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Workbook for

NISM – Series – II – A: Registrars and Transfer Agents (Corporate) Certification Examination

Workbook
for
NISM-Series-II-A: Registrars to an Issue and Share Transfer Agents - Corporate Certification Examination

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This workbook has been developed to assist candidates in preparing for the National Institute of Securities Markets (NISM) Certification Examination for Registrars and Transfer Agents (Corporate).

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About NISM

In pursuance of the announcement made by the Finance Minister in his Budget Speech in February 2005, Securities and Exchange Board of India (SEBI) has established the National Institute of Securities Markets (NISM) in Mumbai.

SEBI, by establishing NISM, has articulated the desire expressed by the Indian government to promote securities market education and research.

Towards accomplishing the desire of Government of India and vision of SEBI, NISM has launched an effort to deliver financial and securities education at various levels and across various segments in India and abroad. To implement its objectives, NISM has established six distinct schools to cater the educational needs of various constituencies such as investor, issuers, intermediaries, regulatory staff, policy makers, academia and future professionals of securities markets.

NISM brings out various publications on securities markets with a view to enhance knowledge levels of participants in the securities industry.

NISM is mandated to implement certification examinations for professionals employed in various segments of the Indian securities markets.

Acknowledgement

This workbook has been developed by NISM in cooperation with the Examination Committee for Registrar and Transfer Agent Examinations consisting of representatives of Registrars and Transfer Agent Association of India (RAIN). NISM gratefully acknowledges the contribution of all committee members.

About the Authors

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About the Certification Examination for Registrars and Transfer Agents – Corporate

The examination seeks to create a common minimum knowledge benchmark for persons working in Registrars to an Issue and Share Transfer Agents (R&T agent) organizations in the corporate R&T function, in order to enable better quality investor service, operational process efficiency and risk controls.

Examination Objectives

On successful completion of the examination the candidate should:

- Know the basics of securities and securities markets
- Understand broadly the role and functions of the R&T Agents in the corporate securities issuance and transaction process.
- Know the regulatory environment in which the R&T Agents operate in India.

Assessment Structure

The examination consists of 100 questions of 1 mark each and should be completed in 2 hours. The passing score on the examination is 50%. There shall be negative marking of 25% of the marks assigned to a question.

Examination Structure

The exam covers knowledge competencies related to the basics of securities and markets and those related to the processing of corporate offerings and subsequent operations.

How to register and take the examination

To find out more and register for the examination please visit *www.nism.ac.in*

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1.1. Introduction to Equity and Debt

A firm requires money to conduct its operations. The funding of a business can be of two dominant forms:

- Contribution by owners
- Loans from outsiders

Businesses are typically created by promoters, who bring in the initial funds, to create and nurture a business. Later as the business grows bigger, the need for money can be met by asking for more contributions to the business from outsiders.

Capital used in running a business can be primarily classified based on:

- The contributors of funds
- The period for which money is contributed
- The cost of the funds to the firm
- The rights that accrue to the contributors of the funds

Contributors

Fund brought in by promoters and owners of the business is called equity capital. Equity capital can be brought in at the start of a business or at a later date as the business grows. Equity capital also can be contributed by outside investors. To enable such contribution, the business offers equity shares to outside investors, who become share holders.

Funds brought in as loan is called debt capital. Those that contribute debt capital are called as lenders to the business. Lenders can be individuals or institutions including banks. To enable such lending, a business issues debt instruments to investors, or obtains term loans by mortgaging the assets of the company.

Time Period

The period for which capital is brought in may vary. Equity capital cannot be taken out of the firm unless the firm is liquidated. Such capital is for perpetuity. Debt has to be repaid by the company after a certain period. The period of repayment may be short-term (less than one year) or long-term (usually up to 10 years) and is decided at the time such capital is brought in.

Cost of Capital

The business has to pay a price for using equity or debt capital. The cost may be fixed at the time the money is brought in and may constitute an obligation for the company. Debt instruments usually pay a periodic interest at a pre-determined rate. The cost of capital may vary depending on the earnings of the company, as is the case with equity capital.

Rights of the Contributors

The contributors of capital enjoy certain rights and obligations depending upon the type of capital that they have brought in. Equity investors enjoy rights such as ownership and voting rights and rights to share the profits of the company. Debt investors have the right to receive periodic interest and return of the capital on the expiry of the fixed period. The contributors of debt capital may have their rights secured against the assets of the company.

1.2. Features of Equity Capital

Those who contribute equity capital to the company buy equity shares, when they are issued by the company. They are called equity shareholders of the company.

Limited liability

Equity capital is issued with limited liability. This means, if the creditors to a business are not able to recover their dues, equity shareholders will not be asked to pay up. The liability of equity shareholders in a company is limited to their contribution made or on any amount unpaid which they have agreed to pay.

Face value

The total equity capital required by a company is divided into smaller denomination called the face value or par value of the equity shares.

For example, if a company has an equity capital of Rs 10,00,000, this can be divided into:

- one lakh shares with a face value of Rs 10; or
- two lakh shares with a face value of Rs 5; or
- ten lakh shares with a face value of Re 1.

Equity shares were earlier issued as certificates; now they are invariably issued in electronic/dematerialised form.

The par value or face value of the shares can be changed subsequently, if the company so desires. This is called a split or a consolidation of shares. If a share with a face value of Rs 10 is divided into two shares with par values of Rs 5 each, it is called a

split. If 5 shares of Rs 2 face value each are clubbed into one share of Rs 10, it is called a consolidation of shares.

Authorised capital

The maximum amount of equity capital that a company will have is defined in the Memorandum of Association (MoA) of the company and is called its authorised capital. The authorised capital of a company can be raised or reduced subsequently by the company.

Issued capital

The company may issue a portion of its authorised capital as and when it requires capital. The capital may be issued to the promoters, public or to specified investors. The portion of authorised capital that has been issued to investors is called issued capital. Capital can be raised at various times as and when the company requires it, provided the sum of all capital issued is less than or equal to the authorised capital of the company.

The capital may be issued by the company either at its face value or at a premium (higher than the face value) or at a discount (lower than the face value). The issued capital will take into account only the face value of the shares issued. The remaining portion paid by the investor is accounted under the share premium account (liability side of the balance sheet) or share discount account (asset side of the balance sheet).

Paid-up capital

When investors subscribe to the capital issued by a company, they may be required to pay the entire price at the time of issue or in tranches (instalments) as application money, allotment money and call money. The portion of the issued capital that has been fully paid-up by the allottees is the paid-up capital of the company.

A company decides that the maximum equity capital it needs is Rs20 cr. In the initial stages, the need is Rs.10cr. It issues equity shares of Rs.10 face value, at par. Investors are required to pay Rs.5 per share with application, Rs.2 on allotment, and balance Rs.3 after it has been called. What is the authorised, issued and paid-up capital of the company, before the issue, after application, after allotment and after the call?

<u>Before the issue:</u>

Authorised capital: Rs 20 Cr

<u>After application:</u>

Authorised capital: Rs 20 Cr

Issued capital: Rs 10 Cr

Paid up capital: Rs 5 Cr

<u>After allotment:</u>

Authorised capital: Rs 20 Cr

Issued capital: Rs 10 Cr

Paid up capital: Rs 7 Cr

After first call:

Authorised capital: Rs. 20 Cr

Issued capital: Rs 10 Cr

Paid up capital: Rs 10 Cr

Thus it can be seen that the paid up capital is always less than or equal to issued capital; issued capital is always less than or equal to authorised capital. Authorised capital is the maximum amount that can be issued or paid up.

Ownership rights

Equity represents ownership of the company. Equity share holders are part-owners of the company, the extent of their ownership defined by their portion of the shares held in issued capital.

For example, if a company has an issued capital of Rs.10cr made up of 1cr shares of Rs.10 each, an investor who holds 10lakh equity shares is a part-owner with a 10% stake in the company.

Equity shareholders have the right to participate in the management of the company. They can do this through voting rights. Each equity share carries one vote. Major decisions of the company require resolutions to be passed, which have to be voted by a majority or more of the equity shareholders.

Equity capital entitles its contributors to participate in the residual profits of the company. After meeting all expenses and provisions,

whatever is the profit that remains in the books belongs to equity share holders.

Liquidity and return

Equity shares are first issued by a company. They are then listed on the stock exchange, where they can be transferred from one investor to another. Such transactions are between existing shareholders, and therefore do not result in change in the capital structure of the company. Equity capital is for perpetuity. It cannot be redeemed and the company does not have to repay it. The return from equity capital is in the form of dividends from the profits of the company and appreciation in the value of the holdings. There is no guarantee of dividends or capital appreciation on equity capital.

1.3. Features of Debt Capital

Debt capital refers to the borrowings of a company. Those contributing equity capital are owners of the company; those that contribute debt capital are lenders or creditors of the company.

Debt is raised by companies by issuing securities such as debentures, bonds and commercial paper to the lenders. The terms at which the borrowing is being made, such as, the period, the interest and other features are mentioned in the document (or certificate) that represents the debt security. Debt securities are also issued in electronic form.

Debt is raised by the company for a fixed period after which it has to be repaid. The period of borrowing will vary depending upon the

need of the company. The company has to pay periodic interest for the sum they have borrowed as decided at the time of the borrowing. Interest is usually a percentage of the par value of the debt instrument. The interest that the company has to pay will depend upon the risk of default associated with the company and the credit policy followed by the bank.

The lenders may have the right against the assets of the company if the company fails to pay interest and/or return the principal amount borrowed. Lending can also be unsecured, where such rights do not exist. Debt instruments may be listed on a stock exchange, in which case investors can buy or sell them. Debt instruments provide pre-defined income at specific intervals and the redemption proceeds on maturity.

1.4. Hybrid Structures

Companies may raise capital in a form that combines the features of both debt and equity. These are called hybrid instruments.

Convertible debentures

Convertible debentures pay interest like any other debt instrument till the date of conversion into equity shares. The terms of conversion, such as the number of equity shares that each debenture will be converted into and the price at which conversion will take place will be mentioned at the time of the issue of the debt instrument.

Preference shares

Preference shares resemble debt instruments because they offer pre-determined rate of dividend. However, they do not have a fixed maturity period or a right over the assets of the company. They have a preference in the payment of dividend over ordinary equity shares and in the return of capital, if the company is wound up.

Key Points

1. The capital structure of the company comprises of equity and debt in varying proportions.
2. Equity and debt capital differ on the rights and obligations for the investor and the company.
3. The equity capital of a company is divided into denominations called face value or par value. The denominations are usually Rs 10, Rs 5, Rs 2, and Re 1.
4. The memorandum and articles of association define the upper limit on the equity capital that a company can raise. This is called the authorised capital of the company.
5. The issued capital is that portion of the authorised capital that has been issued and the paid up capital is that portion of the issued capital that has been paid up by the allottees.
6. Equity capital implies ownership and higher risk for investors. For the company it is higher cost capital but without the obligation of repayment.
7. Debt capital implies regular return and security for the investor. For the company there is an obligation to make periodic interest payments and to repay the capital on maturity.
8. Hybrid products are created that have a combination of the features of equity and debt capital.

Quick Recap

Fill in the Blanks

1. _____ is for perpetuity from the point of view of the company.
2. Equity capital gives returns from _____ and _____ for the investor.
3. The denomination in which equity capital is issued is called_____
4. Debt capital has fixed _____
5. The interest that a company will have to pay on the debt raised will depend upon its _____.

State True or False

1. Companies prefer equity capital because it is less expensive.
2. The Authorised capital of the company can be raised if the company wants to increase the capital once it is fixed.
3. The paid-up capital of a company can be higher than its issued capital.
4. Debt capital is always raised for short-term periods.
5. Debt instruments are listed and traded on the secondary markets.

Answers:

Fill in the Blanks:

1- Equity capital
2- Dividends; Capital Appreciation
3- Face or Par Value
4- Maturity
5- Default Risk

True or False:

1- True
2- True
3- False
4- False
5- True

2. Characteristics of Equity Shares

2.1 Investors in Equity Shares

A company raises equity capital to meet its need for long-term funds for expansion or continuing operations of the company. Equity capital does not impose any liability on the company in terms of returns or repayment. However, when a company issues equity capital, the investors also get control and ownership. Their ownership rights depend on the proportion of issued capital that they hold.

A company can raise capital from different categories of investors. Different categories of investors have different requirements in terms of returns, risk and management control.

Promoters

Promoters are the group of investors who set up the company and bring in the initial capital required to start the business. This is the risk capital that allows the business to leverage and to protect it from fluctuations in earnings. At this stage the entire control of the company is with the promoters. They bring in additional capital as and when required.

As the capital needs of the business grow, promoters find that they cannot meet the company's need for funds. Equity is then issued to eligible investors such as institutions and retail public investors.

Promoters usually retain the majority shareholding in the company so that they can continue to control its affairs even after their stakes are diluted. The stage at which the promoters bring in the initial capital is the riskiest as the business is in the nascent stage and has a high risk of failure.

Institutional Investors

Institutional investors include financial institutions, venture capital companies, mutual funds and foreign financial institutions, banks among others. These are professional investors who have the ability to evaluate the business proposition, the risks associated with it and the expected returns.

The company may allot shares to such investors through a private placement of shares where the regulatory requirements are much less as compared to a public issue of shares. The risks and returns will depend upon the stage at which the institutional investors bring in capital.

Some like venture capital firms may be willing to bring in capital for companies in the start-up stage or even later while others like financial institutions invest in more established firms. Institutional investors such as venture capital firms may be actively involved in the management of the company while others like mutual funds may be more passive investors who are more interested in the returns that their investment can generate rather than in the management of the company.

Apart from the attractiveness of the business proposition, institutional investors would also be interested in factors such as exit options,

since many of them may hold a significant proportion of the equity capital. Many institutional investors like venture capitalists, encourage a company to offer its shares to the public investors as an exit option for themselves.

Public Investors

When the equity shares are held by promoters and a few investors, it is said to be closely held. Such companies are also private companies, which are not required to disclose too much of information about themselves to the public.

When a company offers its equity shares to the public at large, it moves from being a privately held company, to a publicly held company, which agrees to disclose periodic information about its operations and business to the public.

Investors, other than promoters, participate in the equity of a company when a company comes out with a public issue of shares. A public issue of shares requires regulatory compliance with SEBI's guidelines and regulations governing listing of the shares on a stock exchange.

Public investors in shares may be retail investors, high net worth individuals (HNI) or institutional investors. Retail investors, and to a great extent HNIs, are more interested in the returns that they can generate from their investment from capital appreciation in the value of the shares and dividend rather than in the control and management of the company. They hardly exercise their voting rights.

Large stake holders and institutional shareholders actively participate in the affairs of the company. Some large institutional investors are also given a seat on the board of the company. Regulations require extensive and timely disclosures of all information that affects the interests of the public investors in a company.

2.2 Features of Equity Share Capital

Equity share capital has distinct features which define its risk and return. These features determine the suitability of raising equity capital for the company over other sources of financing such as debt. For the investors, the risk and return in the equity investment determine whether such investment is appropriate for their needs.

Ownership rights

Issuing ordinary equity capital implies that the company is giving ownership rights to the shareholders. Investors are given voting rights which allow them to vote on important decisions taken by the company. The voting rights are in proportion to the number of shares held by the investor and allow them to express their views by voting for or against a proposal.

Ownership rights in a company also mean that the investors who hold equity shares are entitled to participate in the residual profits of the company. This participation will be in the form of dividends that are periodically declared by the company. The company may also allot bonus shares to its shareholders from the reserves of the company.

