc. and reflect a conscious effort by the exchange to ensure quality brokering services so as to build and sustain confidence in the Exchange's operations. The exposure and volume of transactions that can be undertaken by trading member are linked to deposits made by him with the exchange as part of the membership requirements.

The trading members are admitted to the different segments of the Exchange subject to the provisions of the Securities Contracts (Regulation) Act, 1956, the SEBI Act, 1992, the rules, circulars, notifications, guidelines, etc. and the bye laws, rules and regulations of the exchange. All trading members are registered with SEBI. The eligibility criteria for membership in different segments is as follows:

CM Segment

The eligibility criteria for the capital market segment is:

1. Individuals, registered firms, corporate bodies, companies and such other persons may be permitted under the SCRA,1956.
2. The applicant must be engaged solely in the business of securities and must not be engaged in any fund-based activities.
3. The minimum net worth requirements for individuals and registered firms are of ₹ 75 lakh and for corporate bodies, it is of ₹ 100 lakh. In the case of registered partnership firm, each partner should contribute at least 5 per cent of the minimum net worth requirement of the firm.
4. A corporate trading member should consist only of individuals (maximum 4) who should directly hold at least 40 per cent of the paid-up capital in case of listed companies and at least 51 per cent in case of other companies.
5. The minimum prescribed qualification is graduation and 2 years experience of handling securities as broker, sub-broker, authorised assistant, etc., must be fulfilled by:
   (i) minimum 2 directors in case the applicant is a corporate,
   (ii) minimum 2 partners in case of partnership firms, and
   (iii) the individual in case of individual or sole proprietory concerns.

WDM Segment

The eligibility criteria for Trading Membership in the WDM segment is:

1. The persons eligible to trading members are bodies corporate companies, institutions including subsidiaries of banks engaged in financial services and such other persons or entities as may be permitted from time to time by RBI/SEBI.
2. The applicant must possess a minimum net worth of ₹ 2 crore.
3. The whole-time directors should possess at least 2 years' experience in any activity related to banking or financial services or treasury.
4. The applicant must be engaged solely in the business of securities and must not be engaged in any fund based activities.

The membership may be in other segments also. This may be summed up in Table 5.5:

Table 5.5. Eligibility Criteria for Membership

(₹ in lakh)

Particulars	CM and F&O segment	CM and WDM segment	WDM segment	CM, WDM and F&O segment
Constitution	Individuals/Firms/ Corporates	Corporates	Corporates	Corporates
Paid-up Capital (in case of corporates)	30	30	30	30
Net worth	100	100	50	100
Interest Free Security Deposits (IFSD)	110	85	BMC	110
Collateral Security Deposits (CSD)	25	25	NIL	25
Annual Subscription	1	1	NIL	1
Education	Individual trading member/ two partners/two directors should be graduates. Dealers should also have passed SEBI approved certification test for derivatives and capital market (basic or dealers) module of NCFM.	At least two directors should be graduates	At least two directors should be graduates	At least two directors should be graduates. Dealers should also have passed SEBI approved certification test for derivatives and capital market (basic or dealer) module of NCFM.
Experience	Two years experience on securities market.	Two years experience in securities market.	Two years experience in securities market.	Two years experience in securities market.
Track Record	The applicant/ partner /director should not be defaulter on any stock exchange or debarred by SEBI.	The applicant / partner/director should not be defaulter on any stock exchange or debarred by SEBI.	The applicant /partner/director should not be defaulter on any stock exchange or debarred by SEBI.	The applicant/ partner/director should not be defaulter on any stock exchange or debarred by SEBI.

(Source: NSE Website)

Growth of Membership

At the end of March 2016, the exchange had 1,416 members. The growth of membership of NSE is presented in Table 5.6.

Table 5.6. Growth of Membership

Particulars	CM segment	WDM segment	CDS	CM, WDM and F&O CDS segment	Total
March 2015	88	06	54	1253	1416
March 2016	89	07	59	1247	1416

(Source: NSE Factbook 2016)

Investor

Investors are the backbone of the securities market. Protection of their interests is paramount for NSE. In furtherance of their interest, NSE has put in place systems to ensure availability of adequate, up-to-date and correct information to investors to enable them to take informed decisions. It ensures that critical and price sensitive information reaching the exchange is made available to all classes of investor at the same point of time. Such price-sensitive information as bonus announcements, mergers, new line of business, etc., received from the companies is disseminated to all the market participants through the network of NSE terminals all over India. Despite all precautionary measures by NSE and investors, certain grievances and issues do arise in the day-to-day functioning. To address these issues/complaints reported to NSE, an Investor Grievance Cell (IGC) has been set up to handle the complaints lodged by investors against trading members/companies.

Arbitration is a speedy and alternative dispute resolution mechanism provided by the exchange for resolving disputes between the trading members and between a trading member and his client, in respect of trades done on the exchange. The arbitration mechanism is provided by the exchange in all its regional offices to facilitate the speedy dispute resolution mechanism.

Investor Protection Fund

The exchanges maintain an Investor Protection Fund to make good investor claims, which may arise out of non-settlement of obligations by the trading member, who has been declared a defaulter, in respect of trades executed on the Exchange. The maximum amount of claim payable from the fund to the investor is ₹ 25 lakh per investor per defaulter.

Clearing and Settlement

The clearing and settlement operations can be studied in the following heads:

(I) Settlement Procedure

The Settlement Procedure is as follows:

(1) **Trade Recording:** The key details about the trades are recorded to provide basis for settlement. These details are automatically recorded in the electronic trading system of the exchanges.

(2) **Trade Confirmation:** The parties to a trade agree upon the terms of trade like security, quantity, price, and settlement date, but not the counter party which is the NSCCL. The electronic system automatically generates confirmation by direct participants.

(3) **Determination of Obligation:** The next step is determination of what counter-parties owe, and what counter-parties are due to receive on the settlement date.

(4) **Pay-in Funds and Securities:** The members bring in their funds and securities to the NSCCL (National Securities Clearing Corporation Ltd.). They make available required securities in designated accounts with the depositories by the prescribed pay-in time. The depositories move the securities available in the accounts of members to the account of NSCCL. Likewise members with funds obligations make available required fund in the designated accounts with clearing banks by the prescribed pay-in time. The NSCCL sends electronic instructions to the clearing banks to debit member's account to the extent of payment obligation. The banks process these instructions, debit accounts of members and credit accounts of the NSCCL.

(5) **Pay-out of Funds and Securities:** After processing for shortages of funds/securities and arranging for movement of funds from surplus banks to deficit banks through RBI clearing, the NSCCL sends electronic instructions to the depositories/clearing banks to release pay out of securities/funds. The depositories and clearing banks debit accounts of the NSCCL and credit accounts of members.

(6) **Risk Management:** A sound risk management system is integral to an efficient settlement system. The NSCCL ensures that trading members obligations are commensurate with their net worth.

(II) Settlement Agencies

The NSCCL, with the help of clearing members, custodians, clearing banks and depositories settles the trades executed on exchanges. The role of each of these entities is explained below:

(1) **NSCCL:** It was set up in August 1995 as a fully owned subsidiary of NSE. The NSCCL is responsible for post-trade activities of a stock exchange. Clearing and settlement of trades and risk management are its central functions. It clears all trades, determines obligations of members, arranges for pay-in of funds/securities, receives funds/securities, processes for shortages in funds/securities, arranges for pay-out of funds/securities to members, guarantees settlement, and collects and maintains margins/collateral/base capital/other funds. It is the counter party to all settlement obligations of the members.

(2) **Clearing Members:** They are responsible for settling their obligations as determined by the NSCCL. They have to make available funds and/or securities in the designated accounts with clearing bank/depositories, as the case may be, to meet their obligations on the settlement day.

(3) **Custodians:** Custodian is a clearing member but not a trading member. He settles trades assigned to him by trading members. He is required to confirm whether he is going to settle a particular trade or not. If it is confirmed, the NSCCL assigns that obligation to that custodian and the custodian is required to settle it on the settlement day.

(4) **Clearing Banks:** Every clearing member is required to open a dedicated clearing account with one of the clearing banks. The clearing member makes funds available in the clearing account for the pay-in and receives funds in case of a pay-out.

(5) **Depositories:** Depositories help in the settlement of the dematerialised securities. Each custodian/clearing member is required to maintain a clearing pool account with the depositories. He is required to make available the required securities in the designated account on settlement day. The depository runs an electronic file to transfer the securities from accounts of the custodians/clearing member to that of NSCCL. The depositories transfer the securities on the pay-out day from the account of the NSCCL to those of members/custodians as per schedule of allocation of securities determined by NSCCL.

(6) **Professional Clearing Member:** NSCCL admits special category of members namely, professional clearing members. Professional Clearing Members (PCM) may clear and settle trades executed for their clients (individual, institutions, etc.) In such an event, the functions and responsibilities of the PCM would be similiar to the custodians. PCMs may also undertake clearing and settlement responsibility for trading members. A PCM has no trading rights but has only clearing rights.

(III) Settlement Cycles

NSCCL clears and settles trades as per well defined settlement cycles. Since the beginning of the financial year 2002, all securities are being traded and settled under T+3 rolling settlement (From April 1, 2003, trades have been under T+2 rolling settlement). This is a step towards further reducing the settlement cycle to T+1 in 2004. The NSCCL notifies the consummated trade details to clearing members/custodians on the trade day. The custodians affirm back the trades of NSCCL by T+1 day. Based on the affirmation, NSCCL nets the positions of counterparties to determine their obligation. A clearing member has to pay-in/pay-out funds and/or securities. The obligations are netted for a member across all securities. To determine his fund obligations he has to either pay or receive funds. Members pay in/pay out obligations are determined latest by T+1 day and are forwarded to them on the same day so that they can settle their obligations on T+2 day. The securities/funds are paid in/paid out on T+2 day and the settlement is complete in 3 days from the end of the trading day.

(IV) Settlement Statistics

- During 2015-16, NSCCL settled trades for ₹ 12,52,658 and ₹ 1,352 crore in F&O. This has ushered in an era of dematerialising trading and settlement of total delivery, nearly 100 per cent of securities were delivered in demat form in 2006-07.

Risk Management Measures

The Exchange has a dedicated Risk Group which looks into aspects relating to risk management. The risk containment measures in vogue are described below:

(1) **Capital Adequacy:** The capital adequacy requirements stipulated by the NSE are substantially in excess of the minimum statutory requirements as also in comparison to those stipulated by other stock exchanges. The deposits kept with the exchange as part of the membership requirements are taken as base minimum capital of the member to determine the member's intra-day trading limit and/or gross exposure limit. Additional base capital is required to be deposited by the member for taking additional exposure.

(2) **Trading and Exposure Limits:** NSCCL imposes limits on turnover and exposure in relation to the base minimum capital or additional base capital of a member, which is the amount of funds and securities that a member keeps with the exchange/NSCCL. Gross intra-day turnover of a member shall not exceed 33½ times the base capital. Gross exposure of a member at any point of time shall not exceed 8.5 times the free base capital up to ₹ 1 crore. If a member has free capital in excess of ₹ 1 crore, his exposure shall not exceed ₹ 8.5 crore plus 10 times of the capital in excess of ₹ 1 crore. Members exceeding these limits are automatically and instantaneously disabled by the automated trading system. A penalty of ₹ 5,000 is levied for each violation of gross exposure limit and intra-day turnover limit.

(3) **Margin Requirements:** NSCCL imposes stringent margin requirements as a part of its risk containment measures on April 01, 2003. The categorisation of stocks for imposition of margins has the structure as given below:

(i) The stocks which have traded at least 80 per cent of the days for the previous 18 months shall constitute the Group I and Group II.

(ii) Out of the scrips identified above, the scrips having mean impact cost of less than or equal to 1 per cent shall be categorised under Group I and the scrips where the impact cost is more than 1, shall be categorised under group II.

(iii) The remaining stocks shall be categorised under Group III.

(iv) The impact cost shall be calculated at 15th of each month on a rolling basis considering the order book snapshots of the previous six months. On the calculated impact cost, the scrip shall move from one group to another group from the 1st of the next month.

(4) **Index based Circuit Filters:** An index based market-wide circuit breaker system applies at three stages of the index movement either way at 10 per cent, 15 per cent and 20 per cent. These circuit breakers bring about a co-ordinated trading halt in all equity and equity derivatives markets nationwide.

(5) **Settlement Guarantee Fund:** A large Settlement Guarantee Fund, which stood at ₹ 4,055.18 crore at the end of March 2006, provides the cushion for any residual risk. It operates like a self-insurance mechanism where members contribute to the Fund. In the event of failure of a trading member to meet settlement obligations or committing a default, the fund is utilised to the extent required for successful completion of the settlement.

(6) **Online Monitoring:** NSCCL has in place an online monitoring and surveillance system whereby exposure of the members is monitored on a real time basis. A system of alerts has been built in so that both the member and NSCCL are alerted as per pre-set levels when the members approach their allowable limits. The online surveillance mechanism also generates various alerts/reports on any price/volume movement of securities not in line with past trends/ patterns.

(7) **Investigation and Inspection:** A minimum of 10 per cent of the active trading members are to be inspected every year to verify the level of compliance with various rules, bye-laws and regulations of the exchange. The inspection randomly verifies if investor interests are being compromised in the conduct of business by the members. If the detailed investigation establishes any irregular activity, then disciplinary action is initiated against the member.

Subsidiaries of NSE

1. National Securities Clearing Corporation Ltd. (NSCCL)

The National Securities Clearing Corporation Ltd. (NSCCL), a wholly owned subsidiary of NSE, was incorporated in August 1995. It was set-up to bring and sustain confidence in clearing and settlement of securities; to promote and maintain, short and consistent settlement cycles; to provide counter-party risk guarantee, and to operate a tight risk containment system. NSCCL commenced clearing operations in April 1996.

NSCCL carries out the clearing and settlement of the trades executed in the Equities and Derivatives segments and operates Subsidiary General Ledger (SGL) for settlement of trades in

government securities. It assumes the counter-party risk of each member and guarantees financial settlement. It also undertakes settlement of transactions on other stock exchanges like, the Over the Counter Exchange of India.

NSCCL has successfully brought about an upgradation of the clearing and settlement procedures and has brought Indian financial markets in line with international markets. The company has paid-up capital of ₹ 45 crore and earned a profit of ₹ 165.89 crores for the year 2015-16.

NSCCL, The Organisation

The National Securities Clearing Corporation Ltd. (NSCCL), a wholly owned subsidiary of NSE, was incorporated in August 1995. It was the first clearing corporation to be established in the country and also the first clearing corporation in the country to introduce settlement guarantee.

Objectives

It was set-up with the following objectives:

- To bring and sustain confidence in clearing and settlement of securities;
- To promote and maintain, short and consistent settlement cycles;
- To provide counter-party risk guarantee; and
- To operate a tight risk containment system.

NSCCL commenced clearing operations in April 1996.

Committees

Various committees have been constituted to advise on areas such as good market practices, settlement procedures, risk containment systems, etc. These committees are manned by industry professionals, trading members, exchange staff as also representatives from the market regulator.

- **Executive Committee (Derivatives segment)**
- **Risk Management Advisory Group**

2. India Index Services & Products Ltd. (IISL)

India Index Services and Products Limited (IISL), a joint venture between NSE and CRISIL Ltd. (formerly the Credit Rating Information Services of India Limited), was set-up in May 1998 to provide a variety of indices and index related services and products for the Indian capital markets. It has a consulting and licensing agreement with Standard and Poor's (S & P), time world's leading provider of investible equity indices, for co-branding equity indices.

IISL provides a broad range of services, products and professional index services. It maintains over 80 equity indices comprising broad-based benchmark indices, sectoral indices and customised indices. Many investment and risk management products based on IISL indices have been developed in the recent past, within India and abroad. These include index based derivatives traded on NSE and Singapore Exchange (SIMEX) and a number of index funds.

About S & P

S & P owns the most important index in the world, the S & P 500 index, which is the foundation of the largest index funds and most liquid index futures markets in the world. The S & P 500 index is used by professionals around the world as the standard measure of the US market. Over US $ 800 billion is indexed, or directly linked, to the S & P 500 through index or tracker funds, more than any other index in the world. Daily trading volumes of derivatives transactions based on the S & P 500 amount to over US $ 50 billion. Standard & Poor's plays an active role in the construction, development and maintenance of IISL's indices and brings its international expertise to the joint venture. With this involvement, IISL is committed to providing to the market the same assured quality, objectivity, integrity and service which are a constant source of inspiration to the international markets. This marks the first time Standard & Poor's, the world's largest index services provider, has offered its brand name and technical support to any such venture anywhere in the world.

Objectives of IISL

IISL pools the index development efforts of CRISIL and NSE into a coordinated whole - India's first specialised company focused upon the index as a core product. IISL has the following objectives:

- To develop, construct and maintain indices on Indian equities and commodities that serve as useful market performance benchmarks and are the underlying indices for derivatives trading.
- To develop related products and services which can be used by investors for managing their exposures in the equity and commodity markets.
- To provide data and information on the trading activity in the Indian stock markets.
- To provide market participants with value added research on the Indian equity and commodity market.

All the erstwhile indices of NSE and CRISIL, such as Nifty, Nifty Junior, Defty, CRISIL 500, CRISIL Midcap 200 index, etc. have been transferred to IISL which now maintains, develops, compiles and disseminates the indices.

The indices of IISL are now known under the following names:

S.No.	Old Name	New Name
1.	Nifty	S&P CNX Nifty
2.	Defty	S&P CNX Defty
3.	CRISIL 500 Equity Index	S&P CNX 500 Equity Index
4.	Nifty Junior	CNX Nifty Junior
5.	CRISIL Midcap 200	CNX Midcap 200 Index
6.	CRISIL PSE	CNX PSE Index
7.	CRISIL MNC	CNX MNC Index

3. NSE. *IT* Ltd.

NSE. IT, a 100% subsidiary of National Stock Exchange of India Limited (NSE), is the informatio technology, arm of the largest stock exchange of the country. A leading edge technology user, NS houses state-of-the-art infrastructure and skills. NSE. IT possesses the wealth of expertise acquired *the last six* years by running the trading and clearing infrastructure of largest stock exchange of th

country. NSE. IT is uniquely positioned to provide products, services and solutions for the securities industry. There has been a long felt need for top-of-the-line products, services and solutions in the area of trading, broker front-end and back-office, clearing and settlement, web-based trading, risk management, treasury management, asset and liability management, banking, insurance, etc. NSE and IT's expertise in these areas is the primary focus. The company also plans to provide consultancy and implementation services in the areas of Data Warehousing, Business Continuity Plans, Stratus Mainframe Facility Management, Site Maintenance and Backups, Real Time Market Analysis and Financial News over NSE-Net, etc.

NSE. IT is an Export Oriented Unit with STP and plans to go global for various IT services in due course. In the near future the company plans to release new products for Broker Back-office Operations and enhance Neat XS / Neat iXS to support Straight Through Processing on the net. The company has the paid-up capital of ₹ 10 crore and one hundred and earned a profit after tax of ₹ 20.34 crore in the year 2015-16.

4. DotEx International Limited

"The data and info-vending products of the National Stock Exchange are provided through a separate company DotEx International Ltd., a 100% subsidiary of NSE, which is a professional set-up dedicated solely for this purpose." The company has the paid-up capital of ₹ 9 crore and earned the net profit of ₹ 33.60 crore after tax in the year 2015-16.

5. NSE Strategic Investment Corporation Limited

NSE Strategic Investment Corporation Limited (NSICL) was incorporated to make or hold all strategic investments in the equity shares and/or other securities of various companies. The paid up share capital of NSICL as on March 31, 2016 is ₹ 825.99 crore which is being 100% held by National Stock Exchange of India Limited (NSEIL). During the F.Y. 2015-16, NSICL earned net profit after tax of ₹ 60.95 crores as compared to net profit after tax of ₹ 70.35 crores during the FY 2014-15. NSICL was formed with an intention to conserve resources for the group to invest in the capital of other companies in the group or outside.

6. NSE Infotech Services Limited

NSE Infotech Services Limited (NSETECH) has been incorporated to cater to the needs of NSE and all its group companies. NSE has regularly upgraded its information technology systems and infrastructure to achieve higher capacity and lower latency, improving market efficiency and transparency, enhancing user access and providing flexibility for future business growth and market needs. During the F.Y. 2015-16, NSETECH earned net profit after tax of ₹ 1.09 crores as compared to net profit after tax of ₹ 0.86 crores during the F.Y. 2014-15. As the profit is required to augment operational needs, the Board of NSETECH did not recommend any dividend to be paid in respect of the equity shares.

6

The Securities and Exchange Board of India (SEBI)

Introduction

The SEBI was established in 1992 by passing of the Securities and Exchange Board Act. Th board was established to protect the interests of investors in securities and to promote the developme and regulation of securities market.

Applicability or Scope

It extends to the whole of India.

Objectives of the Board

As per the SEBI Act, the objectives of the establishment of the SEBI are **to protect the interest o investors in securities and to promote the development of, and regulate the securities marke for matters connected therewith or incidental therewith.** Actually, the SEBI has been entrus with both the regulatory and development functions. The objectives of SEBI are as follows:

1. To protect the investors, so that steady and regular flow of savings into the capital marke may be maintained.
2. To ensure the fair practices by the issuer of securities, so that they can raise resources easi and cheaply.
3. To promote the efficiency services by brokers, subbrokers, merchant bankers, and othe intermediaries, so that they may become competitive and professional.

Management of the Board

1. Formation of the Board

As per Section 4 of the SEBI Act, 1992 as amended by the Securities and Exchange Board o India (Amendment) Act, 2002, the Board shall consist of the following members, namely:

(i) a chairman;

(ii) two members from amongst the officials of the Ministry of the Central Government dealing with finance and administration of the Companies Act, 1956;

(iii) one member from amongst the officials of the Reserve Bank;

(iv) five other members of whom at least three shall be the whole time members to be appoint by the Central Government.

2. Term of Office and Conditions of Service

The term of office and other conditions of service of the Chairman and the members appointed by the Central Government shall be such as may be prescribed. However, the appointment can be terminated at any time before the expiry of the prescribed period of giving not less than 3 months notice.

3. Removal of Member from Office

The Central Government shall remove a member from office if he:

(i) is or at anytime has been adjudicated as insolvent;

(ii) is of unsound mind as declared by a competent court;

(iii) has been convicted of an offence involving moral turpitude;

(iv) has so abused his position as to render his continuation in office detrimental to public interest.

4. Meetings

The Board shall meet at such times and places and shall observe such rules of procedure in regard to the transactions of business at its meetings as may be prescribed by regulations. Decisions at the meeting are to be made by a majority vote of the members present.

Functions and Powers of the Board

The functions and powers of the board are as follows:

(i) Regulating the business in stock exchanges and any other securities markets;

(ii) Registering and regulating the working of stockbrokers, subbrokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisors and such other intermediaries who are associated with securities market in any manner;

(iii) Registering and regulating the working of venture capital funds and collective investment schemes including mutual funds;

(iv) Promoting and Regulating self-regulatory organisations;

(v) Prohibiting fraudulent and unfair trade practices relating to securities market;

(vi) Promoting investors' education and training of intermediaries of securities markets;

(vii) Prohibiting insider trading in securities;

(viii) Regulating substantial acquisition of shares and takeover of companies;

(ix) Calling information for undertaking inspection, conducting inquiries and audits of stoc exchanges, mutual funds and other persons associated with the securities market an intermediaries and self-regulatory organisations in the securities market;

(x) Calling for information and record from any bank or any other authority or board or corporatio established or constituted by or under any central, state or provincial Act in respect of ar transaction in securities which is under investigation or inquiry by the Board;

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

(xii) Levying fees or other charges for carrying out the purpose of this section;

(xiii) Conducting research for the above purposes;

(xiv) 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.

(xv) Performing such other functions as may be prescribed.

SEBI Guidelines

Primary Market

The important guidelines relating to the primary market are concerned with: (1) registration of merchant bankers; (2) issue of securities, registration of venture capital funds; and (3) mergers and amalgamations. As we are concerned only with the issue of securities, we have covered only this aspect here.

Regulation of Public Issues

Objectives and Scope of SEBI Guidelines: The Capital Issues (Control) Act, 1947 was repealed on May 29, 1992. Hence it became necessary to issue certain guidelines through which the issue of capital and pricing of issue by companies can be controlled. So with a view to ensure proper disclosure and investor protection, the Securities and Exchange Board of India has issued certain guidelines in this regard. The guidelines broadly cover the requirements as to the first issue by new companies and existing private/closely held companies and also further issues of capital by other companies by way of shares, debentures and bonds. These guidelines are applicable to all issues of capital.

General Guidelines

(1) **Subscription List:** As per SEBI guidelines, subscription list for public issues should be kept open for 3 working days and it should be disclosed in the prospectus. In the case of right issues it should not be kept open for more than 60 days. The announcement of the closure of issue should be made only after 90 per cent has been subscribed. The gap between closure dates of various issues should not exceed 30 days.

(2) **Minimum Number of Shares and Application Money:**

  (i) In case of public issue at par, the minimum number of shares for which the application is to be made should be fixed at 200 shares of the face value of ₹ 10 lakh.

  (ii) The minimum application money to be paid shall not be less than 25 per cent of the issue price.

  (iii) Where the issue is at a premium or comprises of debentures whether convertible or non-convertible, the amount payable by each application should not be less than ₹ 5,000 irrespective of the size of the premium. It is subject to applications dealing with a multiple of tradeable lots.

  (iv) The successful applicants will be issued share certificates/instruments in tradeable lots.

(3) **Oversubscription:** The quantum of issues should not exceed the amount specified in the prospectus/letter of offer. No retention of oversubscription is permitted.

(4) **Compliance Report:** The lead managers have to file a report in the prescribed form with a compliance certificate from Chartered Accountants to the SEBI within 45 days of the closure of an issue.

Guidelines for Debentures

(1) **Fully Convertible Debentures:**

  (i) **Put and Call Option:** SEBI restricts the conversion period to 36 months for fully convertible debentures. Conversion after 36 months is permissible only if, conversion is made optional with **put** and **call option.**

  (ii) **Premium on Conversion of Debentures:** The amount of premium on conversion has to be predetermined and disclosed in the prospectus.

  (iii) **Conversion Option:** Any conversion in part on whole of the debentures will be optional at the hands of the debentureholder if the conversion takes place at or after 18 months from the date of allotment but before 36 months.

  (iv) **Debenture Trustees:** The names of debenture trustees must be disclosed in the prospectus. The trust deed should be executed within 6 months of the closure of the issue. The SEBI has stipulated the obligations and responsibilities of debenture trustees. The SEBI has also laid the procedure for inspection and a code of conduct. Debenture trustee should not be an associate of the body corporate or it has not sent the money which is not fully repaid or is not proposing to lend money to the body corporate.

(2) **Non-Convertible Debentures (NCD) and Partially Convertible Debentures (PCD):**

  (i) **Debenture Redemption Reserve:** If the non-convertible debentures have the maturity period of more than 18 months, then a Debenture Redemption Reserve has to be created. DRR may be created in equal instalments or with higher amounts in the remaining period, if profits permit. If the profits after the creation of DRR are not sufficient to distribute the dividends, the company can use the general reserve for distributing the dividends. Dividends more than 20 per cent cannot be declared by existing company without the prior permission of the lead institution, if the company does not comply with institutional conditions regarding interest and debt service coverage ratio. DRR will be treated as a part of general reserve for consideration of bonus issue proposals and for price fixation. Withdrawal from DRR is permissible only when 10 per cent of the amount of debenture liability has been actually redeemed by the company.

  (ii) **Debentures of Less than 18 Months Duration:** If the maturity period of debentures is less than 18 months, it is not necessary to create a charge or appoint a trustee or create DRR. If no charge is created, they are unsecured and are treated as deposits.

  (iii) **Prospectus of PCD/NCD:** The premium amount shall be predetermined at the time of conversion and should be disclosed in the prospectus. Amount of redemption, period of maturity and yield on redemption of PCD/NCD shall also be disclosed in the prospectus.

  (iv) **Disclosures for Issue of Debentures:** The disclosures relating to the raising of debentures should also include existing and future debt-equity ratios, servicing behaviour on existing debentures, payment of interest on due dates on term loans and debentures, certificate from a financial institution or bankers about their no objection for a second or *pari-passu* charge being created in the favour of trustees to the proposed debenture issue.

  (v) **Rollover of Non-convertible Portion:** Rollover of non-convertible portion of PCD/NCD can be done early only on a positive consent and not on passive consent. The companies have to give an option compulsorily to those debentureholders who want to withdraw and encash the debentures. The execution of fresh trust deed for ro convertible portion of PCD is required before rollover.

Disclosure for Issue of Debentures

The discloures relating to raising of debentures should include, among others, existing and future debt equity ratios, servicing behaviour on existing debentures, payment of due interest on due dates on term loans and debentures, certificates from a financial institution or banker about their n objection for a second or *pari passu* charge being created in favour of the trustees to the propose debenture issue.

Protection of Debenture Holders' Interest

Trustees to the debenture issue should be vested with requisite powers to protect the interes of debenture holders including a right to appoint a nominee director on the board of the compan in consultation with the debenture holders. The progress in respect of debentures raised for proje finance/modernisation/expansion/diversification/normal capital expenditure is to be monitored by the lead institution/investment institution. In regard to debentures issued for working capital, the lead bank for the company should do the monitoring. Institutional debenture holder and trustees shoul obtain a certificate from the company's auditors about the utilisation of funds during the period implementation of the project.

In the case of debentures for working capital, a certificate has to be obtained at the end of eac accounting year. Issues by companies belonging to the groups for replenishing funds or to acqui share holding in other companies is not permitted.

The company issuing debentures, has to file with SEBI certificates from its bankers, that t assets on which security is to be created are free from encumbrances and the necessary permission t mortgage the assets have been obtained or a no objection certificate from the financial institution bank for a second or *pari passu* charge in cases where assets are encumbered. The security should b created within six months from the date of issue of the debentures. If the company for any reason, not in a position to create a security within 12 months from the date of issue of the debentures, a pen interest of 2 per cent has to be paid to debenture holders. If the security is not created even after 1 months, a meeting of debenture holders should be called within 21 days to explain the reason wh and the date by which, the security would be created.

The trustees to the Debenture Issue will supervise the implementation of the conditions regarding the creation of security for the debentures, and regarding the Debenture Redemption Reserve.

Past Issues of FCDs and PCDs

In the case of FCDs and PCDs issued in the past where conversion was to be made at a price t be determined by the Controller of Capital Issues at a later date, SEBI has laid down the procedur The price of conversion and the time of conversion should be determined by the company in a dul organised meeting of the debentureholders and shareholders. The decision in the meeting has to b certified by the shareholders, such conversion will be optional. The dissenting shareholders shall hav the right to continue as debentureholders if the terms of conversion are not acceptable to them. Th letter of option should be vetted by SEBI.

New Types of Debentures

New types of Debentures mentioned by SEBI are deep discount bonds, debentures with warrants and secured premium notes. While making an issue of any new financial instrument, the issuer of capital shall make adequate disclosures regarding the terms and conditions, redemptions, security, conversion and any other relevant features of the instruments.

Guidelines for Issue of Commercial Paper

Commercial Paper is one of the non-bank sources of working capital finance. It is a money market instrument, unlike debentures which are capital market instruments. Corporate Borrowers, especially the large and financially sound, can diversify their short term borrowing by the issue of Commercial Paper. Commercial Paper is especially attractive for companies with cyclical cash flows and for cash rich companies during periods of greater cash inflows than overdraft or cash credit since monitoring is more convenient. The raising of funds through Commercial Paper is regulated by the directions of the Reserve Bank of India. The issue of commercial paper is regulated by Non-banking Companies (Acceptance of Deposits through Commercial Paper) Directions, 1989 which came into force on January 1, 1990. Scheduled Banks have emerged as significant holders of Commercial paper. The secondary market is yet to develop. The commercial papers of a few companies are traded on the National Stock Exchange.

Issue of Commercial Paper

Commercial Paper can be issued by a company whose;

(i) tangible net worth (paid-up capital plus free reserves) is not less than ₹ 4 crore;

(ii) fund based working capital limits are not less than ₹ 4 crore;

(iii) specified Credit Rating of P2 is obtained from CRISIL, A2 from ICRA and PR2 from CARE;

(iv) borrower health is classified under health code No.1; and

(v) current ratio is 1.33:1.

Usance

Commercial Paper should be issued for a minimum period of three months and maximum of one year (with effect from October 1993). No grace period is allowed for payment and if the maturity date falls on a holiday it should be paid on the previous working day. Every issue of commercial paper is treated as a fresh issue.

Denomination

Commercial Paper is issued in denominatiion of ₹ 5 lakh. But the minimum lot or investment is ₹25 lakh (face value) per investor. The secondary market transactions can be for ₹ 5 lakh or multiples thereof. The total amount proposed to be issued should be raised within two weeks from the date on which the proposal is taken on record by the bank. The paper may be issued in a signle day or in parts on different dates in which case each paper should have the same maturity date.

Ceiling

The aggregate amount that can be raised by commercial paper should not exceed 75 per cent of the company's fund based working capital.

Mode of Issue and Discount Rate

Commercial Paper should be in the form of usance promissory note negotiable by endorsem and delivery. It can be issued at such discount to face value as may be decided by the issuing compa

Issue Expenses

Issue expenses consisting of dealer's fees, rating agency fees and other relevant expenses as w as the charges derived by the bank for providing stand-by facilities should be borne by the compa

Investors

Commercial Paper may be issued to any person, bank, company or other registered (in Ind corporate body and incorporated body. Issue to NRI can only be on non-repatriable basis and is n transferable. The paper issued to NRI should state that it is non-repatriable and non-endorseable

Procedure for issue

Commercial Paper is issued only through the bankers who have sanctioned working capi limits to the company. It is counted as a part of working capital. Unlike public deposit, commercia paper really cannot augment working capital resources. There is no increase in the overall short te borrowing facilities.

Every company proposing to issue commercial paper should submit the proposal in the for prescribed by the RBI to the bank which provides working capital along with the credit rating of th company. The bank scrutinises the application and on being satisfied that eligibility criteria are me and conditions stipulated are met, will have to privately place the issue within two weeks by th company or through the good offices of a merchant banker. The initial investor pays the discounte value of the paper to the account of the issuing company with the bank in writing. The working capi limit is correspondingly reduced by the bank. The company must advise RBI, through the bank, of th amount of commercial paper issued within three days.

Guidelines for Issue of Shares

SEBI has also devised guidelines for issue of shares by the companies to ensure proper disclosu and investor protection. The guidelines classify companies issuing share on the basis of (a) numbe of years in commercial production, (b) track record, and (c) nature and background of promote entrepreneurs.

I. First Issue by a New Company

A. By Manufacturing Companies

(1) **Should be Dividend Paying Company:** On April 16, 1996 and August 12, 1997, SEBI issued guidelines in order to tighten the entry norms for companies. Accordin before going to public, a company should have a track record of dividend payment i the immediate preceding 3 years. If a manufacturing company does not have such t track record then it can approach the public only when its project has been appraised by a public financial institution or a scheduled commercial bank and such appraising enti also participates in the project funding. In May 18, 1999, SEBI revised the eligib norms. Now, a company should have a track record of distributable profits for at lea 3 out of 5 immediately preceding 5 years and a pre-issue net worth of not less tha ₹ 1 crore in 3 out of preceding 5 years with a minimum net worth to be met immediat preceding 2 years.

(2) **IPO Size and Pre-Issue Net Worth:** The entry norms for IPOs were tightened on June 15, 2000, by requiring the IPOs size up to 5 times the pre-issue net worth would be allowed only if the company had a record of profitability and net worth as specified in the guidelines. If the company does not have such track record or is issuing shares beyond 5 times the pre-issue net worth, then they are allowed to raise the capital only through book-building process with 60% of the issue to be allotted to qualified institutional buyers (QIBs).

(3) **Minimum Public Offer by IT, Media, Entertainment and Telecom Companies:** Information Technology companies were permitted on August 17, 1999 to make initial public offer of 10% of the post equity issue. Public offer should be of at least ₹ 50 crore and offer at least 20 lakh securities. On April 7, 2000, companies in the media, entertainment and telecom sectors can make a minimum level of public offer of 10% of post equity issue. The size of the net offer to the public should not be less than ₹ 5 crore.

(4) **Infrastructure Companies:** Infrastructure companies were exempted on September 9, 1998 from making a minimum public offer of 25% of its security, 5 shareholders per ₹ 1 lakh of offer and a minimum subscription of 90%.

B. Finance Companies

Those finance companies who have a minimum track record of 2 years of operation or registered as a non-banking finance company by the RBI or as intermediary by the SEBI, are eligible to issue the securities as per the guidelines issue on 29th September, 1995.

II. First Issue by New Company Set up by an Existing Company

New company set up by an existing company with 5 years track record of consistent profitability is free to price, provided the participation of the promoting company is not less than 50% of the equity of the new company and the issue price is made uniform to all investors.

III. Public Issue by Existing Listed Companies

Existing listed companies can raise fresh capital in the capital market. These companies are free to price their new issues. However, the price determination should be done in consultation with the lead managers to the issue. SEBI has the power for vetting of the prospectus to ensure adequacy of disclosures. If the banks are raising fresh capital at premium then they have to satisfy the criteria of any 2 years profitability for such issue. Companies also have to indicate the high and low prices of its share for the last two years in the offer document.

If such an issue enhances the foreign shareholding to 51% or more, then such issue can be made at a price which is determined by the shareholders in a special resolution under Section 81(1)(A) of the Companies Act, subject to permission of the RBI//Government of India.

IV. Public Issue by Existing Unlisted Public Companies

Existing unlisted company can enter in the capital market only when it has paid the regular dividend in the immediately preceding 3 years out of 5 years if its post-issue net worth becomes more than 5 times the pre-issue net worth. SEBI has also laid norms for pre-issue requirements for such companies.

V. First Issue by Existing Private/Closely-held Companies

The following norms are to be fulfilled by the existing private/closely-held companies:

The following norms are to be fulfilled by the existing private/closely-held companies: An unlisted company can

(i) Companies without track record can price the issue at par only. An unlisted company can freely price its securities provided it earned net profits in the immediately preceding 3 years

(ii) Companies with 3 years track record or companies without track record, but promoted by companies with 5 years track record are free to price the issue.

(iii) Not less than 20% of equity should be offered to public.

(iv) Draft prospectus will be vetted by the SEBI to ensure adequacy of disclosure.

(v) Pricing would be determined by the issuer and lead manager to the issue and would be subject to specific disclosure requirements about the net asset value of the company as per the latest audited balance sheet and justification for issue price.

Guidelines for Rights Issue

As per the guidelines issued by the SEBI on 23-5-95, the companies were dispensed with the requirements to submit a draft letter of offer for vetting to obtain an acknowledgement card from it which are listed on the recognized stock exchange to raise the capital on a right basis. The companies are not allowed to raise the capital of more than ₹ 50 lakh on rights basis unless the Category-I merchant banker has submitted the offer document to the SEBI.

If the company does not receive the amount of minimum subscription within 42 days from the date of closure of the issue, the entire amount of subscription has to be refunded to the applicants within next 8 days. If the company fails to refund the application money within such period, then the company will pay an interest for the delayed period, at prescribed rates in subsection (2) and (2A) of Section 73 of the Companies Act, 1956.

The merchant banker has to submit the draft letter of offer to the SEBI at least 6 weeks before its issue, incorporate comments received from the SEBI, within 3 weeks of the receipt of the draft and submit a copy of the letter of offer to the SEBI within 2 weeks of issue. A due diligence certificate is also to be submitted by them to the SEBI.

Any statement of the offer document should not contravene any of the provisions of the Companies Act. The Board of Directors should certify that all the legal requirements and guidelines issued by the SEBI, Government and any other competent authority have been duly complied with.

Guidelines for the Issue of Bonus Shares

The SEBI (Securities Exchange Board of India) has modified the previous guidelines for bonus shares w.e.f.13.4.94. The modified guidelines are as follows:

(i) The bonus issue should be made out of free reserves built out of the genuine profits or shares premium collected in cash only;

(ii) Reserves created by revaluation of fixed assets should not be capitalised;

(iii) The Development Rebate Reserve or the Investment Allowance Reserve is considered as free reserves for the purpose of calculation of residual reserves test only;

(iv) No bonus issue shall be made which will dilute the value of rights of the holders of debentures convertible fully or partly;

(v) A company which announces its bonus issue after the approval of the Board of Directors must implement the proposals within a period of 6 months from the date of such approval;

(vi) The residual reserves after the proposed capitalisation shall be at least 40 per cent of the increased paid up capital.

(vii) 30 per cent of the average profits before tax of the company for the previous 3 years should yield a rate of dividend on the expanded capital base of the company at 10%;

(viii) All contingent liabilities disclosed in the audited accounts which have bearing on the net profits, shall be taken into account in the calculation of the residual reserves;

(ix) The capital reserve appearing in the balance sheet of the company as a result of revaluation of assets or without accrual of cash resources are neither capital nor taken into account in the computation of the residual reserves of 40% for the purpose of bonus issues;

(x) The declaration of bonus in lieu of dividend is not made;

(xi) The bonus is not made unless the partly paid shares (if any) are made fully paid-up;

(xii) The company:

(a) has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof, and

(b) has sufficient reasons to believe that it has not defaulted in respect of the payment of statutory dues of the employees, such as contribution to provident fund, gratuity, etc.

(xiii) There should be a provision in the Articles of Association of the company for capitalisation of reserves, etc., and if there is no provision, the company shall amend the Articles of Association by passing a resolution in this behalf in the General Body Meeting;

(xiv) If the subscribed and paid-up capital of the company is exceeded the authorised capital due to issue of bonus shares, then a special resolution should be passed by the company at its General Body Meeting for increasing the authorised capital;

(xv) The company shall get a resolution passed at its General Body Meeting for bonus issue and in that resolution, the management's intention regarding the rate of dividend to be declared in the year immediately after the bonus issued should be indicated.

Reservations and Firm Allotment

SEBI clarified through its circular, dated 11-10-93 that the firm allotment/reservations should not exceed 75% of the total issue amount. Earlier under the SC (R) Rules, 1957, it was made clear that a company has to issue 25 per cent of each class of securities to the public. The balance may be offered to the various categories of investors on a firm allotment or reservation basis. On 10th October, 1994, the SEBI further clarified that firm allotment are not subject to any lock-in period.

Reservation in Issue of Shares

The following categories of investors are eligible for firm allotment as per following norms:

(i) Permanent employees including directors of the company and in the case of a new company, the permanent employees of the promoting company—MPA is 10 per cent.

(ii) Shareholders of the promoting companies in case of a new company and in the case of existing companies, the shareholders of group companies – maximum permissible amount (MPA) is 10 per cent.