Equity capital is for perpetuity

A company is not required to return the equity capital to the investor. Investors who do not want to hold the capital of the company can sell the shares in the stock market to other investors who may want to buy the shares. This is, however, possible only if the shares are listed on a stock exchange. The company does not redeem or repay the amount invested to the investor in equity shares.

Returns are not fixed

Investment in equity shares does not come with a guarantee of income or security for the investor. The income for the investor from equity is from dividends and capital appreciation. Neither of these is guaranteed by the company or any other entity.

At the time of the issue of shares the company does not commit to pay a periodic dividend to the investor or a pre-fixed date for payment of dividend, if any. The investor cannot take any action against the company if dividends are not declared or if the share value depreciates.

The profits made by the company, after all contractual and regulatory payments have been made, are for the benefit of its equity shareholders. These profits are either distributed to the investors as dividend or retained as reserves which add to the net worth of the company and the inherent value of its equity shares.

2.3 Risks in Equity Investing

No fixed return

The return in the form of dividend from equity is not pre-defined either in terms of the percentage of dividend or the date on which the payment will be made. Dividend is paid if the company makes sufficient profits and the management of the company feels it is appropriate for some of the profits to be distributed among the shareholders.

In case the company makes losses or the profits made by the company is ploughed back for the expansion and other operations of the company, the shareholders may not get a dividend.

The other source of return for the holder of equity shares is the appreciation in the price of the share in the secondary market. This constitutes the major portion of the return for the equity investor.

If the company's performance is bad or if the stock markets are going through a downturn, the value of the shares may actually depreciate leading to a loss for the investor. There is no guarantee that the principal amount invested in equity shares will remain intact.

No fixed tenor

Equity shares are issued for perpetuity. This means that there is no period of maturity after which the money will be returned to the shareholders. Investors who want to exit their investments may do so by selling the shares on the stock exchange to other investors.

The investor who is selling all his shares ceases to be a shareholder of the company. The shares are transferred to the buyer who now gets all the rights and obligations associated with it. Transactions between investors on the secondary market do not increase or decrease the share capital of the company. The risk to the shareholder arises if the shares are illiquid and not easily sold at its market value or if the shares are unlisted. The investor's investment may get struck without an exit option.

No collateral security

Equity capital is not secured by the assets of the company. The cash and assets of the company are first applied to settle the claims of the lenders and creditors. The claims of the equity shareholders always rank last in order of preference. During the normal course of operations of the company, dividends are payable to the equity shareholders only after the expenses, interest and taxes are provided for. In the event of liquidation of the company, the equity shareholders are only entitled to a refund of capital after the claims of all the other creditors are satisfied from the auction sale of the company's assets.

2.4 Dividend from Equity Shares

Equity shareholders are entitled to share in the residual profits of the company. One way to do this is through the dividend that the company may periodically declare.

Dividend declared by a company is not pre-fixed in terms of the percentage of the dividend or the period when it will be declared. Dividends are declared by the company when there is sufficient

profits that can distributed among the shareholders. The board of directors of the company will take a decision on the dividend to be declared. Shareholders approve such dividend proposed by the board, in an annual general meeting.

Dividend is declared as a percentage of the face value of the shares. A 40% dividend declared by company will translate into a dividend of Rs 4 for a share with a face or par value of Rs 10 (10*40/100), Rs 2 for a share with a face value of Rs5 (5*40/100).

Dividend for a company is usually declared at the end of a year which is called the final dividend. Companies may also declare dividends during the year. This is called interim dividend.

Dividend income received on equity shares is exempt from tax for the investor at this time. The company is however required to pay a dividend distribution tax on the dividend.

The dividend declared by a company is a percentage of the face value of its shares. When the dividend received by an investor is compared to the market price of the share, it is called the dividend yield of the share.

For example, a company declares a dividend of 60% on its shares which have a face value of Rs 2. The market price of the share is Rs 80. The dividend yield is the dividend amount, which is Rs 1.2 (Rs 2*60/100) as a ratio of the market price which is Rs 80. The dividend yield is therefore 1.2/80*100= 1.5%.

The dividend yield of a share is inversely related to its share price. If the price of equity shares moves up, the dividend yield comes down, and vice versa.

2.5 Preference Shares

When we talk of shares of a company we usually refer to the ordinary shares of a company. A company may also raise equity capital with varying rights and entitlements. These are called preference shares because they may offer certain special features or benefits to the investor. Some benefits that investors in ordinary equity capital have, such as, voting rights, may instead not be available to preference share holders. Preference shares are usually given preference over equity shares in the payment of dividends and the repayment of capital if the company is wound up.

Dividend is paid to the preference share holder at a fixed rate mentioned at the time of the issue of the shares. The terms of issue may allow the preference share holders to participate in the residual profits too in some defined ratio. These are called participating preference shares.

Preference shareholders are paid dividend only if the company has sufficient profits. The unpaid dividend may be carried forward to the following year(s) and paid if there are profits to pay the dividends, if the terms of issue of the shares so allow. Such shares are called cumulative preference shares.

The returns for the preference shares are only from the dividend the company pays. These shares are usually not listed and there is not much scope for capital appreciation. This is because these shares do not participate in the profits of the company. Their value is not affected by the over-performance or under-performance of the company.

Though preference shares are similar to debentures, they differ on the following points:

- A preference share holder is a shareholder of the company. A debenture holder is a creditor of the company.
- A debenture is usually secured on the assets of the company. A preference share is not secured since it is not a borrowing.
- The coupon interest on the debenture is an expense to be paid by the company before calculating the profits on which tax has to be paid. Dividends on preference shares are paid from the residual profits of the company after all external liabilities, including tax, have been paid.

2.6 Rights Issue of Shares

A company may raise equity capital from its investors at various times, provided it is within the authorised capital limits of the company. Whenever a company makes a fresh issue of shares, it has an impact on the existing shareholders since their proportionate holding in the shares of the company gets diluted.

For example, a company may have 10 lakh shares of Rs.10 each, amounting to an issued and paid-up capital of Rs. 1cr. If it issues another 10 lakh shares, to increase its capital, the proportion held by existing shareholders will come down by half, as the issued and paid up capital has doubled. This is called as dilution of holdings. To prevent this, section 81 of the Company's Act requires that a company which wants to raise more capital through an issue of shares must first offer them to the existing shareholders. Such an offer of shares is called a rights issue.

The rights shares are offered to the existing investors in a proportion as approved by the board of a company. For example, the company may choose to issue rights at 1 for 1, to double its capital. This means each existing shareholders will get one equity share for every one equity share that they already hold.

The issued and paid up capital will double, but proportionate holdings will not change. Ratio of rights issues need not always be one. They can be 1:2, 2:3, 2:5 and so on, depending on the decision of the board of the company.

Investors have to subscribe to a rights issue, by paying for and buying the equity shares being offered. The rights issue is kept open for a fixed period during which investors subscribe to the shares or can also sell/renounce their right entitlement.

A rights issue of shares must follow all SEBI's regulation on issue of shares. The company must issue a letter of offer giving details of the issue including the purpose for which funds are being raised. The

draft letter of offer must be filed with SEBI at least 30 days prior to filing the same with the designated stock exchange.

An abridged letter of offer must be dispatched to all investors at least one week before the issue opens. Investors can also apply on a plain paper if they do not receive the application form. The investors are given the option to receive the shares in dematerialised form.

A company cannot withdraw a rights issue after announcing it. If the company does so, it will not make an application for listing any securities within a minimum period of 12 months from such withdrawal.

Key Points

1. Equity capital may be raised from the promoters, institutions and the public at various points in time.
2. Ordinary equity shares give ownership rights to the investor. Equity capital is for perpetuity. This means the company does not have to repay the capital that is raised from investors.
3. Investors can however exit from the investment by selling the shares in the secondary market to other investors.
4. Returns from equity are in the form of dividend and capital gains when the shares are sold in the secondary markets.
5. Investors receive dividends only if there are profits and the company decides to distribute them. Dividends are declared as a percentage of the face or par value of the shares.
6. The dividend yield of a share compares the dividend paid to the market price of the share.
7. The risk in equity investing arises from the fact that returns from equity are not fixed and the secondary market for the shares may be illiquid making it difficult for the investor to exit.
8. Preference shares give the investor a fixed rate of dividend and priority over ordinary equity shareholders in repayment of capital if the company goes into liquidation.
9. Rights shares are further shares issued to existing shareholders in proportion to their existing holding.

Quick Recap

Fill in the Blanks

1. _____ rights give the equity investor a say in the management of the company.
2. A 20% dividend declared on face value of Rs 10 and market price of Rs 120 translates into a dividend payout of Rs. _____.
3. When market price goes up dividend yield goes_____.
4. Cumulative preference shareholders can carry forward _____
5. The price of at which rights shares are issued are decided by _____ .

State True or False

1. Retail investors usually participate in the equity of a company at its inception stage.
2. A company may not declare a dividend even if there are profits.
3. Preference share holders get preference over debenture holders in the payment of dividend.
4. Preference share holders and debenture holders are creditors of the company.
5. Rights shares, if subscribed to, maintains the investors proportionate holding of the investor in the company.

Answers:

Fill in the blanks:

1- Voting

2- Rs 2

3-Down

4- Unpaid dividend

5-Company

State True or False:

1- False

2-True

3-False

4-False

5- True

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Companies can raise capital using equity and debt instruments. The basic features of these instruments can be modified to suit the specific requirements of the borrowers or lenders. Such modifications bring advantages such as wider participation, better management of cash flows and better return prospects.

3.1 Warrants

Warrants are securities usually issued by companies along with a debenture to make the debt issue more attractive to the investors. Warrants give the investors in the debentures, the right to buy shares of the company in the future.

Warrants are usually attached to a debenture issue of the company to make the debenture more attractive. The number of shares that the warrant entitles the holder to subscribe to, the price at which such shares can be bought and the period during which the warrant can be exercised are specified at the time of the issue.

Warrants will be exercised if the share price at the time of exercise is higher than the price at which the investors have the option to buy the shares. For example, assume a warrant enables an investor to buy an equity share of a company at Rs.100. The warrant will be exercised if, when it is due to be exercised, the price of the share in the markets is more than Rs.100. If the market price is less than Rs.100, the investor can always buy from the market, rather than use the option to buy the same share at a higher price. When warrants are exercised they result in additional shares being issued

by the company and a dilution in the stake of the existing shareholders.

Warrants may be traded on the stock exchange as a security separate from the debenture with which it was issued. Warrants usually have a longer lifetime (usually in years) as compared to option contracts which they closely resemble.

Warrants may be used by promoters to increase their stake in the company. SEBI requires that shares issued to promoters as a result of exercising the option on the warrant will have a lock-in of three years from the date the shares are allotted.

3.2 Convertible Debentures

Convertible debentures are debt instruments that can be converted into equity shares of the company at a future date. The security has features of both debt and equity. It pays periodic coupon interest just like any other debt instrument.

At the time of redemption of the debenture, the investors can choose to receive shares of the company instead of cash.

The issuer specifies the details of the conversion at the time of making the issue. This will include:

- The date on which the conversion will be made
- The ratio of conversion i.e. the number of shares that the investor will be eligible to get for each debenture

- The price at which the shares will be allotted to the investor on conversion. Usually this is at a discount to the market price
- The proportion of the debenture that will be converted into equity shares.

Debentures may be fully convertible debentures (FCD) where the entire face value of the debenture is converted into equity shares or they may be partly convertible debentures (PCD) where a portion of the debenture is converted into equity. The non convertible portion will continue to remain as debentures and will be repaid in cash on redemption.

The advantage to the issuer of convertible debenture lies in the fact that convertible debentures usually have a lower coupon rate than pure debt instruments. This is because the yield to the investor in such debenture is not from the coupon alone but also the possibility of capital appreciation in the investment once the debentures are converted into equity. Moreover, the issuer does not have to repay the debt on maturity since shares are issued in lieu of repayment. The disadvantage to this is that holding of the existing shareholders get diluted when fresh shares are issued on conversion.

The investors in a convertible debenture have the advantage of equity and debt features. They earn coupon income in the initial stages, usually when the company's project is in its nascent stage. Once the debenture is converted into shares, the investor may benefit from the appreciation in the value of the shares.

An issue of convertible debentures by way of a public issue will have to abide by the regulations of SEBI. The guidelines also require that the investors be given the option of not converting the debenture into shares, if the price at which conversion is to be made is not defined at the time of the issue.

3.3 Depository Receipts

Depository receipts (DRs) are financial instruments that represent shares of a local company but are listed and traded on a stock exchange outside the country. DRs are issued in foreign currency, usually dollars.

To issue a DR, a specific quantity underlying equity shares of a company are lodged with a custodian bank, which authorises the issue of depository receipts against the shares. Depending on the country of issue and conditions of issue, the DRs can be converted into equity shares.

DRs are called American Depository Receipts (ADRs) if they are listed on a stock exchange in the USA such as the New York stock exchange. If the DRs are listed on a stock exchange outside the US, they are called Global Depository Receipts (GDRs). The listing requirements of stock exchanges can be different in terms of size of the company, state of its finances, shareholding pattern and disclosure requirements.

When DRs are issued in India and listed on stock exchanges here with foreign stocks as underlying shares, these are called Indian Depository Receipts (IDRs)

The shares of a company that form the basis of an ADR/GDR/IDR issue may be existing shares i.e. shares that have already been issued by the company. These shareholders now offer the shares at an agreed price for conversion into DRs. Such a DR issue is called a sponsored issue.

The company can also issue fresh shares which form the underlying for the DR issue. The funds raised abroad have to be repatriated into India within a specified period, depending on the exchange control regulations that will be applicable.

The company whose shares are traded as DRs gets a wider investor base from the international markets. Investors in international markets get to invest in shares of company that they may otherwise have been unable to do because of restrictions on foreign investor holdings. Investors get to invest in international stocks on domestic exchanges. Holding DRs gives investors the right to dividends and capital appreciation from the underlying shares, but does not give voting rights.

The steps in issuing DRs are the following.

- The company has to comply with the listing requirements of the stock exchange where they propose to get the DRs listed.
- The company appoints a depository bank which will hold the stock and issue DRs against it.
- If it is a sponsored issue, the stocks from existing shareholders are acquired and delivered to the local custodian of the depository bank. Else the company

issues fresh shares against which the DRs will be issued.

- Each DR will represent certain number of underlying shares of the company.

Once the custodian confirms that the shares have been received by them, the depository bank in the foreign country will issue the depository receipts to the brokers to trade in the chosen stock exchange where the DRs have been listed. DRs may feature two-way fungibility, subject to regulatory provisions. This means that shares can be bought in the local market and converted into DRs to be traded in the foreign market. Similarly, DRs can be bought and converted into the underlying shares which are traded on the domestic stock exchange.

SEBI has laid down the guidelines to be followed by companies for IDRs. This includes the limit on the money raised by a company in India, a one year lock-in on the conversion of IDRs to shares, the availability of IDRs to only resident Indian investors and not to FIIs.

3.4 Foreign Currency Convertible Debenture (FCCB)

FCCBs are a foreign currency (usually dollar) denominated debt raised by companies in international markets but which have the option of converting into equity shares of the company before they mature.

The payment of interest and repayment of principal is in foreign currency. The conversion price is usually set at a premium to the current market price of the shares. FCCB allow companies to raise

debt at lower rates abroad. Also the time taken to raise FCCBs may be lower than what takes to raise pure debt abroad.

An Indian company that is not eligible to raise equity capital in the domestic market is not eligible to make an FCCB issue either. Unlisted companies that have raised capital via FCCB in foreign markets are required to list the shares on the domestic markets within a stipulated time frame.

FCCBs are regulated by RBI notifications under the Foreign Exchange Management Act (FEMA). The Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism), 1993 lays down the guidelines for such issues.

The issue of FCCBs should be within the limits specified by RBI from time to time. Public issue of FCCB will be managed by a lead manager in the international markets. Private placement of FCCBs is made to banks, financial institutions, foreign collaborators, foreign equity holders holding at least 5% stake.

The maturity of FCCB will be not less than five years. Proceeds from FCCB shall not be used for stock market activities or real estate. If it is to be used for financing capital expenditure, it can be retained abroad.

The expenses shall be limited to 4% of the issue size in case of public issue and 2% in the case of private placement. Within 30 days of the issue a report has to be furnished with RBI giving details of the amount of FCCBs issued, the name of the investors outside India to

whom the FCCBs were issued and the amount and the proceeds that have been repatriated into India.

Key Points

1. Instruments can be created with features of equity and debt to suit the specific needs of the borrower and lender.
2. Warrants give the investor the option to buy shares of the company in future. They are traded separately in the market.
3. Convertible debentures come with the feature that they can be converted into shares of the company at a future date.
4. The price and conversion ratio are decided at the time of the issue. Till conversion, the debenture will pay coupon interest like other debt instruments.
5. The issue of convertible debentures is regulated by SEBI's norms for issue, price and lock-in.
6. Depository receipts are instruments that represent underlying shares of a local company but listed on a foreign stock exchange. The issue has to meet the requirements of the stock exchange where it proposes to list the DRs.
7. An Indian Depository Receipt (IDR) is listed on an Indian stock exchange and represents the shares of a foreign company. An IDR issue has to meet the specifications laid down by SEBI.
8. DRs can be converted into the underlying shares and vice versa.
9. FCCBs are issued as convertible debentures abroad, with the debt component in foreign currency and the equity on conversion, into Indian equity shares.

Quick Recap

Fill in the Blanks

1. Warrants are usually issued along with _____.

2. Warrants resemble _____.

3. The non-convertible portion of a partly convertible debenture is _____ on maturity.

4. The stocks which underlie a DR issue are held by a _____.

5. Holders of DRs do not have _____ rights.

State True or False

1. Warrants have to be compulsorily exercised by the holder on the specified date.

2. Convertible debentures may be fully or partly converted into equity shares.

3. A convertible debenture issue does not have to be credit rated since it is going to be converted into shares.

4. Investors in convertible debentures may be given the option of not converting the holding into shares.

5. A sponsored DR issue has existing shareholders offering their shares for conversion into DRs.

Answers:

Fill in the blanks:

1-Debentures

2-Call Options

3- Repaid in cash

4- Depository Bank/ (Local Custodian)

5- Voting

State True or False:

1- False

2-True

3-False

4-True

5-True

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4.1 Features of a Debt Security

A debt security denotes a contract between the issuer (company) and the lender (investor) which allows the issuer to borrow a sum of money at pre-determined terms.

These terms are referred to as the features of a bond and include the principal, coupon and the maturity of the bond. In Indian securities markets, a debt instrument denoting the borrowing of a government or public sector organizations is called a bond and the borrowings by the private corporate sector is called debenture. The terms bonds and debentures are usually used interchangeably these days.

The principal is the amount which is being borrowed by the issuer. Each debenture represents a portion of this principal amount borrowed. The face value or par value of the debenture is the amount of the principal that is due on each debenture. The face value of a debenture is usually Rs100.

The coupon is the rate of interest to be paid by the borrower to the lender. This is a percentage that is applied to the face value or par value f the bond. The periodicity (annual, semi-annual, or quarterly.) with which the interest will be paid is also agreed upon.

The maturity of a bond refers to the date on which the contract requires the borrower to repay the principal amount. Once the bond is redeemed or repaid, it is extinguished and ceases to exist.

Each of these features of a bond can be modified to create instruments that meet the specific requirements of the borrower or the lender. A plain vanilla bond will have a fixed term to maturity with coupon being paid at pre-defined periods and the principal amount is repaid on maturity. The bond is usually issued at its face value, say Rs100 and redeemed at par, the same Rs100.

The simple variations to this structure could be a slightly varied issue price, higher or lower than par and a slightly altered redemption price, higher or lower than par. In some cases, the frequency of the interest payment could vary, from monthly, to quarterly and annual. All these variations still come under the plain vanilla definition of a bond, where the interest is paid at a fixed rate periodically, and principal returned when the bond is retired. There are however many ways in which bonds are differently structured, by tweaking their features.

4.2 Varying Coupon Structures

Zero Coupon Bond

In such a bond, no coupons are paid. The bond is instead issued at a discount to its face value, at which it will be redeemed. There are no intermittent payments of interest. When such a bond is issued for a very long tenor, the issue price is at a steep discount to the redemption value. Such a zero coupon bond is also called a deep discount bond.

The effective interest earned by the buyer is the difference between the face value and the discounted price at which the bond is bought. There are also instances of zero coupon bonds being issued at par, and redeemed with interest at a premium. The essential feature of this type of bonds is the absence of periodic interest payments.

Floating Rate Bonds

Instead of a pre-determined rate at which coupons are paid, it is possible to structure bonds, where the rate of interest is re-set periodically, based on a benchmark rate. Such bonds whose coupon rate is not fixed, but reset with reference to a benchmark rate, are called floating rate bonds.

For example, a company can issue a 5 year floating rate bond, with the rates being re-set semi-annually with reference to the 1- year yield on central government securities and a 50 basis point mark-up. In this bond, every six months, the 1-year benchmark rate on government securities is ascertained.

The coupon rate the company would pay for the next six months is this benchmark rate, plus 50 basis points. The coupon on a floating rate bond thus varies along with the benchmark rate, and is reset periodically.

The other names, by which floating rate bonds are known, are variable rate bonds and adjustable rate bonds. These terms are generally used in the case of bonds whose coupon rates are reset at longer time intervals of a year and above. These bonds are common in the housing loan markets.

Other Variations

Some of other structures are: (a) deferred interest bonds, where the borrower could defer the payment of coupons in the initial 1 to 3 year period; (b) Step-up bonds, where the coupon is stepped up periodically, so that the interest burden in the initial years is lower, and increases over time.

4.3 Other Types of Bonds

Callable Bonds

Bonds that allow the issuer to alter the tenor of a bond, by redeeming it prior to the original maturity date, are called callable bonds. The call option provides the issuer the option to redeem a bond, if interest rates decline, and re-issue the bonds at a lower rate. The investor, however, loses the opportunity to stay invested in a high coupon bond, when interest rates have dropped.

Puttable Bonds

Bonds that provide the investor with the right to seek redemption from the issuer, prior to the maturity date, are called puttable bonds. A put option provides the investor the right to sell a low coupon-paying bond to the issuer, and invest in higher coupon paying bonds, if interest rates move up. The issuer will have to re-issue the put bonds at higher coupons.

Amortising Bonds

The structure of some bonds may be such that the principal is not repaid at the end/maturity, but over the life of the bond. A bond in which payments that are made by the borrower includes both

interest and principal, is called an amortising bond. Auto loans, consumer loans and home loans are examples of amortising bonds. The maturity of the amortising bond refers only to the last payment in the amortising schedule, because the principal is repaid over time i.e. redemption in more than one instalment.

Asset-backed Securities

Asset backed securities represent a class of fixed income products, created out of pooling together assets, and creating bonds that represent participation in the cash flows from the asset pool. For example, select housing loans of a loan originator (say, a housing finance company) can be pooled, and bonds can be created, which represent a claim on the repayments made by home loan borrowers. Such bonds are called mortgage–backed securities.

In some markets like India, these bonds are known as structured obligations (SO). Assets with regular streams of cash flows are ideally suited for creating asset-backed securities.

4.4 Classification of Debt Instruments

Issuers in Bond Markets

There are two broad ways in which bond markets can be segmented.

- Based on the type of borrower, we can segment the market between the bonds issued by governments, and those issued by non-government agencies like banks, corporations and other such entities.

- Based on the tenor of the instrument, we can segment the bond markets as short-term, medium term and long term.

These are not mutually exclusive segments. The government issues bonds to meet its requirements for various periods as does the private sector. Each issued bond has an issuer and a tenor.

Government Securities comprises the central government bonds, and quasi-government bonds issued by local governments, state governments and municipal bodies. Government securities do not have credit or default risk.

Corporate bond markets comprise pre-dominantly of short-term commercial papers and long-term bonds. Another segment comprises of short term paper issued by banks, in the form of certificates of deposit. The rate at which this segment borrows depends upon the credit quality of the borrower. The credit or default risk of the borrower is defined by the credit rating of the bond. Higher the credit rating lower is the risk of default.

Companies also raise fixed deposits from the retail investors to meet their borrowing requirements. Such deposits are for a fixed term and carry a pre-defined interest rate. The interest can either be paid periodically, such as annual, semi-annual, or quarterly or it is paid cumulatively at the end of the term along with the repayment of the principal.

Company deposits are credit rated but unsecured borrowings of companies and as such pay a higher interest rate on the deposit.

Since these are deposits and not a security, there is no liquidity in such fixed deposits. The investors hold the deposits to maturity.

Treasury Bills

The government borrows for periods such as 91 days, 182 days and 364 days using these instruments. Treasury bills are issued through an auction process which is managed by the RBI. Banks, mutual funds, insurance companies, provident funds, primary dealers and FIs bid in these auctions. The treasury bills are usually issued as zero-coupon bonds.

CBLO

A Collateralised Borrowing and Lending Obligation (CBLO) is created using government securities as collateral and held with the Clearing Corporation of India Ltd. (CCIL) to enable borrowing. It is a discounted instrument available for maturities from one day to up to one year. Banks use the CBLO to borrow from mutual funds and insurance companies.

Certificates of Deposit (CD)

Banks use CDs to meet their short-term needs for funds. CDs are different from deposits because they involve creation of paper. This makes the CD transferable before maturity. Secondary market activity in CDs are however low.

Commercial Paper (CP)

CPs are short-term papers issued by companies to meet their working capital requirements. They can be issued for various

maturities of up to 364 days. The popular CP is the 90-day CP. CPs are unsecured credit-rated borrowings with a limited secondary market.

Government Securities

Government securities, also called treasury bonds, are predominantly issued to fund the fiscal deficit of the government. Treasury bonds also set benchmark for pricing corporate paper of varying maturities. All other borrowers in the system borrow at a spread over this benchmark rate on government securities.

The instruments used in this segment are many, including fixed coupon bonds, commonly referred to as dated securities, treasury bills, floating rate bonds, zero coupon bonds and inflation index bonds.

Treasury Bonds may have tenors ranging from a year to 30 years.

Corporate Bonds

The market for corporate debt securities is dominated by private placements with large institutional investors. Public issue of corporate debt securities are regulated by SEBI's guidelines for the same. The guidelines require the issue to be credit-rated, appointment of a debenture trustee, creation of debenture redemption reserve and creation of a charge on the assets of the company.

The secondary market for long-term bonds is concentrated in the government securities segment. In this segment too, trading primarily happens in the benchmark securities. Trades in the government securities segment as well as the corporate bond segment are reported to the exchanges.

4.5 Yield from Debt Instruments

The returns to an investor in bonds, is primarily made up of the coupon payments. However, if the investor acquires or sells the bond at a price that is different from the par value the returns can vary from the coupon. Therefore, the coupon rate of the bond is not an indicator of the returns on the bond, but merely helps in computing what cash flows would accrue periodically, to the investor.

We use the term 'yield', rather than 'coupon rate', to denote the returns to the investor.

Current Yield

Current yield simply compares the coupon of a bond with its market price. For example, if a bond paying an annual coupon of 12% is trading in the markets for Rs. 109.50, we compute the current yield as:

12/109.5

=10.95%

Yield to Maturity (YTM)

Yield to maturity (YTM) is a popular and extensively used method for computing the return on a bond investment. Every bond is made up

of a set of cash flows that accrue at various points in time, from the time the bond is acquired, until it is sold or redeemed.

We can then use the very well known principle in finance, to value the bond: the price at which a series of future cash flows should sell is the sum of the discounted value of these cash flows. The rate which equates the discounted value of the cash flows with the price of the bond is the yield to maturity of the bond.

4.6 Credit Rating

The biggest risk faced by investors in debt securities is the possibility of the lender not honouring their commitment on payment of interest on the borrowing and repayment of the principal on maturity of the instruments.

The ability of the borrower to meet its obligation will depend upon factors internal and external to the business. Lenders therefore evaluate these factors associated with the borrower before entering into the transaction. The decision of a lender on whether or not to lend to a borrower and at what cost would be determined by the risk associated with the borrower. This risk of the possibility of a default on obligations by the borrower is called the credit risk of the borrower.

The credit risk of a borrower is evaluated by credit rating agencies. Credit rating agencies have to be registered with SEBI and abide by the regulation laid down in SEBI (Credit Rating) Regulations, 1999 in the conduct of such evaluations.

The credit rating agencies consider all the qualitative and quantitative factors that impact the business of the borrower and consequently their ability to meet their financial obligations. The appraisal is done by industry experts and the information collected not only from the borrower but from other sources as well. Based on their appraisal, the rating committee of the credit rating agency will assign a rating to the borrowing. Rating is therefore an exercise that converts into a symbol the ability and willingness of the company to service the instrument proposed to be issued.

The credit rating assigned to an instrument is not static but is dynamic. This means that the credit risk associated with a borrowing may change over time. Credit rating agencies are required by SEBI to constantly monitor factors that affect the status of the instrument and to reassign a rating if the credit quality of the instrument improves or deteriorates.

The rating symbols usually used by rating agencies are described in the table below:

Rating Symbol	Instrument	Description	Implication
AAA,LAAA P1,A1+ FAAA	Long-term Short- term Fixed Deposit	Investment Grade	Highest Safety
AA,LAA P2,A1 FAA	Long-term Short- term Fixed Deposit	Investment Grade	High Safety
A,LA P3,A2	Long-term Short- term	Investment Grade	Adequate Safety

FA	Fixed Deposit		
BBB,LBBB A3	Long-term Short- term	Investment Grade	Moderate Safety
BB,LB A4 FB	Long-term Short- term Fixed Deposit	Speculative Grade	Inadequate Safety
B, LB P4	Long-term Short- term Fixed Deposit	Speculative Grade	High Risk
C,LC FC	Long-term Short- term Fixed Deposit	Speculative Grade	Substantial Risk
D,LD P5,A5 FD	Long-term Short- term Fixed Deposit	Speculative Grade	Default
NM	Long-term Short- term	Speculative Grade	Not Meaningful

(Rating symbols used by CRISIL, ICRA)

Key Concepts

1. The three basic features of a debt instrument are the principal amount that has to be repaid, a coupon interest that has to be paid on the principal amount till it is repaid and a maturity period at which the debt or the principal amount is repaid.
2. The three features of a debt instrument can be modified to create instruments such as zero coupon bonds and bonds with put and call options.
3. Debt markets can be segmented based on the issuer as government bonds and corporate debentures and based on maturity as long and short term bonds.
4. Issuers use different types of instruments to raise debt in the short-term and long-term markets.
5. The yield from a bond can be calculated either as the current yield which relates the coupon income to the market price of the bond or as the YTM which is the internal rate of the bond that would accrue if the bond is held until maturity.
6. The interest that is paid on a debt instrument depends on the credit risk associated with it and the term of borrowing.
7. The credit risk associated with a bond is measured by an exercise called credit rating undertaken by credit rating agencies such as Crisil and Icra, Care and Fitch.

Quick Recap

Fill in the Blanks

1. _____ of a bond refers to the interest payable on a bond.
2. Bonds are segmented as long and short term based on their _____.
3. Call and put options modify the _____ of the bond.
4. The government uses _____ to borrow for the short-term.
5. A bond with a higher credit rating will pay _____ interest rates.