(iii) Indian mutual funds on a competitive basis – MPA is 20 per cent.

(iv) Foreign institutional investors including NRIs and OCB– MPA is 30 per cent.

(v) Indian and multilateral developmental financial institutions – MPA is 20 per cent.

Firm Allotment: As per the SEBI's circular dated October 11, 1993, the firm allotment is allowed to Foreign Institutional Investors (FIIs) including NRI and OCB, Development Financial Institutions (DFIs), Indian mutual funds and permanent regular employees of the issuing company. Firm allotment is allowed to them as per the following norms:

(i) FIIs – 30 per cent

(ii) FIs – 20 per cent

(iii) Indian Mutual Funds – 20 per cent

(iv) Permanent Regular Employees – 10 per cent (limited to 200 shares of ₹ 10 lakh)

SEBI further clarified through its circular dated 29th September, 1995, that lead merchant banker is eligible to firm allotment for up to 5 per cent of the issue. SEBI clarified in October 1994, that issuers can make firm allotments to scheduled banks in their public issue within the prescribed percentage for the category of development financial institutions.

SEBI, through clarification XII, dated 27-09-1995, has removed the individual ceiling in respect of firm reservation basis, except the ceiling of 10 per cent applicable to employees as well as to the shareholders.

Guidelines for Preferential Allotment

The guidelines laid down by the SEBI permit the issuing company to make preferential allotment to promoters by complying with the provisions of the Companies Act. As per the guidelines issued by the FIs on 14-12-93, preferential allotment can be made to existing or new local promoters, foreign collaborators, parent companies only on the approval of shareholders holding 90 per cent of the equity. The allotment should be made at the market value of shares. The market price shall be determined by the average value of weekly high and low of the closing prices during the preceding 6 months or the averge of the weekly high and low of the closing prices during the preceding 2 weeks whichever is higher.

As per the guidelines issued by SEBI in 1994, issues of capital by the listed companies on a preferential basis of any select group of persons will be at market related prices. SEBI also allowed to listed companies to make preferential allotment to FIIs, if they are registered with the SEBI. 10 per cent ceiling was imposed in case of a single FII. The maximum holdings of all non-resident portfolio including those of registered FIIs and NRIs should not exceed 30 per cent.

SEBI has imposed a 5 year lock-in period for shares, warrants and debentures issued on preferential basis. The lock-in period limitation will also apply to FIIs and mutual funds. The lock-in period provision for preferential allotment was removed on March 1, 1996 for all categories except for the promoters. On 15th June 2000, a lock-in period of 6 months (amended in 2005) was imposed on shares issued on preferential basis by listed companies to any person.

Employees Stock Option Scheme

Employees Stock Option Scheme (ESOP) or stock option is a voluntary scheme which encourages employees' participation in the company. This scheme is particularly beneficial for those companies whose activities are dominantly based on the talent of the employees such as, software companies

Guidelines Regarding Employee Stock Options in India (ESOP)

Every company whose securities are listed on any stock exchange may offer securities to its employees through ESOP, but subject to the following specified conditions. These conditions are:

(i) The issue size under ESOP should not exceed 5% of the paid-up capital of the company in one year.

(ii) The company cannot allot securites to promoters and the part-time directors under ESOP, even if they are employees of the company.

(iii) The companies are free to devise the ESOP including the terms of payment.

(iv) Issue of shares under ESOP on a preferential basis can be made at a price not less than the higher of the following:

- (a) The weekly average of high and low of the closing prices of the related shares quoted on the stock exchange during the previous 6 months.
- (b) The weekly average of high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

(v) A company who is introducing ESOP has to submit a certificate to the concerned stock exchange that the securities have been issued as per the scheme to permanent regular employees.

Guidelines for a special stock option scheme for Indian software companies were announced on June 22, 1998. This scheme is available to non-resident and resident permanent employees. The Indian and overseas working directors are also eligible under the scheme. This scheme enabled the software companies to offer on comparable terms with international companies. The issuing company is entitled to issue stock options not exceeding 10% of its paid-up capital. On June 16, 2000, the government expanded the scope of the scheme for issue of foreign currency convertible bonds and ordinary shares.

J.R. Verma Panel submitted its repot in June , 2002. On the basis of the report, the SEBI on 4th October, 2002 put a lock-in-period of 3 years on sweat equity shares to employees and directors. A new pricing formula on the line of preferential allotments was also given by the SEBI.

- The ESOS/ESPS would mean the scheme under which a company grants option to employees and offers shares to its employees as a part of public issue or otherwise.
- The employees have been given flexibility of exercising their option during the exercise period and to exercise option in accordance with the ESOS. The companies can offer equity shares and securities convertible into equity shares. The scheme includes American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) or other Depository Receipts representing underlying equity shares or securities convertible into equity shares.
- The company has the freedom to determine the exercise price or pricing formula.
- The employees have been given the option to avail of such right but not an obligation to apply for shares of the company at a predetermined price.
- The employees can exercise the time period granted to them as a matter of their right to apply for shares against the option vested with them in accordance with the guidelines under ESOS.
- The right of option vested with the employees can lapse in case of termination of employment for misconduct.

- The ESOS can be offered to employees of the company provided the shareholders of the company approve the proposal by passing a special resolution in general meeting.
- There shall be a minimum period of one year between the grant of option and vesting of options. The company shall have the freedom to specify the lock-in period for the shares issued in accordance with the provisions of ESOS.
- The employee shall not have the right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to him till shares are issued on exercise of option.
- Option granted to an employee shall not be transferable to any person. The option granted to the employee shall not be pledged, hypothecated or mortgaged.
- In respect of options granted under ESOS during any accounting period, the accounting value of the option shall be treated as another form of employee compensation in the financial statement of the company.
- The accounting value of options shall be equal to the aggregate, overall employee stock options granted during the accounting period, of the fair value of the option.

Guidelines for Book Building

Book-building is relatively a new option for issue of securities. The first guidelines regarding this were issued on October 12, 1995 and after that these guidelines were revised from time to time. Book building is a method of issue of shares based on floor price which is indicated before the opening of the bidding process. The issue price is fixed after a bid closing date. Book-building involves firm allotment of the instrument to a syndicate or a merchant banker. That lead merchant banker or the syndicate member of the issue will nominate as a book runner by the issuer company. The book runner has to circulate the copy of the draft prospectus to be filed with SEBI and among the instructional buyers who are eligible for firm allotment. The draft prospectus should indicate the price band within which the securities are being offered for subscription.

The offers are sent to the book runners. The record of names and number of securities offered by the institutional buyer is maintained by the book runner within the placement portion. The underwriter should also intimate the orders received by him within the placement portion and the price for which the order is received to the book runners. The price is finalised by book runner and issuer company and the issue price for the placement portion and offer to the public should be the same. The book runner collects the application forms along with application money one day earlier to the operating of the issue to the public from the institutional buyers and the underwriters. Proper records should be maintained by the book runner and other intermediaries involved in the book-building process. These records can be inspected by the SEBI at any time.

The book-building is compulsory for companies for IPOs which do not have specified track record of profits. These companies have also to allot 60% of offer to qualified institutional buyers (QIBs), such as, financial institutions, banks, mutual funds, etc. SEBI introduced the modified rules on September 5, 1997 for book-building exercise. The process of book-building has been made applicable to 100% of the issue size in case of issue of ₹ 100 crore or more.

An issuer company proposing to issue capital through book building shall comply with the following:

(A) 75% Book Building Process

In an issue of securities to the public through a prospectus the option for 75% book building shall be available to the issuer company subject to the following:

(i) The option of book-building shall be available to all body corporate which are otherwise eligible to make an issue of capital to the public.

(ii) (a) The book-building facility shall be available as an alternative to, and to the extent of the percentage of the issue which can be reserved for firm allotment.

  (b) The issuer company shall have an option of either reserving the securities for firm allotment or issuing the securities through book building process.

(iii) The issue of securities through book-building process shall be separately identified/indicated as 'placement portion category', in the prospectus.

(iv) (a) The securities available to the public shall be separately identified as 'net offer to the public'.

  (b) The requirement of minimum 25% of the securities to be offered to the public shall also be applicable.

(v) In case the book-building option is availed of, underwriting shall be mandatory to the extent of the net offer to the public.

(vi) The draft prospectus containing all the information except the information regarding the price at which the securities are offered shall be filed with the Board.

(vii) One of the lead merchant banker to the issue shall be nominated by the issuer company as a Book Runner and his name shall be mentioned in the prospectus.

(viii) (a) The copy of the draft prospectus filed with the Board may be circulated by the Book Runner to the institutional buyers who are eligible for firm allotment and to the intermediaries eligible to act as underwriters inviting offers for subscribing to the securities.

  (b) The draft prospectus to be circulated shall indicate the price band within which the securities are being offered for subscription.

(ix) The Book Runner on receipt of the offers shall maintain a record of the names and number of securities ordered and the price at which the institutional buyer or underwriter is willing to subscribe to securities under the placement portion.

(x) The underwriter(s) shall maintain a record of the orders received by him for subscribing to the issue out of the placement portion.

(xi) (a) The underwriter shall aggregate the offers so received for subscribing to the issue and intimate to the Book Runner the aggregate amount of the orders received by him.

  (b) The institutional investor shall also forward its orders to the book runner.

(xii) On receipt of the information, the Book Runner and the issuer company shall determine the price at which the securities shall be offered to the public.

(xiii) The issue price for the placement portion and offer to the public shall be the same.

(xiv) On determination of the price, the underwriter shall enter into an underwriting agreement with the issuer indicating the number of securities as well as the price at which the underwriter shall subscribe to the securities.

(xv) On determination of the issue price within two day, thereafter the prospectus shall be filed with the Registrar of Company.

(xvi) The issuer company shall open two different accounts for collection of application money, one for the private placement portion and the other for the public subscription.

(xvii) One day prior to the opening of the issue to the public, Book Runner shall collect from the institutional buyers and the underwriters the application forms along with the application moneys to the extent of the securities proposed to be allotted to them/subscribed by them.

(xviii) Allotments for the private placement portion shall be made on the second day from the closure of the issue.

(xix) In case, the Book Runner has exercised the option of requiring the underwriter to the net offer to the public to pay in advance all moneys required to be paid in respect of their underwriting commitment by the eleventh day of the closure of the issue the shares allotted as per the private placement category shall be eligible to be listed.

(xx) In case of under subscription in the net offer to the public spill over to the extent of under subscription shall be permitted from the placement portion to the net offer to the public portion subject to the condition that preference shall be given to the individual investors.

(xxi) The Book Runner and other intermediaries associated with the book building process shall maintain records of the book building process.

(B) Offer to Public Through Book Building Process

An issuer company may, subject to the requirements, make an issue of securities to the public through a prospectus in the following manner:

(a) 100% of the net offer to the public through book building process, or

(b) 75% of the net offer to the public through book building process and 25% at the price determined through book building.

Allocation/Allotment Procedure

(i) In case an issuer company makes an issue of 100% of the net offer to public through 100% book building process:

- (a) not less than 35% of the net offer to the public shall be available for allocation to retail individual investors;
- (b) not less than 15% of the net offer to the public shall be available for allocation to non institutional investors *i.e.*, investors other than retail individual investors and Qualified Institutional Buyers;
- (c) not more than 50% of the net offer to the public shall be available for allocation to Qualified Institutional Buyers.

(ii) In case an issuer company makes an issue of 75% of the net offer to public through book building process and 25% at the price determined through book building:

- (a) in the book built portion, not less than 25% of the net offer to the public, shall be available for allocation to non Qualified Institutional Buyers and not more than 50% of the net offer to the public shall be available for allocation to Qualified Institutional Buyers.
- (b) the balance 25% of the net offer to the public, offered at a price determined through book building, shall be available only to retail individual investors who have either not participated or have not received any allocation, in the book built portion.

7

Investor's Protection

Introduction

Capital market exists only when there are investors to invest in the securities of companie Therefore, confidence of investors is the prerequisite for the growth of capital market. Their confiden shall be generated only if both the markets (primary and secondary) are efficient and have transparen in their functioning and the interest of investors is well protected. In the recent past, SEBI has initiat many reforms in the primary and secondary markets with focus on investor protection. In this regar a committee under the Chairmanship of Dr. N.L. Mitra was also formed. A number of other measu have also been taken in this regard.

Investor

Investor is one who invests the money to get returns in the future. It includes: individual, bod of persons, corporates, banks, financial institutions, co-operative societies, etc. If a person has mo money than he requires for current consumption, he would be called as potential investor. A person commitment to buy a flat or a house for his personal use does not make him investor. In other word investor is one who reaps money for some return in future. But if a spouse buys a stock/debentu for its dividend/interest, she may be termed as an investor. Time and risk are the two attributes investment. The investor tries to match the risk and return.

Characteristics

The investor has the following characteristics:

1. **Time:** He plans for a longer time horizon. The period of holding may vary between one ye to few years.
2. **Risk:** He assumes moderate risk. The investor likes to invest in securities where his princip would be safe and he will get moderate rate of return.
3. **Decision:** He considers fundamental factors and evaluates the performance of the compa regularly.
4. **Long-run Performance:** The investor is interested in the long-run return and therefore he i interested in the consistent good performance of the company.
5. **Funds:** Generally, he uses his own funds and avoids borrowed funds.

Objectives of Investment or Why do the Investors Make Investment

The main investment objectives of investors are as follows:

1. **Return:** Investors invest the money to earn a good rate of return so that he can maximise his earnings. The rate of return could be defined as a percentage of total income received during the period to purchase price of the security. It can be calculated as follows:

$$\text{Rate of Return} = \frac{\text{End Period Value} - \text{Beginning Period Value} + \text{Divide}}{\text{Beginning Period Value}}$$

2. **Liquidity:** Investors invest in the securities as they are more liquid in comparison to other fixed assets. Easy marketability of the investment provides liquidity to the investment. The investor can sell these investments easily and therefore these are considered as good as cash. He can also take the loans from banks and financial institutions against these securities.
3. **Hedge Against Inflation:** Since there is inflation in the economy, the investor invests his surplus money to ensure a cover against the inflation. Growth stocks appreciate in their values overtime and provide a protection against inflation.
4. **Risk:** It is a synonym of the variability of return. An investment whose rate of return varies widely from period to period is risky. Every investor likes to reduce the risk of his investment by a proper combination of securities. Generally, the securities of fundamentally strong companies have minimum risks, therefore, people (investors) want to invest in these securities.
5. **Safety:** The investors are well protected by a legal and regulatory framework. Investment in government securities are assumed to be more safe than the securities of other companies. Because of safety norms, the number of investors and the amount of investment is increasing year by year.

The first survey of Indian investors was conducted during 1998-99. SEBI and NCAER conducted another survey of Indian investors during April-December, 2000, based on a sample of 2,88,081 households located in geographical dispersed rural and urban areas. The findings of the survey were published in March, 2003. The important findings are:

(i) An estimated 13.1 million or 7.4 per cent of all India households totalling 21 million individuals directly invested in equity shares or debentures or both during 2001-02.

(ii) An estimated 11.8 million households totalling 19 million individuals invested in units of mutual funds during 2001-02.

(iii) The number of debentures owing households at 9.6 million far exceeded the number of debentures owing households at 6.5 million.

(iv) Altogether there is a projected total of 13.1 million investor households as per 2000-01 survey as against 12.8 million investor households as per 1998-99 survey, thereby indicating an increase of 3 lakh investor households.

(v) While the number of investor households in the urban sector declined by 1 million between both the surveys, the number of investor households in the rural sector increased by 1.3 million.

(vi) The number of investor households owing equity shares declined to 6.6 million in 2000-01 (12.1 million in 1998-99) while the number of investor households owing debentures shot up to 9.6 million in 2000-01 (3.7 million in 1998-99).

(vii) The growth of investor households has decelerated to 2.3 per cent.

(viii) The percentage of households has decelerated to 2.3 per cent is more in urban areas ([illegible] per cent) than in rural areas (4.24 per cent).

(ix) The number of non-investor households increased from about 156 million in 1998-99 to nearly 164 million in 2000-01.

(x) The Southern Region (46 per cent), Western Region (33 per cent) and Eastern Region (11 per cent) figure in the same order in the share of investor households.

Investor Protection

Investors are the backbone of the securities market. The **'investor protection'** is a wider term which includes the various measures taken by government and SEBI to protect the investors from malpractices of companies, brokers, merchant bankers, issue managers and registrars of new issues, etc. Since the investors' confidence is an essential prerequisite for the growth of capital market. Therefore, it is necessary to generate their confidence in the capital market. For boosting their confidence, it is necessary to ensure availability of adequate, up-to-date and correct information to investors, so that they can make the cost and benefit analysis before investment. The Government, SEBI and stock exchange authorities are working as watchdog through rules, regulations and control mechanisms. Many reforms have taken place in the primary and secondary markets to protect investors in the recent past.

Despite all the precautionary measures by the regulating authorities and investors, certain grievances and issues do arise in the capital market. Such grievances have been increasing in number in recent years. The complaints of investors come mainly against:

(i) member brokers of stock exchanges;

(ii) companies listed for trading on the stock exchanges.

In addition to the above, the complaints against subbrokers, agents, merchant bankers, issue managers, etc., can also be seen. But the stock exchanges cannot entertain the complaints against these as per their rules.

1. **Complaints Against Brokers:** Investors make complaints mainly against subbrokers, agents and brokers regarding the price, quantity, defective delivery, delayed delivery and payment and non-payment, etc.
2. **Complaints Against Companies:** The complaints against companies are in the nature of non-receipt of allotment letters, refund letters, non-receipt of dividends, interest, delay in transfer of shares and refusal of splitting or consolidation, etc.

The grievance procedure in respect of complaints against members is as follows:

(i) Joint meeting of members vis-a-vis the clients for an amicable settlement.

(ii) Arbitration proceedings by the committee under the bye-laws.

(iii) Special committee appointed by the Executive Director for settlement.

(iv) Disciplinary proceedings including warnings, fines, penalties, etc., particularly in case of fraud, cheating, etc., by the members.

The grievances of investors may be classified as follows:

I. Grievances against the Companies

The common grievances of investors regarding companies are as follows:

(i) Delay in transfer or delay in dematerialisation.

(ii) Non-payment or non-delayed payment of dividend.

(iii) Non-receipt of notice of meetings.

(iv) Non-receipt of annual reports.

(v) Non-payment/delayed payment of fixed deposits.

(vi) Non-receipt of rights share offer.

(vii) Issue of duplicate shares in lieu of lost or misplaced shares.

II. Grievances against Brokers

The grievances against brokers are as follows:

(i) Non-issue of contract note.

(ii) Non-delivery/delayed delivery of securities.

(iii) Non-payment/delayed payment for selling of securities.

(iv) Charging for purchases at the rates higher than the exchange prices.

(v) Charging brokerage for selling and purchasing of securities at higher rates.

(vi) Non-passing of corporate benefits to the purchaser.

III. Grievances against the Depository Participants

The grievances against the depository participants are:

(i) Delay in sending for dematerialisation of physical securities.

(ii) Non-receipt of statement of account by the accountholder.

(iii) Charging at higher rates for dematerialisation and transactions of securities.

(iv) Wrongly debiting the account of demat.

(v) Delay in transferring the securities as per delivery instructions of the clients.

Redressal of Grievances

I. Stock Exchange and Investor Protection

Investors are the backbone of the securities market. Protection of their interest therefore is paramount for exchanges. In furtherance of their interests, exchanges have put in systems to ensure availability of adequate, up-to-date and correct information to investors to enable them to take informed decisions. They ensure that critical and price sensitive information reaching the exchange is made available to all classes of investors at the same point of time. Such price sensitive information as bonus announcements, mergers, new line of business, etc., received from the company is disseminated to all the market participants through the network terminals of exchanges all over India. Exchanges can initiate the action where such price-sensitive information is not provided to them at the prescribed time. The exchanges conduct various seminars and programs for the investors all over the country with a view to educate them on their rights and obligations and precautions they should take while dealing in the securities market. The exchanges have also prescribed and made effort to ensure the implementation of various safeguards like time schedules for issuing contract notes, for receiving funds and securities purchased by investors, segregation of client funds and securities from those of members, etc. Exchange makes an audit trail available on request for all transactions executed on the exchange to enable investors to countercheck trade details for the trades executed on this behalf by the member. Using this facility, an investor who had received a contract note from the trading member of the exchange can check whether the trade has been executed.

The removal of grievances can be studied under the following heads:-

(1) **Grievances Cells:** The Central Co-ordination and Monitoring Committee (CCMC) has set up a joint mechanism to initiate actions against companies which do not comply with the conditions of listing agreement and which are not physically traceable at the registered office address. CCMC reviews the various actions initiated against defaulting companies from time to time.

SEBI has a separate investor grievances and guidance division at head office for the redressal of investors' grievances. The grievance letters received by this division are classified into different categories. To further strengthen investor confidence and market safety, it was decided to set-up an Investor Grievances Redressal Cell (IGRC) in the Department of Economic Affairs (DEA). This cell will coordinate the efforts of the regulatory agencies, viz., RBI, SEBI and DEA to redress investor grievances.

SEBI had debarred under Section 11B of SEBI Act, 61 companies and 235 directors, till the end of 2000-01, from associating themselves in every respect from capital market related activities. The Department of Company Affairs initiated the prosecution against 108 companies for non-filing of required information and had undertaken inspection of 61 companies under Section 209-A.

(2) **Investor Protection Fund:** The committee under the chairmanship of **Dr. N.L. Mitra** submitted its study report on investor protection to SEBI and Government. Its main recommendations were:

(i) A judicial forum is required to redress investors' grievance concerning award of compensation.

(ii) Provisions relating to Investor Education and Protection Fund (IEPF) be removed from the Companies Act and be included in the SEBI Act, 1992. IEPF should be administered by SEBI.

(iii) SEBI should be the only regulator of capital market.

(iv) All IPOs be insured on the principle of third party insurance with different premium based on the risk study by insurance companies.

(v) SEBI Act be amended to provide for standing committees on investors' protection, market operation and standard setting.

(vi) The SC(R) Act be amended to facilitate corporatisation of exchanges and to ensure good governance of stock exchanges. On the recommendation of the **N.L. Mitra** report, the Central Government notified the establishment of the IPEF with effect from October 1, 2001. The IPEF shall be credited with amounts in unpaid dividend accounts of companies, application money received by companies for allotment of any securities and due for refund, matured deposits and debentures with companies and interest accrued thereon, if they have remained unclaimed and unpaid for a period of 7 years from the due date of payment. The IPEF will be utilised for promotion of awareness amongst investors and protection of their interest. The amount of a single claim by investors from the fund has been increased to ₹ 10 lakh for exchanges. NSE had accumulated an amount of ₹ 548.92 crore in its Investor Protection Fund on 31st March, 2016. SEBI also established IPEF on 23rd July 2016.

(3) **Investor Protection Cell:** All the exchanges have an active and efficient dispute resolution mechanism. The Investor Service Cell is established to look into the investors' grievances against the listed companies and stockbrokers. It also settles the disputes between investors and trading members and among the trading members. The stock exchange authorities are authorised to delist the specified companies for specified periods. Now, the investors are being given the right to name the arbitrator.

(4) **Trade Guarantee Fund:** The BSE created the Trade Guarantee Fund in 1997. The main objectives are given below:

(i) To guarantee the settlement of the bonafide transactions of members to exchange inter-se which forms a part of stock exchange settlement.

(ii) To ensure timely completion of settlement of contracts and thereby protecting the interest of investors and the members of the exchange.

(iii) To build confidence in the minds of the secondary market operations.

(iv) To protect the interest of investors, promote the development and regulate the secondary market.

A defaulter's committee having 60% public representatives is set-up to manage the fund. The failure of the member to meet his obligation on pay-in-day to the Clearing House is informed to Executive Director or the President of the Exchange. The President or Governing Board or any two elected directors after giving two hours notice to the defaulting member declare him as defaulter. Now, the defaulters committee has to pay the unpaid settlement dues of the defaulter to the clearing house before the pay out.

(5) **Brokers' Contingency Fund:** The stock exchange Brokers Contingency Fund has been established by the stock exchanges in July 1997 to grant refundable advance to members who may have temporary mismatch of funds. Every existing active member has to contribute an initial non-refundable contribution of one thousand rupees to the fund.

(6) **Arbitration:** Arbitration is a speedy and alternative dispute resolution mechanism provided by the exchange for resolving disputes between the trading members and between a trading member and his client, in respect of the trades done on the exchange. The arbitration mechanism is provided by the exchange in all its regional offices to facilitate the speedy dispute resolution mechanism. The parties to dispute appoint an arbitrator from the panel of arbitrators maintained by the exchange and approved by SEBI. The arbitrators pronounce an award after going through various documents submitted by the parties and hearing them. The arbitration matters with the NSE as at the end of March 2016 is as follows:

Table 1

Years and Segment	No.of Cases Received	Withdrawn	Awards	Pending
2014-15				
CM	265	5	260	0
F & O	213	210	3	0
CDS	13	13	0	0
2015-16				
CM	203	4	151	48
F & O	213	7	164	42
CDS	11	0	5	6

(Source: NSE Fact Book, 2015-16, p. 81)

II. Company Law Board

(1) Investor Protection Cell: The following Table 2 explains the nature of complaint and procedure for the redressal:

Table 2
Investor Protection Cell

Nature of Complaint	Forum to be Approached and its Procedure
1. If the complaint is relating to non-receipt of matured fixed deposit from a non-banking financial company.	1. Move to Company Law Board and file Form No. 4 for each matured fixed deposit along with a DD of ₹ 50/- drawn in favour of Pay and Accounts Officer, Deptt. of Company Affairs of the State. 2. Company Law Board will pass an order under Section 45QA of the RBI Act, 1934 based on the Form No. 4. 3. On receipt of the order of the Company Law Board, if such order is not obeyed by the company within the specified date, the affected investor has to approach the Deptt. of Non-banking Supervision, RBI being the prosecution authority under Section 45QA of RBI Act, 1934.
2. If the complaint is relating to non-receipt of matured fixed deposit from manufacturing companies (other than non-banking financial company.	1. Move to Company Law Board and file Form No.4 for each matured fixed deposit along with a DD for ₹50/- drawn in favour of Pay and Accounts Officer, Deptt. of Company Affairs of the State. 2. Company Law Board will pass an order under Section 58A (9) of the Companies Act,1956. 3. On receipt of the order of CLB, if such order is not obeyed by the company, within the specified date, the affected investor has to prefer a complaint before the ROC of the state to enable ROC to take action under Section 58A (10) of the Companies Act,1956.
3. If the complaint is relating to non-refund of money invested in the companies which came out with various schemes like plantation scheme, time-share, teak-schemes, holiday resorts, goat farms, buying and selling of units.	The affected investor has to approach SEBI, D'Monte Building, 3rd Floor, 32, D'Monte Colony, TTK Road, Alwarpet, Chennai, under the Collective Investment Scheme framed under Section 11B of SEBI Act, 1992, read with Regulations 65 and 73 of SEBI Collective (Investment) Regulations 1999.
4. If the complaint is relating to any other issue as covered under the Companies Act, 1956.	Complaint may be preferred with Registrar of Companies of the State.

(2) Power to Investigate: The Company Law Board under Section 235 of the Companies Act, 1956 have the right to investigate the affairs of the company and take proper action if an application is made to it by not less than 200 members or such number of members holding not less than 1/10 of the total voting power.

(3) Variation of Investor's Rights and Obligations: No variation of the rights and obligations can be made unless 75% of the shareholders present at a general meeting agree to do so. In fact, if the rights attached to any class of shares are varied at any time, the members holding not less than 1/10th of shares of that class may apply to the court to have the variation cancelled.

(4) Prevention of Oppression and Mismanagement: Under Section 397 of the Companies Act, 1956, members of a company who have a complaint that the affairs of the company are being conducted in a manner prejudicial to the public interest or in a manner oppressive to any member, they (minimum 100 or not less than 1/10th of total numbers) can make an application to the Company Law Board.

Under Section 398, members (minimum 100 or not less than 1/10th of total numbers) may petition to the Company Law Board in case they have a complaint that the affairs of the company are mismanaged.

(5) Legislative Protection to Investors: The Companies Act and the Listing Agreement of the stock exchanges provide certain safeguards to investors. The normal complaints against companies and the protection available are listed below:

Table 3
Nature of Complaint and Relief Provided

Complaint	Legislative Provision	Relief Provided
1. Delay in refund of excess application money or allotment letters.	Section 73 of the Companies Act as amended by Amendment Act of 1988.	Payment of interest for the delayed period beyond 30 days from the closure of subscription list at the rate of 15%.
2. Delay in transfer of shares.	Section 111 of the Companies Act.	A time limit of two months provided in the Act for effecting transfer. As per the listing agreement, the time limit is only one month from the lodgment of shares.
3. Refusal to transfer shares.	Section 22(A) of SC(R) Act. This section lists the reasons for which transfer of shares can be refused.	Transfer can be refused only for specific and valid reasons given in the Act and not otherwise.
4. Problem of odd lots.	Listing Agreement provides for issue of certificates in marketable lots and avoidance of odd lots with demat form of shares, this problem does not exist.	Need for consolidation of odd lots and ensuring the issue of shares only in marketable lots through conversion of debentures or rights issue, provision of an odd lot trading session and listing out brokers willing to trade in odd lots.

5. Takeover bids.	New clauses of 40 (A) and 40 (B) of Listing Agreement and SEBI Rules on takeover bids.	Purchases or acquisition of shares beyond 5% to be notified to the stock exchange. Acquisition beyond 10% plus an obligation on the transferor and transferee and intermediary to notify the Stock Exchange and the public and offer to the other shareholders of the company to buy at their price or the highest market price during the preceding six months.
6. Insider trading, rigging and other malpractices.	SEBI (Insider Trading) Regulation 1992.	The investors have to guard themselves regarding the price and their investment.
7. Delay and non-payment of interest/fixed deposits by companies.	Section 58(A) of the Companies Act.	Complaint to the Company Law Board.
8. Delay and non-payment of dues or non-delivery of shares, etc., by brokers.	Rules, bye-laws, etc., of the Stock Exchange.	Complaint to the Grievance Cell of the concerned Stock Exchange and to SEBI.

(6) Investor Education and Protection Fund: Section 205C of the Companies Act, 1956 empowers the Central Government to establish a fund to be called 'The Investor Education and Protection Fund'. The Fund shall be utilised for promotion of investors' awareness and protection of the interests of investors in accordance with such rules prescribed. For the administration of the Fund, the Investors Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001 were made.

III. SEBI and Investor Protection

SEBI has a comprehensive investor grievances processing mechanism. A standardised complaint format is available at all SEBI offices and on the SEBI website for the convenience of investors. Complaints received from investors are acknowledged and a reference number is sent to the complainant. Complaints are taken up with the concerned companies. SEBI officers also hold meetings with the company officials to impress upon them their obligation to redress the grievances of investors. Recalcitrant companies are referred to Enforcement Division for appropriate action. SEBI also issues fortnightly press release for public information, on the status of redressal of investor grievances.

(1) Secondary Market: SEBI is consistently taking up complaints against companies, brokers and other intermediaries. But still there may be occasions when investors have a grievance against the company or against the member brokers. They first approach the company or the concerned broker in this regard. But if they are not satisfied with their response, they can take up the matter with the concerned authority. A list of the nature of grievances and the concerned authority of SEBI is given in the Table 4.

Table 4

Nature of Grievances and Concerned Authority of SEBI

Nature of Grievances	Concerned Authority of SEBI
Type-I: Issue Related, i.e., non-receipt of refund order/ allotment advice, cancelled stock invests.	Respective Investor Grievances and Guidanc Division (IGG), SEBI.
Type-II: Non-receipt of dividend.	Respective IGG Division, SEBI.
Type-III: Shares related, i.e., non-receipt of share certificates.	– do –
Type-IV: Debentures related, i.e., non-receipt of debenture certificates, interest warrants.	– do –
Type-V: Non-receipt of letter of offer for rights and interest on delayed payment of refund orders.	– do –
Type-VI: Complaints related to collective investment schemes.	– do –
Complaints related to Mutual Funds (MF).	MF Deptt., SEBI, Mumbai.
Complaints related to Dematerialisation or Depository Participant.	Depositories and Custodian Cell, SEBI, Mumbai.
Complaints related to Fresh Issue of Capital, e.g., Public Issue documents.	Primary Market Division, SEBI, Mumbai or Respective Regional Offices of SEBI.
Complaints related to buyback of shares.	Primary Market Division, SEBI, Mumbai.
Complaints pertaining to Takeovers.	Takeover Division, SEBI, Mumbai.
Complaints against Stock Exchanges, Stockbrokers, Subbrokers.	Secondary Market Division, SEBI, Mumbai.

However, the following types of grievances could be taken up with the other authorities/agencies as given below:

Table 5

Nature of Grievances and Concerned Authority

Nature of Grievances	Concerned Authority
Complaints related to securities traded/listed with the exchanges. Complaints regarding the trades effected in the exchange against the companies. Complaints regarding the trades effected in the exchange against the members of the exchange.	At the Investor Information Centre of all the recognised stock exchanges.
Complaints against unlisted companies. Complaints regarding non-receipt of annual report, AGM notice. Fixed Deposits in manufacturing companies.	With the Department of Company Affairs/ concerned Registrar of Companies.
Fixed deposit in banks and NBFCs.	With the Reserve Bank of India.
Forfeiture of shares.	Concerned Company/ROC.

(i) **Investors' Association:** The Board has been granting registration to Investor Association in order to bring about an organised form of investor movement. The role of investor associations are two fold-one, to take up investor complaints and raise issues which may affect the interest of investors and two, educating and creating awareness about the securities markets to investors. SEBI has also nominated these investor associations in various Committees so that they have an opportunity to represent the 'investor angle' in any proposed policy changes, some of the investors' associations registered with SEBI have organised seminars for educating investors on various topics of capital market with the financial support extended by SEBI. At the end of 2013-14, 25 investors' associations were registered with the SEBI.

(ii) **Stock Watch System:** The stock watch system is a method under which SEBI keeps a regular eye on the price movement of securities in the market and movement of stock market as a whole. To check the volatility in the prices of the securities, circuit breaker system is introduced.

(iii) **Appellate Tribunal:** An appellate tribunal to hear appeals against orders issued by SEBI was set-up in 1997. The tribunal is located in Mumbai. The tribunal hears all appeals against the adjudication orders issued by SEBI officials. Appeals against tribunal's decisions lie in the High Court.

(iv) **Ombudsman/Stipendiary Ombudsman Regulations, 2003:** The SEBI has established ombudsman/stipendiary ombudsman to redress the grievances of investors in securities and for connected matters. As per the regulations, the SEBI may appoint one or more ombudsman/stipendiary ombudsman for specified territorial jurisdiction. The office of the ombudsman would be located at the head office or at other specified offices of the SEBI. Whereas the stipendiary ombudsman would be located at the place of specific complaints. The ombudsman should be a citizen of India with high moral integrity and below the age of 45 years. A person retired as district judge or having special knowledge and experience of at least 10 years in law, finance, economics, management or corporate matter or a member of recognised investor protection with minimum 10 years experience is eligible for becoming ombudsman.

The ombudsman may receive complaints against any intermediary/listed company or both for the following:

(i) Non-transfer of securities by an issuer company/mutual fund, collective investment management company, depository within the stipulated time.

(ii) Any grievances in respect of public /rights/bonus issue of a listed company.

(iii) Any grievances in respect of issues/dealing in securities against any intermediary/listed company.

(iv) Any of the matters covered under Section 55-A of the Companies Act.

(v) Non-receipt of share certificates, debenture certificates or unit certificates, bonus shares rights issue offer, etc.

(vi) Non-receipt of refund orders/allotment letters in respect of public issue of securities.

(vii) Non-receipt of interest on debentures, redemption amount of debentures.

(viii) Non-receipt of redemption amount from a mutual fund or collective investment schemes.

(ix) Non-receipt of letter of offer/consideration in takeover or buy-back offer or delisting.

(x) Non-receipt of annual reports/statements pertaining to portfolios.

The ombudsman would try to promote a settlement of the complaint by mediation between the parties. In case the matter is not resolved by mutual agreement, he would hear the concerned parties on the basis of the material placed before him and will give his award in writing or pass other appropriate directions or orders within 3 months. The award should be implemented by the directed party within 30 days. Otherwise he would deemed to have failed to redress grievances and will be liable for penalty under section 15-C of the SEBI Act.

He would also be liable for:

(i) action under Section 11(4) of the SEBI Act;

(ii) suspension/delisting of securities;

(iii) being debarred from accessing the securities market/dealing in securities;

(iv) an action for suspension/cancellation of registration; and

(v) such other permissible appropriate action in the circumstances or facts of the case.

(2) **Primary Market:** SEBI considered the recommendations made by the "Informal Group on Primary Market" and accepted most of the recommendations for the implementation, including the following:

(i) Primary issues to be compulsorily made through the depository mode after a specified date.

(ii) 100% book building in respect of issues of ₹ 25 crore or more.

(iii) Reduction in the minimum number of mandatory collection centres in respect of issues above ₹ 10 crore to 4 metropolitan cities plus the place having the regional stock exchange.

A significant step by SEBI for bringing greater transparency and accountability to the primary market is for merchant bankers to attach the **'due diligence'** certificate to the prospectus, so that their accountability extends to the investor and not only to SEBI. The due diligence certificate is issued by the lead manager to the SEBI. Thus, the lead manager holds the accountability and the regulatory authority retains an overall supervisory role.

In addition to the above, the SEBI has also taken various steps to safeguard the interest of shareholders and debentureholders. In case of IPO, the SEBI scrutinizes the various offer documents from the viewpoint of investors, protection and full disclosure. In the allotment procedure to make sure of transparency, SEBI also appoints its nominee apart from the nominee of the stock exchange in the allotment committee.

During the period 1991-92 to 2015-16, SEBI received 29,63,454 grievances from investors. Of this, a total of 28,27,081 grievances were redressed by companies, which indicate a redressal rate of 95.40 per cent. The cumulative status of investor grievances received by SEBI, resolved by companies and the redressal rate in this regard is as follows:

Table 6
Redressal of Grievances

	Grievances Received		Grievances Redressed		Grievances Pending
Years	Year-wise	Cumulative	Year-wise	Cumulative	Cumulating
2014-15	38,442	29,24,516	35,090	27,91,936	5,736
2015-16	38,938	29,63,454	35,145	28,27,081	5,452

(Source: SEBI Annual Report 2015-16, p. 118)

IV. CRISIL Rating and Investor Protection

The Credit Rating and Information Services of India Ltd. (CRISIL) is protecting the interests of investors through rating the various securities. The CRISIL and ICRA (Information and Credit Rating

Agency) analyse the securities from various angles and then rate them as A or A⁺ or A⁺⁺ or B, as per their credibility and performance. As per the SEBI guidelines, companies should get these ratings and publicise them compulsorily. Rating of company deposits is also made compulsory under the Companies Amendment Bill, 1993.

The implications of the ratings used are as follows: For Debentures, simple 'A' and 'B' are used; for preference shares, "Pf" is prefixed. For fixed deposits and short-term instruments, "F" and "P" are prefixed.

Ratings	Implications
Debentures	
Triple A – (AAA)	—Highest Safety
Double A – (AA)	—High Safety
Single A– (A)	—Adequate Safety
Triple B – (BBB)	—Moderate Safety
Double B – (BB)	—Inadequate Safety
B, C & D	—High Risk and Default prone
Fixed Deposits	
F Triple A – (FAAA)	—Highest Safety
F Double A – (FAA)	—High Safety
F Single A – (FA)	—Adequate Safety
FB, FC and FD	—Inadequate Safety and Default prone

In addition to all the above avenues, other measures are always available to the investors to seek redressal of their complaints.

V. Investor Protection and Press

Press is a mass media with a very large circulation. The media can be newspapers, magazines, television and radio. Media is generally used by all the sections of the society. Press helps not only in making people aware of controversial issues but also helps in building public consensus on such issues. In this respect, it is also called a watchdog in a democratic set-up. The sufferer can approach the press for raising the issues. Once a problem is highlighted through press, it presses the government and the concerned authority to take remedial measures immediately. Even on the basis of such news a good number of petition by way of Public Interest Litigation (PIL) can be filed before High Courts and Supreme Court. The concept of PIL is catching fast. Under PIL, it is not the aggrieved person, any person can move the court in the interest of the weak or a group who or which may not be in a position to seek legal remedy on his own. Secondly, a complaint sent to the Supreme Court even on a post card may be treated as a writ petition. PIL, virtually a consumer interest litigation has helped a lot in the cause of consumer protection.

Recently, after the defeat of **Vajpayee Government,** the sensex of Bombay Stock Exchange fell down by 800 points in a single day. The television reporters flashed the news on all channels and also showed the pictures of agitated people on the TV screen. This forced the outgoing Government, RBI and **S. Manmohan Singh**, a senior member of the probable incoming Government to make favourable comments to protect the interest of the investors.

VI. Investor Protection and Courts

The ultimate remedial measure in any grievance are the courts. In case of investor protection, the sufferer can also approach to the consumer redressal forums under Consumer Protection Act, 1986. He can file a suit under deficiency in services. The complaint can be filed with District Forum, State Commission or with National Commission on the basis of the amount involved in the case. The District Forums are authorised to take up the matter which involves the amount up to ₹ 20 lakh. The District Forum shall have the same powers as vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit. Section 13 of the Act provides that every proceeding before the District Forum shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228 of the Indian Penal Code. If the complaint involves the amount of ₹ 20-100 lakh, then he has to file case a with State Commission and if the amount exceeds ₹ 100 lakh, then with the National Commission.

VII. Investor Protection and Consumer Forum

In the entire world, the need for consumers' protection and satisfaction have been widely accepted. India has also taken up the concept of consumer protection more seriously and vigorously. For this purpose, Consumer Protection Act, 1986 was enacted to protect the consumer against the unfair practices of the producers and sellers. In India, it is the only legislation which directly pertains to the market place and seeks to redress complaints arising from it. According to Consumer Protection Act, 1986, Consumer means any person who buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, but does not include a person who obtains such goods for resale or for any commercial purpose. Shares issued by the companies are treated as goods and the services provided by share transfer agents, depository participants, stockbrokers are treated under services for the purpose of this Act. Therefore, the Act provides the relief to shareholders for deficiency in services or goods. Following are some of the examples where the consumer can approach the consumer forum:

(i) Delay in sending refund amount on non-allotment of shares.

(ii) Delay in transfer of shares.

(iii) Delay in sending the shares certificates after transfer.

(iv) Non-settlement of account by broker.

(v) Wrongly transfer of shares with malafide intentions.

(vi) Dishonour of broker's cheque.

(vii) Non-delivery or delay in delivery of shares by the broker.

(viii) Non-payment or delay in payment of dividend by the company.

(ix) Failure of bank to forward the share application to the company.

(x) Delay in issuing unit certificates by mutual funds or UTI.

(xi) Loss of shares by the company.

Any shareholder, recognised investor association, any of the shareholders having same complaint or Central or State Government can file a claim in the District Forum, State Commission or in the National Commission. District forum has jurisdiction to entertain complaints where the value of goods/

ervices complained against is less than ₹ 20 lakh; the State Commission for claims between ₹ 20 akh and ₹ 100 lakh and National Commission for claims exceeding ₹ 100 lakh.

actors needed to make the Investor Protection Effective

The following factors are necessary for making the investor protection more effective:

(1) **Investors' Awareness:** Although the SEBI has introduced a system for investor awareness and protection on its website. Still the investor awareness mechanism is quite limited since very few persons have computers and internet facilities. To remove this drawback, provisions of information regarding the status of an application and redressal of grievances should be provided at all centers where the applications are collected and media services should also be utilised extensively.

(2) **Strict Norms for Premium Fixation:** In December 1996, on the basis of Malegam Committee recommendations, the SEBI issued guidelines for justification of premium. These guidelines still leave scope for fixation of relatively high premiums. Therefore, it is desirable to evolve a compact formula on the lines of valuation guidelines under the Capital Issues Control Act.

(3) **Safety Nets:** It is imperative to provide for safety nets at least in respect of small investors holding shares for at least one year. The safety net should be honoured by the issuers, merchant bankers and underwriters under a formula normally agreed upon. This safety net itself will result in the fixation of realistic premium.

(4) **Promoters' Stake:** It is necessary to raise the promoters' stake in new issues from 20% to at least 40%. This will help in the reduction of malpractices and manipulation of prices.

(5) **Punitive Actions:**

(i) The Department of Company Affairs (DEA) should step up action under Section 209A of the Companies Act against the fly by the night operators. The powers under this section may be delegated to SEBI for effective functioning.

(ii) The punitive action under the Companies Act, 1956 needs to be stepped up, especially under Sections 62 and 63. Section 62 provides for compensation to investors for losses arising out of misstatement in the prospectus.

(iii) Compensation should be provided to investors out of Investors Protection Fund in case of promoters being declared insolvent.

8

Functionaries on Stock Exchange

Introduction

The secondary market in India has registered enormous growth in the recent years almo in all the segments. The number of listed companies market capitalisation, market value of list companies to gross national product and number of shareholders, etc., all have gone up. There ar 23 stock exchanges in India, out of which 14 are public limited companies, 6 are companies limite by guarantee and 3 are voluntary non-profit organisations. These exchanges do not work of its ow rather, these are run by some persons and with the help of some persons and institutions. All these a known as functionaries on stock exchanges. These are:

I. Stockbrokers

Stockbrokers are the members of stock exchanges. These are the persons who buy, sell or dea in securities. A certificate of registration from SEBI is mandatory to act as a broker. SEBI can impos certain conditions while granting the certificate of registration. It is obligatory for the person to abid by the rules, regulations and by the bye-laws.

In the broader sense, a member performs two functions, namely, broker and dealer.

1. Functional Specialisation or Types of Brokers

The types of brokers or functional specialisation of brokers are as follows:

(i) Commission Broker: The commission broker is a person who executes buying and selling orders on the floor of exchange placed by his constituents on commission basis. Almost all the members of exchanges act as commission brokers.

(ii) Floor Broker: These are the persons who are officially attached to other members. They execute the orders of buying and selling placed by the member. In compensation, he charges commission from the commission broker.

(iii) Odd-lot Dealer: Odd-lot means the number of shares which are not in trading lots. The dealer who buys and sells in less than the prescribed trading units is known as the odd-lo dealer. He buys these shares of his own and sells them to the needy persons. Therefore, he not only earns commission but also profit as the price difference on which he buys and sells.

(iv) Taravaniwalla: The Taravaniwalla may be a jobber or specialist who specialises in stocks located at the same trading post. He specialises in certain stocks which are relatively less active. He purchases and sells these stocks for a small price difference. Thus, he is an important factor in 'market making'.

(v) Dealer in Non-cleared Securities: He is a specialist in those stocks or securities which are not on the active list and are non-cleared securities. He buys what is on offer and sells what is required. He purchases at lower rates and sells at higher rates.

(vi) Security Dealer: He is a specialist in buying and selling of gilt-edged securities. He acts mainly as a jobber. He takes risk in the ready sale of securities to meet current requirements. The dealers keep in touch with each other and with other financial centers, like commercial banks, LIC and RBI, etc.

(vii) Arbitrageur: The arbitrageur is a person who purchases and sells securities in different markets at the same time to earn the profits by the difference in prices between the two centers. Arbitrage depends on the common securities available on the different exchanges and the existence of difference in prices of those stocks on those exchanges.

2. Registration of Brokers

The registration of brokers may be studied under the following heads:

(1) Qualifications for Registration: A person having the following qualifications may be registered as brokers:

- (i) He should be a citizen of India with an age of at least 21 years;
- (ii) He should not be a bankrupt;
- (iii) He has not been convicted for any fraud or dishonesty;
- (iv) He has not been compounded with creditors;
- (v) He should not be engaged in any other business except that of an agent or broker in securities;
- (vi) He is not connected with a company or a corporation;
- (vii) He should not be a defaulter of any stock exchange;
- (viii) He should have passed at least 12th standard examination.

As a selection of a member of recognised stock exchange, the selection committee should also consider financial status, experience and professional qualification necessary for the securities market and the performance in the written test and interview in addition to the above said qualifications.

(2) Conditions for Grant of Certificate to a Stockbroker: SEBI may impose the following conditions while granting a certificate of registration to a stockbroker:

- (i) He holds the membership of any stock exchange;
- (ii) He shall pay the amount of fees for registration in the manner provided in regulations;
- (iii) He shall abide by the rules, regulations and bye-laws of the stock exchange or exchanges of which he is a member;
- (iv) He shall obtain the prior permission of the SEBI to continue to buy, sell or deal in securities in case of change in any status or constitution;
- (v) He shall take adequate steps for redressal of grievances of the investors within 1 month of the date of receipt of the complaint and shall inform to SEBI regarding the number, nature and other particulars of the complaints received from the investors.

(3) Fees to be Paid by Stockbrokers: Every stockbroker has to pay registration fees in th manner given below:

(i) A sum of ₹ 5,000 for each financial year where the annual turnover of the stockbrok does not exceed ₹ 1 crore in any financial year; or

(ii) A sum of ₹ 5,000 plus 1/100 of 1 per cent of the turnover in excess of ₹ 1 crore for eac financial year where the annual turnover of the broker exceeds ₹ 1 crore in any financi year; or

(iii) He has to pay a sum of ₹ 5,000 for a block of 5 financial years commencing from the 6 financial year after the date of grant of initial registration to keep his registration in forc

The stockbroker has to pay the fees within 6 months of the completion of that financial yea on the basis of which the fees has been calculated. It should be accompanied by a signe certificate as to the authenticity of the turnover.

In addition to the above fees, every stockbroker shall pay to the Board, a fee in respect of th securities transactions including off-market transactions undertaken by them. The rates are as follow

S. No.	Nature of Securities Transactions	Rate of Fee
1.	All sale and purchase transactions in securities other than debt securities.	0.0002 per cent of the price at which the securitie are purchased or sold (₹ 20 per crore).
2.	All sale and purchase transactions in debt securities.	0.00005 per cent of the price at which the securities are purchased or sold (₹ 5 per crore).

(4) Procedure of Registration of Stockbrokers: The procedure of registration of stockbrokers is as follows:

(i) **Application for Registration:** A person has to apply for registration with SEB through the stock exchange of which he is a member. On receipt of application, the stoc exchange will forward it to SEBI within 30 days.

(ii) **Furnishing of Information, Clarification, etc.:** After receipt of application from stoc exchange, the SEBI may ask the applicant to furnish clarification or further information regarding the dealings in securities and matters to consider the application for grant of a certificate. SEBI may also ask the applicant or its principal officer in person.

(iii) **Consideration of Application:** After obtaining the necessary information and clarification from the applicant, the SEBI considers whether the stockbroker:

(a) is eligible to be admitted as a member of a stock exchange;

(b) has the necessary infrastructure like adequate office space, equipments and manpower to discharge his activities actively;

(c) has any past experience in the business of buying, selling or dealing in securities

(d) is subjected to disciplinary proceedings under the rules, regulations and bye-laws of a stock exchange with respect to his business as a stockbroker.

Granting Certificate of Registration: The SEBI shall grant a certificate to the broker afte being satisfied itself and send an intimation to that effect to the stock exchange.

3. Code of Conduct for Stockbroker

A code of conduct is laid down for every broker to be registered with SEBI. The objective of the ode is to stop a broker from indulging in malpractice and manipulation. This code of conduct can be ded in the following two parts:

(1) General Conduct

(i) **Compliance with Statutory Requirements:** A stockbroker must abide by all the rules and regulations made by the Government, SEBI and the stock exchange from time to time.

(ii) **Integrity, Promptness and Fairness:** A stockbroker must maintain high standards of integrity, promptness and fairness in the conduct of all business.

(iii) **Manipulation:** A stockbroker shall not indulge in manipulative, fraudulent or deceptive transactions or schemes or spread rumours with a view to distort market equilibrium or making personal gains.

(iv) **Malpractices:** A stockbroker should not involve himself in speculative business in the market beyond reasonable levels. He should also not create false market, either singly or in concert with others.

(v) **Exercise of Diligence in the Conduct of Business:** A stockbroker must act with due skill, care and diligence in the normal conduct of his business.

(2) Duties to the Investor

(i) **Execution of Orders of All Investors:** A stockbroker should not refuse to deal with small investors merely on the ground of business involved. He must faithfully execute the orders for buying and selling of securities at the best available market price. He must also promptly inform his clients about the execution or non-execution of an order, must make prompt payment in respect of securities sold and should also arrange for prompt delivery securities purchased by clients.

(ii) **Issue of Contract Note:** A stockbroker should issue a contract note to his clients without delay, for all transactions in the form specified by the stock exchange.

(iii) **Breach of Trust:** A stockbroker should not disclose or discuss the details of personal investments and other information of confidential nature with any other person or should not make improper use of that information of the client which he comes to know in the usual course of his business relationship.

(iv) **Brokerage and Commission:** A stockbroker should not encourage sales or purchase of securities and/or furnish false or misleading quotations or give any other false or misleading advice or information to the clients with the sole objective of earning brokerage or commission.

(v) **No Business with Defaulting Clients:** A stockbroker should avoid to deal or transact business knowingly, directly or indirectly or execute an order for a client who has failed to carry out his commitments in relation to securities with another stockbroker.

(vi) **Fairness to Clients:** A stockbroker must disclose to his clients whether he is acting as a principal or as an agent. He should also ensure that no conflict of interest arises between him and the client.

(vii) **No Recommendations to Investors:** A stockbroker should not make any investment advice to any client on the basis of which he acquires, disposes off or retains any security unless he has reasonable grounds for believing on the basis of facts that the recommendation is suitable for such a client.

(viii) **Prompt and Competent Service to Investors:** A stockbroker should provide prompt and competent service to his clients and for this purpose, he should have adequately trained staff and necessary arrangements.

4. Maintenance of Books and Records

A stockbroker has to keep and maintain the following books of account, records and documents

(i) Sauda Book (register of transactions);

(ii) Client Register;

(iii) General Ledger;

(iv) Journals;

(v) Cash book;

(vi) Bank Passbook;

(vii) Documents register which should include particulars of shares and securities received and delivered;

(viii) Members' contract books showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other members;

(ix) Counterfoil or duplicates of contract notes issued to clients;

(x) Written consent of clients in respect of contracts entered into as principals;

(xi) Margin deposit book;

(xii) Registers of accounts of sub-brokers;

(xiii) An agreement with a sub-broker specifying the scope of authority and responsibilities of the stockbroker and such broker.

Minimum Period: Every stockbroker has to preserve the above mentioned books of accounts and records for a minimum period of 5 years. He has also to submit a copy of the audited balance sheet and profit and loss account to SEBI within 6 months of the close of the period.

Inspection of Books: SEBI has the power to appoint one or more persons to undertake inspection of books of account, other records and documents of stockbrokers for any of the following purposes:

(i) to ensure that the books of account and other books are being maintained in the manner required.

(ii) that the provisions of the SEBI Act, rules, regulations and the provisions of the SE (R) Act and rules made thereunder are being complied with;

(iii) to investigate into the complaints received from investors, other stockbrokers, sub-brokers or any other person on any matter having a bearing on the activities of the stockbroker; and

(iv) to investigate suo moto, in the interest of securities business or investors' interest, into the affairs of the stockbroker.

SEBI can also appoint a qualified auditor to investigate into the books of accounts or the affairs of stockbroker with the same powers as that of the inspecting authority. SEBI can issue directions to the stockbroker in the interest of the securities market on receiving the report of the inspecting authority the auditor.

5. Suspension of Registration

A penalty of suspension of registration may be imposed if:

(i) the stockbroker violates the provisions of the Act, rules and regulations;

(ii) the stockbroker does not follow the code of conduct laid down by SEBI;

(iii) the stockbroker fails to resolve the complaint of the investor or fails to give satisfactory reply to the SEBI in this behalf;

(iv) the stockbroker:

  (a) fails to furnish any information related to his securities as required by the board

  (b) furnishes wrong or false information

  (c) does not submit periodical returns as required by the board

  (d) does not co-operate in any inquiry conducted by the board

(v) the stockbroker indulges in manipulating price or concerning activities in the market;

(vi) the stockbroker is guilty of misconduct;

(vii) the stockbroker fails to pay the fees;

(viii) the financial position of the stockbroker deteriorates to such an extent that the board is of the opinion that his continuance in securities business is not in the interest of investors and other stockbrokers;

(ix) the stockbroker violates the conditions of registration;

(x) the membership of the stockbroker is suspended by the stock exchange.

6. Cancellation of Registration

A penalty of cancellation may be imposed if:

(i) the stockbroker violates any provisions of insider trading regulations or takeover regulations;

(ii) the stockbroker is guilty of fraud, or is convicted of a criminal offence and cancellation of membership of the stockbroker by the stock exchange.

During the current year, inspections of brokers, sub-brokers were carried out as per various regulations of SEBI. The number of inspections conducted on broking entities were higher at 162 during 2012-13 compared to 69 in 2011-12.

7. Penalties for Stockbroker

(i) **Penalty for Failure to Furnish Information:** If a broker fails to furnish the information under the rules and regulations of the SEBI Act, he shall be liable to the following penalties:

  (a) A penalty of ₹ 1.5 lakh for each failure for not furnishing any document, return or report to the board;

  (b) A penalty of ₹ 5,000 per day during which failure to file any return or furnishing any information, books or other documents continues;

(c) A penalty not exceeding ₹ 10,000 for every day during which the failure to maintain books of accounts or records continues.

(ii) Penalty for Failure by Any Person to Enter into An Agreement with Clients: If a broker fails to enter into an agreement with his client, he shall be punished with a penalty not exceeding ₹ 5,00,000 for such every failure.

(iii) Penalty for Failure to Issue Contract Notes or Making Payment:

(a) If any broker fails to issue contract notes in the manner and form specified by the concerned stock exchange, he shall be liable to a penalty not exceeding 5 times the amount for which the contract note was not issued;

(b) If he fails to deliver any security or fails to make the payment of due amount within the specified period, a penalty of ₹ 1 lakh for each day during which such failure continues or ₹ 1 crore, whichever is less, can be imposed;

(c) If he charges excess brokerage, he shall be liable to a penalty of ₹ 1 lakh or 5 times the amount of excess brokerage, whichever is higher.

8. Capital Adequacy Norms for Stockbrokers

The capital adequacy norms for stockbrokers are fixed with an objective of enabling smooth financial operations in the stock exchanges and to minimise chances of financial defaults by stockbrokers. These requirements consist of two components:

(A) Base Minimum Capital: This is the absolute minimum amount which each stockbroker has to maintain with the stock exchange. The member stockbrokers of Kolkata and Mumbai stock exchange have to deposit a minimum of ₹ 5 lakh and ₹ 3.5 lakh of Delhi and Ahmedabad stock exchanges and ₹ 2 lakh for the members of other stock exchanges. The base capital is maintained by members in the following way:

(i) The security deposit kept in the exchanges forms a part of the base minimum capital;

(ii) 25 per cent of the base minimum capital is to be maintained in cash with the exchange;

(iii) Another 25 per cent remains in the form of a long-term fixed deposit with a bank on which the stock exchange is given a completely unencumbered and unconditional lien;

(iv) The remaining requirement being maintained in the form of securities with a 30 per cent margin. The securities should be kept in the name of members and pledged in favour of the exchange. The value of securities should be reviewed by the exchange at least every two months keeping in view the market fluctuations.

(B) Additional Capital Related to Business Volume: In addition to the above, the additional or optional capital required from a member be such that it should not be less than 8 per cent of the gross outstanding business in the exchange at any point of time. The gross outstanding business in the exchange is the aggregate of up-to-date sales and purchases by a member broker in all securities put together. It includes inter-client business not executed on the floor of the exchange.

The gross outstanding business of member at any point of time should not exceed 12.5 times the base capital and additional capital requirements. A broker has the responsibility to intimate the exchange as and when the outstanding business reaches 10 times the base and additional capital. If the outstanding business reaches 12.5 times the base and additional capital, the member should not crease the outstanding business until the additional capital has been brought into business. The ck exchange should also be satisfied that the member could be allowed to trade further.

Calculation of Capital: The capital of a member is computed by adding capital and free erves less non-allowable assets, i.e., (a) fixed assets, (b) pledged securities, (c) member's card, (d) non-allowable securities, (e) bad deliveries, (f) doubtful debts and advances, (g) prepaid expenses, (h) tangible assets, and (i) 30 per cent of marketable securities.

Every member has to submit an auditor's certificate of each quarter indicating the net liquid apital with the member/member firm.

9. Brokers' Rights

Brokers enjoy the following rights in relation to their dealings with clients:

(i) **Right of Lien:** Brokers have the right to lien, set-off, counter-claim, charge or otherwise against money standing to the credit of client's account for all legitimate dues recoverable from them.

(ii) **Right to Refuse to Sell Securities only on Receipt of Transfer Documents:** Brokers can refuse to sell securities on behalf of clients without the receipt of 20 per cent of the price of the securities to be sold unless valid transfer documents have been received prior to the sale.

(iii) **Right to Refuse Purchase Securities Without Margin Money:** Brokers have the right to refuse purchase of securities unless the client pay the 20 per cent margin money or already have equivalent credit with them. But this marginal requirement may not apply to mutual funds and financial institutions.

(iv) **Broker's Right to Close Contracts:**

(a) The brokers have the right to close the purchase transaction by selling the securities if the client fails to make the full payment within the 2 days of delivering the contract in case of cash shares, within 7 days for specified shares or before pay-in day fixed by the stock exchanges for the concerned settlement, whichever is earlier. Loss incurred on account of the transaction can be recouped out of the margin money of the client.

(b) The brokers have right to close the selling contract by making a purchase if client fails to deliver the securities with valid transfer documents within 48 hours of the delivery of the contract note or before the delivery days as fixed by the stock exchange for the concerned settlement, whichever is earlier. Loss incurred on account of the transaction can be recouped out of the margin money of the client.

10. Current Position

Table 8.1 shows the details of registered brokers as on 31.3.15 and 31.03.16.

Table 8.1
Details of Registered Brokers

Total No. of Registered Brokers as on 31.3.15	Addition During the Year 2015-16	Cancellation/ Surrender of Membership	Total No. of Registered Brokers as on 31.3.16
3,210	63	54	3,219

(Source: SEBI Annual Report 2015-16, p. 99)

Table 8.2

Exchange-wise Brokers Registered with SEBI

Stock Exchange	As on March 31, 2015			As on March 31, 2016		
	Total Brokers	Corporate Brokers	Corporate Brokers as a Percentage of Total Brokers	Total Brokers	Corporate Brokers	Corporate Brokers as a Percentage of Total Brokers
1	2	3	4	5	6	7
Ahmedabad	333	176	52.9	333	176	52.9
Bengaluru	NA	NA	NA	NA	NA	NA
BSE	1,323	1103	83.4	1,352	1,129	83.6
Bhubaneshwar	NA	NA	NA	NA	NA	NA
Kolkata	842	208	24.7	842	209	24.8
Kochi	NA	NA	NA	NA	NA	NA
Delhi	469	259	55.2	467	258	55.3
Guwahati	NA	NA	NA	NA	NA	NA
ISE	NA	NA	NA	NA	NA	NA
Jaipur	NA	NA	NA	NA	NA	NA
Ludhiana	NA	NA	NA	NA	NA	NA
MPSE	282	81	28.7	NA	NA	NA
Madras	177	77	43.5	NA	NA	NA
MSEI	528	488	92.4	503	466	92.6
NSE	1,283	1130	88.1	1,231	1,139	92.5
Pune	167	46	27.5	NA	NA	NA
UPSE	200	54	27.0	NA	NA	NA
Vadodara	295	55	18.6	NA	NA	NA
Total	**5,899**	**3,677**	**62.3**	**4,727**	**3,377**	**71.4**

(Source: SEBI HBS 2015–16, p. 31)

II. Sub-broker

A sub-broker acts as an agent of stockbroker. He is not a member of a stock exchange. He assists the investors in buying, selling or dealing in securities through stockbroker. The broker and the sub-broker should enter into an agreement in which the obligations of both should be specified. Sub-brokers are intermediaries between the broker and the investor. Sub-brokers must be registered with SEBI for dealing in securities. For getting registered with SEBI, he must fulfil certain conditions and must follow code of conduct, rules and regulations made from time to time.

1. Eligibility Criteria for Registration as a Sub-broker

The following eligibility criteria must be satisfied for registration of an individual, firm or a company as sub-broker:

(I) For Individual:

(a) The applicant should be of at least 21 years of age;

(b) He must not have been convicted of any offence involving fraud or dishonesty;

(c) He must have passed at least 12th standard or equivalent examination from government recognised institution.

Exception: The SEBI has the power to relax educational qualifications on merit having regard his experience.

(II) **For Firm or Body Corporate:** The partners in case of partnership firm and directors in case of body corporate must comply with the requirements contained in clauses (a) to (c) for an individual.

2. Conditions for Grant of Certificate to Sub-broker

SEBI may grant a certificate of registration to a sub-broker if he satisfies the following conditions:

(i) He shall pay the fees in the manner provided in the regulations;

(ii) He shall take adequate steps for grievances of the investors within 1 month of the date of the receipt of the complaint and SEBI is kept informed about the number, nature and other particulars of the complaints;

(iii) He is authorised in writing by a stockbroker for affiliating himself in buying, selling or dealing in securities; and

(vi) In case of any change in the status and constitution, the sub-broker shall obtain prior permission of the SEBI to continue to buy, sell or deal in securities in any stock exchange.

3. Registration of Sub-brokers

SEBI requirements include registration of sub-brokers through the stock exchanges at which the broker is a member. A sub-broker is required to submit the following documents with the application as per SEBI guidelines:

(i) A recommendation letter in the specified form from a stockbroker with whom he will be affiliated;

(ii) Two references including one from his banker.

The application along with above documents has to be submitted to the concerned stock exchange. The stock exchange submits the application to SEBI after verifying the eligibility criteria and other conditions within 30 days of its receipt. After being satisfied itself, the SEBI grants a certificate of registration subject to specified terms and conditions.

The SEBI accepted all the recommendations of **Chandra Sekharan Committee** on August 12, 1997 and decided that only registered sub-brokers would be allowed to trade legally.

4. Fees to be Paid by Sub-brokers

As per the amendments made in 2006, every sub-broker shall pay fees in the following manner:

(a) Where a sub-broker was granted certificate of registration by the board before August 1, 2006.

(i) he shall pay a sum of ₹ 10,000 for the block of 5 financial years commencing from April 1, 2007; and

(ii) after 5 years, he shall pay a sum of ₹ 5,000 for every block of 5 years.

(b) Where a sub-broker is granted certificate of registration by the board on or after August 1, 2006.

(i) He shall pay a sum of ₹ 10,000 for first 5 years commencing from the financial year in which the registration has been granted; and

(ii) After the expiry of first 5 years, he shall pay a sum of ₹ 5,000 for every subsequent block of 5 years.

5. Books of Accounts

A sub-broker has to keep and maintain the same books which are maintained by brokers except those specified in clause (viii) to (xiii).

6. Code of Conduct for Sub-brokers

The sub-brokers have to follow the following code of conduct:

(A) General:

(i) **Integrity and Fairness:** A sub-broker must maintain high standard of integrity, promptness and fairness in the conduct of all investment business.

(ii) **Act with Due Diligence:** A sub-broker must act with due skill, care and diligence in the conduct of all investment business.

(B) Duty to the Investor:

A sub-broker has the following duties towards investors:

(i) **Execution of Orders:** A sub-broker should faithfully execute the orders of clients for buying and selling of securities at the best available market price. He should be clear in his dealings with the clients and the general investing public. A sub-broker must promptly inform his clients about the execution or non-execution of an order. He should also make prompt payment in respect of securities sold and should also arrange for prompt delivery of securities purchased by clients.

(ii) **Prompt Issue of Sale or Purchase Notes:**

(a) A sub-broker must issue purchase or sale documents to his clients promptly for all the transactions entered into by him with them.

(b) He should also split the contract notes client-wise and script-wise originally issued to him by the affiliated brokers into different denominations.

(c) He must also promptly issue bills and receipts showing separately in respect of all transactions in the specified form.

(d) He must not match the purchase and sale order of his clients and each such order must invariably be routed through a member broker of the stock exchange with whom he is affiliated.

(iii) **No Disclosure of Confidential Information:** A sub-broker must not disclose or discuss confidential information of the clients with any other person.

(iv) **Business and Commission:** A sub-broker must not:

(a) encourage sale or purchase of securities with the sole object of generating brokerage or commission;

(b) furnish false or misleading quotations or give any other false or misleading advice or information to the clients with a view to induce him to do business in particular securities and enabling himself to earn brokerage or commission thereby;

(c) charge from his clients commission exceeding one and one-half of one per cent of the value mentioned in the respective sale or purchase notes.

(v) **No further Dealing with Defaulting Clients:** A sub-broker must not deal or transact business knowingly, directly or indirectly or execute an order for a client who has failed to carry out his commitments in relation to securities and is in default with another broker or sub-broker.

(vi) **No Conflict with Clients:** A sub-broker should ensure that no conflict of interest arises between him and the client. In the event of conflict of interest, he should inform the client accordingly and should not seek to gain a direct or indirect personal advantage from the situation and should not consider the clients' interior to his own.

(vii) **Investment Advice:** A sub-broker should not make a recommendation to any client who might be expected to rely thereon to acquire, dispose off or retain any securities unless he has reasonable grounds for believing that the recommendation is suitable for such a client upon the basis of the facts, if disclosed by such a client as to his own security holdings, financial situation and objectives of such investment. The sub-broker should seek such information from clients whenever they feel it is appropriate to do so.

(viii) **Fair, Prompt and Competent Service:** He should have adequately trained staff and arrangements to render fair, prompt and competent services to his clients and continuous compliance of the regulatory system.

7. Duties of Sub-broker

The duties of sub-broker can be studied under the following two heads:

(A) Towards Stockbrokers

A sub-broker has the following duties towards stockbrokers:

(i) **Conduct of Dealings:** A sub-broker should cooperate in comparing the unmatched transactions with his broker. He must not deliver bad delivery of securities knowingly and wilfully. He should also cooperate with other contracting party for the prompt replacement of documents which are declared bad by the stock exchange or the company.

(ii) **Protection of Clients' Interests:** A sub-broker should fully protect the interest of his clients and in this regard he should also cooperate with the stockbroker. Here interest of clients means right to dividends, bonus shares or any other such related rights to such securities.

(iii) **Transaction with Brokers:** A sub-broker should not fail to carry out his stockbroking transactions with his broker nor should he fail to meet his obligations or show negligence in completing the settlement of transactions with them.

(iv) **Legal Agreement between Brokers:** A sub-broker should execute an agreement or contract with his principal broker which would clearly specify the rights and obligations of the sub-broker and principal broker.

(v) **Advertisement and Publicity:** A sub-broker should advertise his business publically only after getting permission from the stock exchange.

(vi) **Inducement of Clients:** A sub-broker should not follow unfair trade practices to procure clients from other brokers.

(B) Towards Regulatory Authorities

A sub-broker also has some duties towards regulatory authorities:

(i) **General Conduct:** A sub-broker should not indulge in dishonourable, disgraceful, disorderly or improper conduct on the stock exchange. He should also not obstruct the business of the stock exchange wilfully.

(ii) **Following Rules and Regulations:** A sub-broker should also comply the rules, bye-laws and regulations made by the stock exchange and the SEBI.

(iii) **Failure or Refusal to Give Information:** A sub-broker should not neglect or fail or refuse to submit the books, special returns, correspondence, documents and papers to the SEBI or to the concerned stock exchange.

(iv) **False or Misleading Statement:** A sub-broker should not make any false or misleading statement on any returns and should not neglect or fail or refuse to submit the required returns.

(v) **Manipulation:**A sub-broker should not spread rumours or should not indulge in manipulative, fraudulent or deceptive transactions or schemes with a view to distort market equilibrium or making personal gains.

(vi) **Malpractices:** A sub-broker should not create a false market either singly or jointly with others. He should also not indulge in any such activity which is detrimental to the public interest. He should not indulge himself in excessive speculative transactions.

8. Procedure for Inspection and Actions for Default

The procedure for inspection and actions for default in case of sub-brokers are same as in the case of brokers.

9. Current Position

The Table 8.3 shows the details of registered sub-brokers exchange wise. The table depicts that nearly 98.6% of the sub-brokers were registered through members of NSE and BSE during 2014-15. But this percentage increased to 99.1% at the end of year 2015-16 as the other exchanges also witnessed the registration of sub-brokers.

Table 8.3

Stock Exchange Wise Registered Sub-brokers: Percentage Share in Total

S. No.	Stock Exchange	Sub-brokers as on March 31			
		2015		2016	
		Number	Percentage of Total	Number	Percentage of Total
	1	2	3	4	5
1.	Ahmedabad	71	0.2	71	0.2
2.	Bengaluru	NA	NA	NA	NA
3.	BSE	18,559	43.8	15,769	44.7
4.	Bhubaneshwar	13	0.00	NA	NA
5.	Calcutta	43	0.10	43	0.10
6.	Cochin	41	0.10	NA	NA
7.	Delhi	185	0.4	185	0.5
8.	Guwahati	4	0.00	NA	NA
9.	ISE	NA	NA	NA	NA
10.	Jaipur	NA	NA	NA	NA
11.	Ludhiana	NA	NA	NA	NA
12.	MPSE	5	0.00	NA	NA
13.	Madras	103	0.2	NA	NA
14.	MSEI	NA	NA	NA	NA
15.	NSE	23,226	54.8	19,173	54.4
16.	OTCEI	NA	NA	NA	NA
17.	Pune	145	0.3	NA	NA
18.	UPSE	2	0.00	NA	NA
19.	Vadodara	12	0.00	NA	NA
	Total	**42,409**	**100.00**	**35,241**	**100.00**

(Source: SEBI HBS, 2015-16, p. 38)

II. Market Makers

Market maker is a designated specialist in the specified securities. They make both bid and offer at the same time. Bid price means the quoted price at which they would pay to a prospective seller. Offer or asking price is the price which they would charge from a prospective buyer. The market makers' quotes are binding on them up to a certain commitment. A market maker has to abide by bye-laws, rules and regulations of the concerned stock exchange. He is exempted from margin requirement.

Market makers are rewarded for their activities in two ways. The **first** way is through the bid-offer spread (difference between the bid or purchase price and offer or selling price). The **second** way is through taking a position (speculation). If they believe that prices will rise in the near future, they will increase their holdings, while if they expect prices to fall, they will reduce or eliminate holdings.

Bid and offer spreads are very narrow because of large volume of transactions. The width of the spread depends on the transaction cost and associated risks. These costs and risks are influenced by the size and frequency of transactions. Transaction cost per unit of currency traded is affected by the size whereas, the frequency or turnover rate affects both cost and risks by spreading fixed costs of currency trading and reducing the time for something unforseen to occur.

As per the listing requirements, a company where the paid-up capital is ₹ 3 crore but not more than ₹ 5 crore and having a commercial operation for less than 2 years should appoint a market maker at the time of issue of securities. The two-way quotes should be offered by the market maker for a specified stock for a minimum period of 18 months from the date of trading on the stock exchange. The difference between the bid and offer should not exceed 10 per cent. The market maker should have an inventory of 5 per cent of the post issue capital as on the date of allotment.

SEBI appointed a committee under the chairmanship of **Shri G.P. Gupta (Chairman, IDBI)** on 'Market-Making' to study the various facts of it, including the merits and demerits of the two trading systems, i.e., the order driven system and the quote driven system. The Committee submitted its report in October 1999. According to the Committee's view, the shares could be classified into two categories, viz. liquid and illiquid. The market making facility should be provided for liquid stock. The Committee stressed the obligation of market makers to offer two-way quotes continuously and they should be forced to hold an inventory of stocks. While working out the operating mechanism for market making, the Committee also underscored the need to keep in mind the implications of this aspect in terms of commitment to capital and exposure to market risks. The commendations of the committee are as follows:

1. Market making to be allowed in specific shares. All shares excluding the shares satisfying the criteria given below would be eligible for market making:
    (i) Shares included in the BSE sensex of the Stock Exchange, Mumbai and the S&P CNX Nifty of the NSE;
    (ii) Shares where the average number of trades is more than 50;
    (iii) Shares where the value of trades on a daily basis is more than ₹ 10,00,000;
    (iv) Shares where the company is not in operation and the net worth erosion is beyond 50%.
2. Market making activity would be voluntary in nature.
3. The market maker should provide two way quotes in the shares which he has committed to undertake market making, at regular intervals of 30 minutes with a minimum depth of ₹ 5,000 or one market lot whichever is higher, within 5 days of registration.
4. The obligation of the market maker to make market, i.e., to give a two-way quote would end at 1% less than the price band in that share.
5. The member brokers of the exchanges would be allowed to act as market maker.
6. The market maker would operate in exclusively quote driven system.
7. If a market maker fails to provide two-way quotes for more than 3 consecutive days, his registration as market maker would stand cancelled.
8. There would be a maximum of 5 market makers in share on an exchange.
9. Margins would be applicable to the market maker as in the normal market.
10. The exchanges would prescribe the capital adequacy to be in commensurate with the types of shares, number of shares undertaken by the member for making market, infrastructure and volume of business of the member.
11. The market maker would be eligible to avail of lending/borrowing facilities under the Stock Lending Scheme, 1997. The market maker may also draw shares from the promoters in a fair and transparent manner.
12. The Committee urged the investment institutions to encourage their broking subsidiaries to take up market making in order to aid and strengthen the activity.
13. The exchanges to pursue with their clearing banks to open special cells for lending to the market makers with adequate safeguards. The Committee strongly recommended that RBI encourages banks to participate in lending to market makers.

14. The spread between the bid and ask price would be as follows:

For shares priced up to ₹ 10	no limit on spreads
> ₹ 10 and up to ₹ 20	10% maximum spread
> ₹ 20 and up to ₹ 50	5% maximum spread
> ₹ 50 and up to ₹ 100	4% maximum spread
> ₹ 100	3% maximum spread

The Committee recommended that all the stock exchanges should adhere to the recommendations regarding selection of shares, capital adequacy and price bands. For others, the exchange may mould the scheme to make it more attractive to the market makers.

Types of Market Making

Market making is of the following three types:

(i) **Compulsory Market Making:** The sponsors of the issue have to undertake the responsibility of market making for a period of 3 years from the date of public trading. It is known as compulsory market making. The sponsor bears all the risks and responsibilities associated with the compulsory market making. The discharge of the compulsory market making is the responsibility of the sponsor even if the sponsor assigned the market making to some other member. The sponsor can withdraw from the market making function after the initial 3 years period if he could provide another compulsory market for the scrip. The market maker can apply for the termination of his duty if the scrip sponsored has incurred cash loss for 3 years or if the company has become insolvent or the company's prospects are bleak.

(ii) **Voluntary Market Making:** Market making will be called voluntary if it is offered voluntarily by the member. He should continue at least for 3 months from the date of commencement of market making. He can offer two-way quotes. But he cannot give sell quotes if he does not possess the specified quantity.

(iii) **Additional Market Making:** The sponsor can appoint the additional market maker for a period not less than 1 year from the date of public offering. The number of additional market maker can be more than one.

IV. Jobber

Jobber is also named as Taravaniwalla. He is a person who specialises in stocks at the same trading floor. There may be more than one jobber in case of actively traded scrips. Jobbers offer two-way quotes for the scrip with a small difference in price and thus they act as a market maker and provide liquidity to the market. The jobber or taravaniwalla generally specialises in those shares which are relatively less active and he receives orders from those other members who are away from the market. The order is executed either by auction or negotiation. In negotiated settlement, the broker approaches the concerned jobber, confirms the latest quotation and makes a bid or an offer. The final price is settled through mutual acceptance. Once the transaction is finally settled, the details are recorded in a *chaupri*. The prices at which different scrips are traded on a particular day are published in the newspapers on the next day. But when the settled scrips are not delivered on the specified date, then those scrips are auctioned in the market and the loss due to this is to be borne by the faulty broker or jobber which he ultimately charges from the faulty investor.

V. Portfolio Consultants

A combination of securities such as stocks, bonds and money market instruments is called portfolio. Whereas the portfolio consultants are the persons or firms or companies who advise or dire or undertake the management or administration of securities or funds on behalf of their clients. Th portfolio management can be *discretionary* or *non-discretionary.*

1. Registration of Portfolio Managers

A certificate of registration from SEBI is mandatory in order to carry on portfolio manageme services. But a separate registration is not required for category I and category II merchant banke to act as portfolio managers. However, they have to work within the framework of SEBI regulatio applicable to portfolio managers. The SEBI is authorised to grant and renew the certificate registration on the payment of the requisite registration or renewal fee. This certificate will be val for 3 years. For renewal, an application must be made 3 months before the expiry of the certifica The annual registration fee payable to the SEBI is ₹ 10 lakh for first 2 years and ₹ 5 lakh for th third year. Every portfolio manager shall pay a non-refundable fee of ₹ 1 lakh with the applicatio for registration.

2. Procedure for Registration

An application for registration is to be made to SEBI in the prescribed form. After receiving the application, the SEBI considers all the matter relating to the portfolio activities and in particular the following:

(i) He has necessary infrastructure like adequate office staff, equipment and manpower to discharge his activities;

(ii) He has at least 2 employed persons with experience to conduct portfolio management business;

(iii) A person directly or indirectly connected (such as associate or subsidiary) with the applicant has not been granted registration;

(iv) He has capital adequacy of not less than net worth of ₹ 50 lakh in terms of capital plus free reserves;

(v) The applicant or partner or director or principal officer has not been convicted for any offence involving moral turpitude or guilty of any economic offence;

(vi) The applicant or partner or director or principal officer is not involved in any litigatio connected with the securities market;

(vii) The applicant has professional qualification in finance or law or accounting or busines management;

(viii) Granting the registration is in the interest of investors.

After considering the above requirements, the SEBI grants the certificate of registration.

3. Code of Conduct

Code of conduct for portfolio consultants can be divided in the following three heads:

(A) General Conduct

(i) **High Standards of Integrity and Fairness:** A portfolio consultant has to observe hig standards of integrity and fairness in all his dealings with his clients and other portfoli consultants. The consultant should deploy the money received by him from a client f

investment at the earliest. Similarly the amount payable should be paid immediately as and when it becomes due.

(ii) **High Standards of Service and Due Diligence:** A portfolio consultant should render high standards of service, exercise due diligence, ensure proper care and exercise professional judgement while doing portfolio investment on behalf of his clients.

(iii) **Avoidance of Conflict:** A portfolio consultant should avoid any conflict of interest in his investment or disinvestment decisions. If any conflict of interest arises, then he should ensure fair treatment to all his customers. He must disclose possible sources of conflict of duties and interest to the clients while providing unbiased services.

(iv) **No Contradiction with the Provisions of Act or Unfair Competition:** A portfolio consultant should not make any statement which is contrary to any act, practice or increases unfair competition and causes harm to the interest of other portfolio managers or is likely to place them in a disadvantageous position in comparison of him.

(v) **No Disclosure of Confidential Information:** A portfolio consultant should not disclose any confidential information, of his client to other clients, which has come to his knowledge in the due course of his business.

(vi) **No Exaggerated Statement:** He should not make any exaggerated statement to the clients written or orally about his qualification or the capability to render services.

(vii) **Adequate Steps for Registration of Clients' Securities:** He should take adequate steps for the registration of the transfer of the clients' securities and for claiming and receiving dividends, interest payments and other rights accruing to the client.

(B) Conduct with Clients

Every portfolio consultant should enter into a contract with his clients before taking up an ssignment of portfolio management on behalf of his clients. The contract should contain the following:

(i) The investment objectives and services to be provided;

(ii) Areas of investment and restrictions imposed by the client with regard to investment in a particular industry or a company;

(iii) Period of the contract and the provisions of the early termination, if any;

(iv) Amount to be invested;

(v) Fees to be charged;

(vi) Procedure of settling the client's account including the form of repayment on maturity or early termination of contract;

(vii) Custody of securities;

The portfolio consultant should place the funds of all his clients in a separate account to be aintained by him in a scheduled commercial bank.

(C) Other Responsibilities

(i) He should act in a fiduciary capacity with regard to clients' funds;

(ii) He should transact in securities within the limitation placed by the client;

(iii) He should not derive any direct or indirect benefit out of the clients' funds or securities;

(iv) He cannot pledge or give on loan, any security of a client without obtaining his writte permission;

(v) He should ensure proper and timely handling of complaints received from clients and should take prompt and appropriate action.

4. Maintenance of Books of Accounts and Records

Every portfolio consultant must keep and maintain the following books of accounts, records and documents:

(i) A copy of balance sheet at the end of each accounting period;

(ii) A copy of profit and loss account for each accounting period;

(iii) A copy of the auditors report on the accounts for each accounting period;

(iv) A statement of financial position; and

(v) Records in support of every investment transaction or recommendation which indicate the data, facts and opinions leading to that investment decision.

A copy of balance sheet, profit and loss account and such other documents must be submitted to the SEBI at the end of each accounting period. The books of accounts and other records and documents must be preserved for a minimum period of 5 years. The books of accounts and other accounts have to be audited by a qualified auditor to ensure that the proper accounting methods and procedures have been followed by the consultant. A certificate, that consultant has performed his duties in accordance with the law, should be submitted to the SEBI within 6 months of closing of the accounting period.