State True or False

1. A ceiling limits the minimum interest that an investor will receive from a floating rate bond.
2. Fixed deposits raised by companies are unsecured but rated borrowings.
3. The corporate bond market is dominated by public issues of bonds.
4. The YTM of a bond is the yield that investors will earn on holding a bond to maturity.
5. The credit rating assigned to a bond will change with a change in the financial viability of the borrower.

Answers:

Fill in the Blanks:

1- Coupon

2- Term to maturity

3- Maturity

4- Treasury Bills

5 - Lower

State True or False:

1-False

2-True

3-False

4- True

5- True

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5. Mutual Funds

A mutual fund is an investment option, where investors contribute small amounts of money. These contributions are pooled together to make it a large sum. This sum is then invested in various securities.

When we say 'mutual fund' we are referring to the money contributed by the investors. When we say 'portfolio' we are referring to the securities in which the investments have been made.

A mutual fund thus enables investors to participate in securities markets and invest in equity shares, bonds and such instruments by pooling their money together. A mutual fund will state its objective up front. This indicates how the money will be invested and how the portfolio will be constructed. Investors choose a fund, which matches their own objectives.

For example, an equity fund may state that its objective is to invest in equity shares to generate long term growth. An investor, who likes to invest in a portfolio of equity shares, will buy the units of this fund. A liquid fund may state that its objective is to provide steady return from investing in money markets over the short term. Investors having a short term surplus may decide to invest it in such a fund.

5.1 Collective Investment Vehicle

A mutual fund is a collective investment vehicle. Usually a mutual fund product is first described by its investment objective. Investors

then invest their money in the product. The money is pooled together and is invested according to the stated objective.

Example

HDFC Income Fund is a debt fund that invests pre-dominantly in debt instruments, with the objective of generating regular income for its investors.

DSPBR Top 100 Equity Fund is a fund that seeks to generate capital appreciation from a portfolio of equity shares of the 100 largest listed companies.

Fund managers invest the pool of money into securities such as equity and debt, according to the stated investment objective of the fund. The risk and return of the fund depend on the investment portfolio of the fund. The benefits from the investment portfolio accrue to those that contribute to the pool. There is thus mutuality in the contribution and the benefit. Hence the name 'mutual' fund.

When a mutual fund pools money from several investors, each investor does not contribute the same sum of money. Depending on their needs and preferences, investors put in money into the fund. Therefore each investor's share in the pool of funds is not equal.

5.2 Proportionate Share of Benefits

The benefits from the fund accrue to all investors in proportion to their share in the pool.

Example

Three investors invest Rs 10,000, Rs 20,000 and Rs 30,000 respectively in a mutual fund. So the pooled sum is Rs 60,000. The money is invested and gains Rs 12000 over time. This means, the pool is now worth Rs 72,000. The value of the investors' holding in the mutual fund also goes up proportionately (in the ratio of 1:2:3) to Rs 12,000, Rs 24,000 and Rs 36,000 respectively.

Investors can contribute into a fund or redeem and take away their contributions, depending on the nature of the pool. In a closed end fund, investors tend to stay until maturity. If a fund is open-ended, investors can come in and move out at will. Therefore, there is the need to standardize the contributions of investors to be able to objectively measure their share in the fund.

5.3 Units Vs Shares

When investors subscribe to a mutual fund, they buy a share in the pool of funds. This share is called a unit of the mutual fund scheme. The investment in a mutual fund is represented to the investor in units.

A mutual fund investor is called a unit holder just as an investor in equity shares is called a share holder. The ownership of the fund is jointly held by all the unit holders. Just as investors in equity hold shares of a company, mutual fund investors hold units of the fund. Each unit has a face value. This is typically Rs 10 per unit for most mutual funds.

Equity shares are offered to investors for the first time in an IPO (Initial public offering). Mutual funds are offered for the first time to investors in an NFO (New fund offer).

Subsequently equity shares are bought and sold on the stock exchange.

Mutual fund units can usually be bought and sold through the fund itself. Funds enable continuous transactions at their offices and at investor service centres. Sometimes mutual funds are listed and can be bought and sold on the stock exchange.

Unit Capital

Investments are made in rupee terms by the investor. But the fund will always record this investment in terms of number of units. Number of units = Invested amount/price per unit.

For example,

If the value of a unit is Rs 10, and

2000 units have been sold at Rs 10 each,

the value of the pool is

10 x 2000 = Rs 20,000.

For example,

If the price of 1 unit is Rs 10.225, and

amount invested is Rs 20,000,

the number of units issued against this investment is

20,000/10.225 = 1955.99 units.

Units can thus be denoted also as a fractional value. Unit capital is a term used to denote the corpus of a fund. This is nothing but the total face value of ALL the units issued by a fund.

For example, if a fund has issued 10,000 units so far, its unit capital is 10,000 x 10 (FV) = Rs 1,00,000.

According to the SEBI Regulations, each mutual fund scheme has to have a separate account. Therefore the unit capital of each scheme is maintained to reflect its current corpus.

5.4 Assets under Management (AUM)

A portfolio is a collection of securities. These securities can be equity shares, bonds, debentures, deposits, money market instruments, derivatives and the like. Mutual funds can invest only in marketable securities, or securities that can be traded in a market and therefore have a market price.

The value of the fund's portfolio changes with changes in market value of the securities that have been bought. The portfolio is updated every day, to represent its current market value. This process is called 'marking to market'.

The market value of the portfolio is known as the assets under management (AUM) of the fund. The value of the portfolio changes every time there is a change in market price of the securities that a mutual fund holds.

Consider this table:

Security	No of shares	Market Price Day 1(Rs)	Market Value Day 1(Rs)	Market Price Day 2 (Rs)	Market Value Day 2 (Rs)
L&T	1000	2500	2500000	2700	2700000
Finolex	2000	50	100000	53	106000
Sun Pharma	1000	1400	1400000	1300	1300000
ICICI Bank	1000	750	750000	700	700000
Total (Rs)			4750000		4806000
Number of Units			475000		475000
Value per unit (Rs)			10		10.12

As the market price of the shares changes, the value of the portfolio has changed from Rs 47.5 lakh to Rs48.06 lakh. Therefore if the units had been issued at Rs. 10 each, there would be 475,000 units. Their market value will now be 4806,000 / 475,000, which is Rs.10.12 per units. The value per unit is higher than 10 because the value of the portfolio have also moved up.

The value of the investors' unit holdings also changes along with the market value of the portfolio. The current market value per unit is called the net asset value (NAV). NAV can move up or down, depending upon whether the value of the portfolio has moved up or down.

If value of the portfolio falls from 4750000 to 4500000, when the prices of the shares held in the portfolio fall, this will led to the NAV per unit falling from Rs.10 to Rs.9.47. Thus the current value of a unit depends on the value of the portfolio of the fund, and can go up and down with changes in the market value of the portfolio.

5.5 Fund Recurring Expenses (FRE)

The activities associated with portfolio management involve costs and fees. These expenses are charged to the fund. Regulations cover what kind of costs can be charged to the fund and also prescribe limits on these expenses. These expenses are called fund recurring expenses (FRE).

FRE is usually represented as a percentage of AUM. These expenses are charged to the AUM of the fund on a daily accrual basis.

FRE, for instance, if calculated at 2.5% of the AUM it is divided by 365 to get the daily accrual. The value of the portfolio is re-calculated daily and represented as market value (AUM). The expenses (FRE) are accrued everyday and charged to AUM.

5.6 Net Assets

Net assets refer to the net value of the portfolio, after charging the daily FRE. When we divide the net assets of a fund by the number of units issued, we get net asset value (NAV) per unit. Net assets of a mutual fund may change with the change in the market value of the portfolio or change in the expenses charged to the fund.

When the net assets of a fund are divided by the number of units in the fund, we get the market value per unit, which is called the net asset value (NAV) per unit. NAV thus includes both market value and expenses charged to the fund.

Mutual funds declare the NAV of all their schemes every business day. Mutual fund NAVs are published in newspapers as well as on the website of AMFI (.amfiindia.com).

5.7 Assets and Liabilities in a Mutual Fund Portfolio

When we refer to total assets, we are referring to the market value of the mutual fund portfolio. A mutual fund rarely holds any other long-term asset in its balance sheet. There may be few receivables and accrued income, which are current assets. These are added to the portfolio value to get the total assets of the fund. Similarly on the liability side, a mutual fund does not have long-term liabilities. The assets are fully funded by the unit capital contributed by the investors. Therefore when we refer to liabilities, we are referring to current liabilities, in terms of payables that may be due.

The expenses associated with managing the portfolio are accrued as current liabilities and are paid as they become due. Therefore net assets of a fund refer to the market value of the portfolio, plus accrued incomes, less any current liabilities and accrued expenses. Net asset value (NAV) is a per unit representation of the net assets of a fund. NAV is a very frequently used term in the mutual fund industry. It refers to the current value per unit, deriving out of the current value of the mutual fund portfolio.

Example 1

The market value of a fund's portfolio is Rs 700 Crore. If the current liabilities are Rs.50 Crore, what are the net assets?

Net assets = Portfolio value less liabilities

= 700 – 50

= Rs 650 Crore

Example 2

Assume that the net assets of a fund are Rs 750 Crore. The unit capital (face value Rs10) is Rs 250 Crore. What is the NAV?

Number of units = Unit capital/Face value

= 250/10

= 25 Crore units

NAV = Net asset /number of units

= 750/25

= Rs 30 per unit

Example 3

If a fund's NAV was Rs 15 and the number of units was 100 Crore, what are its net assets?

Net Assets = NAV x Number of units

= 15 x 100

= Rs 1500 Crore

5.8 Advantages of Mutual Funds

The following are the advantages of mutual funds to investors:

- Portfolio diversification from securities spread over various companies, industries, issuers and maturities. The portfolio will not be affected by the bad performance of one or few of the securities.
- Low transaction cost from economies of scale. Since the fund invests large sums of money, the transaction cost comes down. Small amounts of investors get benefits of the large pool.
- Professional managers who are employed by mutual funds offer their expertise in managing the investors' funds, given their knowledge of markets and securities, according to the investment objective of the scheme.
- Portfolio diversification and the professional management of funds offer reduction in risk for the investor. The investment is always in a managed portfolio and not a single stock or sector.
- Investors can choose their investment to suit their particular needs and preferences. Minimum investment is low for most funds. Investors can choose from dividend and growth options. Mutual fund transactions are flexible and easy to conduct.
- Mutual funds structure the portfolio in such a way that they are able to provide liquidity to the investor. Investors can take their money out when they need it.

Key Points

1. Mutual funds are collective investment vehicles that pool together investors' funds and invest them in securities according to stated investment objectives.
2. An investor's holding in a mutual fund is denoted in units. The face value of the units is usually Rs 10.
3. The value of the units goes up or down depending on the value of the underlying securities.
4. The AUM of the fund is the market value of its portfolio. This less the FRE and current liabilities of the fund is the Net Assets of the fund.
5. The FRE of a fund are expressed as a percentage of its AUM. The expenses that can be included and the limit are specified by regulations.
6. The expenses are charged to the fund on a daily basis.
7. The NAV of a unit is the per unit representation of the net assets of the fund.
8. Mutual funds give the advantages of lower risk from diversification and professional management, lower costs and convenience and flexibility to the investor.

Quick Recap

Fill in the Blanks

1. The securities that a fund invests in depend upon its _____.
2. Marking to market is the process of valuing the security at _____
3. The type of expenses that can be charged to a fund and the limit is decided by _____.
4. A mutual fund cannot have _____ liabilities on its balance sheet.
5. Mutual funds have lower risks because of _____ & _____.

State True or False

1. Units of a mutual fund have a similar connotation as shares of a company.
2. The unit capital of a fund is the number of units issued x NAV of the fund.
3. The funds of each scheme are maintained in a separate bank account.
4. The value of a unit cannot go below its face value.
5. FRE is charged to the fund at the end of the financial year.

Answers:

Fill in the Blanks:

1- Investment objective

2-Market price

3-SEBI

4-Long-term

5-Portfolio diversification & Professional management

State True or False:

1- True

2- False

3- True

4-False

5-False

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The existence of an efficient and stable financial system is essential to make the securities market vibrant, wide reaching and effective. An efficient capital market ensures that resources are priced and allocated correctly in an economy. Institutions and mechanisms that enable this must be supported by regulatory structures that will streamline and enable the proper functioning of the securities markets. The purpose of securities regulation should be to have markets that are fair, transparent and efficient and ensure protection of the investor's interests.

In India the prime regulators are the Reserve Bank of India (RBI), the Securities Exchange Board of India (SEBI), the Ministry of Corporate Affairs and the Department of Economic Affairs (DEA). Both RBI and SEBI have been set up through Acts of the Parliament which define their role and responsibilities.

SEBI is the apex regulator of the securities market and also responsible for its orderly growth and protection of the investor's interests. The RBI, as the manager of public debt, is responsible for the primary issue of government securities, all contracts involving such securities and money market instruments. Other regulators such as the Insurance Regulatory Development Authority (IRDA) and the Pension Fund Regulatory and Development Authority have been set up with the specific mandate to regulate the functioning and growth of particular industries.

6.1 SEBI's Role

The preamble of SEBI provides for "The establishment of a Board to protect the interests of investors in securities and to promote the development of and to regulate the securities market." The objective of SEBI is therefore to facilitate the growth and development of the capital markets in terms of mechanisms, participants and securities and to ensure the protection of the investors in the securities market.

The SEBI Act entrusts the responsibility of inspection, investigation and enforcement of the activities, systems and mechanisms of the institutions and intermediaries of the securities market. SEBI has been assigned the powers of recognizing and regulating the functions of a stock market under the Securities Contracts Regulation Act (SCRA).

The requirements for granting recognition to a stock exchange include representation of SEBI on the board of the stock exchange and an undertaking to make and amend their rules only with the prior approval of SEBI. The stock exchanges have to furnish periodic reports to the regulator and submit bye-laws for SEBI's approval. Stock exchanges are required to send monitoring reports daily and for every settlement. SEBI has set up surveillance mechanisms, both internal and at stock exchanges, to deal with unfair trade practices. Measures such as circuit filters, price bands and caps have led to enhanced safety in the market.

An integrated surveillance mechanism which tracks the activities of the stock exchanges, the brokers, depository, R&T agents, custodians and clearing agents aim at timely identification of

fraudulent activities. SEBI and the central government have over-riding powers under the SCRA in all matters relating to the stock markets.

Regulating market intermediaries through registration and supervision is a primary function of the securities market regulator. Market intermediaries such as brokers, sub-brokers, R&T agents, depositories, custodians, bankers, merchant bankers, portfolio managers and underwriters have to get themselves registered under the respective regulations of SEBI.

The regulations specify the net worth, experience, infrastructure and other requirements necessary for an intermediary to be eligible for registration. The registration given, if found eligible, has been made permanent subject to certain conditions under the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 discussed later in this chapter.

SEBI makes routine inspections of the intermediaries functioning in the securities markets to ensure compliance with prescribed standards. It can also order investigations into the operations of any of the constituents of the securities market for activities such as price manipulation, artificial volume creation, insider trading, violation of the takeover code or any other regulation, public issue related malpractice or other unfair practices. Investigation is based on SEBI's surveillance activities or those of the stock exchange. A preliminary probe is conducted after which, if necessary, a full-fledged investigation is undertaken.

SEBI has the powers to call for information, summon persons for interrogation, examine witnesses and conduct search and seizure. If the investigations so require, SEBI is also empowered to penalize violators. The penalty could take the form of suspension, monetary penalties and prosecution.