5. Disclosure of Information

The disclosure of information can be studied under two heads:

(i) To Clients: The portfolio consultant should furnish a report to the client within agreed period but not exceeding 6 months containing the following details:

(a) The composition and the value of the portfolio, description, number and value of each security held in the portfolio, the aggregate value of the portfolio and the available cash balance as on the date of report;

(b) Transactions undertaken including the date of transaction and details of purchases and sales during the period of report;

(c) Benefits received during the period in respect of interest, dividend, bonus shares, rights shares and debentures;

(d) Expenses incurred in managing the portfolio of the client; and

(e) Details of risk foreseen by the portfolio consultant and the risk relating the securities recommended by him for investment or disinvestment.

(ii) To SEBI: A portfolio consultant must disclose the following information to SEBI as and whe required:

(a) Particulars regarding the management of a portfolio;

(b) The names of the clients whose portfolios he has managed;

(c) Particulars relating to the capital adequacy requirement; and

(d) Any change in the information or particulars furnished previously which have a bearing on the certificate granted to him.

6. Inspection by SEBI

The SEBI has the authority to appoint one or more persons as the inspecting authority to undertake inspection of the books of accounts, records and documents of the portfolio consultant:

(i) to ensure that the books of accounts are being maintained in the prescribed manner;

(ii) that the provisions of the SEBI Act, rules and regulations are complied with;

(iii) to investigate suo moto in the interest of securities business/investors interest into his affairs; and

(iv) to investigate into the complaints received from the investors, other portfolio managers or any other person or any matter having a bearing on his activities of the portfolio consultant.

The SEBI can give a due notice to the consultant for the inspection. But the SEBI can also undertake inspection without any prior notice to protect the interests of the investor.

7. Suspension of Registration

A portfolio consultant who fails to comply with any conditions subject to which the certificate has been granted and/or contravenes any of the provisions of the Act, rules or regulations is liable to suspension or cancellation of registration as follows:

(A) Suspension of Registration

A penalty of suspension of registration may be imposed on a portfolio consultant if he:

(i) violates the provisions of the SEBI Act, rules or negotiations; or

(ii) (a) fails of furnish any information relating to his activity as portfolio consultant as required by SEBI;

(b) furnishes wrong or false information;

(c) does not submit periodical returns as required by SEBI;

(d) does not cooperate in any enquiry conducted by it; or

(iii) fails to resolve the complaints of the investors or give a satisfactory reply to the SEBI in this behalf; or

(iv) indulges in manipulating or price rigging or cornering activities; or

(v) is guilty of misconduct or improper or unbusiness-like or unprofessional conduct which is not in accordance with the specified code of conduct; or

(vi) fails to maintain the capital adequacy requirement; or

(vii) fails to pay the fees; or

(viii) violates the conditions of registration; or

(ix) does not carry out his obligations as specified in the regulation.

(B) Cancellation of Registration

A penalty of cancellation of registration may be imposed on a portfolio manager where:

(i) he is indulged in deliberate manipulation or price rigging or cornering activities affecting the securities market and the investor's interest; or

(ii) his financial position deteriorates to such an extent that the SEBI is of the opinion that h continuance as portfolio consultant is not in the interest of the investors; or

(iii) he is guilty of fraud or is convicted for a criminal offence; or

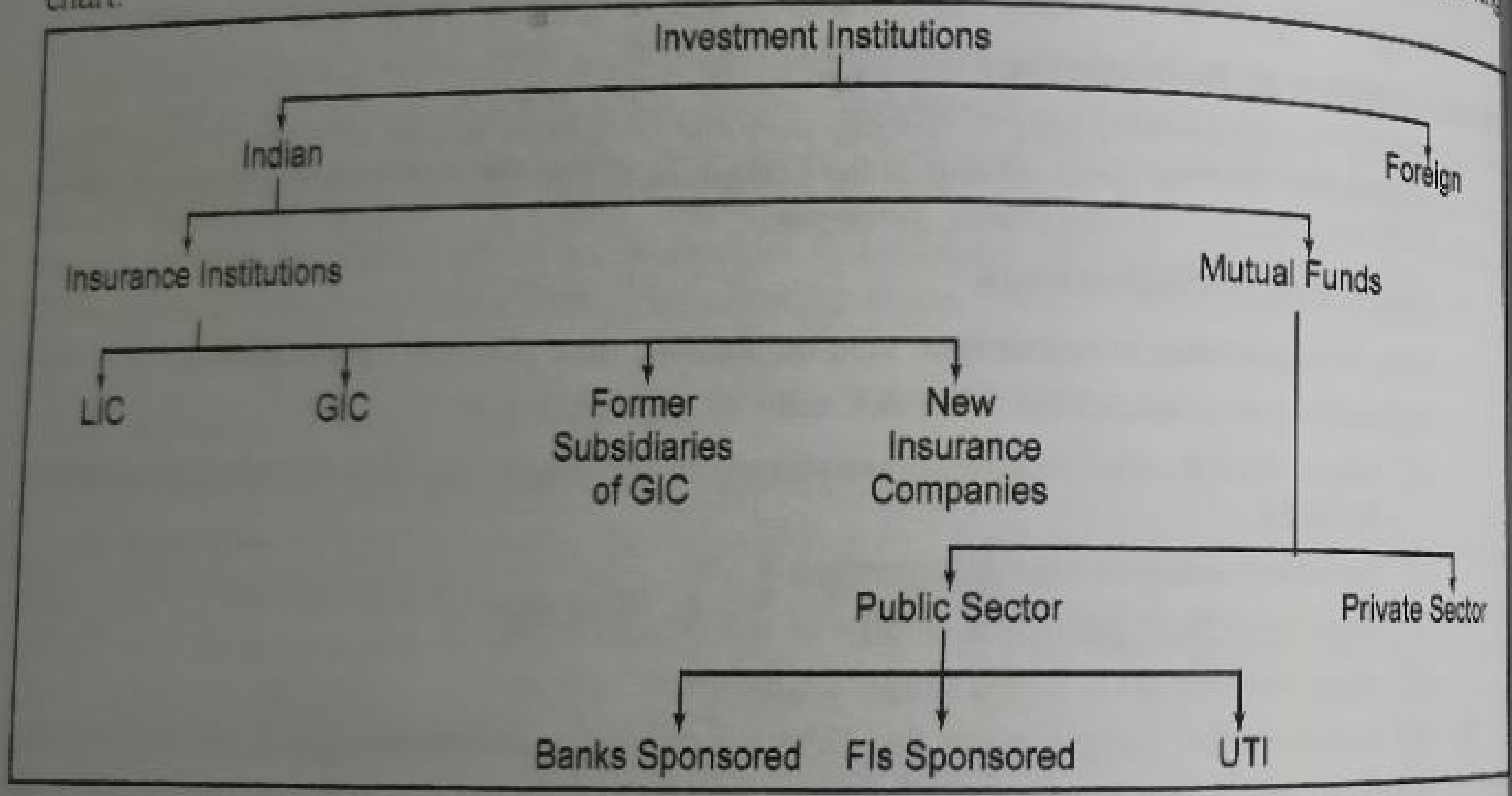
(iv) he is guilty of repeated defaults which may lead to the suspension of registration provided the SEBI furnishes the reason for cancellation in writing.

Current Position:

The number of portfolio managers registered with the SEBI was 243 in 2009-10 as compared to 232 in 2008-09.

VI. Institutional Investors

Institutional investors mean the different investment institutions which mobilise the savings of the people and invest them in different types of securities. These institutions are depicted in the following chart:



Different Institutional Investors

(A) Indian Institutional Investors

There are two types of institutional investors— one is insurance institutions and the other is mutual funds. The general insurance industry was nationalised in 1971 and a government company known as General Insurance Corporation of India (GIC) was formed by the Central Government in November, 1972. The 107 Indian and foreign insurers who were operating in the country prior to nationalisation, were grouped into four companies, namely, (i) National Insurance Company Ltd. (ii) New India Assurance Ltd. (iii) Oriental Insurance Company Ltd. (iv) United India Insurance Company Ltd. These insurance institutions which are primarily assigned the task of insuring the properties of the people amass large sums of money by way of premium and invest them in long-term securities.

Life Insurance Corporation of India Ltd. was set up in 1956. It took over the assets and liabilities of 245 insurers engaged in the transaction of life insurance business in India. LIC has a central office

Mumbai and 7 zonal offices at Mumbai, Kolkata, Delhi, Chennai, Hyderabad, Kanpur and Bhopal. insurance institution which was primarily assigned the task of insuring the lives of the people, asses large sums of money by way of premium from the public and invest it in long-term securities. addition to LIC, new insurance companies have recently been set-up as the insurance sector has opened to the private companies. These private companies are also mobilising investable funds.

Mutual funds are the associations or trusts of public members who wish to make investments in financial instruments or assets of the business sector or corporate sector for the mutual benefit of its members. The funds collect the money of these members from their savings and invest them in a diversified portfolio of financial assets with a view to reduce risks and to maximise their income and capital appreciation. These funds are of various types and are set-up for various purposes and objectives. The funds can be classified into 3 types by objectives, such as, those for income alone, for capital appreciation (growth) and for both. Thus, the mutual funds play an important role in widening and strengthening the capital market in the country.

1. Registration of Mutual Fund

A mutual fund can be set-up after a certificate of registration is issued by SEBI on an application filed by a sponsor. The sponsor means any person who, acting alone or in combination with another body corporate, establishes a mutual fund. Following conditions should be fulfilled by a sponsor:

(i) The sponsor should have a sound track record and general reputation of fairness and integrity in all his business transactions. The sponsor should have an experience of at least 5 years of carrying on business in financial services and its net worth should be positive in all the immediately preceding 5 years and in the immediately preceding year, its net worth should be more than the capital contribution of the sponsor in the asset management company (AMC) and the sponsor has profits after depreciation, interest and tax in 3 out of the immediately preceding 5 years.

(ii) In case of an existing mutual fund, such fund is in the form of a trust and the trust deed has been approved by the SEBI.

(iii) The sponsor has contributed or contributes at least 40% of the net worth of the asset management company.

(iv) Any person associated with mutual fund/trust should not have bee guilty of fraud or convicted for an offence involving moral turpitude or economic offence.

2. Constitution

A mutual fund shall be constituted in the form of a trust. The instrument of trust shall be in a form of a deed. This deed should be duly registered under the provisions of the Indian Registration Act, 1908 and executed by the sponsor in favour of the trustees. Initially at least 50% of the trustees were required to be independent persons but this percentage has been raised to two-thirds w.e.f. January 12, 1998. The trustees should be appointed with the prior approval of the SEBI.

3. Schemes

An asset management company or a mutual fund can launch any scheme with the prior approval of the trustees. A copy of the offer document should be filed with the board. This document should contain disclosures which are adequate to enable the investors to make investment decisions. The board may ask the AMC or mutual fund to make modification in the offer document as it deems fit.

4. Offering Period

Any scheme of a mutual fund shall be open for subscription for not more than 45 days except the equity linked savings scheme. The AMC shall specify the following in the offer document:

(i) The minimum amount of subscription; and

(ii) The extent of subscription it may retain in case of over-subscription. In such a case, all the applicants applying up to 5,000 units shall be given full allotment.

If the conditions given in (i) and (ii) are not fulfilled, then AMC shall be liable to refund the application money to the applicants. The application money has to be refunded within 6 months from the date of closure of subscription list, otherwise interest @15% p.a. shall be payable.

5. Investment Objectives

Mutual funds shall invest the money collected through various schemes only in transferable securities in the money market or in the capital market or securitised debts. Mutual funds cannot give loans for any purpose. Mutual fund shall invest the money collected under any money market scheme only in money market instruments in accordance with the Reserve Bank of India's directions. The securitised debts may be invested in asset-backed securities. Following rules are applicable on the mutual funds:

(i) A mutual fund cannot invest more than 10% of any company's paid up capital under all its schemes.

(ii) A mutual fund is allowed to transfer investments from one scheme to another scheme if:

  (a) such transfer is done at the prevailing market price for quoted instruments on spot basis; and

  (b) the securities so transferred shall be in conformity with the investment objectives of the scheme to which such transfer has been made.

(iii) A mutual fund can invest the funds in short-term deposits with scheduled commercial banks in case of pending deployment of funds of a scheme in securities in terms of investment objectives of the scheme.

(iv) Asset management companies are also not permitted to undertake security transactions with associate brokers beyond 5% of the quarterly business done by mutual fund.

6. Borrowings by Mutual Funds

Mutual funds have been permitted to borrow only to meet temporary liquidity needs of the fund for the purpose of re-purchase, redemption of units or payment of interest or dividend to the unit-holders. It shall not borrow more than 20% of the net assets of the scheme and the duration of the borrowing shall not exceed 6 months.

7. Underwriting of Securities

Mutual funds can enter into underwriting agreement only after obtaining a Certificate of Registration from SEBI. The underwriting obligation of a mutual fund shall not exceed the total net asset value of the scheme at any time.

8. Publication of Price of Units

Mutual funds shall publish, at least once a week, the sale and re-purchase price of units in case of open-ended schemes. It shall be ensured by the mutual fund that the re-purchase price is not lower than 93% of the Net Asset Value (NAV) and the sale price is not more than 107% of the NAV. In case of close-ended scheme, the re-purchase price of the units shall not be less than 95% of the NAV.

9. Investments Abroad

Mutual fund schemes were allowed to invest in American Depository Receipts (ADRs)/Global Depository Receipts (GDRs) of Indian companies listed on overseas stock exchanges. SEBI allowed the mutual funds to invest in foreign debt securities on 30th March, 2002 in the countries with fully convertible currencies and with highest foreign currency credit rating by registered credit rating agency. They were also allowed to invest in government securities where the countries are AAA rated. The mutual fund can invest a maximum amount of US $500 million on these investments.

10. Accounting Requirements

Mutual funds have to segregate their earnings as current income, short-term capital gains and long-term capital gains. They are also required to calculate weekly net asset value at the last available closing market prices of all quoted schemes. The valuation of unquoted instruments may be done once a week either at cost or by any other method authorised by SEBI.

11. New Norms for Mutual Fund Investments

SEBI prescribed new limits for mutual fund investments in group companies, equity, debt and unlisted companies in October 1999 as follows:

(i) Individual schemes can invest up to 10% of their NAV in equity instruments of a single firm. But this limit does not apply to index funds and sector-specific funds.

(ii) Individual schemes can invest up to 15% of their NAV in rated investment grade debt instruments of a single issuer. This limit may be extended to 20% of NAV with prior approval of the trustees and the board of Asset Management Company.

(iii) The scheme may invest in unlisted equity and equity related instruments up to 5% of the net assets.

(iv) The above restrictions shall not be applicable to government securities and money market instruments.

(v) In case of unrated debt instruments, the maximum limit is 10% of its NAV for a single issuer and the total investment should not exceed 25% of the NAV of the scheme.

(vi) The schemes shall not make any investment in any unlisted security of an associate or group company of the sponsor; or any security issued by way of private placement by an associate or group company of the sponsor; or the listed securities of the group companies of the sponsor which is in excess of 25% of the net assets.

(vii) Investors will have to be informed individually if there is a change in the fundamental attributes of a scheme. In this case, the investors must be given an option to exit at prevailing NAV without any exit load. There shall be no change after 1 year from the date of allotment of units of a new scheme.

(viii) Mutual funds are required to disclose in their results, any underwriting obligations undertaken by their schemes for issues of associate companies, developments in such issues, subscription in issues lead managed by associate companies, subscription in equity or debt or private placement basis where sponsor or associate companies act as manager.

(ix) Any advertisement or performance must be supported by relevant figures such as NAV, yields or returns for at least past 3 years.

12. Penalty for Certain Defaults in case of Mutual Funds

According to Section 15D of SEBI Act, 1992, a penalty for certain defaults in case of mutual funds may be imposed on a person, who is:

(i) required to obtain a certificate of registration from the board for sponsoring or carrying on any collective investment scheme, including mutual funds, but fails to obtain such certificate, he shall be liable to a penalty of ₹ 1 lakh for each day or ₹ 1 crore, whichever is less, during which he sponsors or carries on any such collective investment scheme.

(ii) registered with the board as a collective investment scheme including mutual funds, fails to comply with the terms and conditions of registration, he shall be liable to a penalty of ₹ 1 lakh rupees each day during which such failure continues or ₹ 1 crore rupees, whichever is less.

(iii) registered with the board as a collective investment scheme including mutual funds, fails to make an application for listing of its scheme, he shall be liable to a penalty of ₹ 1 lakh for each day during which such failure continues or ₹ 1 crore, whichever is less.

(iv) registered as a collective investment scheme, including mutual funds, fails to refund the application money paid by the investors within the period specified in the regulations, he shall be liable to pay a penalty of ₹ 1 lakh for each day during which such failure continues or ₹ 1 crore, whichever is less.

(v) registered as a collective investment scheme, including mutual funds, fails to despatch unit certificates of any scheme in the prescribed manner, he shall be liable to a penalty of ₹ 1 lakh each day for which such failure continues or ₹ 1 crore, whichever is less.

(vi) registered as a collective investment scheme, including mutual funds, fails to invest money collected by such collective investment schemes in the manner or within the period specified in the regulations, he shall be liable to a penalty of ₹ 1 lakh for each day during which such failure continues or ₹ 1 crore, whichever is less.

13. Current Position

During the year 2012-13, registration was granted to 4 new mutual funds in the private sector, viz. PPFAS Mutual Fund, SREI Mutual Fund, IIFCL Mutual Fund and IL and FS Mutual Fund. The present position of mutual funds is as follows:

Table 8.4

Mutual Funds Registered with SEBI (in Nos.)

Sector	As on 31-03-15	As on 31-03-16
Public Sector (including UTI)	07	07
Private Sector	40	41
Total	47	48

(Source: SEBI Annual Report 2015-16, p. 105)

Over the last 8 years, MFs have become a significant mechanism for financial intermediation in the economy. Table 8.5 summarises the assets managed by the MF industry, which now offers over 450 products to consumers and manages ₹ 6,65,146 crore of assets.

Table 8.5

Assets Managed by Mutual Fund Industry

(₹ crore)

Funds' Source	2016
Money Market	1,99,404
Gilt	16,306
Debt	5,65,460
Infrastructure Development	1,730
ELSS	41,696
Others	3,44,707
Balanced	39,146
Gold ETF	6,346
Other ETF	16,063
FOF Investing Overseas	1,967
Total	**12,32,824**

(Source: SEBI Annual Report, Table 2.59, p. 781)

(B) Foreign Institutional Investors (FIIs)

Foreign Institutional Investors are those investors who are non-resident in the nature but invest the money in the capital or primary or secondary market securities including the Government securities. It has to be channelised within the framework of guidelines from the Government/RBI/SEBI. Foreign institutional investors include foreign pension funds, mutual funds, investment trusts, asset management companies, nominee companies and the incorporated and institutional portfolio managers or their power of attorneyholders.

1. Registration of FIIs

The FIIs must be mandatorily registered with the SEBI to buy, sell or otherwise deal in securities. The applicant should be established and incorporated as:

(i) A pension fund or mutual fund or investment trust ; or

(ii) An asset management company or nominee company or bank or institutional portfolio manager proposing to make investments in India on behalf of (a) broad-based funds, and (b) proprietory funds, if any. Broad-based fund means a fund with at least 20 investors and no single individual investor holds more than 10% of the shares/units of the fund. But this condition shall not apply if the funds have proprietory funds; or

(iii) Trustee or power of attorneyholder and proposing to make investments in India as in (ii); or

(iv) University fund, endowments, foundations or charitable trusts or societies.

While granting certificate of registration, it considers all the relevant matters and in particular, the following:

(i) The applicant should have been in existence for at least 5 years;

(ii) Applicant should have good track record and professional competence, should be financially sound and have general reputation of fairness and integrity;

(iii) The applicant should be under the regulations of an appropriate foreign regulation authority;

(iv) It has permission under the Foreign Exchange Regulation Act by the RBI for making investments in India as FIIs.

(v) It is legally permitted to invest in securities outside the country of its incorporation;

(vi) It is registered with a statutory authority and no legal proceedings have been initiated by any statutory authority against it;

(vii) The grant of certificate of registration is in the interest of development of securities market.

2. Conditions for Grant or Renewal of Registration

The SEBI may grant renewal of certificate of registration, subject to the following conditions:

(i) It has to abide by the provisions of SEBI's FIIs regulations.

(ii) It has to inform SEBI in writing if:

  (a) any information or particulars submitted to it are found to be false or misleading.

  (b) there is any material change in the information previously furnished, which has a bearing on the grant of the certificate.

(iii) It has appointed a domestic custodian and before making any investment in India, enter into an agreement with him providing for custodial services in respect of securities.

(iv) It has entered into an agreement with a designated bank before making any investment in India for the purpose of operating a special non-resident rupee or foreign currency account.

(v) It has to obtain permission from SEBI before making any investments in India on behalf of a sub-account registration of such sub-account under SEBI FIIs regulations.

If the SEBI is satisfied that the application is complete in all respects, all particulars have been furnished and all the conditions are met with, the certificate would be granted within 3 months after the information called for is furnished. The registration fee is US $10,000 payable within 15 days from the date of intimation by the SEBI. The registration is valid for 5 years.

3. Investment Conditions and Restrictions

The investments by FII are restricted to the following:

(i) Securities in the primary and secondary markets including shares, debentures and warrants of companies listed or unlisted or to be listed on a recognised stock exchange in India.

(ii) Units of schemes floated by domestic mutual funds including UTI whether listed or not.

The total investments of FII on own account or on account of its sub-accounts in equity and equity related instruments cannot be less than 70% of the aggregate of all the investments of the FII. However, this restriction does not apply on investment in debt securities.

4. Secondary Market Transactions

The following additional conditions apply to secondary market investments:

(i) The FIIs can transact business only for taking or giving deliveries of securities bought or sold provided this would not apply in respect of transactions in derivatives traded on a recognised stock exchange.

(ii) They are prohibited from engaging in short selling in securities, compulsory delivery and/or selling in respect of FII transactions are also applicable during no delivery period of a security. No transaction on the stock exchange can be carried forward.

(iii) The transactions of business in securities can be only through a stockbroker registered with SEBI. However, the FII may sell the securities held by it to the company in case of a buy-back offer of its securities by the company.

(iv) The FII or its sub-account having an aggregate of securities which are worth ₹10 crore or more as on the last balance sheet date should settle its transactions only through dematerialised securities.

(v) The securities should be registered:

  (a) in the name of the FII if he is making the investments on his own behalf; and

  (b) in his name on account of his sub-account or in the name of the sub-account in case he is investing on behalf of the sub-account whose name has been disclosed by the FII to SEBI.

5. Suspension of Registration

Suspension of registration may be made if the FII:

(i) indulges in fraudulent transactions in securities;

(ii) fails to furnish any information related to its transactions in securities as required by the SEBI and RBI;

(iii) furnishes false information; and

(iv) does not cooperate in any enquiry conducted by the SEBI.

6. Cancellation of Registration

The certificate of registration may be cancelled if the FII:

(i) indulges in deliberate manipulation of the prices or price rigging or cornering activities prejudicially affecting the securities market or investors interest;

(ii) is guilty of fraud or criminal offence involving moral turpitude;

(iii) does not meet the eligibility criteria as laid down in SEBI regulations;

(iv) violates the provisions of SEBI's Insider Trading Regulation, 1992 or SEBI Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market Regulation, 1995; and

(v) is guilty of repeated defaults in respect of failure to comply with any condition subject to which certificate was granted or contravenes with the provisions of SEBI Act.

VII. Non-Resident Indians (NRIs)

A non-resident Indian is one who has gone out of India for business, profit, service, employment, etc. The NRI include:

(i) Indian citizens who stay abroad for employment or carrying on any business, vocation or any other purpose in circumstances indicating an indefinite period of stay outside India;

(ii) Indian citizens working abroad on assignment with foreign governments or government agencies or international agencies like the United Nations, IMF and World Bank; and

(iii) Officials of the central or state government or public sector undertakings deputed abroad.

As per the **Income Tax Act,** NRI is a person whose stays in India during the first year of his residence abroad, should be confined to less than 60 days. His stay for the second year should be less than 150 days. After two years of such stay, the NRI may visit India freely for next 8 years. If in any year, his stay is more than 150 days, he would become resident but not ordinary resident.

(1) Types of NRI Accounts

There are two types of NRI accounts:

(i) **Ordinary Non-resident Account:** The ordinary non-resident account may be opened in rupees with funds remitted from abroad through banking channels. Withdrawals from the account can be made purely for the local disbursements, for investment in government securities, national plans/saving certificates and for payment towards Indian taxes and premium payable on insurance policies. Withdrawals for all other purposes require prior specific approval of the RBI. Interest income from the accounts is not exempted from income tax. Funds held under this type of account are non-repatriable.

(ii) **Non-resident External Account:** The non-resident external account can be opened by non-resident, in rupees, pound sterling, or dollars by transferring funds from the country of his residence. The balance held in the account together with the interest may be purely repatriated outside India. Withdrawals are also allowed to be made freely for local disbursement as well as purchase of government securities, national plans/saving certificates and units of the UTI. The income from such investments can be credited to the non-resident external account.

Investment in non-resident external accounts may also be made by companies, partnership firms, trusts, societies and other corporate bodies owned to the extent of at least 60% by non-residents of Indian origin.

(2) Investment in Government Securities, Units, etc.

Non-residents of Indian origin are permitted to invest in government securities, national plans/savings certificates and units of the UTI by remittances from abroad or out of funds in non-resident external accounts. The interest or dividend on securities or units may be freely repatriated or credited to non-resident external accounts.

(3) Subscription of Memorandum and Articles of Association

The RBI has granted the general permission to subscribe to Memorandum and Articles of Association in order to facilitate the setting up of new projects or companies by NRIs in India. NRIs were also granted permission by the RBI to take up shares of Indian companies for their incorporations. Such Indian companies have general permission to issue the shares to NRIs up to the maximum face value of ₹ 10,000. Such company should not be engaged in any activity related to agriculture and plantation. The company is required to file a declaration of such issue within 90 days from the date of its incorporation to the RBI. RBI has kept the authority to decide the repatriatibility of such investment while granting permission for the issue of further shares to NRIs.

(4) Sale/Transfer of Shares/Debentures through Stock Exchange

NRIs/OCBs/PIOs with repatriation rights are permitted by the RBI for sale or transfer of shares/bonds/debentures through stock exchanges to an Indian citizen/PIO resident in India/company subject to the following conditions:

(i) The transferor had purchased or acquired such shares/bonds/debentures in accordance with the terms and conditions of permission granted by the RBI.

(ii) The shares/bonds/debentures are sold in a recognised stock market through a member and the sale transaction is effected at the ruling price as determined on the floor of the exchange by normal bid/offer method.

The authorised dealers may, in such cases, allow the remittance of net sale proceeds provided:

(a) the brokers' contract note showing the sale price is produced;

(b) documentary evidence is produced to show that the original investment was permitted on repatriation basis specifically by the RBI or was covered under the general permission granted by the RBI and was made out of funds remitted from abroad in foreign exchange or out of funds held in NRE/FCNR account of the non-resident investor; and

(c) a no objection certificate from income-tax authorities or undertaking or certificate regarding the payment of tax.

The authorised dealer and designated branch may also permit repatriation of sale proceeds and credit to NRE/FCNR account to the extent of the original cost of investment immediately on realisation of the sale proceeds where the amount of capital gains tax is not immediately determinable. The excess amount of sale proceed representing capital gain should be kept by them in a separate NRO account of the seller or in a suspense account. This amount may be allowed to be credited to the NRE/FCNR account of the seller or to remit it abroad on the production of necessary tax collection certificate.

(5) Gift of Shares/Bonds/Debentures/Immovable Property

The persons of Indian origin (Foreign Citizens) have been allowed to transfer their shares/debentures/bonds of an Indian company to PIO and residents in India or to a charitable trust by way of gift if:

(i) they were held with the permission of RBI;

(ii) transfer is between relatives; and

(iii) provisions of any applicable law are duly complied within case of transfer to a charitable trust.

Similarly, the transfer of immovable property is allowed subject to the condition that the provisions of all other applicable laws are duly complied with, such as, Foreign Contribution (Regulation) Act's provisions are complied with and the gift tax liability, if any, is discharged.

(6) Investment in Sick Industrial Units

The NRIs and OCBs are allowed to undertake revival of sick industrial units by making bulk investment up to 100 per cent of the equity capital of any sick unit either by purchasing equity shares from existing shareholders or in the form of subscription of new equity issues of sick company on the basis of private placement. Repatriation of capital brought into India for the revival of the sick units is permitted after a minimum period of 5 years after taking into account the future payment liabilities of the investee company.

A certificate along with the application form is to be enclosed indicating the basis on which the company has been classified as a sick unit. The certificate should be either from the public financial institution or consortium formulating the plan for the company's rehabilitation or revival or from the bank or financial institution providing the credit facilities to the company. An auditor's certificate showing a fair valuation of shares and a special resolution from the existing shareholders of the company apart from the otner documents for proposed issue/transfer of shares to NRIs and OCBs need to be disclosed.

(7) Investment in New Issues up to 40 per cent Equity

NRIs and OCBs (Overseas Corporate Bodies) owned to the extent of at least 60 per cent by non-resident of Indian origin, may invest in new issues of shares/debentures of any new or existing company (other than FERA company) engaged in industrial manufacturing activities or a hospital or hotel project, or shipping or oil exploration services or development of computer software, raising capital through a public issue with prospectus up to 40 per cent of the new capital, issue of the company with full repatriation rights, provided that such investment is made by remittance from abroad or from NR external account of India.

(8) Direct Investment Under 30 per cent Scheme

The NRIs/OCBs are permitted to invest up to 30 per cent in equity shares/convertible debentures issued by the existing or new private and public limited Indian companies engaged or proposing to engage in any activity including finance, hire purchase, leasing, trading or other services except agricultural and plantation activities.

(9) Direct Investments in New Issues of Shares/Debentures of Indian Companies

The RBI has granted general permission to the NRIs/OCBs to take up or subscribe to the shares or debentures of an Indian company on non-repatriation basis. Similarly, Indian companies are permitted to issue shares or convertible debentures by way of new rights/bonus issues to NRIs/OCBs on non-repatriation basis. This investment may be up to 100 per cent of the issued capital of the company. However, this general permission is subject to the following conditions:

(a) The investee company is not engaged in agricultural/plantation activities and/or real estate business (excluding real estate development).

(b) The payment for the shares/debentures should be received from the NRIs/OCBs by inward remittance from abroad through normal banking channels or by transfer of funds held in investor's NRE/FCNR/NRO account maintained with an authorised bank or an authorised dealer in India.

(c) Neither the capital invested nor any income arising therefrom whether by way of capital appreciation or dividend or otherwise is eligible for repatriation out of India.

(d) The dividend/interest accruals in respect of the shares/convertible debentures may be credited to the investor's Ordinary Non-resident Rupee Account with an authorised bank in India.

(e) The Indian Company issuing the shares or convertible debentures should file a declaration within 90 days from the date of receipt of the investment on the prescribed form together with necessary documents to the RBI.

(10) Portfolio Management

On Repatriation Basis

Portfolio investment in both types of shares and debentures (convertible and non-convertible) which are quoted on stock exchanges in India is also permitted to NRIs/OCBs. The full benefit of repatriation of capital invested and income earned is available subject to the following conditions:

(i) Provided that the shares/debentures are purchased through recognised stock exchange in India.

(ii) The shares/debentures are purchased at the prevailing rate on the floor of the stock exchange

The purchase of shares/debentures in any one company by each NRI should not exceed 1 per cent of the paid-up value of the equity/preference capital or 1 per cent of the total paid-up value of each series of convertible debentures.

There is an overall ceiling of 10 per cent of the total paid-up equity capital of the company concerned, and 5 per cent of the total paid-up value of each series of convertible debentures for investment by all eligible NRIs.

The above ceiling is applicable to all NRIs taken together with repatriable and non- repatritable basis.

The payment for purchase of shares/debentures on repatriable basis should be made either by fresh remittances from abroad or through NRE/FCNR account.

NRIs and OCBs are permitted to acquire up to 30 per cent instead of 10 per cent under the folio investment scheme through stock exchanges in India provided that the Indian company ies through general body resolution. This is subject to the condition that the total purchase of all Is/OCBs both on repatriation and non-repatriation basis are within an overall ceiling of:

(a) 30 per cent of the total paid-up capital of the company concerned;

(b) 30 per cent of the total paid-up value of each series of the convertible debentures issued by the company concerned.

The RBI has permitted in general to banks in India to purchase shares/debentures on behalf of stors through stock exchanges.

On Non-repatriation Basis

Investment in shares/debentures can also be carried out by a non-resident investor if he undertakes t to seek repatriation of the capital invested and income earned thereon. Overall ceiling of 10 r cent or 30 per cent as the case may be, applies in the case of purchase of equity shares and vertible debentures on non-repatriation basis also. Payment for such investment can be made ther by remittances from abroad or from the investors' /FCNR/NRO account. The banks are also nted permission by the RBI to act as an authorised dealer for purchase/sale of shares/debentures behalf of NRIs.

NRIs and OCBs investing in Indian companies on non-repatriable basis can repatriate their nings in full (after payment of tax). The principal investment and gains realised on disinvestment uld, however, continue to the non-repatriable.

(11) Sales and Transfer of Shares/Debentures

The RBI has granted general exemption for the sale of such securities from NRI to residents in r to facilitate quick transfer of shares/bonds/debentures of Indian companies previously acquired NRIs/OCBs subject to certain conditions. These conditions are:

(a) The shares should be sold at the ruling market price on a stock exchange through the same designated branch through which they were purchased; and

(b) the sale proceeds should be paid to the said designated branch.

On the basis of non-repatriation sale of shares/debentures by NRIs, the requirement is that the sale eds of the shares are credited to the non-resident seller's NRO account.

9

Merchant Banking

Introduction

The merchant banks are known as "accepting and issuing houses" in the England and as "investment banks" in the America. Merchant banks in other countries undertake a larger number of activities. They operate both in the money market as well as in capital market and undertake direct and indirect lending portfolio management for institutions, trusts, charities, etc. They also undertake the funds management for existing companies, underwriting for new and old companies, etc. It is now obligatory that all the public issues should be managed by merchant bankers functioning as lead managers except the rights issue not exceeding ₹ 50 lakh.

Definitions

1. According to **L.M. Bhole,** "The merchant banks are different from securities dealers, traders and brokers. They deal mainly in new issues, while the latter deal mainly in existing securities. The MBs are engaged more in broking than in banking business. They arrange funds or negotiate financial deals for their clients for a fee as 'arrangers,' 'brokers' or intermediaries."
2. According to **V.A. Avadhani,** "Merchant banks are issue houses rendering such services to industrial projects or corporate units as floatation of new ventures and new companies, preparation, planning and execution of new projects, consultancy and advice in technical, financial, managerial and organisational fields. A number of other functions such as restructuring, revaluation of assets, mergers, takeovers, acquisitions, etc., are also undertaken by them."
3. According to **H.R. Machiraju,** "Merchant banking which is synonymous with financial services has identified in India with just issue management in academic and popular parlance. Actually, merchant banking includes the entire range of financial services. The services provided by a merchant banking outfit, however, are subject to their inclination and resources, technical and financial."
4. According to **M.Y. Khan,** "The importance of merchant bankers as sponsors of capital issues is reflected in their major services/functions, such as, determining the composition of capital structure, drafting of prospectus and application forms, compliance with procedural formalities, appointment of registrars to deal with the share application and transfers, listing of securities, arrangement of underwriting and sub-underwriting, placing of issues, selection of brokers, bankers to the issue, publicity and advertising agents, printers, and so on."

5. The notification of the **Ministry of Finance** defines a merchant banker as, "any person who is engaged in the business of issue management either by making arrangements regarding selling buying or subscribing to securities as manager, consultant, advisor or rendering corporate advisory service in relation to such issue management."

The origin of merchant banking can be traced to Italy in late medieval times and France during 17th and 18th centuries. In the UK, merchant banks came into existence in the late 18th and early th century. Baring Brothers was the oldest merchant bank in London which was very prominent Europe during the 19th century. In India, merchant banking activity was formally initiated into Indian capital markets when Grindlays Bank received the license from RBI in 1967. State Bank India started the merchant banking division in 1972 based on the recommendations of Banking mmission in 1972. Some of the commercial banks followed the SBI. They were Central Bank of ia, Bank of India and Syndicate Bank in 1977, Bank of Baroda, Standard Chartered Bank and antile Bank in 1978 and United Bank of India, United Commercial Bank, Punjab National Bank, ara Bank and Indian Overseas Bank in late 1970s and early 1980s. Development banks like ICICI rted this activity in 1973, followed by IFCI in 1986 and IDBI in 1991.

ture of Merchant Banking

The nature of merchant banking is as follows:

1. It is a skill-based activity.
2. It involves servicing of any financial need of the client.
3. It requires a focused skill base to provide for the requirements of a client.
4. The merchant banking activities require sophistication.

SEBI has made the quality of manpower as one of the criteria for renewal of merchant banking gistration. Merchant bankers can provide the entire gamut of services or develop niche business. chant bankers can turn to any of the activities mentioned in functions of merchant banking, pending on resources, such as capital, foreign tie-ups for overseas activities and skills.

unctions of Merchant Banking

The functions of merchant banking or the role played by the merchant banking are as follows:

(1) Issue Management

A major function of the merchant banking is the issue management. The issue can be public ue through prospectus, offer of sale or private placements, etc. The issue management involves the owing functions in respect of issue through prospectus:

(i) Obtaining approval for the issue from the SEBI.

(ii) Arranging underwriting for the proposed issue.

(iii) Drafting and finalising of the prospectus and obtaining its clearance from the underwriters, stock exchanges, auditors, solicitors, registrar of companies and other necessary contents required for filing the prospectus.

(iv) Drafting and finalisation of other documents such as application forms, newspaper announcements of the prospectus material and application to the stock exchanges.

(v) Selection of the registrar to the issue, printing press, advertising agencies, underwriters, brokers and bankers to the issue and finalisation of the fees and charges to be paid to them.

(vi) Arranging the conferences of the press, brokers and investors through the advertising agency.

(vii) To finalise the terms of issue to make the issue more attractive.

Where the capital base of the company is very large and issue of new capital is not justified, the promoters can approach to the merchant banker who sell their existing holding through a letter of offer to the members of the public, so that the shares of the existing company got listing on the stock exchanges. The letter of offer must give all material particulars relating to the company. This letter of offer is prepared by merchant banker. The initial offer should be at par and if further issues are made at a premium, this has to be justified by the merchant bankers.

When the financial institution directly subscribes to the equity/preference shares and/or debentures issued by the company it is called as private placement of securities. The company can also approach a well identifiable body of persons like merchant banks in place of financial institutions.

(2) Pre-investment Studies for Investors

The merchant bankers undertake the feasibility explorations in selected areas of interest of the client. It includes the studies for foreign companies wishing to participate in joint ventures in India and involve a package which covers the advice on the nature of participation and Government regulations. Pre-investment study or project counselling broadly covers the study of the project and covers the following aspects:

(i) Development or review of project profile.

(ii) Preparation of project report after considering its financial, economic and market feasibility.

(iii) Estimation of the cost of the project.

(iv) Studying the procedural aspects of project implementation.

(v) Deciding the means of financing and deciding the capital structure.

(vi) Assisting in legal formalities for implementation of the project.

(3) Corporate Counselling

Merchant bankers provide this facility to corporate enterprises free of charge in order to improve the performance of the enterprises. They also provide the service to build good image of themselves in the minds of investors and to increase the market value of its equity shares. In the following areas they provide corporate counselling:

(i) Area of diversification considering the Government's economic and licensing policies.

(ii) They undertake the market analysis for growth, present demand, future demand and profitability of each product produced by the corporate enterprises, so that they may advise whether the product should be continued or discontinued.

(iii) They help in reviving sick units by assessing need of change in their capital structure, manufacturing process, technology, etc.

(4) Project Finance

When a merchant banker undertakes a particular project/expansion/modernisation scheme, then he also assists in working out a comprehensive package for the project funding. It includes the study

of financing available from merchant banks and funding institutions. For this, they work in with the client and his technical consultant and submit the complete financial report to . They also provide assistance in legal documentation for the finance arranged. They provide services in this regard:

(i) Preparation of a financial plan to meet the funds requirements for the project.

(ii) Preparation of loan applications and monitoring their progress.

(iii) Making selection of the institution where the loan application is to be filed.

(iv) Helping in expediting legal formalities listed by the banks or financial institutions.

(v) Arranging the funds required for enterprises' own share.

(5) Working Capital

Merchant bankers also assist in making available the finance for working capital especially for ventures. For the existing companies, the merchant bankers make available the funds from non- al sources such as through the issue of debentures, etc. Central Bank of India and Grindlays have started the working capital finance as one of the merchant banking service areas. It includes following services:

(i) Estimation of working capital requirements.

(ii) Assistance in preparing the application for credit facilities to be submitted with the financial institution.

(iii) Assistance in negotiations for sanction of appropriate credit facilities.

(iv) Helps in preparing legal documents and follow up for loan disbursements.

(v) Advise and help in issuing debentures for meeting long-term working capital requirements.

(6) Foreign Currency Finance

Now the economic activity is not limited up to the boundaries of the country. It has expanded throughout the world due to globalisation. WTO has been implemented. Due to all this, the venturer foreign capital for import of capital goods and services and requires arrangement of various of export credits from different countries. To start the joint ventures in abroad, the businessman foreign currency. For all these, the merchant bankers rescue the venturers by making available foreign currency and by providing assistance in financial structuring of the projects.

(7) Mergers, Amalgamation and Integration

There is a need for industrial rationalisation because industrial organisations are growing more complex day by day. Due to this reason, the mergers, amalgamation and integration with foreign companies is taking place. This requires sophisticated planning and management which the merchant bankers are providing to the corporate sector.

(8) Counselling of Capital Structure

The merchant bankers also provide counsel on capital and capital structure, and the form of the capital, to be raised. They also provide the financial and non-financial services. The capital structuring services include the following:

(i) Examination of the corporate's capital structure to decide the total capitalisation.

(ii) Merchant bankers suggest the alternative capital structure for companies covered under FEMA which is in conformity with the legal requirements.

(iii) They also identify the areas of diversification for existing production system and to sugges the restructuring of the existing capital structure keeping in view the diversification.

(iv) They suggest appropriate capital structure for sick units which will help them in revival. Th also suggest the extent and sources of bringing fresh capital into business.

(9) Managerial and Technical Services

The merchant bankers also provide the services to tackle the problem in technical, financ managerial and organisational fields. A study by the Reserve Bank showed that insufficient proj preparation, defective technical planning, inefficient or indifferent management and financ bottlenecks faced by promoters were primarily responsible for delay in implementation of projec Now the merchant bankers are providing all the services and rectifying the defects.

(10) Underwriting

The main work of merchant banks relates to underwriting of new issues and raising of new capi for the corporate sector. The SEBI had initially made underwriting compulsory for all issues offered to public but later it was made optional.

(11) Portfolio Management

Merchant banks provide service to the institutional investors also. They advise them regardin investments as in which security should they invest and how much to invest. They also advise them on the optimum investment mix taking various factors into account, like objectives of the investmen need for maximising return, tax bracket applicable to the investor, capital appreciation, etc. The purchase and sell securities on behalf of their clients. Merchant bankers are servicing to domestic a well as off-shore clients. So the services provided differs in nature for these clients.

(i) Services to Domestic Investors:

(a) The sale and purchase of securities.

(b) The management of fixed deposits.

(c) The management of trust funds, pension funds and provident fund investments and thei review.

(d) They keep securities in safe custody.

(e) The reinvestment of returns collected from investments in some profitable avenues.

(ii) Services to Off-shore Investors:

(a) Advice on selection of investment.

(b) Evaluation of investment portfolio.

(c) Getting approval from RBI for making transactions in securities.

(d) Maintaining investment records.

(e) Collecting and remitting interest and dividend on investment.

(f) Providing tax counselling and filing tax returns.

(g) Evaluation of investment portfolio periodically.

(12) Venture Capital

Merchant bankers provide capital funds for unproven ideas, products, technology or start-up funds. Venture capital fund means equity financing in the high risk and high reward projects. It has

become a new merchant banking activity. Merchant banks assist the entrepreneurs who lack capital to be risked. It is already discussed in chapter 1.

(13) Lease Finance

Leasing is an agreement between the user of the asset and the owner of the asset in which the user (lessee) uses the asset without purchasing them on a fixed rental basis. The rental is known as lease rental. The agreement regarding terms of amount and timing of the lease rentals. At the end of the agreed period, the asset is given back to the owner of the asset. However, option to buy is given to the user in case of long-term lease. Merchant bankers assist their clients by providing finance for the acquisition of asset taken on lease.

Roles of Merchant Banking

The following roles are played by merchant banking:

1. Advice and liaison obtaining consent of the Central and State Governments for the project;
2. Preparation of economic, technical and financial feasibility reports;
3. Underwriting for issues of securities;
4. Initial project preparation, pre-investment surveys and market studies;
5. Assistance in raising foreign exchange resources;
6. Help in financial management and in designing proper capital structure;
7. Advice on restructuring, i.e, amalgamation, mergers, acquisition and takeovers, etc.
8. Management aid and entrepreneurial aid;
9. Recruitment of technical and managerial personnel;
10. Advice and help on setting up projects in foreign countries and locating foreign markets, etc.

Objectives of Merchant Banking Regulations

The objectives of merchant banking regulations are as follows:

1. To regulate the raising of funds in the primary market.
2. To assure the issuer a market for raising resources effectively and easily.
3. To ensure the issuer a market for raising resources at low cost.
4. To ensure a high degree of protection of the interests of the investors.
5. To provide high standard of professional competence, honesty, integrity and solvency in the market.
6. To promote a primary market which is fair, efficient, flexible and inspires confidence.

Categories of Merchant Bankers

Merchant bankers were categorised as follows:

(1) Category I

Those merchant bankers who can conduct all the activities relating to management of issues. They may act only in advisory/consultative capacity or as co-managers, underwriters or as portfolio managers, if they choose.

(2) Category II

Those merchant bankers who can act as consultants, advisers, portfolio managers and co managers.

(3) Category III

Those merchant bankers who can act as underwriters, advisers and consultants.

(4) Category IV

Those merchant bankers who can act only as advisers or consultants to an issue.

Only category I bankers were allowed to act as lead managers to an issue. SEBI abolished al categories of merchant bankers below category I on September 5, 1997. They were allowed to operate till the end of their existing terms. They were also given an option to upgrade themselves as the equivalent of the prevailing category I merchant bankers.

Conditions for Registration of Merchant Bankers

To carry out merchant banking activities, merchant bankers are compulsorily to be registered with the SEBI. They should satisfy the following conditions for their initial and renewal of registration:

(i) They should satisfy the prescribed minimum capital adequacy norms in terms of its net worth.

(ii) The merchant bankers should be a body corporate other than a non-banking financial company.

(iii) They should have necessary infrastructure, like adequate office space, equipment and manpower for effective discharge of their duties and responsibilities.

(iv) They should have employed at least 2 persons competent to conduct merchant banking activities.

(v) Any person connected directly or indirectly with the applicant, i.e., an associate/subsidiary interconnected or group company, does not have a certificate of registration from the SEBI.

(vi) The partners/directors/principal officers should not be involved in any litigation connected with the securities market.

(vii) They pay the prescribed fee.

(viii) They have recognised professional qualification in finance, law or business management.

(ix) They undertake to adhere to the prescribed code of conduct.

(x) The registration is in the interest of the investors.

Renewal of Registration

The merchant banker should continue to fulfil all the conditions required at the time of registration for getting the renewal of registration. In addition, a declaration signed by at least 2 directors should also be made that:

(i) The applicant company, its promoter, director, partner or employee have not at any time been convicted for any offence involving moral turpitude or have been found guilty of any economic offence;

(ii) It is not involved in litigation connected with the securities market and there are no charges against the merchant banker as on date;

(iii) None of the associate, subsidiary, interconnected or group company of the applicant company has applied for or have been granted registration by SEBI to undertake merchant banking activities;

(iv) The merchant banking company or its directors are not facing any charges/disciplinary action from any stock exchange;

(v) The applicant company or its associates have not been found involved in the securities scam and are not named in Jankiraman Committee Report/Joint Parliamentary Committee Report;

(vi) All investments indicated in the certified annual accounts are held in the name of the company only.

Fees

A merchant banker has to pay the following fees:

(A) Registration Fees

Every merchant banker shall pay a sum of ₹ 20 lakh as registration fees at the time of grant of certificate by the board.

Every merchant banker shall have to pay a fee on every draft offer document [As per amendment 2006] at the following rates:

A. Public Issues

Size of the issue, including intended retention of oversubscription	Amount/Rate of fees
Less than or equal to one crore rupees.	A flat charge of ten thousand rupees (₹ 10,000/-)
More than one crore rupees, but less than or equal to five thousand crore rupees.	0.1 per cent of the issue size.
More than five thousand crore rupees, but less than or equal to twenty five thousand crore rupees.	Five crore rupees (₹ 5,00,00,000/-) plus 0.025 per cent of the portion of the issue size in excess of five thousand crore rupees (₹ 5,000,00,00,000/-).
More than twenty five thousand crore rupees.	A flat charge of ten crore rupees (₹ 10,00,00,000/-).

B. Rights Issues

Size of the issue, including intended retention of oversubscription	Amount/Rate of fees
Less than or equal to two crore rupees.	A flat charge of ten thousand rupees (₹ 10,000/-).
More than two crore rupees, but less than or equal to five hundred crore rupees.	0.05 per cent of the issue size.
More than five hundred crore rupees.	A flat charge of twenty five lakh rupees (₹ 25,00,000/-).

(B) Renewal Fee

A merchant banker shall pay a renewal fee of ₹ 9 lakh after every three years from the date of initial registration.

Capital Adequacy Norms

A merchant banker was granted recognition by the SEBI in different categories on the basis of capital adequacy norms in terms of its net worth (paid-up capital and free reserves). The minimum net worth requirement for each category was:

Category I	₹ 5 crore
Category II	₹ 0.5 crore
Category III	₹ 0.2 crore
Category IV	NIL

SEBI may require half-yearly unaudited financial results of a merchant banker to monitor the capital adequacy norms.

Maximum Number of Lead Managers

The maximum number of lead managers to an issue may be as follows:

Size of Issue	Maximum Number of Lead Managers
(i) Below ₹ 50 crore	Two
(ii) From ₹ 50 crore to below ₹ 100 crore	Three
(iii) From ₹ 100 crore to below ₹ 200 crore	Four
(iv) From ₹ 200 crore to below ₹ 400 crore	Five
(v) ₹ 400 crore and above	More than five with SEBI approval

General Obligations and Responsibilities

The following are some of the important general obligations and responsibilities of the merchant bankers:

(1) Merchant Banker Not to Associate with any Business Other than that of the Securities Market

No merchant banker, other than a bank or a public financial institution, who has been granted a certificate of registration under these regulations shall carry on any business other than that in the securities market. If a merchant banker, who prior to the date of notification of the SEBI (Merchant Bankers) Amendment Regulations, 1997, has entered into a contract in respect of a business other than that of the securities market, may discharge his obligations under such contract.

(2) Maintenance of Books of Accounts, Records, etc.

Every merchant banker shall keep and maintain the following books of accounts, records and documents namely:

(a) a copy of the balance sheet as at the end of each accounting period;

(b) a copy of profit and loss account for that period;

(c) a copy of the auditor's report on the accounts for that period; and

(d) a statement of financial position.

Every merchant banker shall also intimate the place to the board where the books of accounts, records and documents are maintained. The merchant bank shall also furnish copies of the above documents to the board after the end of each accounting period and such any other documents for preceding 5 accounting years when required by the board. It means the merchant banker has to preserve the books of accounts and other records and documents for a minimum period of 5 years.

(3) Submission of Half-yearly Results

Every merchant banker shall furnish half-yearly unaudited financial results to the board when required by board with a view to monitor the capital adequacy of the merchant banker.

(4) Report on Steps Taken on Auditor's Report

Every merchant banker shall take steps to rectify the deficiencies made out in the auditor's report within 2 months from the date of the auditor's report.

(5) Appointment of Lead Merchant Bankers

All issues should be managed by at least one merchant banker functioning as the lead merchant banker. The appointment of a lead merchant banker shall not be essential in a rights issue to the existing members with or without the right of renunciation, provided that the amount of issue of the body corporate does not exceed ₹ 50 lakh.

(6) Responsibility of Lead Managers

No lead manager shall agree to manage or be associated with any issue unless his responsibilities relating to the issue mainly those of disclosures, allotment and refund are clearly defined, allocated and determined and a statement specifying such responsibilities is furnished to the board at least 1 month before the opening of the issue for subscription. Where there are more than 1 lead merchant bankers to the issue, the responsibilities of each such lead merchant banker shall clearly be demarcated and a statement specifying such responsibilities shall be furnished to the board at least 1 month before the opening of the issue for subscription.

(7) Lead Merchant Banker Not to Associate with a Merchant Banker Without Registration

A lead merchant banker shall not be associated with any issue of merchant banker who is not holding a certificate is associated with the issue.

(8) Acquisition of Shares

No merchant banker or any of its directors, partners or manager or principal officer shall, either on their respective accounts or through their associates or relatives, enter into any transaction in securities of bodies corporate on the basis of unpublished price sensitive information obtained by them during the course of any professional assignment either from the clients or otherwise.

(9) Information to the Board

Every merchant banker shall submit the complete particulars of any transactions to the board for acquisition of securities of any body corporate whose issue is being managed by that merchant banker within 15 days from the date of entering into such transaction.

(10) Disclosure to the Board

A merchant banker shall disclose the following informations to the board as and when required:

(i) his responsibilities with regard to the management of the issue;

(ii) any change in the information or particulars previously furnished, which have a bearing on the certificate granted to it;

(iii) the names of the body corporate whose issues he has managed or has been associated with;

(iv) the particulars relating to breach of the specified capital adequacy requirements; and

(v) relating to his activities as a manager, underwriter, consultant or adviser to an issue as the case may be.

Responsibilities/Obligations of Lead Managers/Merchant Bankers

A lead manager or a merchant banker has the following responsibilities/obligations towards the issuing company and SEBI:

(1) Contract

A lead manager should enter into a contract with the issuing company in which they should clearly set out their mutual rights, liabilities and obligations relating to such issues in general and relating to disclosures, allotment and refund in particular.

(2) Submission of Copy of Contract

They should submit a copy of the above contract at least 1 month before the opening of the issue for subscription. In case of more than one lead manager, they should simultaneously submit a statement detailing their respective responsibilities.

(3) Underwriting Obligation

Lead merchant banker should accept a minimum underwriting obligation of 5 per cent of the total underwriting commitment or ₹ 25 lakh whichever is less. He has to make arrangements for underwriting of an equal amount by a merchant banker associated with that issue under intimation to the SEBI, if he is unable to do so himself.

(4) Submission of Due Diligence Certificate

A lead merchant banker should submit due diligence certificate to the SEBI about verification of contents of prospectus or the letter of an offer in respect of an issue and reasonableness of the views at least 2 weeks before the opening of the issue for subscription. He should certify in that document the following:

(i) they are in conformity with the documents, materials and papers relevant to an issue;

(ii) all legal requirements relating to the issue have been fully complied with; and

(iii) all disclosures are true, fair and adequate to enable the investing public to make a well informed decision regarding investment in the proposed issue.

(5) Submission of Documents

The lead manager should submit the following documents with the SEBI at least 2 weeks before the date of filing the draft prospectus or letter of offer with Registrar of Companies or with Regional Stock Exchange:

(i) particulars of the issue, draft prospectus or letter of offer;

(ii) any other literature intended to be circulated to the investors including the shareholders; and

(iii) such other documents relating to prospectus or letter of offer.

He should ensure that modifications and suggestions made by SEBI regarding above documents have duly been incorporated.

(6) Association with the Issue

He or they should continue to remain fully associated with the issue till the subscribers have received share/debenture certificate or the refund of excess application money.

(7) Not to Acquire Unpublished Securities

The merchant bankers should not acquire securities of any company on the basis of unpublished price sensitive information obtained in the course of discharge of his professional assignment.

(8) Refusal to Work as Lead Manager

The merchant banker should also refuse to accept the responsibility as lead manager, if the issuing company is its associate. They should also not associate themselves with a merchant banker who does not hold SEBI registration certificate.

Code of Conduct

A merchant banker has to abide by the code of conduct as given below:

(1) High Standard of Integrity and Fairness

A merchant banker should maintain high standard of integrity and fairness with the clients and other merchant bankers in the regular conduct of his business.

(2) Exercising Due Diligence

He should render high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgement at all times in the conduct of his business.

(3) Disclosure of Conflict of Interest and Duties

He should disclose the possible sources of conflict of duties and interest to the clients, while accepting the assignment and providing the services.

(4) No Exaggerated Statement

He should not make any exaggerated oral or written statement to the client either about his qualification or his capability to render certain services or his achievements with regard to the services rendered to other clients.

(5) No Harmful Statement

He cannot make any such statement or become party to an act or practice unfair competition which is likely to be harmful to the interest of other merchant bankers or is likely to place other merchant bankers in a disadvantageous position in relation to him.

(6) Endeavour to Serve Clients

A merchant banker should always endeavour to:

(i) render the best possible advice to the clients regarding their needs and requirements; and

(ii) ensure that all professional dealings are effected in a prompt, efficient and cost effectiv manner.

(7) Endeavour to Ensure

He should endeavour to ensure that:

(i) the investors are provided with true and adequate information without making any misguided or exaggerated claims;

(ii) the copies of prospectus, memorandum and related literature are made available to the investors;

(iii) adequate steps are taken for fair allotment of securities and refund of application money without delay.

(iv) complaints from investors are adequately dealt with.

(8) Should not Divulge Confidential Information

He should not:

(i) divulge to other clients, press or any other party any confidential information about his client which has come to his knowledge in the due course of his business; and

(ii) deal in the securities of any client company without making disclosure to the SEBI as per the regulations and also the Board of Directors of the client company.

(9) Should not be Part of Unethical or Unfair Action

A merchant banker should not generally and particularly be part to:

(i) creation of false market;

(ii) price rigging or manipulations; and

(iii) passing of price sensitive information to brokers, members of stock exchanges and other players in the capital market or take any other action which is unethical or unfair to the investors.

(10) Abide by Provisions of SEBI

A merchant banker has to abide by the relevant provisions of the SEBI Act and its rules and regulations.

Inspection by SEBI

(A) Objective of Inspection

The SEBI can undertake the inspection of books of accounts, records and documents of a merchant banker with the objective of:

(i) ensuring that the books are maintained in the prescribed manner;

(ii) ensuring that the provisions of the SEBI Act, rules and regulations are being complied with;

to investigate into the complaints from investors, other merchant bankers, or any other person relating to any matter having a bearing on his activities as a merchant banker; and

taking up a suo moto in the interest of securities business or investor interest.

Obligation of Merchant Banker

The merchant banker has the following obligations with regard to such inspection:

to furnish all the information called for;

to allow a reasonable access to the premises;

to provide reasonable facility for examination of books/records/documents/computer data and provide copies of the same; and

to give all assistance to the inspecting authority in connection with the inspection.

SEBI can inspect the books by its own authority or it can appoint qualified auditor with the powers inspection authority to investigate into the books of accounts and the obligations of the merchant

On the basis of the inspection report and after giving him an opportunity to explain his position, SEBI can call upon the merchant banker to take such measures as it deems fit in the interest of the estors and the securities market.

tion for Default

A merchant banker may be penalised by the SEBI with suspension or cancellation of registration

(i) fails to comply with the conditions laid down while granting the certificate of registration; or

(ii) contravenes any of the provisions of the SEBI Act, rules or regulations.

(A) Suspension of Registration

A penalty of suspension of registration may be imposed where a merchant banker:

(i) violates the provisions of the SEBI Act, rules or regulations;

(ii) violates the conditions of registration;

(iii) fails to pay the prescribed fee;

(iv) fails to maintain the capital adequacy requirement;

(v) fails to furnish to SEBI the required information relating to his activity as merchant banker;

(vi) fails to submit periodical returns as required by the SEBI;

(vii) fails to cooperate in any enquiry conducted by the SEBI;

(viii) furnishes wrong or false information;

(ix) fails to resolve the complaints of the investors or fails to give a satisfactory reply to the SEBI in this regard;

(x) indulges in manipulating or price rigging or cornering activities;

(xi) is guilty of misconduct or unprofessional conduct which is not in accordance with the code of conduct; and

(xii) fails to carry out his obligation as per specified regulations.

(B) Cancellation of Registration

A merchant banker may be penalised with the cancellation of registration where:

(i) he indulges in deliberate manipulation or price rigging or cornering activities which are detrimental to the interest of the securities market or the investors' interest;

(ii) the financial position of the merchant banker deteriorates to such an extent that SEBI is of the opinion that his continuance as merchant banker is not in the interest of investors;

(iii) the merchant banker is guilty of fraud, or is convicted of a criminal offence; and

(iv) if he repeatedly defaults leading to suspension of registration provided that the SEBI furnishes reasons for cancellation in writing.

A merchant banker ceases to carry on any activity as a merchant banker on and from the date of suspension and cancellation of registration.

Default of Merchant Bankers and Penalty Points

The SEBI also imposes penalties for non-compliance of conditions for registration and contravention of the regulations on the basis of which registration is suspended/cancelled. The defaults are classified into:

(1) General Defaults

The following activities are classified under general defaults and attract one penal point:

(i) If the SEBI does not receive the draft prospectus/letter of offer from the lead manager before filing with the Registrar of Companies/Stock Exchanges.

(ii) If the SEBI does not receive the interse allocation of responsibilities of lead managers in an issue prior to the opening of issue.

(iii) If the SEBI does not receive the due diligence certificate in the prescribed manner before opening of the issue.

(iv) If the merchant banker fails to ensure the submission of certificate of minimum 90% subscription to the issue.

(v) If the merchant banker fails to ensure the despatch of refund orders, shares/debentures certificates, filing of listing application by the issuer.

(2) Minor Defaults

The following activities are categorised under minor defaults and attract two penalty points:

(i) If the advertisement, circular, brochure, press release and other issue related materials are not being in conformity with the contents of the prospectus.

(ii) If the issuer or associated merchant banker has given any exaggerated information extraneous to the prospectus in any press conference, investors conference, brokers conference or other such conference or meet prior to the issue for marketing of the issue arranged or participated by the merchant banker.

(iii) If the merchant banker fails to substantiate matters contained in highlights to the issue in the prospectus.

(iv) If the merchant banker violates the regulations relating to advertisement on capital issues.

If the merchant banker fails to exercise the due diligence in verifying the contents of prospectus or letter of offer.

If he fails to provide adequate and fair disclosure to investors and objective information about risk factors in the prospectus and other issue literature.

If he delays in refund or allotment of securities.

If he does not handle the investor grievances promptly.

Major Defaults

The following activities are categorised under major defaults and attract three penalty points:

If the managers do not take up mandatory underwriting.

If the number of lead managers is in excess than permissible.

If the unauthorised merchant bankers are in association in an issue.

Serious Defaults

The following activities are categorised under serious defaults and attract four penalty points:

If a merchant banker practices unethically and/or violates the code of conduct.

If he does not cooperate with SEBI in furnishing desired information, documents and evidence as may be called for.

If a merchant banker reaches on cumulative 8 points, he attracts action from SEBI in terms of ension or cancellation of authorisation. To enable a merchant banker to take corrective action, aximum penalty points awarded in a single issue managed by a merchant banker are restricted our.

Defaults in Prospectus

If the highlights are provided, the following deficiencies will attract negative points:

(i) Absence of risk factors in highlights.

(ii) Absence of listing in highlights.

(iii) Extraneous contents to prospectus, if stated in highlights.

The maximum grading points of prospectus will be 10 and prospectuses scoring greater than or to 8 points are categorised as A+, those with 6 or less than 8 points as A, with 4 or less than 6 as B and with score of less than 4 points, the prospectus falls into category C.

The merchant bankers are advised to take note of the above system of prospectus grading and endeavour to give fair and adequate disclosures in prospectus for the benefit of the investors.

General Negative Marks

If all the highlights are not provided in the issue:

(i) Risk factors should form part of 'Highlights', otherwise it will attract negative point of 1.

(ii) Listing details should form a part of 'Highlights', otherwise it will attract negative point of 0.5.

(iii) Any matter extraneous to the contents of the prospectus, if stated in highlights, will attract a negative point of 0.5.

Self-Regulatory Organisations (SRO)

The SEBI had constituted a committee under the chairmanship of Mr. Uday Kotak to examine formation/restructuring of a self-regulatory organisation for merchant bankers. Some of the funda- principles that the committee has used in recommending a framework for the SRO are mentioned

(i) Membership to be restricted to persons involved in merchant banking activities.

(ii) The SRO owes its existence to the regulatory authority, i.e., SEBI.

(iii) No change in the basic constitution or bye-laws of the SRO can be made without the of the SEBI.

(iv) The SRO would have disciplinary powers vis-a-vis its members

— Framework to decide membership.

— Power to suspend membership through a transparent mechanism.

Given that self-regulation seeks to substitute the Government with the private sector, it is imp to set out the purpose of regulation and the basic ingredients of any regulatory system.

Objectives

In keeping with international trends, it is believed that the public policy objectives of any regul system are generally the following:

1. Efficiency
2. Effectiveness
3. Openness and Transparency
4. Fairness and Objectivity
5. Accountability and Responsibility
6. Development of the Underline Market
7. Speedy and Effective Response to Changes in the Market Environment and Practices.

Structure of SRO

These objectives are achieved through a structure that has the following ingredients:

1. Ability to determine the rules that will guide behaviour of its members.
2. Oversight to ensure compliance with the rules.
3. Taking action through enforcement mechanisms or settlement of disputes.
4. Adjudication mechanism in the context of non-compliance or settlement of disputes.
5. Continuous evaluation and assessment of the regulatory system.
6. Consultative mechanism and a discussion forum to promote best practices and respon market changes to aid the overall development of the capital markets.

Type of Self-Regulatory Model

The committee discussed the various types of self-regulatory models that the SRO could ad These included voluntary, statutory, member defined, supervised and self-managed self-regul models.

10

Credit Rating

Introduction

Credit rating is a grading service to investors which helps them in reducing their risk. It provides a bird's eye-view on the credit quality or the instrument quality of a particular credit instrument issued by a business house. It is a technique in which relative ranking is provided to different instruments of a company on the basis of systematic analysis of the strengths and weaknesses of them. This credit ranking is done on the basis of analysis of financial statements, project analysis, creditworthiness factors and future prospects of the concerned project/company.

Credit rating is not a recommendation to purchase or sell or hold security. Credit rating is generally confined to debt instruments, but rating is also made for equity shares also. Credit rating may be different for different instruments of the same organisation. The credit rating reflects the issuer's strengths, weaknesses, soundness of project, quality management and composite performance, through the whole organisation is not graded. Credit rating is done on the information provided by the issuer and the data collected by the agency itself.

Credit rating may be considered as a science as well as an art. It may be considered as a science because it involves a systematic approach to analyse the statistics with given formulas and as an art because there are too many variables which are to be judged.

Credit ratings have spread even outside the territory of the home country market to foreign markets as the capital flows have become increasingly global. Credit ratings are used as a tool in the financial markets of most developed economies and several emerging market economies as well.

Definitions

Some authors have defined credit rating as follows:

1. According to **P. N. Varshney** and **D. K. Mittal**, "Credit rating is a relative ranking arrived at by a systematic analysis of the strenghts and weaknesses of a company and debt instrument issued by the company, based on financial statements, project analysis, creditworthiness factors and future prospects of the project and the company appraised at a point of time."
2. **L.M. Bhole** has quoted some definitions of credit rating as follows:
   (i) *"Credit rating is designed exclusively for the purpose of grading bonds according to their investment quality."*

(ii) "Corporate or municipal debt rating is a current assessment of the creditworthiness of the obligator with respect to a specific obligation."

(iii) *"A corporate credit rating provides lenders with a simple system of gradation by which the relative capacities of companies to make timely repayment of interest and principal on a particular type of debt can be noted. The higher the rating, the greater the likelihood that the borrower will fulfil his obligations towards the creditors."*

3. According to **V.A. Avadhani**, "Credit rating, is essentially giving an expert opinion by a rating agency on the relative willingness and ability of the issuer of a debt instrument to meet the debt servicing obligation in time and in full."

Significance/Importance of Credit Rating

The significance or the importance of credit rating is as follows:

(i) Credit rating becomes significant when many default prone companies are entering the capital market.

(ii) Ratings are very useful to investors especially when the regulatory authority takes no responsibility for those who raise funds and investors are left to defend themselves.

(iii) The leading rating agencies play a vital role in evaluating sovereign ratings.

(iv) It imposes a healthy discipline on borrowers.

(v) It lends greater credence to financial and other representations.

(vi) It encourages greater information disclosures, better accounting standards and improved financial information, which ultimately helps in investor protection.

(vii) It helps merchant bankers, brokers, regulatory authorities, etc., in discharging their functions related to debt issues.

(viii) It may reduce interest costs for highly rated companies.

unctions of Credit Rating

The major functions of credit rating are as follows:

(i) To impose a healthy discipline on borrowers.

(ii) To lend greater credence to financial and other representations.

(iii) To facilitate formulation of public guidelines on institutional investment.

(iv) To help merchant bankers, brokers, regulatory authorities, etc., in discharging their functions related to debt issues.

(v) To encourage greater information disclosures, better accounting standards, and improved financial information to increase investor protection.

(vi) To reduce interest costs for highly rated companies.

es of Credit Rating

Credit rating depends upon the requirements of the later and the security to be rated. Therefore, different types. The following are the common types of credit rating:

1) **Bond Rating:** Rating the bonds or debt securities issued by a company, Governmental or quasi-Governmental body is called bond rating. This type of rating occupies the major share in the business of credit rating agencies.

2) **Equity Rating:** The rating of equity shares in the capital market is called as equity rating and it occupies the minimum share in the business of credit rating agencies.

SEBI in its board meeting held on December 30, 2005 had in principle, approved introduction optional "grading" of public issues by unlisted companies (viz. IPOs) by credit rating agencies tered with SEBI. It was also mentioned that IPO grading would not be mandatory. It would be g at the option of the issuer company.

-Issue Obligations

1. An unlisted company making an IPO of equity shares or any other security which may be converted into or exchanged with equity shares at a later date may opt to obtain grading for such an IPO from one or more credit rating agencies.

2. Where an issuer opts to obtain IPO grading under clause 5.6B 1, it shall disclose all grades so obtained by it, including unaccepted grades, in the prospectus and abridged prospectus.

ntents of the Offer Document

Statement indicating whether IPO grading has been opted for. If yes, disclosure of all grades obtained, including unaccepted grades and reference of the page number where details of IPO ting

IPO **Grading:**

(a) Name of credit rating agency from which grading has been obtained for the proposed IPO of equity shares or any other security which may be converted into or exchanged with equity shares at a later date and the grading so obtained, including unaccepted grades.

(b) If grading has been obtained from more than one credit rating agency, disclosure shall be made of all the grades so obtained, including unaccepted grades.

(c) the rationale/description of the grading/s so obtained, as furnished by the credit rating agency/ies.

(d) Bidders' bank account details.

3. Statement indicating whether IPO grading has been opted for. If yes, disclosure of all grades so obtained, including unaccepted grades and the rationale/description of the grading/s so obtained, as furnished by the credit rating agency/ies, may be given.

3) **Commercial Paper Rating:** It is mandatory on the part of a corporate body to obtain the rating from credit rating agency before issuing commercial paper in the market. This is known as commercial paper rating.

(4) **Borrowers Rating:** This includes rating a borrower to whom a loan/credit facility may be sanctioned.

(5) **Sovereign Rating:** This includes rating a country as to its creditworthiness, probability to risk, etc.

Types of Analysis in Credit Rating Process

Credit rating process involves analysis of financial statements, discussions with auditors, bankers or creditors, etc. The various factors are examined in the process. The types of analysis undertaken in the process are as follows:

(1) Business Analysis

Business analysis is undertaken to analyse the risks involved in the operations of the company. It includes industry risk, marketing risk, operating efficiency and the legal position, etc.

(i) **Industry Risk:** It includes competition from others, market factors, demand and supply position and government policies, etc.

(ii) **Marketing Risk:** It covers competitive advantages or disadvantages, market share, sales network, etc.

(iii) **Operating Efficiency:** It involves locational advantages, labour cooperation, cost efficiency and operating margins, etc.

(iv) **Legal Position:** The legal position reflected in the offer document, trust deed and trustee's reputation, etc.

(2) Financial Analysis

This analysis includes the examination of:

(i) **Accounting Quality:** The quality methods of depreciation, income recognition, treatment of bad debts, contingent liabilities, etc., are examined by the credit rating agency.

(ii) **Earnings Protection:** The projection of future earnings, proportion of interest to gross profit and net profit, profitability ratios, EPS, etc., are analysed to check the truthfulness of the given data.

(iii) **Financial Flexibility:** Financial flexibility of the firm in terms of capital financing plans, flexibility in financing through alternative methods, flexibility in planning methods is examined.

(iv) **Adequacy of Cash Flows:** Cash flow adequacy as reflected in working capital management, current ratio, quick ratio, etc., are examined by the rating agencies.

(3) Management Evaluation

Management evaluation is the examination of track record, qualification and experience of promoters, managers and top executives. It also involves the scrutiny of planning and control systems, capacity to adjust with flexibility, foresightedness, goal setting, etc.

Regulatory and Competitive Environment

The aspect is assessed in terms of the structure and regulatory framework of the financial system, in deregulation or regulation, efficiency of operations of the regulatory authorities and the of the competitors to regulation, etc.

(5) Fundamental Analysis

(i) **Liquidity Management:** Capital structure, leverage, short-term and long-term solvency, ratio analysis, cash flows of the company are also analysed by the credit rating agencies. In addition to the above, assets quality, credit risk management, receivables to current assets, management of problem credits and risk to individual customer, etc., are also considered by the rating agency.

(ii) **Profitability Analysis:** Credit rating agency also analyses the profitability and financial position of the company. For this, the rating agency analyses the past profit record, spread on funds deployment, revenues on the non-funds based services, accretion to reserves, profit margins, etc.

(iii) **Interest and Tax Rates:** The effects of the change in tax rate and interest rate on company's net profitability are also considered by the rating agency. The proportion of interest to gross profit and proportion of interest payment with cash inflows are also used to examine the interest burden on the future earnings are analysed.

Credit Rating Process

The steps involved in the credit rating process are as follows:

1. The rating process begins at the request of the company.
2. A team is formed with professionally qualified analysts who are well-versed with the working of the particular industry in which the requesting company operates. That team visits the company and makes inspections of the operations first hand.
3. The team conducts meetings with different levels of management including the chief executive officer.
4. The team consults with a back-up team which has collected company's information from other sources and prepares the report.
5. The team forwards its report to the internal committee consisting of senior executives of credit rating agency.
6. An open discussion between the team members and the internal committee takes place to arrive at a rating.
7. Then the ratings are placed before an external committee consisting of respected and eminent people unconnected with credit rating agency to avoid any sort of bias.
8. The decision of the external committee is communicated to the company as a final decision.
9. The company may volunteer any further information at this point which could affect the rating. This information is passed on to the external committee again for change or affirmation of the previous rating.

10. The company may request the agency for review of the rating. This process can also b presented through the following flow chart:

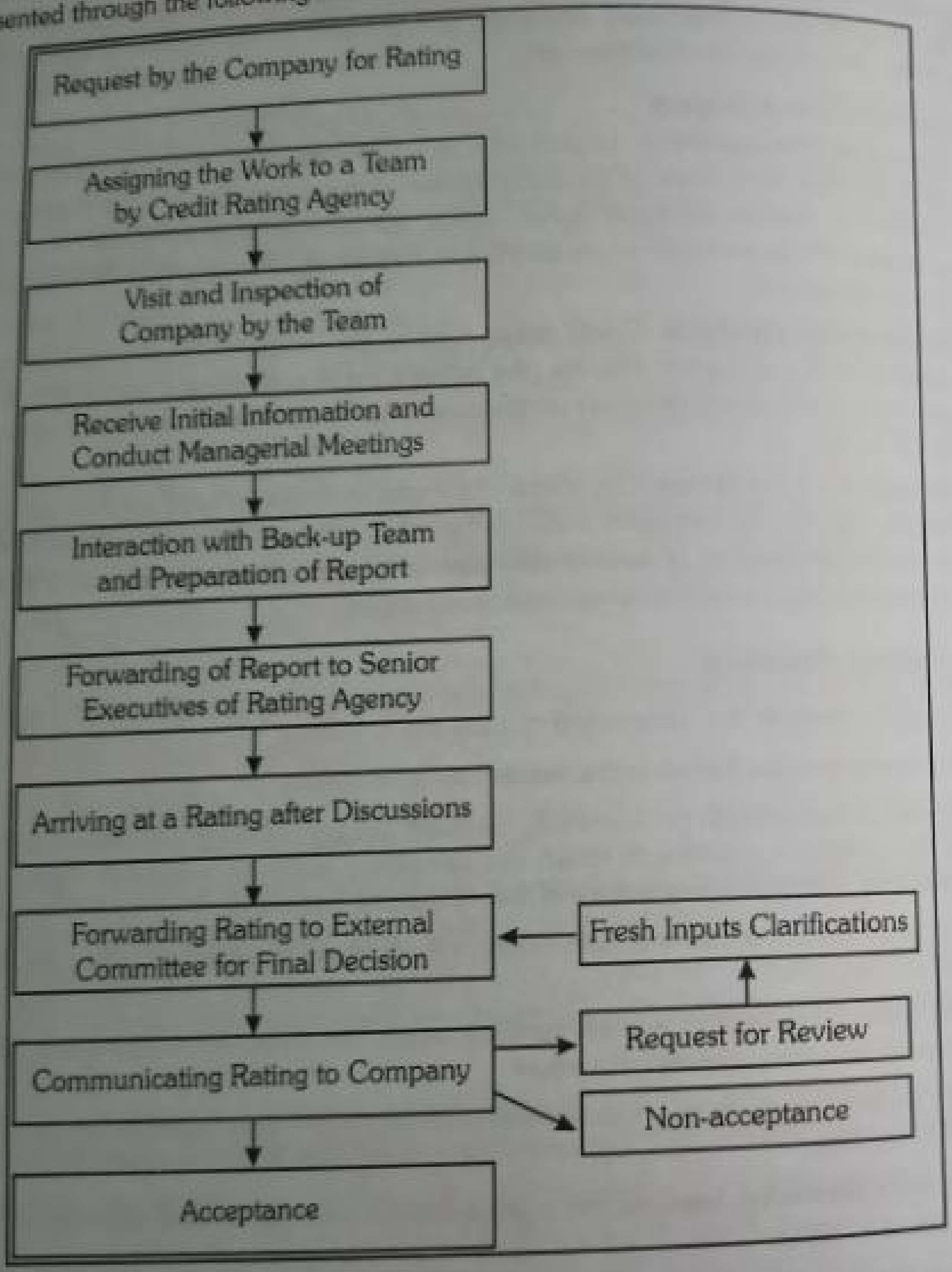


Fig. 10.1: Credit Rating Process

Drawbacks of Credit Rating Process

Rating process has certain advantages but simultaneously suffers from drawbacks also. These are:

1. It does not take into account the factors, like market prices, personal risk or reward preferences that might influence investment decisions.

2. It is based on certain primitives. The analysis is based on information provided by the issuer and the rating agency does not take audit of that information. Consequently the rating process is compromised on the information provided, whether it is accurate or inaccurate.
3. Most of the rating agencies do not give ratings to equity as equity shareholders are supposed to take risk.
4. The ratings are only the matters of opinion and not a recommendation to purchase or sell or hold security.
5. Credit ratings depend on both expertise and honesty of credit rating agencies. Therefore, credit ratings may also serve to misguide the investors.
6. The usefulness of credit rating depends upon the quality of rating agency, its independence from industrial concerns, absence of its vested interest in or linkages with the issuer of securities, quality of its staff, etc.

gistration of Credit Rating Agencies

Application for Grant of Certificate

1. Any person proposing to commence any activity as a credit rating agency on or after the date of commencement of these regulations shall make an application to the board for the grant of a certificate of registration for the purpose.
2. Any person who was, immediately before the said date, carrying on any activity as a credit rating agency, shall make an application to the board for the grant of a certificate within a period of three months from such date.
3. An application for the grant of a certificate under sub-regulation (1) or (2) shall be made to the board in Form A of the first schedule and shall be accompanied by a non-refundable application fee, as specified in part A of the second schedule to be paid in the manner specified in part B thereof.
4. Any person referred to sub-regulation (2) who fails to make an application for the grant of a certificate within the period specified in that sub-regulation shall cease to carry on rating activity.

Promoter of Credit Rating Agency

The board shall not consider an application under regulation 3 unless the applicant is promoted a person belonging to any of the following categories, namely:

(a) a public financial institution, as defined in Section 4A of the Companies Act, 1956 (1 of 1956);
(b) a scheduled commercial bank included for the time being in the second schedule to the Reserve Bank of India Act, 1934 (2 of 1934);
(c) a foreign bank operating in India with the approval of the Reserve Bank of India;
(d) a foreign credit rating agency recognised by or under any law for the time being in force in the country of its incorporation having at least five years experience in rating securities;
(e) any company or a body corporate, having continous net worth of minimum rupees one hundred crore as per its audited annual accounts for the previous five years prior to filing of the application with the board for the grant of certificate under these regulations.

Eligibility Criteria

The board shall not consider an application for the grant of a certificate under Regulation 3 unle the applicant satisfies the following conditions, namely:

(a) the applicant is set-up and registered as a company under the Companies Act, 1956;

(b) the applicant has, in its Memorandum of Association, specified rating activity as one of its main objects;

(c) the applicant has a minimum net worth of rupees five crore. A credit rating agency existing at the commencement of these regulations, with a net worth of less than rupees five crore, shall be deemed to have satisfied this condition, if it increases its net worth to the said minimum within a period of three years of such commencement.

(d) the applicant has adequate infrastructure to enable it to provide rating services in accordance with the provisions of the act and these regulations;

(e) the applicant and the promoters of the applicant, referred to in Regulation 4 have professional competence, financial soundness and general reputation of fairness and integrity in business transactions, to the satisfaction of the board;

(f) neither the applicant, nor its promoter, nor any director of the applicant or its promoter, is involved in any legal proceeding connected with the securities market, which may have an adverse impact on the interests of the investors;

(g) the applicant has, in its employment, persons having adequate professional and other relevant experience to the satisfaction of the board;

(h) neither the applicant, nor any person directly or indirectly connected with the applicant has in the past been:

  (i) refused by the Board a certificate under these regulations or

  (ii) subjected to any proceedings for a contravention of the Act or of any rules or regulations made under the Act.

Explanation: For the purpose of this clause, the expression "directly or indirectly connected person" means any person who is an associate, subsidiary, inter-connected or group company of the applicant or a company under the same management as the applicant.

(i) the applicant, in all other respects, is a fit and proper person for the grant of a certificate;

(ii) grant of certificate to the applicant is in the interest of investors and the securities market.

Application to Conform to the Requirements

(a) Any application for a certificate, which is not complete in all respects or does not conform to the requirement of Regulation 5 or instructions specified in Form A shall be rejected by the board;

(b) Provided that, before rejecting any such application, the applicant shall be given an opportunity to remove, within thirty days of the date of receipt of relevent communication, from the board Such objections as may be indicated by the board.

(c) Provided further, that the board may, on sufficient reason being shown, extend the time for removal of objections by such further time, not exceeding thirty days, as the board may consider fit to enable the applicant to remove such objections.

shing of Information, Clarification and Personal Representation

The board may require the applicant to furnish such further information or clarification as the board may consider necessary, for the purpose of processing of the application.

The board, if it so desires, may ask the applicant or its authorised representative to appear before the board, for personal representation in connection with the grant of a certificate.

nt of Certificate

The Board, on being satisfied that the applicant is eligible for the grant of a certificate of registration, shall grant a certificate in Form B.

The grant of certificate of registration shall be subject to the payment of the registration fee specified in Part A of the second schedule in the manner prescribed in Part B thereof.

ditions of Certificate and Validity Period

1. The certificate granted under Regulation 8 shall be subjected to following conditions, namely:

(a) The credit rating agency shall comply with the provisions of the Act, the regulations made thereunder and the guidelines, directives, circular and instructions issued by the Board from time to time on the subject of credit rating.

(b) Where any information or particulars furnished to the Board by a credit rating agency:

  (i) is found to be false or misleading in any material particular; or

  (ii) has undergone change subsequently to its furnishing at the time of the application for a certificate.

The credit rating agency shall inform the Board in writing.

2. The period of validity of certificate of registration shall be three years.

newal of Certificate

1. A credit rating agency, if it desires renewal of the certificate granted to it, shall submit to the Board an application for the renewal of the certificate of registration.

2. Such application shall be made not less than three months before expiry of the period of validity of the certificate, specified in Sub-regulation (2) of regulation.