SEBI also has the mandate to ensure the streamlined functioning of the primary markets. It has laid out the eligibility, norms and rules to be followed for the public issue of securities in the Disclosure and Investor Protection Guidelines.

The guidelines specify the minimum net worth requirements for an issuer, the minimum public holding to be maintained and the lock-in on the holdings of the promoters. SEBI has also specified the roles and responsibilities of intermediaries in the primary markets such as the merchant bankers, underwriters, R&T agents and brokers in the guidelines for each intermediary.

These guidelines impose minimum disclosure requirements on the issuer to ensure that investors have all the relevant information before making the investment. The listing agreement that companies enter into with the stock exchange has clauses for continuous and timely flow of relevant information to the investors, corporate governance and investor protection. SEBI investigates and penalises the non-conformance to the guidelines by the issuers and intermediaries.

SEBI's has laid down regulations to prevent insider trading and unfair trade practices which are detrimental to the interests of the

investor. Insider trading refers to the dealing in securities by persons connected with a company having material information that is not available to the public.

Such persons include the directors and employees of the company, associates such as bankers and tax consultants or government employees who get sensitive information. The SEBI (Prohibition of Insider Trading Regulations), 1992 seeks to prevent insider trading which erodes the confidence of the common investor in the securities markets.

SEBI's guidelines require companies to have comprehensive code of conduct to prevent such activity. This includes appointing a compliance officer to enforce it, ensuring periodic disclosure of holding by all persons considered as insiders and ensuring data confidentiality and adherence to the requirements of the listing agreement on flow of price sensitive information.

If an insider trading charge is proved through SEBI's investigations, the penalties include monetary penalties, criminal prosecution, prohibiting persons from securities markets and declaring transactions as void.

6.2 Investor Education and Protection Fund (IEPF)

The IEPF is a fund created by the Ministry of Company Affairs for promoting investors' awareness and protecting their interests. The fund is created out of contributions from the central government, state government, companies and institutions.

Apart from this, unpaid dividends, matured debentures and deposits, application and call money due for refund and interest on them shall form part of the fund provided such money has remained unpaid and unclaimed for a period of seven years from the date they were due for payment.

The fund shall conduct investor education programs through the media and seminars. It will fund investor education projects of institutions and organizations engaged in the same and which applies for resources to conduct such programs.

6.3 SEBI Regulations Relevant for Registrars and Transfer Agents

Registrar and Transfer (R&T) agents are identified as 'intermediaries' by the SEBI Act and are regulated by SEBI. They have to abide by the regulations and guidelines of the regulator. The primary regulations that govern the functioning of the R&T agents are as follows:

1. Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993.
2. Securities and Exchange Board of India (Intermediaries) Regulations, 2008
3. Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996

Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993

The SEBI (Registrars to an Issue and Transfer Agents) Regulations came into effect in 1993 and amended periodically. These regulations govern the constitution, capital adequacy, obligations and responsibilities inspection and reporting norms that the R&T agent has to abide by. The broad heads under these regulations are:

a) Application for Registration: An application has to be made in the prescribed format to SEBI for registration as an R&T agent. An entity can take on assignments as a registrar and/or transfer agent only after obtaining the certificate from SEBI. The application can be for registration as a category I intermediary which allows the applicant to act as registrar and transfer agent or category II which allows the applicant to act as registrar or transfer agent. The application shall be evaluated on the basis of:

a. Available infrastructure
b. Past experience
c. Capital adequacy
d. Integrity of partners and promoters

b) Capital Adequacy: The net worth requirement for a category I applicant is Rs.6 lacs and for a category II applicant Rs. 3 lacs. Net worth for the purpose of this regulation is defined as paid-up capital and free reserves in case of a body corporate and in case of partnerships and proprietorship it is value of the capital contributed and free reserves.

c) Obligations and Responsibilities: The regulations require an R&T agent shall:

a. Abide by the code of conduct
b. Not act as R&T agent for an associate company
c. Maintain proper books and accounts and records
d. Appoint a compliance officer to ensure compliance with the regulations

d) Inspection of R&T agent's operations: The regulator, SEBI, may inspect the operations of an agent either on receiving a complaint from an investor or otherwise to ensure compliance with the regulations. The R&T agent is required to give all information and co-operation to enable the inspection.

e) Cancellation/Suspension of Certificate: SEBI may suspend or even cancel the registration granted to an R&T agent in case of non-compliance with the provisions of the regulations. Such a penalty will be imposed only after holding an enquiry into the facts of the case and issuing a show cause notice to the R&T agent.

Securities and Exchange Board of India (Intermediaries) Regulations, 2008

SEBI overseas and regulates the functioning of intermediaries such as brokers, R&T agents, Merchant bankers, Depository participants and Bankers, under specific regulations and guidelines issued by the regulator. The Securities and Exchange Board of India (Intermediaries) Regulations, 2008 consolidates the common

requirements which apply to all intermediaries and will apply to all intermediaries. The salient features of the Regulations are as under:

(a) The Regulations put in place a comprehensive regulation which will apply to all intermediaries. The common requirements such as grant of registration, general obligations, common code of conduct, common procedure for action in case of default and miscellaneous provisions have been provided in the approved Intermediaries Regulations.

(b) Application for registration: An applicant may file application in the prescribed format along with additional information as required under the relevant regulations along with the requisite fees. Such application may be made through the respective stock exchange, clearing corporation or depository participants if the intermediary is to be associated with these institutions. These institutions will examine the eligibility and other criterion before forwarding the application to SEBI.

The existing intermediaries who have already been registered under the relevant regulations have to file the disclosure in the specified Form. The disclosures shall be made public by uploading the information on the website specified by SEBI.

If a registered intermediary wants to operate as an intermediary in a new category, they need to file for registration by giving additional shortened forms disclosing the specific requirements of the new category as per the relevant regulations.

(c) The application will be considered based on factors such as eligibility criteria, activities in the securities market of persons

associated with the applicant and whether the applicant can be considered 'Fit and Proper' based on integrity, competence, including financial net worth, and past history.

(d) The registration granted to intermediaries has been made permanent subject to the compliance of the SEBI Act, regulations, updation of relevant disclosures and payment of fees.

(e) Intermediaries are required under the regulation to:

- Appoint a compliance officer who will give a report to the regulator on adherence to all obligations responsibilities and eligibility criteria.
- Redress investor grievance within 45 days from receipt of such complaint and to maintain records of the same.
- Make complete disclosure of interest before making any recommendation to invest in any security to a client.
- Abide by the specified code of conduct in terms of protecting investors' interests, disclosing all information, maintaining high levels of service, have adequate infrastructure, exercise due diligence in all activities.

(f) SEBI can undertake inspection of the books and records of an intermediary, after giving due notice, in the interest of investors. The intermediary is required to give all cooperation in this exercise.

(g) The certificate granted to an intermediary may be revoked if it fails to comply with the requirement of the regulations or any other guidelines issued from time to time. A show cause notice is issued to the intermediary before such action is taken.

(h) While common requirements will be governed by the new Regulations, the intermediary-specific requirements will continue to be as per the relevant regulations applicable to individual intermediaries.

Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996

R&T agents are a category of intermediaries who are allowed to be participants of a depository under the SEBI(Depositories and Participants) Regulations, 1996. R&T agents have to abide by the regulations for their activities in this capacity. The application as participant must be made in accordance with the regulations and the certificate shall be granted if the depository concerned and SEBI are satisfied as to the eligibility and competence of the R&T agent. Under the regulations, the participant:

a) Undertakes to pay the fees, maintain records, address investor complaints within the specified time and comply with all requirements subject to which the certificate was granted.

b) Undertakes to abide by the code of conduct for participants which require them to

a. Do all activities in such a way that investors' interest are protected
b. Address investor complaints promptly
c. Co-operate with the regulator in case of any enquiry pr inspection
d. Have mechanisms in place, such as the maker-checker concept, to ensure there are checks and balances in all the transactions.

e. Maintain records and data carefully.

f. Have good corporate governance policies in place.

c) The participant shall agree to:

a. Enter into agreements with the beneficiary owners according to the bye-laws of the depository

b. Separate accounts shall be opened for each beneficial owner and the accounts shall be managed separately.

c. They must have continuous electronic connectivity with the depository.

d. The participants must have good accounting systems and procedures in place. Records should be maintained as required and periodic reports sent to SEBI.

e. They must maintain records of all transactions between the investors and the participants- dematerialisation, rematerialisation, records of instructions and approvals.

f. Integrity of data should be ensured and it should be protected from damage, loss or misuse. Records should be maintained depository-wise if the participant is associated with more than one depository.

Key Points

1. SEBI and RBI along with the Ministry of Company Affairs and Department of Economic Affairs regulate the functioning and participants of the securities markets.
2. SEBI is responsible for the orderly development of capital markets and the protection of investors' interests.
3. SEBI undertakes registration of intermediaries, surveillance of market activities, inspection and investigation and enforcement of penalties for violations.
4. The Disclosure and Investor Protection guidelines of SEBI lay down the norms and rules for the primary markets.
5. SEBI has the authority to grant recognition to stock exchanges and oversee trading and settlement mechanisms, surveillance of the stock exchange participants, approving the bye-laws and listing agreement of the stock exchange and inspection of the records of the intermediaries.
6. The SEBI (Prohibition of Insider Trading) Regulations, 1992 seeks to prevent dealing in securities by people categorised as 'insiders.
7. The IEPF has been set up by the central government to educate and protect investors.
8. The IEPF is funded by government grants and funds from unpaid dividend, mature deposits and debentures, application money.

Quick Recap

Fill in the Blanks

1. The Apex regulator of the securities markets is _____.
2. The RBI is responsible for the issue of _____.
3. Powers to regulate stock exchange were given to SEBI by____
4. SEBI insists on the _____ of market participants under the specific regulations.
5. Insider trading is controlled by the regulations of _____.
6. The IEPF is funded by unpaid dividends remaining unclaimed for at least_____.

State True or False

1. SEBI's guidelines apply to government securities.
2. IRDA regulates the activities of the insurance industry only.
3. The protection of investor interest is a secondary objective of SEBI.
4. Stock exchanges have been given complete powers to regulate and are not controlled by SEBI.
5. SEBI has the power to enforce penalties.

Answers:

Fill in the blanks:

1- SEBI

2- Government securities

3- SCRA

4-Registration

5-SEBI

6- Seven years

State True or False:

1- False

2- True

3- False

4- False

5- True

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7. Public Offer of Securities

The capital structure of a company is primarily made up of equity contributed by its shareholders. The first contribution to the equity capital happens from the promoters at the time the company is formed. Subsequently, the share capital increases every time the promoters and others bring in additional capital.

Apart from the promoters, the capital of a company may be contributed by institutional investors such as financial institutions and venture capitalists, large investor groups and retail investors. The capital structure of the company may be modified by actions such as raising fresh capital, offer for sale, rights and bonus issues, buy back and tender offers, splits and consolidation. The regulations that govern each type of action and group of investors will differ as will the role of the constituents involved in it.

7.1 Issuing equity capital

A company may raise capital at different stages from different categories of investors. The capital raised can be categorised based on when it is raised, the investors to whom it is issued and the method used to raise capital. Based on when equity capital is raised, capital issues can be categorised as:

- Initial public offer
- Follow- on public offer

Based on the category of investors, equity capital issues can be categorised as:

- Private placement of shares

- Preferential allotment of shares
- Qualified institutional placement
- Rights issue of shares

Based on the method of issue, equity capital issues can be categorised as:

- Fixed Price offer
- Book- building offer

The issue of capital by a company is governed by the regulations of SEBI and the Companies Act. The extent of regulatory compliances to be followed will depend upon the type of issue and the type of investors from whom capital is being raised.

If capital is being raised from large institutions that have the capacity to evaluate the issue or from promoters or existing investors who already have all relevant information about the company, the procedures and regulatory requirements are simpler, as compared to the company raising issue from the public.

7.2 Public Offer of Shares

In a public offer of shares, a company issues shares to a large number of new investors, who are members of the public. When these investors become shareholders of the company, none of them, in themselves, hold a large enough portion of the equity capital of a company to participate in the management of the company. Therefore a public issue refers to a distribution, rather than concentration of ownership in a company.

This market for the first time offer of shares is called the primary market offer. It is an opportunity given by the promoters of the company for the retail investors to participate in the ownership of the company. This also means that the proportional holding of promoters and large investors in the company, will reduce after the public issue.

When a company offers shares to the public, they have to comply with the regulatory requirements laid down by SEBI and the Companies Act. The listing agreement that the company enters into with the stock exchange where the shares are to be listed, also provides for periodic disclosures.

The regulations of SEBI and the Companies Act aim at protecting the interest of the retail investors by prescribing:

- Disclosure of relevant information both at the time of the issue and periodically thereafter so that investors can evaluate the viability of their investments.
- Arrangement for the allotment of shares in dematerialised form.
- Getting an IPO graded by at least one credit rating agency.
- Listing the shares on a stock exchange so that investors have liquidity.
- The continued participation of the promoters in the business through a lock-in of the promoters' holdings.

The price at which the shares are issued to the public is decided by the company in consultation with the lead manager to the issue. A public offer of shares results in a change in the shareholding pattern of the company.

7.3 Firm allotments

A public issue of shares could be combined with a firm allotment of shares to certain categories of investors such as the employees, mutual funds, scheduled banks and development financial institutions provided such shares are allotted at a price that is higher than the price at which shares are allotted to the public.

The issuing company can have differential pricing for the retail investors, which can be at a discount not exceeding 10% of the price at which shares are allotted to other categories of investors. Shares issued on a firm allotment basis will be locked-in for a period of one year from the date of commercial production or allotment in the public issue, whichever is later.

The promoters of a company making a public issue of shares are required to continue to hold at least 20% of the post-issue paid up capital of the company. This is to ensure that they continue to have a high interest in the performance of the company, even after shares are issued to the public. This is not required for a listed company that has been paying dividends for the three years prior to the public issue.

The minimum contribution made by the promoters will be locked-in for a period of three years from the date of allotment of shares or commencement of commercial production whichever is later. Any holding of the promoter in excess of the minimum prescribed holdings will be locked-in for a period of one year from the date of allotment.

7.4 Initial Public Offer and Follow-on Public Offer

The first public offer of shares made by a company is called an Initial Public Offer (IPO). An IPO is made by a company whose shares are not listed on a stock exchange. Once the IPO is made, the shares have to be compulsorily listed and the shares become available for trading on the stock exchange. An IPO can either be a fresh issue of shares or it can be an offer for sale of existing shares by any of the existing share holder.

A fresh issue of shares results in an increase in the share capital of the company. New shares are allotted to the investors. A fresh issue does not change the holding of shares of the investors prior to the issue in terms of the number of shares held. The percentage holding of the investors in the share capital of the company may however change.

In an offer for sale, existing promoters/or any other existing share holder (venture fund or private equity) off-load a portion of their holdings to the public. This will not increase the share capital of the company. The proceeds of the public offer go to the persons off-loading the shares and not to the company. In a public offer, the money invested by the new shareholders, goes to the company, and its share capital increases.

In an offer for sale, the promoters' holding or the existing share holder who has sold his shares in the company comes down and new shareholders get added to the list of shareholders. There is a change in the list of shareholders, but not in the amount of share capital. The Government had made offer for sale of its holding in

several public sector companies/banks to the public, through the divestment route. The shares of the company get listed on the stock market after the offer for sale is over.

7.5 Eligibility to make a public issue of shares

SEBI's regulations prescribe certain eligibility requirements for a company planning a public issue. This includes:

Minimum net worth requirement of Rs one Crore and distributable profits in the last three years,

and

The proposed issue along with all other issue of capital made during the year should not exceed five times the pre-issue net worth.

or

The issue to be made through a book building process in which 50% of the issue is reserved for qualified institutional buyers (QIB)

and

The minimum post-issue paid up capital shall be Rs 10 Crores.

or

The project should be appraised by commercial banks/FIs who also contribute to the capital to the extent of 10%,

and

There will be compulsory market-making for at least two years from the date of listing of the shares. .

7.6 Follow-on Public Offer

A follow-on public offer is made by a listed company. This means, a company that has already made an IPO in the past and the shares

have been listed now makes a further issue of shares to the public. A follow on public offer may be through an issue of additional shares or through an offer for sale.

When a company wants additional capital for growth or to redo its capital structure by retiring debt, it raises equity capital through a follow-on public offer. A follow-on public offer may also be through an offer for sale. This usually happens when it is necessary to increase the public shareholding to meet the requirements laid down by the listing agreement between the company and the stock exchange. Or promoters may look to dilute their holdings in the company after the lock-in imposed at the time of the IPO is over.

A public offer, whether an IPO or a follow-on public offer has to meet the regulatory requirements laid down by SEBI and the Companies act. This limits a further issue of shares in a financial year to five times its pre-issue net worth based on the audited balance sheet of the last financial year. A listed company can also make a further issue of shares if it complies with the regulatory requirements laid down for IPOs.

A follow-on public offer, as in the case of an initial public offer, is exempt from the requirements of the contribution of the promoter and the lock-in on the promoters' holding if the company has been listed on a stock exchange for at least three years and has a track record of paying dividends for at least the three out of the immediately preceding 5 years.

7.7 Buy Back of Securities

The SEBI (Buy Back of Securities) Regulations, 1999 along with rules of the Ministry of Company Affairs have laid down the rules and procedures to be followed by a company making an offer for buying back its shares. A company would consider buying back shares to increase the promoters holding, increase the earnings per share of the company, support the value of the share, to stave off a take-over bid or to use the cash surplus available with the company. A company can use the free reserves available, amounts available in the share premium account or from the proceeds of securities issued. A company cannot use the proceeds from an earlier issue of the same class of securities that are being bought back.

The process of making a buyback offer is described in the regulations. A special resolution has to be passed at the general meeting allowing the buy back the shares if the proposed buy back is in excess of 10% of the capital of the company. This should be followed by a resolution of the board of directors enabling the same. Buy back cannot however exceed 25% of the share capital of the company.

The company must give a public notice of the buy back in a nationwide newspaper giving details of the proposed buy back. The reasons for the buy back, the total number and percentage of the shares and the price at which they are being bought back, the process and funding of the buy back, the specified date and the timetable of the buyback must be detailed in the notice.

A copy of the board resolution and the public notice shall be filed with SEBI and the stock exchange where the shares are listed within two days of the board resolution.

A company shall open an escrow account on or before the opening of the offer by way of security. The deposit in the escrow account will be to the tune of 25% of the consideration amount up to Rs 100 Crore and 10% over and above that. The amount due can be maintained in the form of cash, bank guarantees or accepted securities deposited with the merchant banker. Any amount remaining in the account after payment of consideration to all security holders will be released to the company.

A company can buy back its securities in any of the following ways:

- Through a tender offer to existing shareholders to buy back the shares on a proportionate basis
- From the open market through a book building process or through the stock exchange
- From odd-lot holders

A company cannot buy back its shares through a private negotiated deal.

Buy Back through a Tender

If the buy back is through a tender offer, the maximum price at which the buyback of shares will be made should be disclosed.

If the promoters are tendering the shares, then the proposal seeking the approval of the shareholders should include information on the quantum of shares to be tendered and the dealings of the promoters

in the securities in the six months prior to the special resolution authorizing the buyback of shares. The public notice shall mention the specified date which is the date for the purpose of specifying the eligible shareholders to whom the offer letter shall be sent.

The company shall file a draft offer letter with SEBI and send the offer letter to the shareholders within 21 days of such filing with SEBI. The offer for buy back shall remain open for a minimum of 15 days and maximum of 30 days. The buyback will be made on a proportionate basis if more than the shares specified are offered by the shareholders.

Within seven days from the expiry of the period for acceptance or rejection of offered shares, the payment has to be made to the shareholders or share certificates returned if the offer is rejected. The share certificates representing the shares that have been bought back will be destroyed and a certificate to that effect signed by the Registrar of the issue, the auditor and directors of the company will be submitted to SEBI and the stock exchanges.

Buy Back Through Stock Exchange

If the buy back is made through a stock exchange, the company has to appoint a merchant banker to manage the buy back. The public notice shall give details of the brokers and stock exchanges through which the buyback will be conducted. The company can only use a stock exchange with nation-wide terminals.

Information about the shares bought-back shall be given to the stock exchange on a daily basis and publish the information in a national

daily on a fortnightly basis. The shares bought back will be extinguished and a certificate to that effect be given to SEBI and the stock exchange.

Buy Back Through a Book Building Process

If the buy back is through a book building process then the company has to appoint a merchant banker to manage the issue. The public notice should give details of the process of book building process to be followed. The book building will be done through an electronically linked facility. There shall be at least 30 bidding centres.

The offer shall remain open for a minimum period of 15 days and a maximum of 30 days. Once the offer closes the buyback price will be decided by the company and the merchant banker. The highest price received will be paid to all the bidders. The certificates pertaining to the accepted bids will be destroyed and the shares tendered in electronic form will be extinguished.

Key Points

1. A company raises capital at various stages depending upon the need for equity capital.
2. Equity capital may be raised from the promoters, institutional investors such as financial institutions and banks or from the retail public investors.
3. Equity capital issues are governed by the regulations of SEBI and the Companies Act and the Listing Agreement.
4. The extent of regulation would depend upon the category of investors. The regulations for raising capital from the retail investors are very stringent.
5. An IPO is an issue of capital by a company to the retail public for the first time. A follow-on public offer is made by a company that has already issued capital to public.
6. SEBI's guidelines lays down the norms for eligibility norms for companies to raise capital from the public,
7. An IPO or FPO can be an offer for sale where an existing large investor such as a promoter divests a portion of their holding to the public.
8. A company can offer to buy back its shares through an open offer, in a tender-driven or book building process

Quick Recap

Fill in the Blanks

1. The first contribution of equity capital is made by the _____.
2. A company has to follow the guidelines laid down by _____ for the issue of capital.
3. A/An _____ is a method of issue of shares to the public where the money raised does not add to the equity of the company.
4. The shares have to be _____ after a public issue of shares.
5. A _____ issue can be made only by a listed company.

State True or False

1. Only a listed company can make a public issue of shares.
2. SEBI's regulation does not consider the financial performance of a company in specifying the eligibility norms for a public issue.
3. A promoter's entire holding in the company is locked-in for a specified period after a public issue of shares.
4. A firm allotment of shares has to be made at a price higher than the price of issue shares to the retail investor.
5. Promoters can divest their entire holdings in a company through a public issue of shares.

Answers:

Fill in the blanks:

1- Promoters

2-SEBI

3-Offer for Sale

4- Listed

5- Follow-on

State True or False:

1- False,

2- False

3-True

4-True

5- False

A public offer of shares involves regulatory compliances and process that have been laid down to ensure that public investors are protected. These requirements can be time-consuming, elaborate, and intended to protect the less informed investor.

A company may decide to make an offer to a select group of investors, who may be better informed, and therefore not requiring elaborate protection mechanisms. The company can also save time, cost and effort in placing its shares to such a group. This is called a private placement of shares.

A private placement of shares can be done by a company irrespective of whether it has made a public offer of shares or not. A private placement of shares made by a listed company is called a preferential allotment of shares. Since the company is listed and has public shareholders, it is required to meet the regulation in this regard of SEBI and the Companies Act.

These regulations aim at ensuring that promoters and large investor groups do not take any action that may be detrimental to the interests of the public investors. The regulations require that a resolution is passed by the shareholders allowing such allotment of shares.

A placement document giving material information will be made available to select investors and on the website of the company and the stock exchange. The shares will be allotted at a price which is the higher of the average of the weekly high and low closing prices

on the stock exchange for the previous six months or previous two weeks. The shares will be locked-in for a period of one year from the date of allotment.

8.1 Qualified Institutional Placement

Qualified institutional placement (QIP) is a private placement of shares made by a listed company to certain identified categories of investors known as Qualified Institutional Buyers (QIBs). To be eligible to make such a placement the shares of the company should have been listed on the stock exchange for a period at least one year before the notice of such issue is given.

A qualified institutional placement will be made at a price not less than the price of the shares will not be lower than the average of the weekly high and low of the closing prices for the two weeks preceding the relevant date.

Qualified institutional buyers (QIB) include financial institutions, mutual funds, scheduled commercial banks, and the like. Preferential allotment of the shares may be made to QIBs at a price which is not lower than the average of the weekly high and low closing prices on the stock exchange for the previous two weeks provided the number of allottees do not exceed five.

There must be a minimum of two allottees under this category if the issue size is less than or equal to Rs 250 Core and five if it is more than Rs 250 Crore. A sale of shares allotted under this category, within one year from the date allotment, can be made by the QIB only on a recognised stock exchange.

8.2 Rights Issue

A rights issue is an issue of fresh capital made to the existing investors of a company. In a rights issue the company has to decide on the proportion of fresh shares to be issued to the investors.

For example, a company may decide to issue rights shares in the ratio 2:3. This means that existing investors of the company on a specified date called the record date will be entitled to 2 shares for every 3 shares held by them.

An investor's percentage holding in the company remains the same after the rights issue unless the shares are foregone by the investor.

Key Concepts

1. A private placement of shares in the form of a preferential allotment or a Qualified institutional placement imposes less regulatory compliances on the company.
2. A preferential allotment and a Qualified institutional placement can be made only by listed companies.
3. SEBI defines the method of calculating the price at which such shares will issued under its Disclosure and Investor Protection guidelines.
4. A rights issue is a fresh issue of capital made to the existing shareholders of the company in a defined ratio.

Quick Recap

Fill in the Blanks

1. A private placement of shares by a listed company is called a _____ of shares.
2. Privately placed shares are locked-in for _____ .
3. A QIP can be only made by a company that has been listed on a stock exchange for _____.
4. A _____ issue of shares is made to existing share holders.
5. A 3:4 rights issue of shares means the investor is entitled to _____.

State True or False

1. A private placement of shares is not regulated by SEBI or the Companies Act.
2. Companies prefer private placement because it gives cost and time benefits.
3. The definition of a QIB depends upon the Company.
4. A QIP of shares can be made only to QIBs
5. There is a one-year lock-in on the sale of shares allotted to a QIB in a preferential allotment.

Answers:

Fill in the Blanks:

1- Preferential allotment

2-One year

3-One year

4- Rights

5-Tthree shares for everyfour4 shares held

True or False:

1- False

2- True

3-False

4- True

5- False

9 Public Offering of Shares

A company making an issue of shares has to go through certain internal and external steps to give effect to the issue. Internally, the company needs to get the approval of the board of directors and the existing shareholders for the issue. Once this is done, the company has to appoint a merchant banker who will be the lead manager of the issue. The lead manager is responsible for ensuring that the regulatory requirements of the issue are complied with. The lead manager is responsible for all activities till the issue is listed.

9.1 Pre-Issue Work

The lead manager undertakes the following steps in managing a public offer of shares:

- Appoint R&T agents, bankers, brokers and underwriters to the issue. In case of a book built issue, the book runners, who are merchant bankers, will be appointed. The merchant banker has to ensure that the constituents are registered with SEBI.
- Obtain the in-principle approval of the stock exchange where the shares are proposed to be listed.
- Ensure that the mandatory number of collection centres is covered by the collection bankers to the issue.
- For an issue by an unlisted company, get the IPO graded by an approved credit rating agency.
- Enter into agreements with depositories for the admission of the securities in both the depositories.
- File draft prospectus with SEBI

- Make changes, if any, to the prospectus as suggested by SEBI and files the prospectus with the Registrar of Companies
- Sign the due diligence that all the regulatory requirements are complied with.
- Issue advertisements in national papers as required by regulations
- Arrange for the printing and dispatch of prospectus and application forms and other issue material.
- Ensure that every application form is accompanied by an abridged prospectus.

9.2 Post-Issue Work

An issue is required to be kept open for a minimum of three days and a maximum of seven working days. The following are the functions of the lead manager in the post-issue period:

- Once the issue opens, ensure that the collection banks and R&T agents collect and reconcile the forms received and obtain a final collection certificate.
- Finalize the basis of allotment in consultation with the stock exchange.

Basis of allotment is the process of deciding the number of shares that each investor is entitled to be allotted. If the number of shares that have been subscribed for is equal to or less than the number of shares offered by the company, then each investor will get the same number of shares he applied for. If the issue is over-subscribed, then the number of shares allotted to each investor will be in proportion to the oversubscription.

Once the issue closes, the applications are collated under various categories such as retail investors, HNIs, QIBs and firm allotment. The number of shares applied for is compared with the shares reserved for each category and the oversubscription ratio is calculated. This is applied to each application to determine the shares to be allotted.

The basis of allotment has to be approved by the board of directors of the company and published in national newspapers.

- Ensure that the shares are credited to the individual shareholders' depository account and dispatch of refund orders.
- Seek listing of shares on the stock exchange and commencement of trading.

9.3 Terms and concepts in public issue of shares

A public issue of shares has certain processes, commitments and concepts that require understanding.

Categories of Investors in public issue

The various categories of investors who are eligible to invest in a public issue of shares are:

- Retail Individual Investors are those who invest less than Rs 1,00,000 in an issue. In a book building issue this category of investors are alone allowed to bid at cut-off price. They are required to tender the entire subscription amount at the time of making the application; unless otherwise specified in the Prospectus.

- Non-Institutional Investors who are individual investors who invest more than Rs 1,00,000 in an issue
- Qualified Institutional Buyers (QIB) which includes mutual funds, financial institutions, scheduled commercial banks, FIIs
- Shareholders of the promoter group companies
- Employees of the company
- Promoters

A public issue by an unlisted company is required by regulations to make a minimum net public offer of 25% of the post-issue paid up capital while for a listed company this limit is applied to the issue size.

The remaining portion of the public issue can be reserved on a competitive basis or allotted on a firm allotment basis or on preferential basis to categories of investors such as employees, mutual funds, FIIs, shareholders of the promoting company, employees of the issuer company and scheduled banks.

Out of the total issue, 50% shall be offered to the QIB's and 15% to HNIs and balance 35% to the retail investors. This is the allocation for a book building offer. For fixed price offers, a minimum of 50% of the net offer of securities to the public shall be initially made for allotment to retail individual investors and the balance to HNIs and other investors.

A company which desires to have less than 25% of the post issue capital offered to the public should then at least offer 10% of the post

issue capital to the public subject to the condition that the issue size shall be a minimum of 100 Crores and there will be 20 lac units of shares which will be on offer and out of the total issue, at least 60% shall be offered to the QIB's and the balance 10% to HNI and 30% to the retail segment.

9.4 Prospectus

The prospectus is the document which contains all the information relevant to an investor to make an investment in a public issue of shares made through a fixed price offer. The content and format of the prospectus is prescribed by SEBI in its regulations.

A company making a public issue of shares files a draft prospectus with SEBI through the lead manager of the issue. SEBI may require clarifications or changes to be made to the draft prospectus which have to be complied with before the prospectus is filed with the Registrar of companies.

9.5 Red Herring Prospectus

This is the document of information made according to SEBI's guidelines for a public issue of shares made through a book building exercise. In this, the price at which the issue is being made and the number of shares being offered or the total number of shares on offer is not given.