3. The application for renewal made under Sub-regulation (1):

  (a) shall be accompanied by a renewal fee as specified in the second schedule, and

  (b) as far as may be, shall be dealt within the same manner as if it were an application for the grant of a fresh certificate under Regulation 3.

ount to be paid as Fees

	₹
Application Fee	50,000
Registration Fee for grant of certificate	26,66,700
Balance Fee for credit rating agencies referred under sub-regulation (3) of regulation 8	6,66,700
Renewal Fees (For Three Year)	10,00,000

General Obligations of Credit Rating Agencies

Code of Conduct: Every credit rating agency shall abide by the code of conduct in the 3rd schedule.

1. Agreement with the Client

Every credit rating agency shall enter into a written agreement with each client whose securities it proposes to rate, and every such agreement shall include the following provisions namely:

(a) the rights and liabilities of each party in respect of the rating of securities shall be defined;

(b) the fee to be charged by the credit rating agency shall be specified;

(c) the client shall agree, to a periodic review of the rating by the credit rating agency, the tenure of the rated instrument;

(d) the client shall agree to cooperate with the credit rating agency in order to enable the latter to arrive at, and maintain, a true and accurate rating of the clients' securities and shall in particular provide to the latter true, adequate and timely information for the purpose.

(e) the credit rating agency shall disclose to the client, the rating assigned to the securities of the latter through regular methods of dissemination, irrespective of whether the rating is or is not accepted by the client;

(f) the client shall agree to disclose, in the offer document;

  (i) the rating assigned to the client's listed securities by any credit rating agency during the last three years, and

  (ii) any rating given in respect of the client's securities by any other credit rating agency, which has not been accepted by the client.

(g) the client shall agree to obtain a rating from at least two different rating agencies for any issue of debt securities whose size is equal to or exceeds, rupees one hundred crore.

2. Monitoring of Ratings

1. Every credit rating agency shall during the lifetime of securities rated by it continuously monitor the rating of such securities.
2. Every credit rating agency shall disseminate information regarding newly assigned ratings, and changes in earlier rating promptly through press release and websites and in the case of securities issued by listed companies, such information shall also be provided simultaneously to the concerned regional stock exchange and to all the stock exchanges where the said securities are listed.

3. Disclosure of Rating Definitions and Rationale

1. Every credit rating agency:

   (a) shall make public the definitions of the concerned rating, along with the symbol, and

   (b) shall also state that the rating does not constitute recommendation to buy, hold or sell any securities.

2. Every credit rating agency shall make available to the general public, information relating to the rationale of the ratings which shall cover an analysis of the various factors justifying a favourable assessment, as well as factors constituting a risk.

mission of Information to the Board

e any information is called for by the Board from a credit rating agency for the purpose of ons including any report relating to its activities, the credit rating agency shall furnish such on to the Boards within a period specified by the Board or within a reasonable time. Every ng agency shall furnish copies of this balance sheet and profit and loss account to the Board d of each accounting period.

mpliance with Circulars, etc. Issued by the Board

y credit rating agency shall comply with such guidelines, directives, circulars and instructions y the Board regarding credit rating.

intenance of Books of Accounts, Records, etc.

y credit rating agency shall keep and maintain the following books of accounts, records and ents for a minimum period of 5 years, namely:

copy of its balance sheet;

copy of its profit and loss account;

copy of its agreement entered into with the client;

formation supplied by each of the clients;

orrespondence with each client;

atings assigned to various securities including upgradation and down gradation (if any) of the ratings so assigned;

ating notes considered by the rating committee;

ecord of decisions of the rating committee;

letter assigning rating;

particulars of fees charged for rating and such other records as the Board may specify from ime to time.

ry rating agency shall also intimate the place to the Board where such documents and books ntained.

onfidentiality

ery credit rating agency shall treat information confidential which is supplied to it by the client credit rating agency shall disclose the same to any other person except where such disclosure ed or permitted by law for the time being in force.

pecifying Rating Process

Every credit rating agency shall:

specify the rating process;

file a copy of the same with the Board for record and file with the Board any modifications or additions made therein from time to time.

Every credit rating agency shall follow a proper rating process;

Every credit rating agency shall have professional rating committees comprising members who are adequately qualified and knowledgeable to assign a rating;

(iv) All rating decisions including the decisions regarding changes in rating shall be taken by the rating committee.

(v) Every credit rating agency shall inform the Board about new rating instruments or symbols introduced by it.

(vi) A credit rating agency shall not rate securites issued by it.

(vii) A credit rating agency shall disclose the ratings assigned to the concerned stock exchange and general investors through press release and websites.

(viii) Every credit rating agency shall exercise due diligence while rating a security.

(9) Securities Issued by Promoters

No credit rating agency shall rate a security issued by its promoter. In case promoter is a lending institution, its chairman, director or employee shall not be a chairman, director or employee of credit rating agency or its rating committee.

(10) Securities Issued by Certain Entities, Connected with a Promoter or Rating Agency not to be Rated

No credit rating agency shall rate a security issued by an entity, which is:

(a) a borrower of its promoter; or

(b) a subsidiary of its promoter; or

(c) an associate of its promoter; if

  (i) there are common Chairman, Directors between credit rating agency and these entities;

  (ii) there are common Employees;

  (iii) there are common Chairman, Directors, Employees on the rating committee;

Provisions Related to Ratings

(A) For Debt Issue

Credit rating is compulsory for debt instruments. Credit rating is compulsory for fully paid-up or partly paid-up or convertible debentures with maturity or conversion period of 18 months or more. A fresh credit rating is required in case of roll over debentures. After 15th March, 2001, all companies can issue investment grade securities through an issue of more than ₹ 100 crore to the public without listing equity on recognised stock exchange but the company must obtain investment grade rating from two rating agencies. In addition to the above, the promoter will have to bring in 20% of the equity requirements of the project for which debts are to be raised. Ratings are also made compulsory for collective investment schemes for plantation companies and animal rearing firms and also for deposit mobilisation schemes of debt instruments.

(B) For Public Issue of Shares

SEBI has not made credit rating as mandatory for public issue of shares in spite of many experts asked for compulsory rating for public issues of equity shares. The SEBI rejected the mandatory requirements on the following grounds:

(i) The ratings of equity shares do not exist in the developed countries.

(ii) The magnitude of risk in equity shares cannot be predetermined.

A few selective credit rating agencies offer rating services of equity issues.

The compulsory rating is not good for the long-term development of capital market.

ver, the companies are free to get their issue rated by a rating agency.

ction and Investigation by SEBI

The Board may appoint one or more persons as inspecting officers to undertake inspection or ion of the books of accounts, records and documents of the credit rating agencies for the ng purposes:

to ascertain whether the provisions of the Act and these regulations are complied with;

to investigate into complaints received from investors, clients or any other person on any matter having a bearing on the activities of the credit rating agency; and

in the interest of the securities market or in the interest of the investors.

The Board shall give not less than 10 days written notice to the credit rating agency before ng an inspection or investigation.

gations of Credit Rating Agency on Inspection or Investigation

all be the duty of every credit rating agency whose affairs are being inspected or investigated every director, officer or employee to produce to the inspecting or investigating officer. Such account and other documents in its or his custody or control and furnish him with such nts and information relating to its rating activities as the inspecting officer may require within sonable period as may be specified by the officer.

The credit rating agency shall:

allow the inspecting officer to have reasonable access to the premises occupied by such credit rating agency or by any other person on its behalf;

extend to the inspecting officer reasonable facility for examining any books, records, documents and computer data in the possession of the credit rating agency; and

provide copies of documents or other materials which are relevant for the purposes of the inspection or investigation in the opinion of the inspecting officer as the case may be.

The inspecting officer shall submit a report to the Board on completion of the inspection or gation as soon as possible.

The Board shall communicate the findings of the inspecting officer to the credit rating agency and a reasonable opportunity of being heard in the matter. The Board may call upon the credit agency to take such measures as the Board may deem fit in the interest of the securities market.

ault by Credit Rating Agency

Liability for Action in Case of Default

A credit rating agency which:

fails to comply with any condition subject to which a certificate has been granted; or

contravenes any of the provisions of the Act or these regulations or any other regulations made under the Act shall be liable to either suspension or cancellation of registration.

2. Suspension of Registration

A penalty of suspension of the certificate of registration of a credit rating agency may be by the Board.

3. Cancellation of Registration

A penalty of cancellation of certificate of registration of a credit rating agency may be imposed by the Board, if:

(a) the credit rating agency is guilty of fraud, or has been convicted of an offence involving moral turpitude or an economic offence; or

(b) in case of repeated defaults; or

(c) the credit rating agency is declared insolvent or wound-up.

Benefits of Credit Rating

The benefits of credit rating to various parties are as follows:

1. Investors

(i) It enables the investors to get factual position.

(ii) It enables the investors to make a choice whether to invest in risky or non-risky investments.

(iii) It encourages the common man to earn good returns by investing in corporate securities.

2. Corporate Borrowers

(i) They can use credit rating as a marketing tool for their securities to be issued.

(ii) The companies with good rating can raise funds at cheaper rates.

(iii) The good rating enables the new companies to enter in the capital market confidently.

(iv) It enhances the discipline among corporate borrowers.

3. Government

(i) Credit rating system plays a vital role in investor protection without any burden on the Government.

(ii) If facilitates formulation of public policy guidelines on institutional investments.

Credit Rating Agencies in India

There are four credit rating agencies in India. These are as follows:

A. Credit Rating Information Services of India Ltd. (CRISIL)

CRISIL was incorporated in 1987. It was set-up in January 1988 jointly by the ICICI, UTI, LIC, GIC and Asian Development Bank as the first credit rating agency in India. CRISIL is the only rating agency in India to operate on the basis of a sectoral specialisation that underpins the sharpness of analysis, the responsiveness of the process and the scale dissemination of opinion pieces. CRISIL ratings continue to provide technical know-how overseas, providing assistance and training to set-up rating agencies in Malaysia (RAM) and Israel (MAALOT).

Its objective is to rate the debentures, fixed deposits, short-term borrowing instruments and preference shares of the companies on request from them. The CRISIL ratings are now required by

ties, banks, UTI, merchant bankers, etc., in the due course of assisting companies. CRISIL ublishing the corporate news regularly, containing information on their financial, business ical aspects.

SIL Rating and Investor Protection

ors should also be familiar with the ratings given by the CRISIL for protecting their interests. SIL ratings are given only for debt instruments of companies, commercial papers (CP), es, bonds and fixed deposits. CRISIL publishes the rating in their 'CRISIL Rating Scan'. uses some symbols and the investors should examine these symbols with regard to their and their implication. The investors should keep a watch on revisions, since a rating given can d upwards or downwards. The SEBI guidelines now insist that all companies should get these nd publicise them compulsorily, if they are borrowing through issue of debentures. Rating is mpulsory for fixed deposits under the New Companies Bill, 1993.

symbols and their implication used for ratings are as follows:

debentures simple 'A' and 'B' are used; for preference shares, 'Pf' is prefixed; for fixed deposits -term instruments, 'F' and 'P' are prefixed.

ture Ratings	Implications
A- (AAA)	Highest Safety
A- (AA)	High Safety
A- (A)	Adequate Safety
B- (BBB)	Moderate Safety
B (BB)	Inadequate Safety
& D	High risk and default prone

d Deposit Ratings	
A- (FAAA)	Highest Safety
A - (FAA)	High Safety
A - (FA)	Adequate Safety

FC and FD are inadequate, high risk and default prone instruments.

CRISIL IPO Grading - Scale

CRISIL IPO Grade	Assessment
5/5	Strong Fundamentals
4/5	Above Average Fundamentals
3/5	Average Fundamentals
2/5	Below Average Fundamentals
1/5	Poor Fundamentals

Facts about CRISIL

1.	1987	Year of Incorporation
2.	1987-88	Commences rating of corporates
3.	1988-89	Publishes CRISIL – IDBI Bond Yield Tables
4.	1989-90	Starts CRISIL Credit Assessment Service for banks
5.	1990-91	Launches CRISIL Rating Scan to announce new and current ratings and disseminate CRISIL rating rationale Establishes Information Service Group and Started CRISIL card service
6.	1991-92	Provides technical assistance and training to Rating Agency Malaysia Berhard and MAALOT, the Israeli Securities Rating Company Ltd. Develops methodology and framework for Rating Structure Obligations and Asset Securitisation Programmes
7.	1992-93	Evolves methodology and framework of bank ratings Introduces CRISIL 'Rating Set-Debentures' and CRISIL 'Rating Set Fixed Deposits' Publishes CRISIL 'Rating Digest'
8.	1993-94	Makes public offer of 20,00,000 equity shares of ₹ 10 each at a premium of ₹ 40 pe share. The offer was oversubscribed by 2.47 times Crosses the mark of 1000 debt instruments rated Launches CRISIL Ban Card Service Sets-up the Advisory Services Group
9.	1994-95	Introduces new products like ratings on real estate developers' projects, assessing cred quality of state electricity boards and state governments, CRISIL ECO SCAN, CRISIL VIEW Sets-up a separate department for securitisation
10.	1995-96	Enters into a strategic alliance with 'Standard and Poors' Ratings Group, New York Tie-ups with international information vendors for dissemination of CRISIL ratings. Introduces ratings on municipal bonds and on liquified petroleum gas (LPG) and supe kerosene oil (SKO). Launched CRISIL – 500 Equity Index Launched CRISIL SECTORVIEW reports for industry research
11.	1996-97	Launched ratings on mutual funds, bank loan ratings, public finance ratings 'Standard and Poors' acquisition of interest in CRISIL by acquiring 9.68% of shareho in the company
	1997-98	Develops and launched Municipal Bond Ratings Launched financial strength rating for insurance companies Introduced CRISERV!CE, a retainership service for research Introduced CRISIL MNC Index and CRISIL Indian Business Group Index sets-up IISL. The new company enters into Licence Agreement with 'Standard and Poors', New York
	1998-99	Developed and launched a framework for rating debt obligations supported by credit encashment based on overseas guarantees called foreign structured obligations Launched the Risk Assessment Model as a user-friendly software package Launched website www.crisil.com Launched information product, viz., CRISIL Card 500, CRISIL Debt Base, CRISIL Bond values, CRISIL Eco View and CRISIL GOI benchmarks. Ties-up with S & P MMS and S & P platts to market their products in India
	1999-2000	Developed new product on ratings of real estate developers in association with National Real Estate Development Council Introduced new products,viz., CRISIL Gilt-X (GOI Index) CRISIL AAA Corporate Bond Index, CRISIL Gilt Base Started two publications – CRISIL Alert and CRISIL Insight Acquires the business of Information Products and Research Services (India) Pvt. LTD. alongwith its brand INFAC. CRISIL is granted certificate of registration under SEBI Regulations, 1999 Strategic alliance with National Economic Research Association Launched a web-based subscription service-CRISIL Millenium Offer
	2000-01	Launched CRISIL Fund Scan Launched mutual fund ranking service for the domestic mutual fund market Sets-up subsidiary for conducting on-line web business named crisil.com ltd., now renamed CRIS-Risk and Information Solutions Co. Ltd. (CRIS-RISC) Lanched CRISIL-NAREDCO ratings initiative for the real estate sector The first ever Mortage Backed Securities (MBS) issue originated by HDFC and LIC Housing Finance Limited rated by CRISIL Sets-up a subsidiary 'Global Data Services of Indian Ltd'. for collecting data relating to companies, trade and industry
	2001-02	Launched grading of healthcare institutions Launched new rating and grading services for stockbrokers, construction industry entities, SMEs and B2B exchanges Launched new website Launched CRISIL marketware, a financial news services Launched Mutual Fund Composite Performance Rankings (CRISIL CPRs), Fund Risk Analytics Model and CRISIL Mutual Funds Portfolio Tracker.
	2002-03	Launched CRISIL Governance and Value Creation (GVC) ratings Introduction of evaluation services for film and TV software producers Rating of the first sales tax receivables securitisation transaction Investment and Risk Management Services was set-up as a division of CRISIL

18.	2003-04	Approves change of name of the company from "The Credit Rating Information Services of India Ltd." to "CRISIL Limited". Rates the first successful Collateralised Debt Obligation (CDO) transaction in India. Rates the first CDO transaction of working capital facilities in the Asia Pacific. Makes an equity investment in the Caribbean Information and Credit Rating Services Limited (Cari CRIS), the first regional rating agency in the world, covering 10 countries. Acquires **Econo Matters Limited,** a London based company engaged in gas consulting information and training/conferences. Takes up a **12.1% stake** in the National Commodity and Derivatives Exchange Limited (NCDEX) Institutes the "CRISIL Awards for Excellence in Municipal Initiatives", aimed at recognising initiatives in the urban sector. AMFI mandates CRISIL to provide daily fund indices as benchmark standards for the mutual fund industry.
19.	2004-05	Open Offer by **Standard & Poor's** to the shareholders of the Company to acquire up to 3,534,488 fully paid-up equity shares of CRISIL representing 55.57% of the Company's voting equity capital as on December 31, 2004, subject to a minimum acceptance level of 2,643,983 shares (41.57% of the Company's paid up equity capital). CRISIL Board okays proposal to acquire **Irevna** group of companies. **Innovative Rating Products launches:** the first rating assigned to a company under a CDR (Corporate Debt Restructuring) package, the first trade receivable securitisation, the first-ever used car loan securitisation. **CariCRIS** receives first rating mandate. CRISIL Infrastructure partners with **Nordpool Consultants** for a mandate from National **Thermal Power Corporation Limited (NTPC)** to set-up the first power trading exchange in India. CRISIL Infrastructure Advisory formulates Blueprint for Infrastructure in Gujarat (BIG) 2020. **CRISIL Infrastructure Advisory's international forays:** Mandate from African Development Bank and demand-supply scenario for natural gas in Bangladesh. **New Launches by EconoMatters:** European Gas Markets Review (EGM), The Shipper's Toolkit (STK), **LNG Focus, Gas Matters Today-Asia**. Global Data Services of India Ltd. Launches a new publication "Accounting & Analysis - **The Indian Experience**". IISL launches an Exchange Traded Fund (ETF) on the CNX Bank Index, a first in India. CRISIL awarded the **Association of Business Communicators of India (ABCI)** award for the CRISIL 2004 table calendar in its category, and the 2nd runner-up for the Best of CRISIL 2003 in the prestige publication category. CRISIL's corporate website and the online ratings information website. **CRISILRATINGS** com completely re-vamped, re-designed and re-structured to reflect CRISIL's unique width of offerings and services.
	2005 (9 months ended Dec. 31, 2005)	Innovative Rating Products Launches: **India's First Fund House Rating, SME Rating and Bank Loan Rating**. CRISIL Ratings launches its "**Executive Training**" initiative in May 2005. CRISIL's Executive Training group has successfully completed 18 executive training programmes, including customised training for multinational banks. CRISIL organises a joint event with **Standard & Poor's**, 'India Country Overview: Financial Trends and Challenges', and launches joint publications titled 'Indian Top 50 Corporates' and 'India Top 20 Banks'. CRISIL Infrastructure Advisory partners with Nordpool Consultants for a mandate from National Thermal Power Corporation Limited (NTPC) to set-up the first power trading exchange in India. New Launches by EconoMatters: new public course **Trading Gas Markets (TGM)** jointly with Eclipse Energy CRISIL Investment & Risk Management Services (CIRM) develops new software tool "**Corporate Risk Evaluator (CORE)**" to enable Corporates to comply with clause 49 of the listing guidelines with three distinct features - a) Institutionalising of CEO/CFO certification process b) a framework to capture various internal controls in line with the best practices and (c) a framework for measuring, monitoring and managing Enterprise Wide Risk. Global Data Services of India Ltd. publishes the second edition of "**Accounting and Analysis - The Indian Experience**" **Cari Cris** completes and releases its first rating, for the National Gas Company of Trinidad & Tobago. CRISIL concludes Phase-I of its technical consulting assignment for CariCRIS in June 2005. CRISIL and **Standard & Poor's** hold the first ever CRISIL~S&P joint franchise even presenting the unified strengths of S&P and CRISIL in sovereign analysis, economy outlook and health of the manufacturing and finance sectors in India. Launches the CRISIL Alumni programme on **http://www.crisilalumni.com/**, developed in-house, in September 2005 aimed at leveraging CRISIL's alumni network for developing business, using alumni as recruiting resources and developing them as CRISIL's brand ambassadors. This popular initiative has been well received by alumni.
	2006	CRISIL assigns **first rating of a hybrid instrument**. CRISIL rates India's first pool of second loss pieces of asset-backed security (ABS) deals CRISIL assigns **first broker rating** CRISIL assign first developer rating (for developers registered under the Slum Re-development Authority) **CRISIL SME Ratings** received over 570 rating requests and assigned 490 ratings CRISIL Infrastructure Advisory launches studies on new energy sources and **clean development mechanisms (CDM)**, logistics, utility benchmarking, upstream asset valuation, import of coal and valuation of multiplexes and micro finance institutions. CIRM launches CRISIL's **Corporate Risk Evaluation Software (CORE)** CIRM makes an entry into the Operational Risk Management space by acquiring its first client in the Indian banking segment for its CORE solutions. CRISIL Research launches the **CRISIL Commodity Views** on gold, wheat, pepper, tur and soya.

		CRISIL Research launches the **CRISIL Agriculture Risk Monitor** to assist bankers to assess their agriculture portfolio as well as identify opportunities and risks associated with lending to agriculture. CRISIL Research launches **IPO gradings**, which analyses the fundamental strengths of IPO issues. CRISIL sets-up its second delivery center in Buenos Aires, Argentina. **Irevna** sets-up its second delivery center in Buenos Aires, Argentina. **CRISIL transfers assets staff of CRISIL Marketwire to TV18** CRISIL constitutes a new team to achieve greater integration with Standard & Poor's (S&P) in brand franchise, market development and sales efforts.
22.	2007	CRISIL transfers its advisory business (CRISIL Infrastructure Advisory and CRISIL Investment & Risk Management Services) into a 100% subsidiary CRISIL Risk and Infrastructure Solutions Limited.
23.	2008	CRISIL announces sales of shareholding in Gas Strategies Group Ltd. CRISIL launches its formal sustainable development programme for corporate social responsibility. It also launched the CRISIL complexity levels.
24.	2010	CRISIL moves into a new, corporate head office - the new CRISIL House, at Powai, Mumbai, is a state-of-the-art, green building. CRISIL SME Ratings crosses its 15,000th SME rating. CRISIL launches Real Estate Star Ratings. CRISIL acquires Pipal Research, further strengthening its leadership in the KPO industry.
25.	2011	CRISIL launches Education Grading, beginning with business schools. CRISIL Rating enhances access to funding for SMEs; Announces 20,000th SME Rating. CRISIL Rating launches Solar grading. CRISIL Research launches Gold and Gilt Index. CRISIL Global Research & Analytics receives NASSCOM Exemplary Talent Practices Award.
26.	2012	CRISIL acquires UK-based Coalition, a company providing high-end analytics to global investment banks. CRISIL assigns its 10,000th Bank Loan Rating. CRISIL announces its 25,000th SME rating. CRISIL transforms the lives of 1000 rural citizens through 'Pragati', a series of financial awareness workshops. CRISIL launches 'Doing what is right: The CRISIL Story' a book on the company's 25-year evolution, on December 19. CRISIL launches four fixed income indices to measure the performance of government securities in the Sri Lankan capital markets in association with NDB Capital Holdings PLC
27.	2013	CRISIL launches CRISIL Foundation, a platform for achieving its twin goals of increasing financial awareness and conservation of the environment. CRISIL launches CRISIL Inclusix, India's most comprehensive financial inclusion index which accurately measures the extent of financial inclusion in the country, right down to each of the 632 districts. CRISIL releases its first 'State of the Nation' report, a unique top-down-meets-bottom-up analysis that offers a holistic perspective on the economic state of India. CRISIL issues the second edition of the Inclusix, expanding its scope to 638 districts.
	2014	CRISIL rates India's first commercial Backed Securities. CRISIL introduces Fund Management Capability for the mutual fund. CRISIL signed up an MOU with IIM, Ahmedabad for sitting up a 'CRISIL Chair of Financial Markets' at institute.
	2015	CRISIL relaunched a programme focusing on environment conversation through employee volunteering.

ancial Performance

earned a net profit of ₹ 326.35 in the year ending on 31-12-16 as against a net profit of ₹ 285.15 in the previous year. CRISIL received 191 investor complaints in the year 01-01-16 to 12-16 and all were resolved.

Investment Information and Credit Rating Agency of India Ltd. (ICRA)

ICRA was incorporated on January 16, 1991 and launched its service on August 31, 1991. It formerly known as Investment Information and Credit Rating Agency of India Ltd. (IICRA). ICRA independent and professional company providing investment information and credit rating ICRA's major shareholders include moody's investor service and leading Indian financial tions and banks. ICRA has actively responded to the growth and globalisation of Indian capital s which has led to an exponential surge in demand for professional credit risk analysis. It has responded to this need by executing assignments including credit ratings, equity gradings and ated studies spanning diverse industrial sectors. ICRA has broad-based its services to the corporate financial sectors both in India and overseas. It presently offers its services under three banners: Rating services; (2) Information services; and (3) Advisory services.

Rating Services

ICRA rates rupee denominated debt instruments, such as:

(i) Bonds and Debentures (long-term);

(ii) Fixed Deposit Programmes (medium-term);

(iii) Commercial Paper and Certificates of Deposit (short-term);

(iv) Structured obligations and sector specific debt obligations (issued by infrastructure companies).

The ICRA rating is a symbolic indicator of the current opinion of the relative capability of timely ing of debts and obligations by the corporate entity with reference to the instrument rated. The ing is based on an objective analysis of the information and clarifications obtained from the concerns also other, which are considered by ICRA to be reliable. ICRA rates long-term, medium-term and term debt instruments. ICRA offers its rating services to a wide range of issuers including:

(i) Manufacturing companies

(ii) Banks and financial institutions

(iii) Power companies

(iv) Service companies

(v) Construction companies

(vi) Insurance companies

(vii) Municipal and other local bodies

(viii) Non-banking financial service companies

(ix) Telecom companies

(x) Infrastructure companies, such as ports, dams, roads and highways

Broadly, ICRA adopts three categories of ratings:

(a) Long-Term Instruments (Debentures and preference shares)	Triple A to Triple B
(b) Medium-Term Instruments (Fixed deposits)	FAAA to FA
(c) Short-Term Instruments (C. P., etc.)	P_1 + to P_3

The rating indicates the degree of risk and the highest safety possible is under the rating of AAA or FAAA or P_1. The creditworthiness is indicated in the ratings and reflects the capacity of the company to service them adequately with a view to ensure the timely payment of interest and payments.

ICRA and Investor Protection

SEBI issued the latest guidelines which made rating as compulsory for all issues of debentures, either convertible or non-convertible if they are issued to public. It was made compulsory for deposits raised from the public, under New Companies Bill, 1993. Now rating of corporate governance in companies is also undertaken by ICRA. ICRA has answered the various questions about the rating and the investor protection on its website.

Facts about ICRA

(1) 1991-92: Incorporation and launching of ICRA.

(2) 1992-93: Launched Investment Information Service and Research Publications.

(3) 1995-96: EPRA (Earnings Prospects and Risk Analysis)

- Launched as information service for the equity investor.
- Launched credit assessment for small and medium scale industry.

(4) 1998-99: Launched grading services for entities involved in construction projects including contractors, consultants, project owners and the project itself.

- Signed agreement with Financial Performas Inc., a Moody's company, to provide credit education, risk management software, credit research and consulting services to commercial banks, financial and investment institutions, financial service companies and mutual funds in India.

(5) 1999-2000: Final agreement between Moody's Investor Service and ICRA Limited to make an equity investment and to provide technical services to ICRA.

- Launched its new corporate website making all its research publication through internet.

(6) 2001-02: Launched its Corporate Governance Ratings for the Indian market.

- ICRA Ltd. and the National Real Estate Development Council (NAREDCO) jointly launched the ICRA- NAREDCO grading system for real estate developers.
- Moody's Investment Company India (Pvt.) Ltd. became the largest shareholder in ICRA by acquiring an additional 9% stake.

2002-03: Moody' Investors Service and ICRA launch 18 Mutual Fund Indices, benchmarking rformance and style consistency among Indian Mutual Fund Schemes.

CRA launches Grading Scheme for Healthcare institutions in India.

2003-04: Grading of Mutual Fund Management Quality

CRA and Online India Capitalcom entered into a Shareholder and Subscription Agreement, sides a Technical Services Agreement. (The company, Online India Capital.com subsequently changed its name to ICRA Online Ltd.)

CRA launches Project Finance Assessment/Rating Service.

2004-05: ICRA enters into a Memorandum of Understanding (MoU) with Turkey's First Turkish Credit Rating Agency(FTCRA) to provide training to FTCRA analysts in India and in Turkey.

CRA demerges Advisory Division into a separate company under the name ICRA Management Consulting Services (IMaCS).

A Technical Services Agreement' was entered into between Credit Rating & Collection, Kuwait and ICRA Ltd ("Agreement") on December 26, 2001 for a period of three years. The said Agreement was extended for a further period of three years with effect from December 26, 2004.

Moody's Investment Company India (Pvt) Limited increases its equity stake in ICRA.

CRA launches Grading of Maritime Training Institutes (MTIs) in India.

CRA launches Outsourced Services Group.

2005-06: Acquired Computer Exchange Private Limited (subsequently name changed to ICRA Techno Analytics Limited).

Acquired a majority stake in ICRA Online Limited.

Demerged Consulting Division and transferred to ImaCS, ICRA's wholly-owned subsidiary, with effect from April 1, 2005.

CRA launches NSIC-ICRA Performance and Credit Rating Scheme for Small Scale Enterprises SEs) in India.

2007: The Equity Shares of ICRA Limited are listed on the Bombay Stock Exchange and ational Stock Exchange on April 13, 2007.

oody's investment company India (Pvt.) Limited makes additional investments in the equity hares of ICRA Limited.

CRA Limited renews its Technical Cooperation Agreement with the Credit Rating Agency of angladesh (CRAB) for another three years.

2008: ICRA Management Consulting Services Limited launches Consulting Services for **Carbon Management**.

CRA Management Consulting Services Limited and Virtus Global Partners Inc. sign a emorandum of Understanding to jointly offer advisory/consulting services to clients based in e USA and in India.

CRA Techno Analytics Limited acquires Axiom Technologies Private Limited, a Kolkata-ased software services company.

CRA Management Consulting Services Limited and Dun & Bradstreet Philippines, Inc. sign a emorandum of Understanding to jointly offer advisory/consulting services in the Philippines.

(13) **2009:** ICRA signs Credit Rating JV with Himalayan Infrastructure Fund in Nepal.

ICRA Techno Analytics Inc. the US-based information technology arm of ICRA Limited, merges with Sapphire International Inc. Overseas. The new entity is known as **ICRA Sapphire Inc** (CSAP).

(14) **2010:** PT. ICRA Indonesia obtains a License from the Capital Market and Financial Institutions Supervisory Agency, Indonesia (Bapepam-LK) to launch Rating Services in Indonesia.

(15) **2011:** ICRA Lanka Limited granted registration to function as a Credit Rating agency by the Securities and Exchange Commission of Sri Lanka. Axiom Technologies Limited, a wholly owned subsidiary of ICRA Techno Analytics Limited (ICTEAS) has merged into ICTEAS following the Order passed by the Hon'ble Calcutta high Court.

ICRA has been granted a letter of intent by the Securities Board of Nepal (SEBON) to establish a Credit Rating Agency in Nepal.

PT. ICRA Indonesia has received recognition as a Credit Rating Agency from Bank of Indonesia, Indonesia's Central Bank.

(16) **2012:** ICRA Nepal Limited (ICRA Nepal) obtains licence from the Securities Board of Nepal (SEBON) to launch Rating Services in Nepal. ICRA Nepal is the first credit rating company granted licence by SEBON.

ICRA, through its wholly-owned subsidiary ICRA Techno Analytics Limited, acquires a majority equity stake of 50.1% in BPA Technologies, Inc. (BPA), a California-based global business consulting and software technology.

ICRA Techno Analytics Inc., New Jersey, USA, a wholly-owned subsidiary of ICRA Techno Analytics Limited (ICTEAS), acquires 100 per cent stake in Sapphire International Inc. (Sapphire), a Delaware Corporation based out of Trumbull, Connecticut, USA.

Financial Performance

During its 25th year of operations, your Company earned a Net Profit of ₹ 61.46 crore as against ₹ 50.42 crore during the pervious year. The Company received 12 complaints from shareholders/ investors during the financial year 2015-16 all of which were redressed.

C. Credit Analysis and Research Ltd. (CARE)

Credit Analysis and Research Ltd. was incorporated in April 1993 as a credit rating, information and advisory services company promoted by IDBI, Canara Bank, UTI and other leading banks and financial service companies. CARE has 15 shareholders in all.

CARE assigned its first rating in November 1993 and up to August 31, 2003 it had completed 2,339 rating assignments for an aggregate value of about ₹ 3,572 billion. CARE's ratings are recognised by the Government of India and all regulatory authorities including the Reserve Bank of India and SEBI. CARE has been granted registration by SEBI under the Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999.

The rating coverage has extended beyond industrial companies, to include public utilities, financial institutions, infrastructure projects, special purpose vehicles, state governments and municipal bodies. CARE's clients include some of the largest private sector manufacturing and financial services companies as well as financial institutions of India. CARE is well equipped to rate all types of debt instruments like commercial paper, fixed deposit, bonds, debentures and structured obligations.

CARE Information and Advisory Services group prepares credit reports on specific requests from of business partners, conducts sector studies and provides advisory services in the areas of structuring, valuation and credit appraisal systems. CARE was retained by the Disinvestment mission, Government of India for assistance in equity valuation of a number of state owned as and for suggesting disinvestment strategies for these companies. CARE is publishing Care Rating Reckoner, Industry Reports, and Debt Market Review.

dit Rating

CARE's credit rating is an opinion on the relative ability and willingness of an issuer to make payments on specific debt or related obligations over the life of the instrument. CARE rates denominated debt of Indian companies and Indian subsidiaries of multinational companies.

CARE undertakes all types of medium and long-term debt securities such as debentures, bonds, tible bonds and all types of short-term debts and short-term obligations, such as commercial inter-corporate deposits and certificates of deposits. CARE also rates quasi-debt obligations the ability of insurance companies to meet policyholders' obligations. CARE's preference share measure the relative ability of a company to meet its dividend and redemption commitments.

lient characteristics of credit analysis ratings are:

(i) CARE rating is issuer specific and not instrument specific.

(ii) One time assessments of credit quality which can be renewed on the specific request of the issuer.

(iii) Confidential ratings meant for specific use of institutional investors/lenders and not for raising funds from the public.

The CARE's ratings are as follows:

CARE 1 – Excellent debt management capability

CARE 2 – Very good management capability

CARE 3 - Good capability for debt management

CARE 4 – Barely satisfactory capability for debt management

CARE 5 – Poor capability for debt management

visory Services

The various advisory services of CARE are as follows:

(1) **Credit Reports:** CARE offers credit reports on companies based on published information and CARE's in-house database. These confidential credit reports are useful to entities considering financing options, joint ventures, acquisitions and collaborations with Indian companies.

(2) **Sector Studies:** CARE from time to time conducts studies on select sectors of the Indian economy, particularly those which are largely government controlled and funded till recently, but have been thrown open for private investment. Studies on the Indian power sector, fertilizer industry and municipal finances have been completed.

(3) **Project Advisory Services:** CARE uses the expertise gained in evaluating the credit risk of projects in areas such as roads, ports, power and telecom to advise investors and banks about the regulatory framework, the specific project risks and the ways of risk mitigation.

(4) **Financial Restructuring:** CARE uses its knowledge about various industry sectors to advise companies about the optimal capital structure and the financial restructuring options.

(5) **Valuation:** CARE carries out enterprise valuations for company managements, perspective and existing business partners or large investors. The Disinvestment Commission, Government of India has used CARE's services for valuing 20 state owned enterprises.

(6) **Credit Appraisal Systems:** CARE helps banks and non-banking finance companies to set up or modify their credit appraisal systems.

D. Fitch Ratings India Ltd.

Fitch ratings is an international rating agency that provides global capital market investors with the highest quality ratings and research. Fitch rates entities in 75 countries and has some 1100 employees in more than 40 local offices worldwide. Fitch ratings provides ratings for Financial Institutions, Insurance, Corporates, Structured Finance, Sovereigns and Public Finance Markets Worldwide. Recently, 3 well-known rating agencies were integrated into Fitch. IBCA, Duff and Phelps and Thomson Bank Watch has expanded capabilities, coverage and markets.

Fitch India is a 100% subsidiary of Fitch Group. It is the only international rating agency with a presence on the ground in India. Fitch India is fully geared to extend the expertise and commitment of its foreign parent to Indian companies. Fitch ratings provides an opinion on the ability of an entity or of a securities issue to meet financial commitments, such as interest, preferred dividends or repayment of principal, on a timely basis. These credit ratings apply to a variety of entities and issues, including, but not limited to sovereigns, governments, structured financings and corporations; debt, preferred/preference stock, bank loans and counter parties; as well as the financial strength of insurance companies and financial guarantors.

Benefits of a Rating from Fitch

As per the company, the benefits of a rating from Fitch are:

(i) It is the only rating agency in India with the ability to issue ratings on both domestic and international debt issuances.

(ii) International fund managers are familiar with Fitch ratings and therefore, their affiliates/TVs in India would be more comfortable dealing with a familiar brand.

(iii) Fitch ratings greatly enhance secondary market liquidity by enhancing an entity's position with investors and lowering future pricing.

(iv) Fitch ratings are quoted daily on the financial magazines in the public press and in research publications.

Fitch Rating Process

The rating process followed by the Fitch is as follows:

(i) Examine the financial and operational strength of an entity.

(ii) Analyses companies' financials, strengths and risks.

(iii) Senior management in India and senior representatives from Fitch Singapore and Hong Kong form the rating committees.

strives to keep management time involved to a minimum while maximising the company's input. The rating process usually takes 3 weeks.

Symbols

Long-Term Investment (12 months and above)

AAA (Ind)	Highest Credit Quality
AA (Ind)	High Credit Quality
A (Ind)	Adequate Credit Quality
BBB (Ind)	Moderate Credit Quality
BB (Ind)	Speculative
B (Ind)	Highly Speculative
C (Ind)	High Default Risk
D (Ind)	Default

Term Deposits (Bank Deposits and Fixed Deposits)

tAAA (Ind)	Highest Credit Quality
tAA (Ind)	High Credit Quality
tA (Ind)	Adequate Credit Quality
tB	Speculative
tC	High Default Risk
tD	Default

Short-Term (Less than 1 year)

F1 (Ind)	Highest Credit Quality
F2 (Ind)	Good Credit Quality
F3 (Ind)	Fair Credit Quality
F4 (Ind)	Speculative
F5 (Ind)	Default

- Within the rating symbols [from AA (Ind) to B (Ind)], the '+' sign or '–' sign denote relative position within the rating category.
- The symbol CP, CD, ICD or PS indicates the Commercial Paper, Certificate of Deposit, Intercorporate Deposit or Preference Shares.
- The symbol so after the rating indicates structured obligation.

11

Development Banks

Introduction

The concept of development banking is a new concept which was used for the first time in the post-Second World War period to refer to the institutional financial machinery built for fostering industrial growth in the country. After the Second World War, several newly liberated underdeveloped countries in Asia, Africa and Latin America became restless and wanted to solve their chronic problems of squalor and poverty. For the rapid industrial growth of the country and to supply the basic ingredients of development like capital, knowledge and entrepreneurship, they established special financial institutions. In India, the emergence of development banking is a post-independence phenomenon.

The origin of development banking may be traced to the establishment of 'Societe General Pour Favoriser I' Industry Nation ale' in Belgium in 1822. But the notable institution was the 'Credit Mobiliser' of France, established in 1852, which acted as industrial financier. In 1920, Japan established the Industrial Bank of Japan, the Industrial Development Bank of Canada in 1944, the Finance Corporation for Industry Ltd. (FCI) and the Industrial and Commercial Finance Corporation Ltd. (ICFC) of England in 1945, and in 1966, the U.K. Government set up the Industrial Reorganisation Corporation (IRC). These were established as modern development banks to provide term loans to industries.

In India, the first development bank called the Industrial Finance Corporation of India was established in 1948.

Definition of Development Bank

There is no precise definition of development bank. A development bank is a development oriented bank. "A development bank is thus a hybrid institution which combines in itself the functions of a finance corporation and a development corporation. A finance corporation is an institution which is concerned primarily with long-term capital, while a development corporation is concerned primarily with equity capital and with fostering and managing specific companies as well as providing financial support." D.M. Mithani has observed, "A development bank may, thus, be defined as a financial institution concerned with providing all types of financial assistance (medium as well as long-term) to business units, in the form of loans, underwriting, investment and guarantee operations and promotional activities economic development in general, and industrial development in particular."

ing of development banks is quite different in developing countries as compared to countries. The financial institutions of developed countries (named as above) have the s of term financing institutions and may be named as finance corporations. On the other pment banks have been established to help in developing new industrial undertaking lending functions to foster accelerated economic growth in developing countries.

pment banks or development financing institutions are owned and managed by the Central t or the State Governments.

s of Development Banks

features or characteristics of development bank are as follows:

a specialized financial institution.

a multipurpose financial institution.

provides long-term and medium-term finance to business units.

does not accept deposits from the public. Hence, its functioning is different from commercial nks.

provides financial assistance to both public and private sector undertakings.

encourages new and small entrepreneurs and seeks balanced regional growth.

primary objective is to promote economic development by promoting investment and repreneurial activity in a developing country.

plays a vital role in filling up the deficiencies of the existing financing facilities in a country.

works in the general interest of the nation. Its aim is to serve masses rather than to make ofits.

also aims at promoting the saving and investment habit in the country.

ves of Development Banks

eloping countries, the task of development banks goes far beyond the conventional function g term finance to qualifying entrepreneurs and mobilizing resources via lending operations. objectives of the country have to be turned into performance areas. The development e to define their objectives in a manner so as to serve these objectives within the territory of e. The priority areas in the country are:

jects producing goods of mass consumption;

jects coming up in the backward regions;

jects coming up in the small sector;

Projects promoted by new entrepreneurs; and

jects in the nature of export promotion and import substitution industrial units.

des these social objectives, there are certain other objectives also:

provide information on market and other related services;

provide finance to above projects in time and even before that;

prevent concentration of economic power; and

optimize the use of scarce resources in achieving a socially desirable product mix.

The development banks have to adopt their lending strategy and activities towards realisation of the socio-economic objectives of the country. "It would be inconsistent with a general development programme if the financial mechanism by which the programme must be applied in practice is operating in a direction different from the priorities laid down by the government's economic policy."

Old Definition: "All bankable projects are not necessarily economically important, nor is every economically important project-necessarily bankable. A development bank will not achieve its development objectives if it devotes its limited capital exclusively to bankable projects, irrespective of their purpose; at the same time, as a bank it cannot afford to ignore the financial aspect of proposals and thereby run the risk of failing to preserve its capital in tact."

Need for Establishment of Development Banks

The various factors responsible for the organization of special finance or development corporations can be cited as follows:

(1) **Planned Economy:** The development corporations can play an important role in the planned economic development of a country. The projects of national importance but in which private entrepreneurs are not interested are entrusted to these corporations. Basic and infrastructure industries, in which the rate of return is less and delayed, can be organized by the government through these special bodies. Scarce financial resources can thus be planned to give the utmost utility.

(2) **Low Capital Formation:** Underdeveloped countries suffer from a chronic shortage of finance because of low rate of capital formation and, consequently, the reduced amount of savings. The gap between savings and investment is to be filled up by the finance corporations. In recent years, these corporations have taken the position of the individual investors who have receded in the background.

(3) **Shyness of Capitalists:** Lack of mobilization of financial resources for the development of industrial enterprises can be seen in underdeveloped countries. Entrepreneurs are reluctant to go in new and untried ventures. Development corporations become indispensable for the economic betterment of such countries. They help in the initial investigations and assume the pioneering risk. Thus, the private entrepreneurs are able to purchase duly established concerns from the development corporations.

(4) **Rehabilitation and Renovation Programmes:** The problems of rehabilitating and renovating the shattered economy assumed huge proportions after World War-II. The private entrepreneurs in various countries discovered its inability to cope with the increasing demand for finance so necessary for the replacement of worn out plant and machinery and other equipments. Therefore, the need for the establishment of special bodies was felt necessary to finance these projects.

(5) **Ill-organized Capital Market:** Development corporations, besides promoting and financing of business enterprises also facilitate the marketing of corporate securities either by underwriting the various issues or by creating a constant demand for them.

(6) **Financing the Small Business:** Special corporations have been established for financing the small-scale industries. It has been examined that a certain gap exists in the financial machinery to meet the requirements of small scale industries in most of the countries. The problems relating to the financing of small business are of special character which can be tackled satisfactorily by institutions organised specially for this purpose.

ypes of Development Banks

The need for economic development has stimulated a variety of development banks. The riations in development banks are found in respect of the sectors of their operations, ownership, the pe of assistance they render, their geographical coverage, the size of units assisted and the size of sistance. A brief explanation of different types of development banks is as follows:

(1) **Sectors of Operations:** Development banks may be broadly divided into general development banks and specialised development banks on the basis of sectors of operations. General development banks are established to assist projects of all the sectors, including agriculture, power, transport and manufacturing. Specialized development banks confine their operations to only one sector. Thus, there are separate development banks for assisting industrial and agricultural projects. Separate development banks for public and private sectors have come into existence. Mixed development banks, which are authorized to help both the public sector and private sector projects, have gained popularity in recent years.

(2) **Ownership:** Development banks may be classified into banks that are owned by the government, by the central bank or by the private sector or they may be owned jointly by the government, the central bank and private interests. A majority of the development banks belong to the first and second categories.

(3) **Types of Financial Assistance:** On the basis of forms of financial assistance, development banks fall into three categories:

(i) Development banks confined to lending activity;

(ii) Development banks confined to loans and guarantees and underwriting activity; and

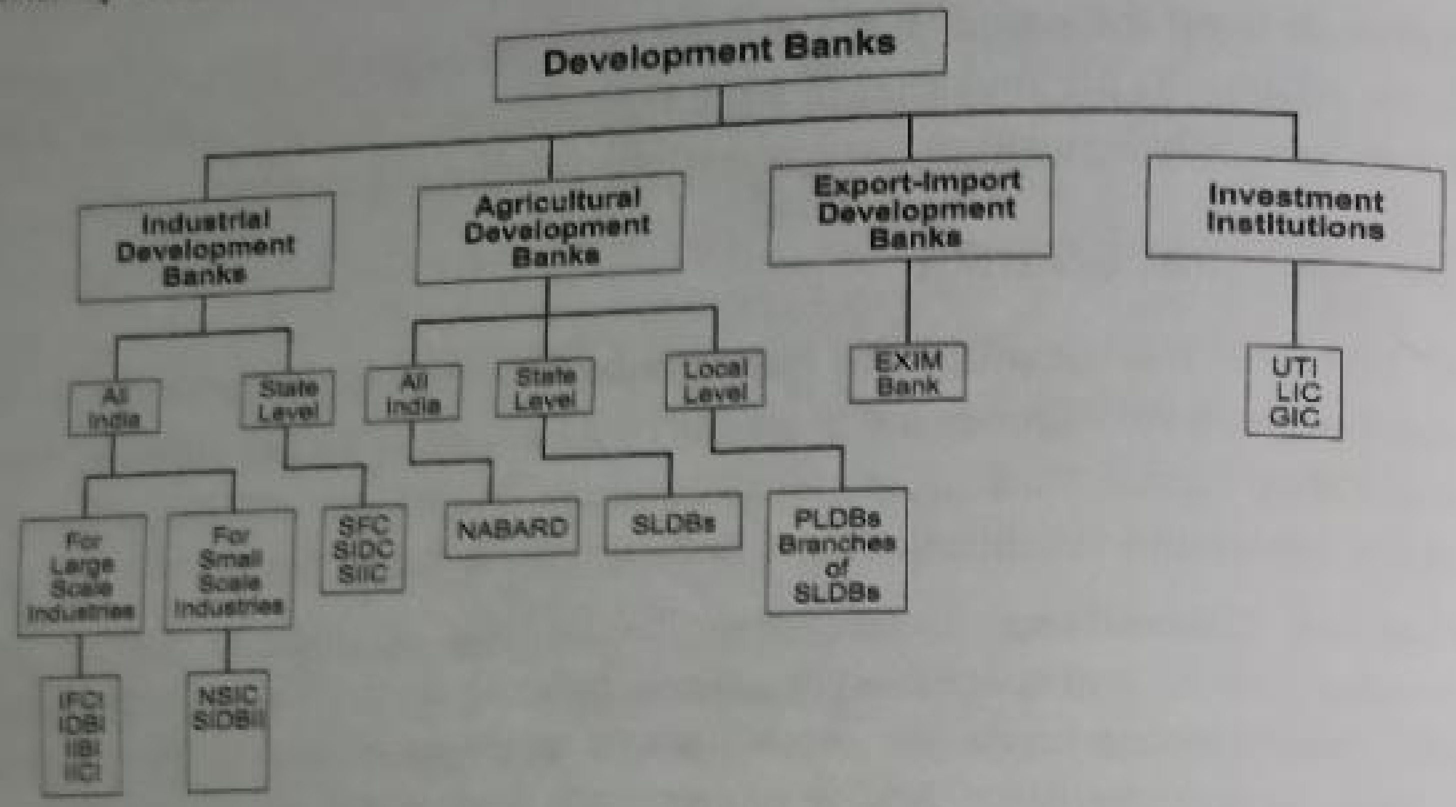
(iii) Development banks providing assistance in all forms, including managerial and technical services.

There is a general tendency in favour of the mixed type of development banks which are authorized to provide both loan and risk capital to industrial concerns.

(4) **Geographical Coverage:** Development banks may be international, national or provincial, depending on the geographical area of their operations. An international bank is one which is authorized by its charter to satisfy the financial and promotional needs of business enterprises of the different countries of the world.

Development Banking in India

At present, we have 57 Development Financial Institutions, catering to the different needs of industry. Following diagram shows the breakup of DFI's:



(A) Industrial Development Banks

(I) All India Development Banks

(a) For large scale industries

(1) Industrial Development Bank of India

(i) Establishment: From the point of view of country's industrial growth, need was felt to establish a financial institution with large resources which could cater to the growing credit need of the industries as also coordinate the activities of various financial institutions. IDBI was accordingly established on July 1, 1964. This development bank was started by the Government of India as a subsidiary of Reserve Bank of India. On February 16, 1976 it became independent of the Reserve Bank of India. In 1995, the shares of this institution has also been sold to the public. This bank can issue up to 49 per cent of its shares to the public. The bank is converted into full commercial bank from Oct. 1, 2004. From May 7, 2008, the name was changed from IDBI Ltd. to IDBI Bank Ltd.

(ii) Objectives:

(a) Its principal objective is to give loans both to the private as well as public sector undertaking in the field of the commodity production, mining and services such as hotels and transport;

(b) This bank provides loans to the industries directly;

(c) It also directly invests in shares of company and underwrite the securities;

(d) It guarantees loans obtained by the industries in the open market;

(e) It offers facility of rebate in the trading bills;

(f) It offers facility of refinance. In 1964, Refinance Corporation was merged with the Industrial Bank;

(g) The bank has established 'Development Assistance Fund'. This is for the benefit of those industries, which fail to get loan from anywhere. However, before offering any assistance out of this Fund, the bank has to seek prior permission of the government;

(h) This bank organizes investment surveys;

(i) This provides managerial and technical assistance to industries;

(iii) Organization: The bank is managed by the Board of Directors comprising 09 members.

(iv) Capital: In 2001, total capital of this bank was of ₹ 659 crore. The bank has reserve fund of ₹ 8558 crore, and ₹ 2000 crore have been raised through bonds and debentures.

(v) Progress: In 2001-02, the bank sanctioned loans of ₹ 16,034 crore and distributed loans of ₹ 11,158 crore. By 2002, the bank sanctioned refinance of the value of ₹ 54,737 crore. The bank expanded its activities by establishing some new institutions, like

(i) Credit Analysis & Research Ltd.,

(ii) Investors Services of India Ltd. It established a Commercial Bank, called IDBI Bank Ltd, in 1995 and a Mutual Fund, called IDBI Mutual Fund Ltd.

(vi) Evaluation: The bank has made significant contribution in the field of industrialisation and export-promotion. This is the biggest specialised financial institution of the country. Besides helping big industries, development bank has also helped small scale and medium sized industries. Industrialisation of the backward region has also been encouraged.

(2) Industrial Credit and Investment Corporation of India Ltd.

(i) Establishment: On the joint agreement of India, U.S.A., and U.K., Industrial Credit and Investment Corporation was established on January 5, 1955. On the basis of ownership and management, this is an international institution of the private sector. In 1997, Shipping Credit and Instrument Corporation of India (SICI) has been merged with ICICI.

(ii) Objective: Three main objectives of corporation are:

(i) To give loans for the development and modernization of private sector industries;

(ii) To encourage investment of indigenous and external capital in industries; and

(iii) To encourage private ownership of industries,

(iii) Organisation: The corporation is managed by the Board of Directors. There are presently 14 members on this Board. Besides representatives of the Indian, British and American investors, there is one member in the Board as representative of the Ministry of Commerce.

(iv) Capital: In 2001, its paid-up capital was of ₹ 2,090 crore. Of its capital 70% is Indian, 20% British and 10% American. Indian capital has been raised through banks, insurance companies, private institutions and public.

(v) Functions: Its principal functions are:

(i) To purchase new shares and debentures of the private sector and underwriting their liabilities;

(ii) To guarantee the loans;

(iii) To give technical and managerial assistance to industries;

(iv) To help modernisation and expansion of industries;

(v) To give loans for a period up to 15 years;

(vi) To give foreign exchange for the import of capital goods;

(vii) To function as a mutual fund.

(vi) Progress: Its progress is mainly as follows:

(i) Provisions of loans in foreign exchange;

(ii) Loans at large scale;

(iii) Loans to small industries and backward areas;

(iv) This corporation, by establishing Merchant Banking Division, has started foreign banking activity.

It has set up many associate institutions, viz., (i) ICICI Securities and Finance Co. Ltd. (ii) ICICI Asset Management Co. Ltd. (iii) ICICI Premier (iv) ICICI Investors Services Ltd. (v) ICICI Banking Corporation Ltd. The corporation sanctioned loans of ₹ 362.29 billion in 2001-02, of which loans of the value of ₹ 258.31 billion were distributed. Foreign exchange loans of the value of ₹ 8990 crore were sanctioned.

(3) Industrial Finance Corporation of India (IFCI) Ltd.

(i) **Establishment:** Central Banking Enquiry Committee suggested the establishment of an industrial bank in India. For many years, this suggestion was not implemented. Industrial Finance Corporation of India was established on July 1, 1948 under the Industrial Finance Corporation Act. Some significant amendments were introduced in this Act in 1964, 1972 and 1980. On Ist July, 1993 it has been reconstituted as a public limited company.

(ii) **Objectives:** This bank gives medium-term and short-term loans to the private sector, cooperative sector, joint stock companies (public & private), shipping corporation, hotels, mines, etc.

(iii) **Organisations:** The corporation is managed by 05 member Board of Directors.

(iv) **Forms of Assistance:** The bank gives financial assistance in the following form:

(i) Gives loans for a maximum period of 25 years;;

(ii) By underwriting shares and debentures;

(iii) Gives loans in foreign exchange;

(iv) Gives security for the loan raised by an industry in the open market;

(v) Buys stocks and shares of companies;

(vi) Gives security regarding deferred payments for the import of capital goods;

(vii) Gives loans for the purchase of machines;

(viii) Functions as merchant banker;

(ix) Gives loans on projects in backward areas.

(v) **Capital:** Its authorized capital was of ₹ 10 crore divided into equal parts of ₹ 5000 each. It was raised to ₹ 100 crore in 1991. In 1999-2000, the share capital of a bank amounted to ₹ 1000 crore. Its shares are purchased by the Central Government, LIC, GIC and various institutions of public sector. Public holds only 18.14% of total capital. Now the capital of IFCI is ₹ 1925.43 crore. The authorised capital is ₹ 3000 crore.

(vi) **Resources:** The Industrial Finance Corporation of India resorts to the following sources for its credit needs:

(i) Selling bond and debentures. Loans raised cannot exceed more than 10 times of the paid-up capital and reserves of the corporation;

(ii) Loans from the reserve bank of India for a maximum period of 18 months and subject to a ceiling of ₹ 3 crore;

(iii) Loans from the Government of India;

(iv) Foreign exchange loans from world bank or other international institutions with the permission of the government;

(v) Deposits from general public, state governments and local bodies up to ₹ 10 crore for a minimum period of 5 years;

(vi) Selling of shares;

(vii) **Progress:** In 2015-16, the corporation sanctioned loans of the value of ₹ 108.95 billion and disbursed loans of the value of ₹ 74.88 billion.

(viii) **Features:** Some of the important features are as follows:

(i) Loans were advanced to the industries producing fertilizers, cement, paper, sugar and cloth;

(ii) Maharashtra occupied the first place as regards the distribution of loans; West Bengal and Tamil Nadu occupied the second and third place respectively;

(iii) The value of loans ranged between ₹ 10 lacs to ₹ 1crore. Most of the loans were of the values of ₹ 40 to ₹ 50 lacs;

(iv) Loans were generally given for a period of 12 years. However, the repayment of loans can be extended up to a period of 25 years;

(v) Underwriting job of the corporation has not been very satisfactory. This is because the capital market was not properly managed nor did people show much interest in it;

(vi) The corporation established Development Reserve Fund and Management Development Institute.

(vii) In June 1976, it established Risk-Capital Foundation to give technical and interest free credit assistance to new industries;

(viii) The corporation has established technical consultancy service regarding backward areas;

(ix) **Criticism:** Functioning of the corporation has been criticised as follows:

(i) The corporation is finding it difficult to effect recovery of the loans, both the principal as well as interest amounts;

(ii) Favouritism is noted while advancing loans to the industrialists;

(iii) Its functioning is infused by some officials and industrialists. As a result, only a few prominent industrialists are able to get loans;

(iv) Its administration is inefficient;

(v) Sanction and distribution of loans is unduly delayed.

(vi) Interest rates are very high;

(vii) Underwriting job of the corporation has been highly unsatisfactory;

(viii) Less assistance has been provided to the backward regions of Assam, Rajasthan and M.P. Therefore, not much progress has been registered in regional growth;

(ix) Less assistance has been offered to basic industry and capital goods industries;

(x) The corporation has failed in supervising the investment expenditure of the industries taking loans. As a result, production and efficiency have suffered.

(4) Industrial Investment Bank of India (IIBI)

(i) Establishment: Originally, it was set up as a corporation (IRCI) in April, 1971 on the recommendations of the Industrial Bank. Its paid-up capital is ₹ 20 crore. In August 1984, it was converted from Industrial Reconstruction Corporation of India into Industrial Reconstruction Bank of India. It authorised capital is fixed at ₹ 200 crore and paid-up capital at ₹ 135 crore. On 27th March, 1997, it was renamed as Industrial Investment Bank of India Ltd.

(ii) Objectives: Its principal objective is to give financial assistance for the reconstruction of sick or closed industrial units. It offers technical and managerial facilities also.

(iii) Progress: This bank had sanctioned loans of the value of ₹ 24.12 billion by 2003-04. Out of this, only ₹ 22.52 billion were actually disbursed.

(b) For Small Scale Industries

(1) Small Industries Development Bank of India (SIDBI)

(i) Establishment: The Small Industries Development Corporation was established in 1989 as a wholly owned associate institution of Industrial Development Bank of India. It started functioning on 2nd April, 1990.

(ii) Capital: The Authorised Capital of SIDBI is ₹ 1,000 crore. All its paid up capital of ₹ 487 crore has been subscribed by Industrial Development Bank of India, Govt. of India, SBI, LIC, PNB, BOB, Canara Bank, NABARD, Bank of India, Central Bank of India and other commercial banks and insurance companies.

(iii) Objectives: The main objective of this bank is to provide adequate financial and non-financial aid to small scale industries. Some of the main functions of this bank are:

(i) To initiate the process of modernisation and technical upgradation of the present units;

(ii) To facilitate the marketing of the products of the small scale sector in India and abroad;

(iii) To provide special aid to labour intensive industries to enable them to provide more employment,

(iv) To provide refinancing, factoring, leasing, and services to the small sector;

(iv) Progress: In 2015-16, the bank sanctioned loans worth ₹ 614.83 billion and distributed loans worth ₹ 594.67 crore.

(2) National Small Industries Corporation Ltd.

(i) Establishment: The National Small Industries Corporation Ltd. was established in 1955 by the government of India. Its head-office is in Delhi and has regional/sub-office in several places.

(ii) Capital: The NSIC has a paid-up capital of ₹ 7.5 crore. The NSIC augments its financial resources by borrowing and grants from the Central Government, loans from nationalised commercial banks and foreign credits. In addition, the NSIC has received financial assistance from a number of countries like the United States, United Kingdom, Germany and Japan.

(iii) Objectives: The main objective of NSIC is to assist small-scale industrial units through promotional, marketing and financial activities.

(iv) Functions: The main functions of NSIC are:

(i) Supply of machinery on hire-purchase basis;

(ii) Securing purchase contracts from Central Government Store Purchase Agencies;

(iii) Providing training to workers and supervisors at Prototype Development and Training Centers opened at Okhla (Delhi), Rajkot, Chennai and Howrah;

(iv) Management of Industrial Estates;

(v) Distribution of scare raw-materials needed by small scale industries;

(vi) Helping promotion of exports of small scale industrial goods.

(II) State Level Development Banks

(1) State Finance Corporation

(i) Establishment: The government of India passed State Finance Corporation Act in 1951 with a view to establish state level finance corporations to cater to the long period credit needs of small scale industries. Punjab Government was the first to establish finance corporation. Presently, there are 17 such corporations.

(ii) Objectives: The principal objectives of these corporations is to provide long period loans to the small scale and medium sized industries at the state level. These industries may be in the form of public or private companies, cooperative societies, partnerships or individual enterprises. These corporations provide special assistance for the growth of regional industries.

(iii) Capital: According to the Act, authorized capital of the corporations is to be defined by the concerned State Government, but it should not be less than ₹ 5 crore or more than ₹ 500 crores. Shares of the corporations are purchased by the State Governments, Reserve Bank of India, Scheduled Banks, Co-operative Banks, Insurance Companies, Investment Trusts and other institutions. General public also has right to buy its shares but the percentage should not exceed 49 per cent of total capital. The corporation can increase its capital by selling bonds and debentures.

(iv) Organisations: The corporation is managed by the Board of Directors comprising 10 members. One managing director is elected. Of these, 2 members are nominated by the state government, 2 directors are nominated by Small Industries Bank and others are representatives from various quarters. On the recommendation of the managing director, the state government appoints the chairman of the corporation.

(v) Functions: Functions of this corporation are similar to those of the IFCI. But some of the notable differences are:

(i) This state finance corporation can advance loans to medium and small scale industries, but IFCI advances loans only to large scale industries.

(ii) Authorized capital of this corporation is less than that of IFCI.

(iii) This corporation can advance 20% of the total loans to individual industrial units, bu IFCI, does not advance any such loans.

(iv) This corporation can guarantee loans up to a maximum period of 20 years while IFC can give guarantee for a period of 25 years.

(v) This corporation advances loans to service industries as well, viz., packing and repai industries. But the IFCI does not.

(vi) These corporations can take loans from RBI and other financial institutions to buy share of the sick indusuial units at the state level.

(vi) Progress: There were 17 State Finance Corporations in 2013-14. These loans and advances of SFCs were of ₹ 116.35 billion.

(vii) Criticism: Principal points of criticism of state finance corporations are:

- (i) Loans sanctioned by these corporations are distributed after too much of delay.
- (ii) Interest rate charged by the corporations is very high.
- (iii) State Finance Corporations have focused only on loans. Little investment has been made in debentures. Also guaranteeing the loans has remained only a restricted activity.
- (iv) Capital of these corporations is very low and, therefore, their loanable capacity is limited.
- (v) The corporations demand high securities for giving loans. The poor and medium class industries, therefore, remain unable to seek loans from these corporations.
- (vi) These corporations have not taken any step to seek technical advice of the experts.
- (vii) The corporations face lot of difficulties in advancing loans to small scale industries.

(2) State Industrial Development Corporations (SIDCs) Or State Industrial Investment Corporations (SIICs)

(i) Establishment: The State Industrial Development Corporations or State Industrial Investment Corporations have been established by many state governments and union territories since 1960. At present, there are 28 SIDCs/SIICs are functioning in the country.

(ii) Objectives: The main objective of SIDCs/SIICs is to promote industrial development of respective state or union territory. They are promotional / financial institutions entrusted with the task of bringing about rapid industrial development within their states.

(iii) Functions: The SIDCs/SIICs undertake a variety of functions such as granting of financial assistance to industrial concerns in the form of direct investment, loans, guarantees for loans and deferred payments to be made by industrial concerns, underwriting of shares issued, provision of industrial sites and sheds and other promotional functions such as identification of project ideas, selection and training of entrepreneurs, provision of technical assistance, etc.

(iv) Progress: At the end of March, 2002 the total financial assistance sanctioned by the SIDC's amounted to ₹ 9.24 billion and disbursements ₹ 12.50 billion. The amount sanctioned have been increasing over the years as is clear from the fact that they amounted to ₹ 2178.1 crore in 1991-92. The amount distributed was ₹ 518 crore in 1990-91.

(B) Agricultural Development Banks

(I) All India Development Banks

(1) National Bank for Agriculture and Rural Development (NABARD)

Shivaraman Committee was appointed by the Reserve Bank of India in March 1979 to study problems related to agricultural credit. On the recommendation of this committee, National Bank for Agriculture and Rural Development was established on July 12, 1982. It was established as an apex bank for agriculture credit. This bank was nicknamed as NABARD. This is expected to play an mportant role in agriculture and rural development.

NABARD, took over the functions of the following departments of the Reserve Bank of India:

- (i) Agriculture Credit Department

- (ii) Rural Planning and Credit Cell, and
- (iii) Agriculture Refinance and Development Corporation.

(a) **Capital:** The subscribed and paid up capital of this bank stands at ₹ 4,000 crore contributed by the central government and the Reserve Bank of India in various phases.

(b) **Management and Organisation:** NABARD is to be managed by the board of director comprising of 15 members.

- (i) Chairman,
- (ii) Managing Director,
- (iii) Two Experts of Rural Economy,
- (iv) Two Experts of Co-operative and Commercial Banks,
- (v) Three Directors of Reserve Bank of India,
- (vi) Three Directors nominated by the Government of India,
- (vii) Three directors, nominated by the state government.

Also it is likely that one Advisory Council, one Executive Council and Managing Committee are appointed for the proper functioning of NABARD.

(c) **Functions:** Following are the main functions of NABARD:

- (i) Refinance of agricultural credit.
- (ii) Inspection of RRB.
- (iii) Foreign help.
- (iv) Institutional rural credit.
- (v) Production credit.
- (vi) Agent of government and Reserve Bank.

(d) **Achievements:** Following are the main achievements of National Bank of Agriculture and Rural Development:

- (i) Resource mobilisation by NABARD.
- (ii) Refinance.
- (iii) Rural Infrastructure Development Fund (RIDF).
- (iv) Kisan Credit Card Scheme.
- (v) Micro Finance Innovation.
- (vi) Agriculture Development Finance Commpanies.

(e) **Progress:** The NABARD sanctioned 130604 schemes in 2015-16. The total amount of financial assistance sanctioned was of ₹ 490.44 billion and disbursed ₹ 480.64 billion.

(2) Central Co-operative Banks

These banks were established according to the Co-operative Societies Act 1912. These were established to provide financial assistance to the primary co-operative societies and to help their efficient organisation. Principal features of these banks are as follows:

(a) Membership and Area: Credit societies, other co-operative societies and eminent persons belonging to the public can become members of these banks. These banks look after the primary societies of a district as a part of them by providing them financial assistance. These banks have limited liability.

(b) Management: All members of the banks constitute general body. These are managed by the board of directors elected every year by the general body on the basis of 'One Individual One Vote'. Their membership differs at different places, but generally, their number varies between 10-24. To run their affairs, these banks appoint trained staff on salaries.

(c) Functions: To give loans to the member societies is the principal function of these societies.

(i) These banks give interest free loan to the primary agricultural credit societies, but from others, interest is charged.

(ii) These banks also perform general banking functions such as to accept deposits from the people, transfer of money, etc.

(iii) These banks help the primary societies in solving their problems.

(iv) In some states, these banks also inspect the functioning of primary societies.

(v) These banks maintain a balance amongst various primary societies. Deposits are accepted from the societies with surplus funds and these are given in the form of loans to those societies which are short of funds.

(d) Capital: These banks procure capital from four sources:

(i) Share Capital,
(ii) Deposits,
(iii) Reserve Fund,
(iv) Loans.

(e) Loans: These banks give loans to the individuals and societies. Loans are given to the societies on the basis of their promissory notes. Individual loans are advanced on the basis of securities.

(f) Progress: In 2013-14, 370 central co-operative banks were functioning in the country. In that year, loans worth ₹ 1810 billion were to be recovered by these banks. Their deposits amounted to ₹ 2769 billion.

(II) State Level Development Banks

(1) Land Development Banks or State Co-operative Agriculture and Rural Development Banks (SCARDB)

Special type of credit societies called Land Development Banks have been formed to meet the long term credit requirement of the farmers. These banks are now called State Co-operative Agriculture and Rural Development Banks. These banks were first established in the Jhang area of undivided Punjab and were called Land Mortgage Banks. But its real start corresponds to the year 1929 when one Central Land Development Bank was opened in Madras. Land development banks are those banks which give long term loans to the farmers against mortage of their land. These banks are of two types:

(a) Central Co-operative Agriculture and Rural Development Banks.
(b) Primary Co-operative Agriculture and Rural Development Banks.

At present, there are 19 SLDCs. Land development banks give loans to the farmers or primary for the improvement of land, for purchasing agricultural implements and for repaying old debts.

The SLDBs obtain their resources through share capital, deposits, loans, advances or debentures. ABARD also helps them.

(III) Local Development Banks

(1) Primary Co-operative Agriculture and Rural Development Banks

The area of operation of these banks is restricted to one tehsil or a particular district. These offer t long term loans to the farmers.

(a) Functions: These banks give special type of loans against the mortgage of fixed assets. These loans may be for the repayment of old debt, the purchase of land and implements or for making some permanent improvements on land. Loans are of the duration of 20 years or more.

(b) Membership: Both the individuals as well as co-operative societies are the members of these banks.

(c) Capital: The capital of these banks comes mainly through the sale of assets. Shares and debentures provide the maximum capital to these banks. These banks also keep reserve balances. The maximum shares and debentures of the PLDBs are purchased by Reserve Bank of India, insurance corporations, State Bank of India, Co-operative Banks, State Governments and NABARD. Since 1975, the Central Government is directly investing in these banks. The total capital of PCARDB was ₹ 1,380 crore as on 31.03.2012.

(d) Progress: During 2015-16, there were 1038 PCARDBs and its branches in India. During that year these banks advanced loans of ₹ 5,261 crore. The loans outstanding mounted to ₹ 19,439 crore. During 2015-16, the loans outstanding amounted to ₹ 14,421 crore.

(C) Export-Import Development Banks

Export-Import Bank of India

(i) Establishment: The Export-Import Bank was established on Ist January, 1982. It is known as EXIM Bank.

(ii) Capital: The authorized capital of this bank is ₹ 1,00,000 million, of which ₹ 63,593.66 million is paid-up. In 2013, the reserves of the bank amounted to ₹ 51274.38 million.

(iii) Objectives: The main objectives of it are as follows:

(i) To ensure an integrated and coordinated approach in solving the allied problems encountered by exporters in India;

(ii) To pay specific attention to the exports of capital goods;

(iii) Export projection;

(iv) To extend buyer's credit and lines of credit;

(v) To facilitate and encourage joint ventures and export of technical services and internationa and merchant banking;

(vi) To tap domestic and foreign markets for resources for undertaking development an financial activities in the export sector.

(iv) Functions: The main functions of EXIM bank are:

(i) Planning promoting and developing exports and imports;

(ii) Providing technical, administrative and managerial assistance for promotion, management and expansion of exports; and

(iii) Undertaking market and investment surveys and techno-economic studies related to development of exports of goods and services.

(v) Organisation: The EXIM Bank has a 14 member board of directors, with chairman and managing director as the chief executive and full time director. The board of directors consists of the representatives of the Government of India, RBI, IDBI, ECGC, Commercial banks and the export community.

(vi) Progress: The Bank began its lending operations from March, 1982. Till June, 1982, it has extended up to ₹ 133 crore to the export sector in various ways. In 2015-16, the Bank sanctioned loans worth ₹ 725.76 billion. Out of this amount ₹ 518.22 billion were disbursed.

(D) Investment Institutions

(1) Unit Trust of India

(i) Establishment: The importance of Unit Trust in mobilizing savings of small savers was recognized as early as 1931 by the Indian Central Banking Enquiry Committee. The need for setting up these trusts was stressed once again by the Shroff Committee in 1954. Unit Trust of India was set up on November 26, 1963 after parliament had passed the Unit Trust Act. The sales of unit were started on July 1, 1964.

(ii) Capital: The financial resources of the UTI can be divided into two categories: (a) Initial capital, and (b) Unit capital. Its initial capital was ₹ 5 crore of which reserve bank contributed ₹ 2.50 crore, i.e., 50 per cent (This has since been transferred to the books of IDBI). Another 15 per cent each is held by the State Bank of India group and LIC, while the remaining 20 per cent is with other institutions and banks. Unit capital has been obtained through the sale of units. During the first year itself (i.e., in 1964), the sale of units amounted to ₹ 19.1crore. Repurchases amounted to ₹ 41 lakhs. Unit capital of UTI rose to ₹ 47,292 crore in 1996-97 and further to ₹ 60,712 crore in 1999-2000. Total investible funds of the UTI stood at ₹ 74,291 crore as on June 30, 2000.

(iii) Objectives: "The primary objective of the UTI is to encourage and mobilize savings of the community and channelise them into productive corporate investments so as to promote the growth and diversification of the country's economy." The following are the main objectives of the UTI:

(i) To provide equitable financial instruments to mobilize savings from the lower and middle class people by selling units of small denomination (of the face value of ₹ 10 per unit).

(ii) To provide a financial instrument to the purchaser of units to have a share in the increasing industrial prosperity of the country to as many people in different parts of the company as possible.

(iii) To pay dividends on units to their purchasers.

(iv) Financial Assistance by UTI: Financial assistance sanctioned by UTI in 1994-95 amounted to ₹ 6,623 crore which fell steeply to ₹ 3,633 crore in 1996-97. However, it rose somewhat to

₹ 4,533 crore in 1997-98 and ₹ 3.07 billion in 2003-04. In a similar way, assistance disbursed increased from ₹ 4,516 crore in 1997-98 to ₹ 4.15 billion in 2003-04.

(v) Benefits of UTI: Investment in units of the UTI offer four major benefits to unit-holders:

(i) Since the investments of the UTI are spread over wide range of securities some of which give a fixed rate of interest and some others a variable rate of return, units provides a fair amount of guarantee that the unit-holders will get a fair return on their units;

(ii) Since nine-tenths of the income of the UTI is distributed among the unit-holders, they are assured of a steadily rising income, as the experience of the last two decades has shown.

(iii) Returns on units to unit-holders enjoy exemption (up to a limit) from income tax.

(iv) The units of the UTI are a highly liquid asset. The board of trustee of the UTI are ready to purchase back the units from the unit-holders any time at prices announced in the national newspapers.

(2) Life Insurance Corporation of India

(i) Establishment: Life Insurance Corporation of India came into existence in 1956 when the life insurance business was nationalised. It took over the assets and liabilities of 245 insurers engaged in the transaction of life insurance business in India. LIC has its central office in Mumbai and 8 zonal offices, 113 divisional offices and 2048 branch offices.

(ii) Resources: The LIC collects huge amounts annually by way of premium from life and endowment policy holders spread all over India. Not all claims mature at one and the same time which in effect means that the LIC has considerable amount of funds on its hand which it can invest profitably.

(iii) Financial Assistance: In 1999-2000, LIC sanctioned assistance worth ₹ 6811 crore while assistance disbursed was ₹ 5611 crore. Assistance by LIC has been provided in the forms of (i) term loans; (ii) underwriting and direct subscriptions in the form of (a) equity and preference shares (b) debentures; (iii) resources support to financial institutions. Of the total investments of ₹ 1,39,032 crore made by LIC at the end of March 2000, public sector accounted for the major share of ₹ 1,17,059 crore while private sector got ₹ 19,268 crore. The balance went to co-operative and joint sector. Financial assistance disbursed by LIC rose from ₹ 65.6 crore in 1980-81 to ₹ 413.11 billion in 2015-16. Amount sanctioned during 2015-16 was ₹ 393.68 billion.

(3) General Insurance Corporation

(i) Establishment: The general insurance industry was nationalised in 1971 and a government company known as General Insurance Corporation of India was formed by Central Government in November 1972. The erstwhile 107 Indian and foreign insurers who were operating in the country prior to nationalization, were grouped into four operating companies, namely (i) National Insurance Company Ltd. (ii) New India Assurance Ltd. (iii) Oriental Insurance Company Ltd. (iv) United India Insurance Company Ltd.

(ii) Resources: All the above four subsidiaries of GIC operate all over the country competing with one another and underwriting various classes of general insurance business. These four subsidiaries companies of GIC operate on all India basis through regional, divisional and branch offices. As compared to 799 offices in 1973, the network consisted of 4208 offices in March 1998. The gross direct premium income of the general insurance industry amounted to ₹ 18,43 crore in 2015-16 while the net premium income amounted to ₹ 15,174 crore in that year.

12

utual Fund

troduction

An investment vehicle that is made up of a pool of funds collected from many investors for the rpose of investing in securities such as stocks, bonds, money market instruments and similar assets. tual funds are operated by money managers, who invest the fund's capital and attempt to produce pital gains and income for the fund's investors.

A mutual fund is an investment company or trust that pools the resources of thousands of its reholders or unit holders and invests on behalf of these diversified securities and a cross-section f companies to attain the objective of investors, which in turn achieve income or growth or both i.e. ady return or capital appreciation or both along with low risk.

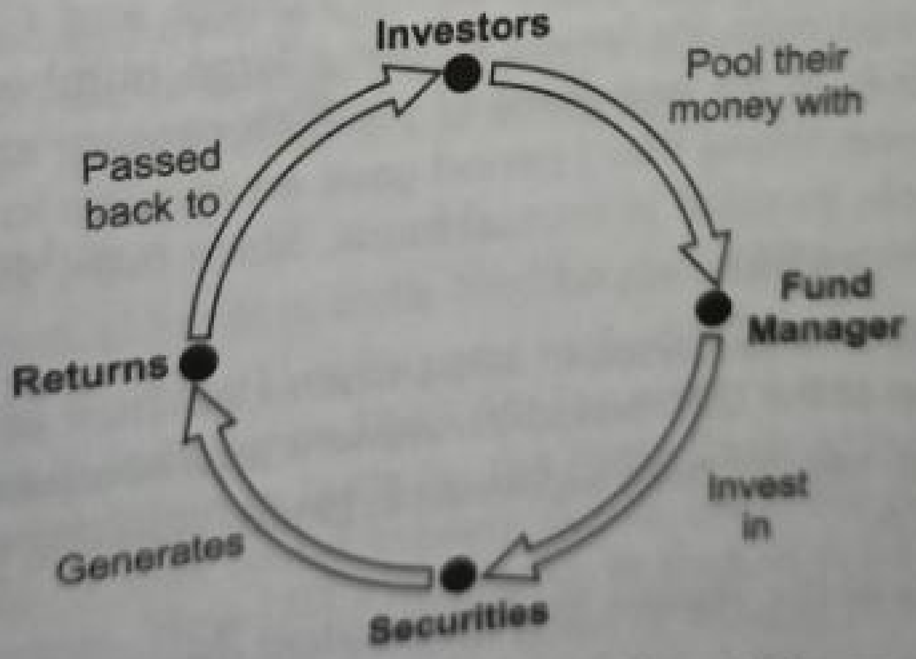


Fig. 1: Mutual Fund Operation Flow Chart (*Source*: AMFI)

Thus mutual funds provide the alternatives to the investors who instead of making direct investments in share or bonds through public issues or through secondary market, subscribe to the corpus of mutual funds. Mutual Funds mobilize funds by selling their own share also known as units. When an investor owns share in mutual funds, he owns a proportional share of their securities portfolio. In other words, share of mutual funds actually, represents a part share in many securities that it has purchased. Mutual fund share certificate combines the industries.

Definitions

1. As per **Mutual Fund Book**, published by Investment Company Institute of the U.S., *"A Mutual Fund is a financial service organisation that receives money from shareholders cash on demand for the current value of his investment. The investment managers of the funds manage these savings in such a way that the risk is minimized and steady return is ensured."*
2. **Securities and Exchange Board of India (Mutual Funds) Regulations,** 1996 define, *"Mutual Funds as a fund established in the form of a trust to raise money through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market instruments."*
3. **Encyclopaedia Britannica** defines a Mutual Fund as, *"Mutual Fund also called unit trust or open-ended trust, a company that invests the fund of its subscribers in diversified securities and in turn issues units representing shares in those holdings. They make continuous offering of new shares at new asset value determined daily by the market value of the securities they hold."*

Concept of Mutual Funds

The concept of Mutual Fund is an American concept and the terms 'Investment Trust', 'Investment Company' and 'Mutual Fund' etc. are being used interchangeably in American literature. The concept of 'Mutual Fund' is a new feature in the capital of Indian capital market but not to international capital markets. The formal origin of mutual funds can be traced to Belgium where Society General De Belgium was established in 1822 as an investment company to finance investments in national industries with high associated risks. In England, the Foreign and Colonial Government Trust was established in 1868 to spread risks for investor over a large number of securities. The concept of mutual funds spread to U.S.A. in the beginning of the 20th century and three investment companies were started in 1924. The post World War I period gave an impetus to mutual funds culture in U.S.A. when more and more people invested in mutual funds. Since then, the concept of mutual funds has been growing all around the world.

In India, first mutual fund was started in 1964 when Unit Trust of India (UTI) was established in the similar line of operation of the U.K. based investment trust companies.

The term 'Mutual Fund' has not been explained in British literature but it is considered as synonym of Investment Trust of U.S.A.

At least 2/3rd directors of the Trustee are independent directors who are not associated with the sponsor in any manner.

Asset Management Company (AMC): The AMC is appointed by the Trustee as the Investment Manager of the Mutual Fund. The AMC is required to be approved by the Securities and Exchange Board of India (SEBI) to act as an asset management company of the Mutual Fund. At least 50% of the directors of the AMC are independent directors who are not associated with the Sponsor in any manner. The AMC must have a net worth of at least 10 crore at all times.

Registrar and Transfer Agent: The AMC, if so authorised by the Trust Deed, appoints the Registrar and Transfer Agent to the Mutual Fund. The Registrar and Transfer Agent processes the application form, redemption requests and dispatches account statements to the unit holders. The Registrar and Transfer Agent also handles communications with investors and updates investor records.

ersons Involved in Mutual Fund

1. **Sponsor:** Sponsor is the person who acting alone or in combination with another bod corporate establishes a mutual fund. Sponsor must contribute at least 40% of the net worth o the investment managed and meet the eligibility criteria prescribed under the Securities an Exchange Board of India (Mutual Funds) Regulations, 1996. The sponsor is not responsibl or liable for any loss or shortfall resulting from the operation of the schemes beyond the initia contribution made by it towards setting up of the mutual fund.
2. **Trust:** The mutual fund is constituted as a trust in accordance with the provisions of the Indian Trusts Act, 1882 by the Sponsor. The trust deed is registered under the Indian Registration Act, 1908.
3. **Trustee:** Trustee is usually a company (corporate body) or a Board of Trustees (body of individuals). The main responsibility of the trustee is to safeguard the interest of the unit holders and inter alias ensure that the AMC functions in the interest of investors and in accordance with the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, the provisions of the Trust Deed and the Offer Documents of the respective Schemes. Features of both open ended as well as close ended schemes. Interval schemes have been permitted by the SEBI in recent year only. The scheme is open for sale or repurchase at fixed predetermined intervals, which are disclosed in the offer document. The units of the scheme are also traded in the stock exchange.

ypes of Mutual Funds:

There are a number of mutual funds to suit the needs and preference of investors. To achieve e differing objectives of the investors mutual funds adopt different strategies and accordingly offer fferent schemes of investment. The various mutual funds may be classified as follows:

(A) According to Ownership

According to ownership, mutual funds in India may be classified as:

(I) **Public Sector Mutual Funds:** Unit Trust of India (UTI) has been functioning in the area of mutual fund business in India since 1963-64. However, it was only after 23 years, in 1987 the second fund was established in India by the State Bank of India. Although the UTI was functioning successfully, it was found inadequate to meet the requirements of small and medium household sectors. Thus UTI's monopoly in mutual fund business was curtailed by the Central Government by opening the operation of Mutual Funds to the requirements of the common investors. SBI MF was first among all the public sector commercial banks that started operations during November 1987. Thereafter a number of public sector organizations like IND Bank-MF, CAN Bank MF, BOI-MF, PNB-MF, GIC-MF, LIC-MF, etc. have joined in the mutual fund business in a short span of time.