The upper and lower band of the price and the number of shares may be disclosed or the issue size may be mentioned. This is because the price at which the shares are being issued will be

determined based on the bids received in a book building offer which will be known only after the issue closes.

A preliminary red herring prospectus is filed with SEBI before the issue opens and the observations made by SEBI, if any, are incorporated into it. Once the price is discovered, it is included in the offer document along with the number of shares if not already mentioned and the prospectus signed and dated is filed with the Registrar of companies and SEBI.

9.6 Underwriting

SEBI's guidelines on public issues and the Companies Act require that an issue should receive subscription of a minimum of 90% of the net offer to the public failing which the company has to refund the entire subscription amount received. To protect against this, Companies enter into an underwriting agreement with institutions at the time of a public offer of shares to subscribe to the shares of the company if they remain unsubscribed by the investors. For undertaking this commitment, the underwriters are paid a commission. Underwriting for a fixed price issue is discretionary. However in the case of a book built issue underwriting is mandatory. Underwriter's agreement is signed only after the closure of the issue subject to the minimum subscription being received. For an issue that is underwritten, SEBI's minimum subscription requirement will be 90% of the net public offer including the subscription by the underwriters.

The underwriting may be a hard or soft commitment. In hard underwriting, the underwriter is expected to subscribe to the extent

of commitment if the issue is undersubscribed. In soft underwriting, the underwriter buys the share at a later stage when the pricing process is complete and if investors do not pay-up on allotment. They usually place these shares with institutional investors.

The minimum subscription norms of SEBI, and hence the requirement for underwriting, does not apply for a public issue through an offer for sale.

9.7 Green Shoe Option

Companies may also go in for a Green Shoe Option (GSO). The objective of this option is to provide stability to price of the share in the secondary market immediately on listing. A company, which opts for Green Shoe option shall disclose the same in the offer document. The company can allot additional shares not exceeding 15% of the issue size to the general public who have subscribed in the issue.

The shares will be allotted in the same ratio in which reservation is being made for the various categories. For this purpose, the required over allotment shares will be lent by the promoter and/or any investor holding more than 5% of the total issued capital.

The money realised out of this over-allotment will be kept in a separate bank A/c to be designated as GSO bank A/c. This amount will be used by the Stabilizing Agent (SA), who is usually one of the merchant bankers or lead managers to the issue.

The SA will utilize the money for buying shares from the secondary market whenever the market price goes below the issue price.

However, he is under no obligation to take any direction from the issuing company or the promoter for his market operations.

The SA can only buy shares and cannot sell any shares. Moreover, he can buy a maximum up to the extent of the over-allotment made. The shares purchased from the secondary market will be kept in a separate demat A/c designated as GSO demat A/c.

The entire process of stabilization will be available only for a period of 30 days from the date on which the shares are listed and traded. At the end of the 30 day period, the SA will take stock of the shares purchased and these shares will be returned to the lender/promoter.

In the event of any shortfall in the shares bought in relation to the shares lent, additional allotment will be made by the company against the unutilised funds lying in the GSO Bank A/c. This will be at the same price as per the original issue price.

Any balance money lying in the GSO bank A/c (arising out of difference between the issue and buying price of the SA) will be transferred by the SA to the Investor Protection Fund of the designated stock exchange.

The GSO bank A/c and the GSO demat A/c are closed once the period of stabilization is over.

9.8 Methods of Making a Public Issue of Shares

There are basically two ways in which a company can raise capital from a public issue of shares. These are

- Fixed Price Issue
- Book Built Issue

Fixed Price Issue

In a fixed price issue of shares to the public, the company in consultation with the lead manager to the issue would decide on the price at which the shares will be issued.

Currently, SEBI permits companies to freely price the issue. The price is justified by the company on the basis of quantitative and qualitative factors. This is clearly laid out in the prospectus for the investors to make an informed investment decision. Investors know the price at which the shares will be allotted to them at the time of making the application.

Shares allotted to the investor will depend upon the basis of allotment finalised after the issue closes. If the issue is oversubscribed, the investor will get shares proportionate to the oversubscription in the respective category. The investor is sent a (Confirmatory Allotment Note) (CAN)/refund order within 30 days of the issue closing date.

Book Built Issue

The objective of a book build process is to identify the price that the market is willing to pay for the shares being issued by the company.

The company and its lead managers will specify either a floor price or a price band within which investors can bid. This information is in the red herring prospectus. When the issue opens, investors will put in bid applications specifying the price and the amount of shares bid at that price. The price bid should be above the floor price or within the price band, as applicable, depending upon the specification in the red herring prospectus of the issue.

Investors can revise the bids in the period when the issue is open. The issuer, in consultation with the book running lead manager will decide on the cut-off price at which the issue gets subscribed.

All allottees who bid at or above the cut-off price are successful bidders and are eligible for allotment in the respective categories.

For example, a company wants to issue 5000 shares through a book built offer within a price band of Rs 120-Rs 144. Bids are received as follows:

	Price	No. of Shares	Total Demand
1.	Rs 120	500	6500
2.	Rs 130	1000	6000
3.	Rs 135	2500	5000
4.	Rs 140	1500	2500
5.	Rs 144	1000	1000

The offer is filled up at the cut-off price of Rs 135. All investors who bid at this price and higher are eligible for allotment in their

respective categories. The company may decide the cut-off price at a price lower than the price at which the issue is subscribed for the benefit of the investors.

Book built issues may also have a clause which allows allotment to retail investors at a price that is at a discount to the cut off price which cannot however exceed 10% of the price at which shares are allotted to the other category of investors.

Regulatory requirements in a book building offer

- The issue must be compulsorily underwritten to the extent of net offer to the public.
- The lead managers have to be appointed as the book runner.
- The cap of the price band will not be higher than 20% of the floor price.
- The price band can be revised during the offer period within the 20% band between floor and cap price. The revision will have to be advertised and the issue period extended by three days.
- In a book built offer, not less than 35% of the net offer to the public will be reserved for retail individual investors, not less than 15% for non-institutional investors and not more than 50% for qualified institutional buyers.

The issue will be open for a minimum of 3 working days and a maximum of seven days. If the price band is revised, then the issue will be open for 10 days.

The details of the syndicate members who can accept the bids as well as bidding centres all of which should have electronically connected terminals should be made widely available.

Bids can also be placed with the syndicate members who are brokers of the exchange through which the securities are being offered under the on-line system.

All bids shall be accepted in the standardised bid forms that will have the details of the investor, the price and the quantity bid for.

The bids can be revised during the period that the offer is open.

Investors who are entitled to allotment in the issue should be sent a confirmatory allotment note (CAN) within 15 days of the issue closing.

Demat credit of shares or dispatch of refund order should be completed within 15 days of the closure of the issue.

Key Concepts

1. The company appoints a merchant bank to lead manage the proposed public issue of the company.
2. Other constituents such as the R&T agent, bankers, underwriters are appointed by the lead manager in consultation with the company. All constituents have to entities registered with SEBI.
3. The lead manager gets in-principle approval of the stock exchange, files the draft prospectus with SEBI, files the final prospectus with the RoC and ensure compliance with SEBI's regulations.
4. Once the issue closes, the lead manager and R&T agent in consultation with the stock exchange finalises the basis of allotment.
5. The basis of allotment is the process of defining the number of shares allotted to each investor based on the over-subscription.
6. Retail investors, institutional investors, promoters, shareholders of promoter group companies, employees are categories of investors eligible to apply in a public issue.
7. A prospectus is the offer document prepared according to regulations which gives the investors complete information about the issue.
8. A Red herring prospectus is an offer document where the price at which the issue is being made and the number of shares is not mentioned as in a book building process.
9. Underwriting is the process of getting commitments from institutions to pick up shares in a public issue if the issue is under subscribed.

10. In a book-built issue the price at which the shares will be allotted and the successful allottees will be decided upon by a bidding process.
11. The process of bidding will be done as per the rules laid down by SEBI.
12. The Green Shoe Option is used by companies making an issue to stabilize the price in the secondary markets. Shares are over-allotted to the investing public for which shares is lent by the promoter. The money received through this over-allotment process is used for stabilizing the price in the secondary market, post the listing of the shares.

Quick Recap

Fill in the Blanks

1. The due diligence certificate is signed by _____.
2. A company must make a minimum public issue of _____
3. A company has to refund the monies collected in a public issue if the issue does not garner _____ subscription in the issue.
4. SEBI's rules for underwriting and minimum subscription does not apply to _____
5. The two ways a company can conduct a public issue of shares are _____ and _____.

State True or False

1. All application forms have to be accompanied by the prospectus
2. All public issues have to get a credit rating done.
3. The red herring prospectus has to be filed with the RoC.
4. A green shoe option results in an increase in the issue size.
5. In a fixed price issue the price of the shares is decided according to the formula defined by SEBI.

Answers:

Fill in the Blanks:

1- Lead Manager

2-25% of the post issue capital

3- 90%

4- Offers for sale

5- Fixed price issue and Book built issue

State True or False:

1- True

2- False

3-True

4- True

5- False

10 Roles and Responsibilities in a Public Issue

An issue of shares by a company involves detailed activity, co-ordination and compliance with regulatory requirements. The lead manager to the issue is primarily responsible for the issue process. The other entities who are involved include the registrar and transfer agents, bankers and brokers to the issue.

The role and responsibility of each constituent is clearly laid out by SEBI. All constituents who are involved with an issue have to be registered with SEBI under the relevant rules.

10.1 Registrar and Transfer Agents

The R&T agents have a significant role to play in a public issue of shares. They are appointed by the issuer in consultation with the lead manager to the issue and enter into an agreement detailing their responsibility in the issue work. The scope of activity of the R&T agents is spread before the issue opens, during the period of issue and after the issue closes.

Pre-Issue Work

- Assist in the finalization of bankers to the issue, controlling and collection branches, syndicate members, bidding centres and give instructions on the procedures to be followed.
- Assist in the work related to designing the application forms and other issue material.

Issue Work

- Collect and report information on the daily collections/bid information to the lead manager/ book running lead managers.
- Provide statutory reports on the progress of the issue as required.
- Arrange for the collection of application forms and their data entry for further processing.
- In case of a book built offer, make a table of all valid applications to identify the cut-off price. Once the cut-off price is determined, the valid applications are identified.
- Identify valid bids from QIBs and print and dispatch Confirmatory Allocation Notice (CAN) so that the balance money can be collected.
- Reconcile funds with the final collection certificate received from the bankers.

Post- Issue Work

Scrutinize the application forms for completeness and correctness of information. Applications may be rejected, among other reasons, if:

- Application is incomplete
- Information such as PAN number, bank account is not provided
- Supporting documents such as those required for corporate applicants is absent
- The bid is at cut-off price for an applicant other than a retail individual investor

    - Terms of offer in terms of minimum application is not met
    - Applications from minors
    - Multiple applications
- Get the approval of the issuer and the lead manager/book running lead manager for applications rejected on technical grounds.
- Draw up the underwriters' obligations in case the issue is under-subscribed and send devolvement notices on the instruction of the lead manager/ book running lead manager.
- Finalise the basis of allotment, if the issue is oversubscribed, in consultation with the lead manager/book running lead manager, issuer and stock exchange.
- Submit the following documents to the stock exchange:
    - Basis of allotment
    - Top 100 applications
    - Certificate of final collection from the bankers and reconciliation statement
    - List of applications rejected on technical grounds
    - Minutes of the meeting held with the issuer, lead manager/book running lead manager and stock exchange for finalizing the basis of allotment
- Make the allotment of shares to the investors on the approved basis.
- Ensure that legal requirements such as payment of stamp duty by the issuer, creation of register of members,

approvals of the board of directors of the issuing company and the stock exchange are complied with.

- Print the Confirmatory Allotment Note (CAN) for all successful applicants.
- Arrange for the printing, signing and dispatch of certificates if allotment is in physical form in case of a fixed price offer or upload securities to demat account of the applicants.
- Arrange for the refund orders to be dispatched.
- Draw up the list of brokers to whom commissions have to be paid.
- Manage the issue work so that the shares are listed on the stock exchange within 30 days from the closure of the issue for a fixed price issue and 15 days for a book built issue.
- Handle all post issue queries from investors.

10.2 Bankers to the Issue

The bankers to the issue are appointed by the lead managers/book running lead managers to manage the collection of funds in the issue into the escrow account opened for the purpose. The bankers to an issue must have collection branches in the mandatory centres as specified by the regulations. They are responsible for giving updates on the collection figures to the managers of the issue based on which the decision to close the issue will be taken.

ASBA

SEBI has also recently introduced an additional mode of payment in public as well as rights issues made through the book built route called the Applications Supported by Blocked Amount popularly

known as “ASBA”. ASBA is an application for subscription to an issue containing an authorisation to the investors’ bank to block the application money in his bank account.

For this purpose his bank should have been registered with SEBI as Self Certified Syndicate Bank (SCSB). The SCSB will identify its designated branches (DB) where the ASBA investor can submit his form. All the DBs of an SCSB will be controlled by one branch of that Bank which will be designated as Controlling Branch (CB). An investor will be eligible to apply through the ASBA process if he/she:

- is a resident retail individual investor;
- is bidding at cut-off price, with single option as to the number of shares bid for;
- is applying through blocking of funds in a bank a/c with a SCSB
- agrees not to revise the bid;
- is not bidding under any of the revised categories.

ASBA Process

An ASBA investor shall submit the application physically or through electronic means to the SCSB with whom the bank Account to be blocked is maintained. The SCSB will block the application money in the investor’s account, which will remain so till finalisation of the basis of allotment or till withdrawal of the issue or withdrawal by the applicant.

The SCSB thereafter will upload the application data through a web-enabled interface to be provided by the stock exchanges. After the

basis of allotment is finalised the registrar shall apply the basis and identify against each one of the ASBA investor the number of shares, if any, allotted and the amount if any to be appropriated for the allotment made and the balance amount to be unblocked/refunded. This information will be furnished by the registrar to the controlling branch who in turn debits the required amount from the investors account to be given to the issuer for the shares allotted. They will also unblock the balance amount in the account of the investor.

10.3 Brokers to the Issue/Syndicate Members

Brokers to the issue are appointed to facilitate the collections of application forms and bids. They are members of stock exchanges. They are responsible for collecting the bid/application forms and ensure that it is accompanied by a payment instrument. They are paid a commission for their role depending upon their collection.

Key Concepts

1. A public issue of shares involves entities such as R&T agents, bankers and brokers apart from the lead manager of the issue.
2. All such entities have to be registered with SEBI.
3. The R&T agent manages the collection, collation, scrutinizing and distribution of information related to the application forms received.
4. They are involved in finalizing the basis of allotment, identifying the allottees, making the allotment and sending data to the depository.
5. Legal formalities such as payment of stamp duty, creating the register of members and the like are the functions of the R&T.
6. Bankers handle the funds collected in an issue and account for the same.
7. Brokers receive a commission for the role of collection agent in the issue.

Quick Recap

Fill in the Blanks

1. In a book built issue a _____ investor can bid at cut-off price.
2. A fixed price issue has to be listed within _____ days of closure of issue.
3. Bankers to an issue are appointed by the _____.
4. Brokers to an issue are _____

State True or False

1. The role and responsibility of each constituent is define by the lead manager
2. An application form is rejected if the bank account details are missing.
3. SEBI has laid down a list of mandatory collection centres for public issues.
4. The lead manager has to be given only the final collection figures as per regulation.
5. Brokers to an issue are responsible for building demand for the share in the secondary market

Answers:

Fill in the blanks:

1- Retail

2-Thirty

3-Issuer

4- Members of a stock exchange

State True or False:

1-False

2-True

3-True

4-False

5- False

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11 Depository Services

A depository is an institution that offers the service of holding the securities of the investors in electronic form. Its services can be compared to that of a bank which holds the depositors' funds and facilitates the conduct of fund related transactions.