(II) **Private Sector Mutual Funds:** Seeing the growth and success of mutual funds in Indian capital market, the government of India allowed the private sector corporate to join the mutual fund industry on February 14, 1992. Since then, a number of private sector companies have approached SEBI for permission to set up private mutual funds.

MUTUAL FUND STRUCTURE

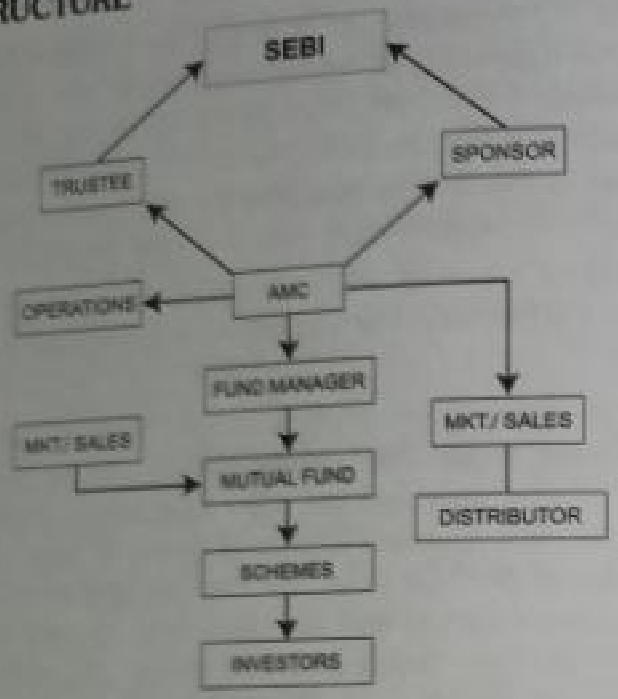


Fig. 2: Mutual Fund Structure (*Source:* AMFI)

(B) According to Portfolio

Mutual Fund can be classified according to portfolio. Some of these funds are as follows:

(i) **Income Fund**: For investors who are more curious for returns, Income funds are floated. Their object is to maximize current income. Such funds distribute periodically the funds income earned by them. These funds further splitted up into categories, those that stress constant income at relatively low risk and those that attempt to achieve the maximum income possible, even with the use of leverage. Obviously the higher the expected return, the higher the potential risk of the investment.

(ii) **Growth Funds**: Such fund aims to achieve increase in the value of the underlying investments through capital appreciation. Such funds invest in growth oriented securities which can appreciated through the expension of production facilities in long run Growth Funds are also known as "Nest Eggs" or "Long Haul" investment. An investor who selects such funds should be able to assume a higher than normal degree of risk.

(iii) **Balanced or Conservative Fund**: Balanced fund spend both on common stock and preferred stock. Some part of funds is spend on buying equity while other part is used in acquiring interest bearing debentures and preference shares ensuring certain amount of dividend. Some funds generally spend half the funds on equity stock while the other half is spent on preferred stock. Balanced funds ensure both appreciations in stock as well as regular return in the shape of interest and dividend. The investors have advantages of regular income and appreciation in value of securities. These funds are also known as Conservative Funds or Income and Growth funds.

(iv) **Equity Fund**: Such funds as the name implies, invest most of their investible funds in equity shares of companies and undertake the risk associated with the investment in equity shares. Such funds are clearly expected to outdo other funds in a rising market, because these have

almost all their capital in equity. Equity funds again can be of different categories varying from those that invest almost exclusively in high quality 'blue chip' companies to those that invest solely in the new, unestablished companies. The strength of their fund is the expected capital appreciation. Naturally, they have high degree of risk.

(v) **Index Funds:** Index fund replicates the portfolio of a particular index such as the BSE sensitive index, S&P NSE, 50 index (Nifty), etc. These schemes invest in the securities in the Regulation 1996 provided guidelines for registrations, constitution, management and schemes of Mutual Funds. Thus, the UTI has now to face competition from the banking and insurance in the public sector and various companies in the private sector so far as mutual funds business is concerned. However, this competition from private sector is expected to increase the services to the common investors.

(C) According to Scheme of Operations

The most important classification of mutual funds is on the basis of the scheme of their operations as all types of mutual funds fall under this classification. According to the scheme of operations, the mutual funds could be divided into following three categories:-

(i) **Open Ended Scheme:** Open ended scheme means a scheme of mutual funds which offers units for sale without specifying any duration for redemption. These schemes do not have a fixed maturity and entry to the fund is always open to investors who can subscribe it at any time. Similarly, the investors have an option to get their holdings redeemed at any time. The funds redeem or repurchases the units/shares at periodically announced rates are based upon the net current assets value of the fund. Thus, opened ended funds provide better liquidity to the investors. In the same manner, the price at which the units are offered to the public is also announced periodically. As an investor can directly purchase and sell units under opened ended schemes, these are not listed. Some of the open ended fund schemes in India are ING OptiMix Active Debt Multi - Manager FoF Scheme, ICICI Prudential Very Cautious Plan and Birla Sun Life AAF - Aggressive Plan.

(ii) **Close Ended Scheme:** A closed ended scheme means any schemes of mutual fund in which the period of maturity of the scheme is specified. Unlike opened ended funds, the corpus of close ended scheme is fixed and an investor can subscribe directly to the scheme only at the time of initial issue. After the initial issue is closed, a person can buy or sell the units of the scheme in the secondary market i.e., the stock exchange where those are listed. The price in the secondary market is determined on the basis of demand and supply and hence could be different from the net asset value. It is always easier to manage a close ended scheme as the fund manager, can evolve long-term investment strategies depending upon the life of the scheme. Some of the close ended fund schemes in India are ING Vyasya Dynamic Asset Allocation Fund and Kotak Dynamic Asset Allocation Scheme.

(iii) **Interval Schemes:** An interval scheme is a scheme of mutual fund which is kept open for a specific interval and after that it operates as a close-ended scheme. Thus, it combines the same weight-age comprising an index. NAVs of such schemes would rise or fall in accordance with the rise or fall in the index, though not exactly by the same percentage due to some factors known as tracking error in technical terms. Necessary disclosures in this regard are made in the offer document of the mutual fund scheme. These are also exchange traded index funds launched by the mutual funds which are traded on the stock exchange.

(iv) **Bond Fund:** These funds employed their resources in bonds. These investments ensure fixed and regular income. Sometimes bonds are available in the market at lower than face value, the net income on these bonds goes higher because interest will be received on the face value of the bond. Some companies offer non-convertible bonds along with the shares. Any person subscribing for the share will have to take up bond also. Bond funds may have a tie up with the companies and offer a certain price if the subscribers want to sell their bonds at the time of allotment. Bond fund will pay a fixed amount to the company and some amount will be paid by the subscriber also. The shareholder is saved from the botheration of buying bonds compulsorily while the bond fund will pay less than the face value of bond, thus saving some money.

(v) **Specialized Funds:** These funds invest in a particular type of securities. The funds may specialise in securities of companies dealing in a particular product firms in a particular industry like Pharmaceuticals, InfoTech, Petrochemicals, etc. There are also some special funds targeted at a particular class of investors like women and children. Any investor wanted to invest in a particular security will prefer a fund dealing in such securities.

(vi) **Leverage Funds:** Some mutual fund broad base their investible fund borrowings from the market and then make investment and thereby making leverage benefits available to the mutual fund investors. Such funds are known as leveraged fund. The primary aim of leverage funds is to maximise capital appreciation. These funds may use even borrowed funds for buying speculative stock, which ensures a profit in the future. The cost of raising loaned funds and the gain from holding shares is the profit of the leverage fund. The leverage is used to the benefit of the shareholders. Leverage funds indulge in speculative activities to earn more and more profit. In a declining market, the fund may indulge in short sales. The reduced price of the stock in future will benefit the fund. Some other methods may also used to ensure higher profits.

(vii) **Taxation Fund:** These schemes offer tax rebate to the investor under specific provisions of the income tax Act 1961 as the government offers tax incentives for investment in specified avenues e.g. ELSS. The contributors to such fund get some concession in income tax. The investors are required to keep the money with the fund for a certain period called lock up period, which at present is 3 years in India. These funds distribute the profit among the unit holders. A repurchase offer of units is also given at the current net asset value. A large number of mutual funds have come up with schemes, which ensures tax benefits to the subscriber besides some income and small appreciation in value of units. The amount collected by these funds is used to acquire shares and interest bearing securities. The net asset value of the units varies with the values of securities held. Generally, income tax payers contribute in these funds.

(viii) **Money Market Mutual Funds (MMMF):** Money Market Mutual Fund means a scheme of a mutual fund which has been set up with the objective of investing exclusively in money market instruments. These instruments include treasury bills, dated government securities with an unexpired maturity of up to one year, call and notice money commercial paper, commercial bills accepted by bank's and certificate of deposits. While equities and bonds or debentures dominate the portfolio of 'Capital Market Mutual Funds', the money market instruments constitute the only portfolio of 'money market mutual funds'. Till recently, only commercial banks and public financial institutions were allowed to set up MMFs. But in November 1995, the government has permitted private sector mutual funds also to set up money market mutual funds.

(ix) **Sector Specific Funds:** These are the funds which invest in the securities of only those sectors or industries as specified in the offer documents e.g., pharmaceuticals, software, fast moving consumer goods, petroleum stock, etc. The returns in these funds are dependent on the performance of the respective sectors. While their funds may give higher returns, they are more risky compared to diversified funds. Investors need to keep a watch on the performance of those sectors and must exit at an appropriate time. They may also seek the advice of an expert.

(x) **Load or No-load Fund:** A load fund is one that charges a percentage of NAV for entry or exit. That is each time one buys or sells units in the fund, a charge will be payable. This charge is used by the mutual fund for marketing and distribution expenses. Suppose the NAV per unit is ₹ 10. If the entry as well as exit load charged is 1%, then the investor who buy would be required to pay ₹ 10.10 and those who offer their units for repurchase to the mutual fund will get only ₹ 9.90 per unit. The investors should take the loads into consideration while making investment as these affect their yields/return. However, the investors should also consider the performance track record and service standards of the mutual funds, which are more important. Efficient fund may give higher returns in spite of loads.

A No-load fund is one that does not charge a commission for entry or exist. That is, no commission is payable on purchase or sale of units in the fund. The advantage of a no-load fund is that entire corpus is put to work.

(D) According to Location

Mutual fund can also be classified on the basis of location from where they mobilize fund as:

(i) **Domestic Funds:** These are the funds, which mobilize savings of people with in the country where investment are made. Domestic funds can further be sub-divide on the basis of scheme of operation or portfolio.

(ii) **Off Share Funds:** Off share Mutual funds are those, which raise or mobilize funds in other countries then where investments are to be made. These funds attract foreign saving for investment in India.

Features or Advantages of Mutual Funds

A mutual fund is a special type of institution, which acts as a investment intermediary and canalises the saving of large number of people in such a way that investors get steady returns, capital appreciation and a low risk. Mutual funds are becoming very popular in the world because of the following advantages:

(i) **Diversification:** Mutual funds invest in a number of companies across a broad cross section of industries and sectors. The diversification reduces the risk because seldom do all stock decline at the same time and in the same proportion. A large number of investors have small savings with them. They can at the most but share of one or two companies. When small savings are pooled and entrusted to mutual funds, then these can be used to buy shares of many different companies. Investors can participate in a basket of shares of different companies. This diversification of investment ensures regular return and capital appreciation at reduced risks, as all the eggs are not put in one basket.

(ii) **Professional Advice:** A small investor cannot be an expert in portfolio management. When he invests mutual funds, he gets the benefits of expert supervision and management, which mutual funds can afford because of large resource at their disposal. The funds can be professionally employed through the mutual funds ensuring good returns. The mutual fund managers also have extensive research facilities at their disposal. They can analyse the performance and prospects of various companies and take better decisions in making investments.

(iii) **Liquidity**: A peculiar advantage of mutual fund is that investment made in its schemes can be converted back into cash promptly without heavy expenditure on brokerage, delay, etc. According to the regulation of SEBI, a mutual fund in India is required to ensure liquidity. For open ended schemes, the investors can approach the mutual fund to repurchase units at declared Net Asset Value (NAV). In case of close ended schemes, units can easily be solded in the stock market.

(iv) **Reduced Risk**: As mutual funds invest in large number of companies and are managed professionally, the risk of the investor is reduced. A small investor, on the other hand, may not be in a position to minimize such risks.

(v) **Tax Advantage:** There are certain schemes of mutual funds provide tax advantage under the income tax Act. Thus, the tax liability of an investor is also reduced when he invests in these schemes of the mutual funds.

(vi) **Low Operating Costs**: Mutual funds have large investible funds at their disposal and thus can avail economies of large scale. This reduces their operating costs by way of brokerage fees, commission, etc. Thus, a small investor also gets the benefits of large scale economies and low operating costs.

(vii) **Flexibility**: Mutual funds provide flexible investment plans to its subscribers such as regular investment plans. Regular withdrawal plans dividend reinvestment plans, etc. Thus, an investor can invest or withdraw funds according to his own requirements to his own requirements.

(viii) **Return Potential:** Over a medium to long term mutual funds have the potential to provide a higher return as they invest in a diversified basket of selected securities and also due to professional management, economies of scale and reduced risk, etc.

(ix) **Investor Protection:** Mutual funds are regulated and monitored by the securities exchange board of India (SEBI). The SEBI (Mutual funds) Regulation, 1996 which have replaced the regulation of 1993, provide better protection to the investors, impart a greater degree of flexibility and facilitate competition.

(x) **Professional Management**: Mutual funds provide the services of experienced and skilled professionals, backed by a dedicated investment research team that analyses the performance and prospects of companies and selects suitable investment to achieve the objectives of the scheme.

(xi) **Convenient Administration:** Investing in a mutual fund reduces paper work and helps you avoid many problems such as deliveries, delayed payments and follow up with brokers and companies. Mutual funds save your time and make investing easy and convenient.

(xii) **Transparency:** You get regular information on the value of your investment in addition to disclosure on the specific investment made by your scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.,

xiii) **Affordability:** Investors individually may lack sufficient funds to invest in high grade stocks. A mutual fund because of its large corpus allows even a small investor to take the benefit of its investment strategy.

(xiv) **Well Regulated:** All mutual funds registered with SEBI and they function with in the provisior of strict regulations designed to protect the interests of investors. The operations of mutua funds are regularly monitored by SEBI.

Risks Considered While Investing In Mutual Funds

Before investing in a mutual fund, an investor must identify his needs and preferences. While selecting mutual funds schemes he should consider the effect of inflation rate, diversification of investment, the tie period of investment and the time period of investment and the risk factors. There are various types of risk factors as :

(i) **The Risk-Return Trade-off:** The most important relationship to undertake is the risk return trade off. Higher the risk greater the return/loss and lower the return/loss. Hence it is up to you the investor to decide how much risk you are willing to take in order to do this, you must first be aware of the different types of risks involved with your investment decision.

(ii) **Market Risk:** Sometimes prices and yields of all securities rise and fall broad outside influences affecting the market in general lead to this whether big corporations or smaller mid-sized companies. This is known as market risk.

(iii) **Credit risk:** The debt servicing ability of a company through its cash flows determines the credit risk faced by you. This credit risk is measured by independent rating agencies like CRISIL who rare companies and their paper. A 'AAA' rating is considered the safest whereas a 'D' rating is considered poor credit quality. A well diversified portfolio might help mitigate risk.

(iv) **Inflation Risk:** Things you hear people talk about "₹ 100 today is worth more than ₹ 100 tomorrow". Remember the time when a bus ride costed 50 paisa. Inflation is the loss of purchasing power over time. Lots of time people make conservative investment decision to protect their capital but end up with a sum of money that can buy less than what the principal could at the time of the investment. This happens when inflation grows faster than the return on your investment. A well-diversified portfolio with some investment in equities might help mitigate this risk.

(v) **Interest Rate Risk:** In a free market economy, interest rates are difficult if not impossible to predict. Changes in interest rates affect the prices of bonds as well as equities. If interest rates rise the prices of bonds fall and vice-versa. Equity might help mitigate this risk.

(vi) **Political Risk:** Changes in government policy and political decision can change the investment environment. They can create a favorable environment for investment or vice-versa.

(vii) **Liquidity Risk:** Liquidity risk arises when it becomes difficult to sell the securities that one has purchased. Liquidity risk can be partly mitigated by diversification, staggering of maturities as well as internal risk controls that lean towards purchase of liquid securities.

SEBI Guidelines Regarding Mutual Funds

Mutual Funds in India are now governed under the Securities & Exchange Board of India (Mutual Funds) Regulation 1996. SEBI has provided a four tier system for managing the affairs of mutual funds.

The four constituents in the organization of mutual fund are:

(1) The Sponsoring Company

(2) The Trustee

(3) The Asset Management Company

(4) The Custodians

SEBI's guidelines have made it clear that sponsors will not be able to use the corpus of funds for heir own benefit.

(1) The Sponsor

SEBI (Mutual Funds) Regulations defines sponsor as any person who, acting alone or in combination with another body corporate, establishes a mutual fund. In other word, a mutual fund s launched by a company either public or private. For example: SBI mutual fund sponsored by state ank of India and LICMF is sponsored by LIC sponsors have to comply with following regulation laid down by SEBI.

(a) **Application and Fee:** A sponsor has to file and application for registration of a mutual fund in the prescribed form along with and application fee of ₹ 5,00,000. The sponsor must furnish all information and give clarification as may be required by the board.

(b) **Eligibility Criteria:** The sponsor may be granted a certificate of registration provided the following conditions are satisfied.

(i) The sponsor has sound track record and general reputation of fairness and integrity in all this business transactions for not less than 5 years.

(ii) In the case of an existing mutual fund, such fund is in the form of a trust and the trust deed has been approved by the Board;

(iii) The sponsor has contributed at least 40% of the net worth of AMC .

(iv) A trustee has been appointed by the sponsors who will act as trustee for the mutual Fund.

(v) An AMC in appointed to manage and operate the scheme of such funds.

(vi) A custodian is appointed to keep custody of the securities or gold

(c) **Grant of Certificate of Registration:** The board may register the mutual fund and grant a certificate of registration in **Form B** to the sponsor after it pays a fee of ₹ 5,00,000. A mutual fund shall pay before the 15th April each year a service fee as specified in the Second Schedule and ranges between ₹ 2.5 lakh to 7.5 lakh as per net assets for every financial year from the year following the year of registration.

(2) The Trustee

SEBI (Mutual Fund) amendment regulations, 1999 defines trustee as a person who holds the roperty of the mutual fund in trust for the benefit of the unit holders and includes a trustee company nd the directors of the trustee company.

(A) Trust Deed To Be Registered Under The Registration Act

(Regulation 14): *A mutual fund shall be constituted in the form of a trust and the instrument of trust shall be in the form of a deed duly registered under the provision of the Indian Registration 1908 executed by the sponsor in favour of the trustees named in such an instrument.*

(B) Disqualification from Being Appointed as Trustees (Section 16)

A mutual fund shall appoint trustees in accordance with the regulations. No person shall be eligible to be appointed as a trustee unless:

(a) he is a person of ability, integrity and standing; and

(b) has not been found guilty of moral turpitude; and

(c) has not been convicted of any economic offence or violation of any securities laws;

(d) has furnished particulars as specified in Form C.

(e) No asset management company and no director (including independent director), officer or employee of an asset management company shall be eligible to be appointed as a trustee of any mutual fund.

(f) No person who is appointed as a trustee of a mutual fund shall be eligible to be appointed as a trustee of any other mutual fund:

(g) Two-thirds of the trustees shall be independent persons and shall not be associated with the sponsors or be associated with them in any manner whatsoever.

(h) In case a company is appointed as a trustee then its directors can act as trustees of any other trust provided that the object of the trust is not in conflict with the object of the mutual fund.

(C) Rights and Obligations of the Trustees (Regulation 18)

(1) The trustees and the asset management company shall with the prior approval of the board enter into an investment management agreement.

(2) The investment management agreement shall contain such clauses as are mentioned in the forth schedule and such other clauses as are necessary for the purpose of making investments.

(3) The trustees shall have a right to obtain from the asset management company such information as is considered necessary by the trustee.

(4) The trustee shall ensure before the launch of any scheme that the asset management company has:

(a) Systems in place for its back office, dealing room and accounting.

(b) Appointed all key personnel including fund manager for the scheme and submitted their bio-data, which shall contain the educational qualifications, past experience in the securities market with the trustees, within 15 days of their appointment.

(c) Appointed auditors to audit its accounts.

(d) Appointed compliance officer to comply with regulatory requirement and to redress investor grievances.

(e) Appointed registrars and laid down parameters for their supervisions.

(f) Prepared a compliance manual and designed internal control mechanisms including internal audit systems.

(g) Specified norms for empanelment of brokers and marketing agents.

(5) The trustee shall ensure that an asset management company has been diligent in empanelling the brokers in monitoring securities transactions with brokers and avoiding undue concentration of business with any broker.

(6) The trustees shall ensure that the asset management company has not given any undue or unfair advantages to any associates or dealt with any of the associates of the asset management company in any manner detrimental to interest of the unit holders.

(7) The trustees shall ensure that the transactions entered into by the asset management company are in accordance with their regulations and the scheme.

(8) The trustees shall ensure that the asset management company has been managing the mutual fund scheme independently of other activities and have taken adequate steps to ensure that the interest of investors of one scheme are not being compromised with those of any scheme are not being compromised with those of any other scheme or of other activities of the asset management company.

(9) The trustee shall ensure that all the activities of the asset management company are in accordance with the provision of these regulations.

(10) Each trustee shall be accountable for and be the custodian of the funds and property of the respective schemes and shall hold the same in trust or the benefit of the unit holders in accordance with these regulations and provisions of trust deed.

(11) The trustees shall take steps to ensure that the transactions of the mutual fund are in accordance with the provisions of the trust deed.

(12) The trustee shall be responsible for the calculation of any income due to be paid to the mutual fund and also of any income received in the mutual fund for the holders of the units of any scheme in accordance with there regulations and the trust deed.

(13) The trustees shall quarterly review all transaction carried out between the mutual funds asset management company and its associates.

(14) The trustees shall continuously review the net worth of the asset management company and in case of any shortfall; ensure that the asset management company make up the shortfall as per clause (F) of sub regulation (1) of regulation 21 .

(15) The trustees shall periodically review all service contracts such as custody arrangements transfer agency of the securities and satisfy itself that such contracts are executed in the interest of the unit holders.

(16) The trustee shall ensure that there is no conflict of interest between the manner of deployment of its net worth by the asset management company and the interest of unit holders.

(17) The trustee shall periodically review the investors complaints received and the redressal of the some by the asset management company.

(18) The trustee shall abide by the code of conduct as specified in the Appendix A.

(19) A trustee shall call for the details of transactions in securities by the key personnel of the asset management company in his own name or on behalf of the asset management company and shall report to the board as and when required.

(20) The trustee shall furnish to the board on a half yearly basis.

- A report on the activities of mutual fund.
- A certificate stating that the trustees have satisfied themselves.
- A certificate to the effect that the asset management Company has been managing the schemes independently of any other activities.

(21) Trustee shall exercise due diligence as under:

(A) General Due Diligence

(i) The trustee shall be discerning in the appointment of the directors on board of AMC.

(ii) Trustee shall review the desirability of continuance of the AMC if subs Fantail irregularities are observed in any of the schemes and shall not allow the AMC to float new scheme.

(iii) The trustee shall ensure that the trust property is properly protected, held and administered by proper persons and by a proper number of such persons.

(iv) The trustee shall ensure that all service providers are holding appropriate registrations from the board or concerned regulatory authority.

(v) The trustees shall arrange for test checks of service contracts.

(vi) Trustees shall immediately report to board of any special development in the mutual fund.

(B) Specific Due Diligence

The Trustee shall

(i) Obtain internal audit reports at regular intervals from independent auditors appointed by the trustees.

(ii) Obtain compliance certificate at regular intervals from the AMC.

(iii) Hold meetings of trustees more frequently.

(iv) Maintain records of the decision of the trustees at their meeting and of the minutes of meeting.

(v) Prescribe and adhere to a code of ethics by the trustee asset management company and its personnel.

(vi) Communicate in writing to the AMC of the deficiencies and checking on the rectification of deficiencies.

(vii) The trustees shall not be held liable for acts done in good faith if they have exercised adequate due diligence honesty.

(3) Asset Management Company (AMC)

SEBI regulations require that mutual funds be managed by a separate body co-operate. The ponsor or the trustee shall appoint an AMC. The application for the approval of AMC has to be made n form D. The appointment of AMC can be terminated by majority of the trustees or by 75% of the nit holders of the schemes. Any change in the appointment of AMC requires the prior approval of oard and the unit holders.

The following are the regulations with regard to constitution and management of AMC:

(A) Eligibility Criteria For Appointment of Asset Management Company (SEBI regulation 21):

(1) For grant of approval of the Asset Management Company, the applicant has to fulfil the followings:

(a) In case the AMC is an existing asset management company it has a sound track record, general reputation and fairness in transactions.

(b) The directors of AMC are person having adequate professional experience in finance and the financial services related field and not found guilty of moral turpitude or convicted of any economic offence or violation of any securities laws.

(c) The key personal of the AMC has not been working for any AMC or mutual fund or any intermediary whose registration has been suspended or cancelled at any time by the board.

(d) The board of directors of such AMC has at least fifty per cent directors, who are not associates of or associated in any manner with, the sponsor or any of its subsidiaries or the trustees.

(e) The chairman of the AMC is not a trustee of any mutual fund.

(f) The asset management company has a networth of not less than rupees ten crores.

The AMC who has been granted approval under SEBI regulation shall with in a period of 12 months from the date of notification of these regulations increases its networth to rupee 10 crores.

(2) The board may after considering an application with reference to the matter specified in sub regulation (1) grant approval to the AMC.

(B) Terms & Conditions to be complied with Regulation 22:

The approval granted under sub-regulation (2) of regulation 21 shall be subject to the following onditions, namely:

(1) Any director of the AMC shall not held the office of the director in another asset mgt. co. unless such person is an independent director regulation (1) of regulation 21 and approval of board of asset management company of which such person is a director, has been obtained.

(2) The asset management company shall forth with inform the board of any material change in the information or particulars previously furnished, which have a bearing on the approval granted by it.

(3) No appointment of a director of an AMC shall be made without prior approval of the trustees.

(4) The asset management company undertakes to comply with these regulations.

(5) Any change in controlling interest of asset management company shall be only with prior approval of trustees the board and the unit holders.

(6) The asset management company shall furnish such information and document to the trustees as when required by the trustees.

(C) Asset Management Company and its Obligation (Regulation 25):

(1) The AMC shall take all reasonable step and exercise due diligence to ensure that the investment of funds pertaining to any scheme is not contrary to the provision of the regulatory and the trust deed.

(2) The AMC shall exercise due diligence and care in all its investment decisions as would be exercised by other persons engaged in same business.

(3) The AMC shall be responsible for the acts of commissions or omissions by its employees or the persons whose services have been procured by the AMC.

(4) The AMC shall submit to the trustee quarterly reports of each year on its activities and compliance with these regulations.

(5) The trustees at the request of AMC may terminate the assignment of AMC at any time provided that such termination shall become affective only after the trustees have accepted and termination of assignment and communicated their decision in writing to the asset management company.

(6) Notwithstanding anything contained in any contract or agreement or termination, the asset management company to its directors or other officers shall not be absolved of liability to the mutual fund for their acts of commission or omissions while holding such position or office.

(6A) The Chief Executive Officer (whatever his designation may be) of the asset management company shall ensure that the mutual fund complies with all the provisions of these regulations and the guidelines or circulars issued in relation thereto from time to time and that the investments made by the fund managers are in the interest of the unit holders and shall also be responsible for the overall risk management function of the mutual fund.

(6B) The fund managers shall ensure that the funds of the schemes are invested to achieve the objectives of the scheme and in the interest of the unit holders.

(7) No AMC shall deal in securities through any broker associated with the sponsor or a firm which is an associate of a spores or beyond 5% of the daily gross business of the mutual fund.

(8) An AMC shall not utilize the services of sponsors and any of its associates, employee and their relatives for the purpose of any securities transaction and distribution and sale off securities.

(9) The AMC shall file with trustees the details of transactions in securities by the key personnel of the AMC in their own name or on behalf of the AMC and shall also report to the board as and when required by the board.

(10) In case the AMC enters into any securities transaction with any of its associates a report to that effect shall immediately be sent to the trustees.

(11) In case any company has invested more than 5% of the net asset value of a scheme, the investment made by the scheme or by any other scheme of the same mutual fund in that company or its subsidiary shall be brought to the notice or the trustees by the AMC and be disclosed on the half yearly and annual averments of the respective schemes with justification for such

(12) The AMC shall file with the trustees and the board.

(a) Detailed bio-data of all its directors along with their interest in other companies within 15 days of their appointment.

(b) Any charge in the interest of directors every six months.

(13) A statement of holding in securities of the director of the AMC shall be filled with the trustees with the dates of acquisition of such securities at the end of each financial year.

(14) The AMC shall not appoint any person as key personal who has been found guilty of any economic offence or involved in violation of securities low.

(15) The AMC shall abide by the code of conduct as specified in appendix A.

(4) Custodian

Custodian is defined under SEBI (Mutual Funds) regulation 1996 as a person who has been granted a certificate of registration to carry on the business of custodian of securities under the securities and exchange board of India (custodian of securities) Regulation. 1996.

Custodian provides custodial services and ensures safe keep of securities. He performs following functions:

(i) Maintains accounts of securities of a client.

(ii) Collects the benefits or rights (i.e., interest and dividends) accruing to the client in respect of securities.

(iii) Maintains and reconciles the records of securities.

(iv) Helps in transfer of securities in the name of trust.

(v) Prevents any manipulation of records and devilments.

Custodian of a mutual fund cannot act as sponsor or trustee of any other mutual fund. The following are the SEBI regulation with regard to custodian:

(a) Appointment of Custodian (SEBI Regulation 26)

(1) The mutual fund shall appoint a custodian to carry out the custodial services for the schemes of the fund and sent intimation of the same to the board with in fifteen days of the appointment of custodian.

(2) No custodian, in which the sponsor or its associate hold 50% or more of the voting rights of the share capital of the custodian or where 50% or more of the directors of the custodian represent the interest of the sponsor or its associates shall act as custodian for a mutual fund constitutes by the same sponsor or any its associate or subsidiary company.

(b) Agreement with custodian (Regulation 27)

The mutual fund shall enter into a custodian agreement with the custodian, which contain he clauses which are necessary for the efficient and orderly conduct of the affairs of the custodian. Provided that the agreement, the service contract terms and appointment of the custodian shall be ntered into with prior approval of the trustees.

Evaluation of Mutual Fund Schemes

There are broadly two aspects on the basis of which any schemes of mutual fund may be evaluated by an investor.

A. Quantitative Aspect

B. Qualitative Aspect

A. Quantitative Aspect

Investors cannot speculate and earn profits by sale or purchase of mutual fund units in the short run. A mutual fund may be evaluated by an investor on the following parameters in the long run.

(1) **Appreciation in the value of Investments:** A mutual fund that ensures higher total return on investments is likely to be considered by the investors Return includes any income received by way of dividend plus capital appreciation a return can be calculated as follows:

$$\frac{\text{Capital appreciation + Dividend}}{\text{Net value in the beginning}}$$

$$\frac{\text{NAV at the end – NAV at the beginning) + Dividend}}{\text{Net value in the beginning}}$$

(2) **Income Ratio:** Income ratio indicates the earning potential of the scheme of mutual fund. It can calculate as follows:

$$\frac{\text{Net investment income}}{\text{Average Net Asset}}$$

Or

$$\frac{\text{Dividend received}}{\text{Y2 (NAV in the beginning + NAV at the end)}}$$

Greater the ratio, better is the mutual fund scheme

(3) **Expenses ratio:** How effectively the scheme is being managed in indicated by the expense ratio. It is calculated as under,

$$\frac{\text{Total Expenses}}{\text{Average Net Asset}}$$

Expense ratio is very much affected by the size of the scheme. Larger is the scheme, lesser will be the cost of operating the scheme. But if the size of scheme reduces, it will increase per unit cost of operating a scheme. A lower expense ratio indicates the efficiency with which the scheme is being managed.

B. Qualitative Aspects

Second aspect that is taken into consideration while evaluating a mutual fund is qualitative in nature. The investor sakes into consideration the following qualitative aspects:

(i) Track record of the sponsoring authority i.e. who is the sponsor of the mutual fund scheme.

(ii) The promptness with which response is given to investor.
(iii) Location of collection centers.
(iv) Timely redemption of units.
(v) Timely dispatch of unit certificates or account statement.
(vi) Efficiency with which a request for the change of address is met.
(vii) Convenience / time taken in switching over to other schemes.
(viii) Time taken for redressal of grievances, or complaints of the investors looked into.
(ix) Timely receipt of dividends etc.
(x) Adequacy of the infrastructure.

Thus qualitative aspects are mostly focused on the quality of service provided before and after the sale of units of mutual fund scheme. Scheme may not turn out to be successful because of the inadequacy of the infrastructure or back up facility or due to indifferent attitude of the sponsor towards investors.

Launching of Mutual Fund Schemes

(A) Procedure for Launching of Schemes

1. No scheme shall be launched by the asset management company unless such scheme is approved by the trustees and a copy of the offer document has been filed with the Board.
2. Every mutual fund shall along with the offer document of each scheme pay filing fees of ₹1,00,000.

(B) Disclosures in the Offer Document

1. The offer document shall contain disclosures which are adequate in order to enable the investors to make informed investment decision including the disclosure on maximum investments proposed to be made by the scheme in the listed securities of the group companies of sponsor.
2. The Board may in the interest of investors require the asset management company to carry out such modifications in the offer document as it deems fit.
3. In case no modification are suggested by the Board in the offer documents within 21 working days from the date of filing the asset management company may issue the offer document.
4. No one shall issue any form of application for units of a mutual fund unless the form is accompanied by the memorandum containing such information as may be specified by the Board.
5. The offer document shall contain the disclosure regarding the prior in principle approval obtained from the recognized stock exchange(s), where units are proposed to be listed in accordance with these regulations.

(C) Nomination (Regulation 29A)

1. The asset management company shall provide an option to the unit holder to nominates, a person in whom the units held by him shall vest even in case of his death.
2. Where the units are held by more than one person jointly, the joint unit holders may together nominate a person in whom all the rights in the units shall vest in the event of death of all the joint unit holders.

Advertisement Material (Regulation 30)

1. Advertisements in respect of every scheme shall be in conformity with the Advertisement Code as specified in Appendix B and shall be submitted to the Board within 7 days from the date of issue.
2. The advertisement for each scheme shall disclose investment objective of each scheme.

Misleading Statements (Regulation 31)

The offer document and advertisement materials shall not be misleading or contain any statement, opinion, which are incorrect or false.

Listing of Close Ended Schemes (Regulation 32)

Every close ended scheme shall be listed in a recognised stock exchange within six months from closure of the subscription:

Provided that listing of close ended scheme shall not be mandatory:

(a) If the said scheme provide for periodic repurchase facility to all the unit holders with restriction, if any, on the extent of such repurchase; or
(b) If the said scheme provides for monthly income or caters to special classes of persons like senior citizens, women, children, windows or physically handicapped or any special class of persons providing for repurchase of units at regular intervals; or
(c) If the details of such repurchase facility are clearly disclosed in the offer document; or
(d) If the said scheme opens for repurchase within a period of six months from the closure of subscription.
(e) If the said scheme is a capital protection oriented scheme.

(G) Repurchase of Close Ended Schemes (Regulation 33)

1. Units of a close ended scheme, other than those of an equity linked savings scheme, launched on or after the commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2009 shall not be repurchased before the end of maturity period of such scheme.
2. The units of close ended schemes referred to in the proviso to regulation 32 may be open for sale or redemption at fixed predetermined intervals if the maximum and minimum amount of sale or redemption of the units and the periodicity of such sale or redemption have been disclosed in the offer document.
3. The units of close ended scheme may be converted into open ended scheme:
   (a) If the offer document of such scheme discloses the option and the period of such conversion; or
   (b) the unit holders are provided with an option to redeem their units in full A close ended scheme shall be fully redeemed at the end of the maturity period.
   (c) the initial issue expenses of the scheme launched prior to commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2008 have been amortised fully in accordance with the Tenth Schedule.
4. A close ended scheme shall be fully redeemed at the end of the maturity period.

(H) Offering Period

No scheme of a mutual fund other than the initial offering period of any Equity linked savings schemes shall be open for subscription for more 15 days.

(I) Allotment of Units and Refunds of Moneys (Regulation 35)

(1) The asset management company shall specify in the offer document:

- (a) The minimum subscription amount it seeks to raise under the scheme; and
- (b) In case of over subscription the extent of subscription it may retain: provided that where the asset management company retains the oversubscription referred to in clause (b), all the applicants applying up to five thousand units shall be given full allotment subject to the oversubscription mentioned in clause (b).

(2) The mutual fund and asset management company shall be liable to refund the application money to the applicants:

- (i) If the mutual fund fails to receive the minimum subscription amount referred to in clause (a) of sub-regulation (1).
- (ii) If the moneys received from the applicants for units are in excess of subscription as referred to in clause (b) of sub-regulation (1).

(3) Any amount refundable under sub-regulation (2) shall be refunded within a period of five working days from the date of closure of subscription list, by Registered AD. and by cheque or demand draft marked "A/C. Payee" to the applicants.

(4) In the even of failure to refund the amount within the period specified in subregulation (3), the asset management company shall be liable to pay interest to the applicants at a rate of fifteen per cent per annum on the expiry of five working days from the date of closure of the subscription list.

(J) Unit Certificates or Statement of Accounts (Regulation 36)

(1) The asset management company shall issue to the applicant whose applications has been accepted, unit certificates or a statement of accounts specifying the number of units allotted to the applicant as soon as possible but not later than five working days from the date of closure of the subscription list provided that if an applicant so desires, the asset management company shall issue the unit certificates to the applicant within six weeks of the receipt of request for the certificate.

(2) An applicant in a close ended scheme whose application has been accepted shall have the option either to receive the statement of accounts or to hold units in dematerialised form and the asset management company shall issue to such applicant, a statement of accounts specifying the number of units allotted to the applicant or issue units in dematerialised form as soon as possible but not later than five working days from the date of closure of the initial subscription list.

(3) The asset management company shall issue units in dematerialised form to a unit holder in a close ended scheme listed on a recognised stock exchange within two working days of the receipt of request from the unit holder.

(4) The asset management company shall ensure that consolidated account statement for each calendar month is issued, on or before tenth day of succeeding month, detailing all the

distribution

(K) Transfer of Units (Regulation 37)

1. An unit certificate unless otherwise restricted or prohibited under the scheme, shall be free transferable by act of parties or by operation of law.

1A. A unit holder, in a close ended scheme listed on a recognised stock exchange, who desires trade in units shall hold units in dematerialised form.

2. The asset management company shall, on production of instruments of transfer together wit relevant unit certificates, register the transfer and return the unit certificate to the transfere within thirty days from the date of such production: Provided that if the units are with th depository such unit will be transferable in accordance with the provisions of the securities an Exchange Board of India (Depositories and Participants) Regulations, 1996.

(L) Guaranteed Returns (Regulation 38)

No guaranteed returns shall be provided in a scheme,

- (a) Unless such returns are fully guaranteed by the sponsor or the asset management company;
- (b) Unless a statement indicating the name of the person who will guarantee the return, is made in the offer document;
- (c) The manner in which the guarantee is to be met has been stated in the offer document.

(M) Capital Protection Oriented Schemes (Regulation 38A)

A capital protection oriented scheme may be launched, subject to the following:

- (a) the units of the scheme are rated by a registered credit rating agency from the viewpoint of the ability of its portfolio structure to attain protection of the capital invested therein;
- (b) the scheme is close ended; and
- (c) there is compliance with such other requirements as may be specified by the Board in this behalf.

(N) Winding Up (Regulation 39)

1. A close-ended scheme shall be wound up on the expiry of duration fixed in the scheme on the redemption of the units unless it is rolled-over for a further period for a further period under subregulation (4) of regulation 33.
2. A scheme of a mutual fund may be wound up, after repaying the amount due to the unit holders:
   - (a) On the happening of any event which, in the opinion of the trustees, requires the scheme to be wound up; or
   - (b) If seventy-five per cent of the unit-holders of a scheme pass a resolution that the scheme be wound up; or
   - (c) If the Board so directs in the interest of the unit-holders.
3. Where a scheme is to be wound up under sub-regulation (2), the trustees shall give notice disclosing the circumstances leading to the winding up of the scheme:
   - (a) To the Board; and

(b) In two daily newspapers having circulation allover India, a vernacular newspaper circulating at the place where the mutual fund is formed.

(O) Effect of Winding Up (Regulation 40)

On and from the date of the publication of notice the trustee or the asset management company as the can may be, shall:

(a) Cease to carry on any business activities in respect of the scheme so wound up;

(b) Cease to create or cancel units in the scheme;

(c) Cease to issue or redeem units in the scheme.

(P) Procedure and Manner of Winding Up (Regulation 41)

(1) The trustee shall call a meeting of the unit-holders to approve by simple majority of the unitholders present and voting at the meeting resolution for authorising the trustees or any other person to take steps for winding up of the scheme provided that a meeting of the unit-holders shall not be necessary if the scheme is wound up at the end of maturity period of the scheme.

(2) (a) The trustee or the person authorised under sub-regulation (1) shall dispose of the assets to the assets of the scheme concerned in the best interest of the unit-holders of that scheme.

(b) The proceeds of sale realised under clause (a), shall be first utilised towards discharge of such liabilities as are due and payable under scheme and after making appropriate provision for meeting the expenses connected with such winding up, the balance shall be paid to the unit-holders in proportion to their respective interest in the assets of the scheme as on the date when the decision for winding up was taken.

(3) On the completion of the winding up, the trustee shall forward to the Board and the unitholders a report on the winding up containing particulars such as circumstances leading to the winding up, the steps taken for the disposal of the fund before winding up, expenses of the fund for winding up, net assets available for distribution to the unit-holders and a certificate from the auditors of the fund.

(4) The provisions of these regulations in respect of disclosures of half-yearly reports and annual reports shall continue to be applicable unit winding up is completed or the scheme ceases to exist.

Winding up of the Scheme (Regulation 42)

After the receipt of the report under sub-regulation (3) of regulation 41, if the Board is satisfied that all measures for winding up of the scheme have been complied with, the scheme shall cease to exist.

Delisting of Units (Regulation 42 A)

The units of a mutual fund scheme shall be delisted from a recognised stock exchange in accordance with the guidelines as may be specified by the Board.