Similarly, a depository allows the investors to hold their securities in electronic rather than physical form and provides services related to transaction in securities.

The Depositories Act was passed in 1996 which allow companies and investors to issue, hold and transact in securities through a depository. There are currently two depositories operational in India, National Securities Depository Ltd. (NSDL) & Central Securities Depository Ltd. (CDSL). The securities can be dematerialised at the time of issue or subsequently.

SEBI's Disclosure and Investor Protection Guidelines require all issues made through the book building route to be issued only as dematerialised securities.

Issues made through the fixed price route can be issued either as physical securities or as dematerialised securities if the issue is less than Rs 10 Crores. All other issues have to be only using the dematerialised route.

11.1 Dematerialisation

Companies are required to apply to a depository for dematerialising their securities. The executive committee of the depository will evaluate the eligibility of the securities for admission.

Under the SEBI (Depository and Participants) Regulations of 1996 the categories of securities eligible for dematerialisation are:

- Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable security of any incorporated company or other body corporate.
- Units of a mutual fund, rights under a collective investment scheme, venture capital funds, certificates of deposit, commercial paper, money market instruments, government securities and unlisted securities.

Under the Depository Act, the physical securities that are dematerialised are required to be destroyed by the R&T agent and a credit entry is made in the electronic records of the depository.

The dematerialised securities are fungible. This means that once a share is dematerialised, it does not have a distinctive identity in terms of share certificate number or distinctive numbers or folio numbers.

The investor's ownership of the security is described in terms of number of shares held. In the depository, the dematerialised securities are identified in terms of the ISIN (International Securities Identification Number) and the number of shares.

The ISIN is a unique 12 digit number allotted to each security in conformity with the ISIN Standard. The first two digits identify the country. For example, for India it is IN. The next 9 alpha-numeric characters are the basic numbers that identify the company and the specific security of the company. The last digit is the check digit.

11.2 Constituents of the Depository System

The services of the of the depository, such as electronic transaction in securities, is provided in conjunction with the constituents of the system namely the Issuing Company/R&T agent and the depository participants.

The depository, issuing company and the registrar and transfer agent enter into a tripartite agreement that lays down the role and responsibilities of each party. The responsibilities of the parties to the agreement are as follows:

Depository

- The depository shall assign a unique identity code to the dematerialised security.
- The depository shall give the list of beneficial owners periodically to the issuer/R&T agent.
- The depository will provide the details of beneficial owners as on the record date for a corporate action.
- The depository shall give information sought by the issuer such as pending dematerialisation requests or information about beneficial owners within a specified period on the payment of a prescribed fee.

- Any complaint received by a beneficial owner will be resolved within a period of 21 days.

Issuer / R&T Agent

- The issuer/R&T agent shall enable continuous electronic connectivity with the depository and will ensure that the hardware, software and other system requirements specified by the depository is used for the operations.
- The issuer/R&T agent will give appropriate notice to the depository of any fresh issues and other corporate actions such as dividends and bonus.
- The issuer/R&T agent will abide with the 15 day and 30 day limit for processing requests for dematerialisation and rematerialisation of securities respectively.
- The issuer/R&T agent will be responsible for the destruction, cancellation and mutilation of certificates received for dematerialisation.
- The issuer/R&T agent will be responsible for any liability undertaken by the depository according to the bye-laws laid down.
- Any complaint received by a beneficial owner will be resolved within a period of 21 days.

Depository Participants

The investor's interface with the depository happens through an entity called the depository participant (DP). The DPs are appointed by the depository to act as their agents or contact points for the

investor. The investor has to open a depository account through the DP to avail of the services offered by the depository.

DPs are appointed by the depository with the approval of SEBI. The SEBI (Depository & participants) Regulations, 1996 lays down the eligibility criteria to become a DP. The following categories are eligible to become DPs:

- Banks, including foreign banks
- Financial Institutions
- Non-banking Finance Companies
- Stock brokers
- R&T Agents
- Custodians
- Clearing Corporations

SEBI has prescribed minimum net worth requirements for stock brokers, NBFCs and R&T agents to act as DPs. There is no net worth requirements for other categories of persons to act as DPs. The extent of business that a stock broker can undertake, in terms of the value of the securities held in dematerialised form for beneficial owners, is a multiple of the net worth of the stock broker. The depository can prescribe a higher net worth requirement for the participants.

11.3 Investor's Interface with the Depository

The Depository Act permits investors to hold and transact in securities in electronic form rather than in physical form. Holding securities in the electronic form or in a dematerialised form has the following advantages:

- The risks of loss, mutilation and forgery associated with physical securities are eliminated.
- The time taken to transact in securities is reduced.
- The cost of transaction, including stamp duty is reduced.
- Services such as transfer, transmission, nomination, receipt of benefits, automatic credit of shares arising out of split, consolidation, mergers are done faster and more efficiently.
- Consolidation of holding across folios and across instruments such as equity, debt and government securities becomes possible.

An investor who wants to hold and transact in securities in the dematerialised form has to first open an account with a DP. There are certain formalities such as proof of identity, proof of address, and PAN card that have to be submitted for opening a demat account.

Once the account is opened, securities of the investor get credited to the account in two ways:

- Securities applied for in a public offer or in any issue including bonus are credited directly to the investor's DP account mentioned in the application form
- Physical securities held by the investor can be submitted for dematerialisation. Once the securities are dematerialised, it gets credited to the investor's account.

Once the securities are dematerialised, their position is as follows:

In the records of the issuer

The investor is the beneficial owner. This means that all the benefits of a share holder, such as dividends, bonus, rights, voting rights and the like are with the investor. Similarly, all the liabilities related to the security are again with the investor. The Depository is the registered owner of the securities.

In the records of the DP

Separate accounts have to be maintained for each beneficial owner. Transfer to and from the account of the beneficial owner and all other entries in the account must be supported by instructions from the client. The DP should provide a transaction statement at least on a monthly basis to the clients.

Rights of the investor as the beneficial owner

The investor is the beneficial owner of the securities held in electronic form with the depository through the account with the depository participants.

This entitles the investors to:

- Transact in the securities as they deem fit.
- Receive all entitlements such as dividends, bonus, rights, interest and the like.
- Exercise voting rights on the shares held in their account
- Require the consolidation, transfer, transposition, nomination, pledge and other transactions as deemed fit.

- Receive periodic information, as agreed, from the depository about the status of their account.

Key Concepts

1. A depository converts the shares of a company into electronic form. This is called dematerialisation. The shares so converted are destroyed by the R&T agent. NSDL and CSDL are the two depositories currently available in India.
2. The shares of a company are admitted for dematerialisation based on an application made by the company.
3. The depository will assign a unique identity number to the security, maintain the record of beneficial owners and give periodic information to the company.
4. A depository offers its services to the investors through the depository participants who are banks, R&T agents, brokers, custodians and the like.
5. Holding shares in the dematerialised form gives the investor the benefits of doing away with the problem of theft and mutilation risks associated with physical stocks, ease of transacting and lower costs of transacting.

Quick Recap

Fill in the Blanks

1. Shares that are dematerialised are _____ by the R&T agent.
2. All issues made through the _____ route have to be issued only as dematerialised shares.
3. An investor opens a demat account with _____.
4. _____ is the registered owner of the shares held in the dematerialised form.
5. The minimum net worth requirement for DPs is specified by _____.

State True or False

1. Shares can be dematerialised only at the time of public issue.
2. The investor is the beneficial owner of the shares held in dematerialised form.
3. The DP holds one account each for each company's shares that are in the dematerialised form.
4. Shares once dematerialised can be converted into physical securities at the request of the investor.
5. Fungibility means that the certificate number, distinctive numbers and folio numbers of dematerialised shares are preserved.

Answers:

Fill in the Blanks:

1-Destroyed

2- Book built

3-Depository participant

4- Depository

5- SEBI

State True or False:

1- False

2-True

3-False

4-True

5- False

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12 Processes Related to Depositories

12.1 Dematerialisation of Securities

Dematerialisation is the process of converting physical securities into electronic form. It involves the investor, the DP, the issuer/R&T agent and the depository.

The steps in this are:

- Investor hands over the securities to be dematerialised along with the Dematerialisation Request Form (DRF) to the DP.
- The DP sends the request through the electronic system to the issuer/R&T agent and the depository. The Dematerialisation Request Number (DRN) that is generated by the system is entered on the DRF and sent along with the physical documents and a standard covering letter to the R&T agent.
- The certificates received by the R&T agent will be mutilated and have the words 'Surrendered for Dematerialisation" on it.

The R&T agent has to verify that:

- The DRF has the DP's authorization
- The dematerialisation request has been received in electronic as well as physical form.
- The DRN in the physical documents matches with the DRN in the electronic request.

- The certificates have the distinguishing marks such as hologram/water mark.

The inward counter of the R&T agent will verify the physical documents with the details in the covering letter and DRF, send a copy of the duly acknowledged copy of the DRF back to the DP and forward the documents for dematerialisation.

The process of giving effect to dematerialisation by the R&T agent is similar to that of transfer of registered ownership. The data to be captured, reports to be generated, documents to be filed are similar. In the Register of Members (RoM) of the company, the depository's name is included in the place of the investor to the extent of securities dematerialised. However, no stamp duty is payable on dematerialisation unlike other transfer of ownership transactions.

Once the RoM of the company is amended, confirmation is sent to the depository and the investor's account with the DP is credited with the number of dematerialised shares.

A dematerialisation request may be fully or partially rejected for the following reasons:

- Mismatch in the information between the DRF and physical certificates.
- Certificates are fake, stolen or for which duplicates have been issued.
- Securities stand in a different name from that mentioned in the DRF.
- The Securities do not pertain to the issuer/R&T agent.

- Signature of the holders does not tally with the records of the R&T agent.
- Delay of more than 15 days in the receipt of physical securities from the day of electronic request.

The R&T agent shreds the certificates once the process of dematerialisation is complete. The details of the certificate destroyed are entered into the Register of Destroyed Certificates.

The account number of the beneficial owner is entered into the holding master maintained by the R&T agent for future reference. The process of dematerialisation has to be completed within a period of 15 days from receiving the request.

For dematerialisation at the time of an IPO, the following steps have to be followed:

- The Company, R&T agent and the depository enter into an agreement for dematerialisation.
- The depository assigns an ISIN for the security.
- The R&T agent will segregate successful applicants' forms based on request for physical or demat shares.
- The allotment advice for demat shares will have the client account number, DP id and depository details.
- For the demat shares, the depository will be entered as the registered holder in the register of members of the company and the details of the corresponding beneficial owners will be uploaded in the depository's system.

- The issuing company/R&T agent may also maintain the details of the beneficial owners.

12.2 Rematerialisation of Securities

Rematerialisation of securities is the process of converting the electronic holding in a security to physical form.

The steps involved in this process are:

- Investor submits a Rematerialisation Request Form (RRF) to the DP.
- The DP validates the signature and the availability of the shares in free form in the investor's account.
- The request is then electronically forwarded to the depository.
- The RRF will have details such as the name(s) of the holder(s), signature, Number of shares to be rematerialised, address, bank account details, PAN Number, age, tax status and nominees, if any.
- The depository verifies the information and sends confirmation to the DP and the issuer/R&T agent.
- The DP sends the RRF to the Issuer/R&T agent who cross verifies it with the electronic confirmation received from the depository and forwards it for processing.
- Acknowledgement of this is sent to the DP.
- The R&T agent will capture the information in the RRF and create a new folio or add to an existing folio. The procedure to be followed is the same as that for creating a folio in other circumstances.

- The R&T agent will assign a new certificate number and distinctive numbers from the set of shares already dematerialised.
- The names of the beneficial owners will be included in the Register of members of the company and the name of the depository removed to that extent.
- In the records of the depository, the investor's account will show a reduction to the extent of rematerialisation.
- The R&T agent will pay the applicable stamp duty.
- The R&T agent will print certificates in the name of the investor and dispatch them directly to the shareholder.
- Confirmation of the rematerialisation will be electronically sent to the depository and the DP will be informed of the same.

Rematerialisation of securities will have to be completed within a period of 30 days from the receipt of a request.

12.3 Trading and Settlement

One of the primary functions of a depository is to facilitate the movement of securities that is necessitated by trading activities.

Trading in securities involves the movement and transfer of securities between the seller and the buyer. These transactions may be done within the structure of a stock exchange or on a person to person basis outside the purview of the stock exchange.

Trades done and settled within the mechanism provided by the exchange are called market trades. Trades done one-on-one and settled outside the clearing and settlement mechanism of a stock exchange are called off-market trades.

Both market and off-market trades involve movement of securities from the seller to the buyers and hence the involvement of the depository.

The beneficiary account of a holder can be debited or credited only on the instruction of the holder. For debits, the account holder gives this instruction to the DP through a Delivery Instruction Slip (DIS). The DIS form has the name, address and DP id pre-printed on the form. The client id is also pre-stamped on the form.

The account holder will have to fill in the following information:

- Receiver details- For market trades this would be the clearing member id, for off-market trades the DP id, the DP name and the client id of the receiver.
- The settlement number of market trades
- The ISIN and the name of the security
- The quantity in figures and words
- The execution date which is the date on which the account will be debited
- The signature of all the holders of the account

Credits to the account are received automatically if the account holder has given standing instructions (SI) to the DP for receipts

If SI has not been given, then a receipt instruction has to be given every time a credit is expected. The receipt instruction will have to be filled in for:

- Details of the client and DP, clearing member id, settlement number if receipt is expected from a client, clearing member or as a result of market trade respectively.
- The ISIN and name of security
- The quantity of security
- The execution date
- The signature of all account holders

Off-Market Trades

In an off-market trade, there is no participation of the stock exchange or its institutions such as the clearing corporation. Usually large trades between institutions and large private clients among others may be done as off-market trades.

The securities involved in the trade, if held in electronic form, will have to be transferred from the beneficiary account of the seller to that of the buyer. The depository mechanism is used only for the transfer of securities; the cash settlement is done outside the ambit of the depository.

The process is as follows:

- The seller gives instructions to the DP to debit the sellers beneficiary owners account with the securities according to the details in the DIS.

- The DP verifies the signature of the holders on the DIS and enters the instruction on the depository system. The securities are moved out of the sellers account on the execution date.
- The account of the buyer receives credit of the securities if a standing instruction has been given to the buyer's DP

Market Trades

Market trades are trades done through the trading, clearing and settlement mechanism of the stock exchange. The transfer of shares available for trading in the dematerialised form is conducted through the depository system.

Since the trades done on a stock exchange are anonymous, the clearing corporation or clearing house of the exchange stands between all trades. There is no direct transfer of shares between the buyer and the seller.

The transfer of securities for trades done on an exchange has to be within the time cycle, called the settlement cycle, specified by the exchange. The details of the settlement positions of each trading member in terms of obligation for delivery and receipt of shares are downloaded by the exchange to each broker.

Market trades are done through members of the stock exchange who are required to be participants in the depository system also.

Once a trade is done, the securities move in the following manner:

- The seller gives instructions to his DP to move securities to the clearing member account of the broker.
- The broker will in turn transfer the securities to the clearing corporation by the pay-in date specified in the settlement schedule of the exchange
- The clearing corporation will transfer the securities to the clearing member account id of the receiving broker, i.e. the broker through whom the buyer bought the shares, on the pay-out day.
- The buyer's broker will give instructions to transfer the securities to the beneficiary account of the buyer. For this, either the buyer should have given standing instructions to his DP to receive all credits to his beneficiary account or give receipt instruction for every credit that is expected.

Movement of securities entailed by a market trade is according to the schedule prescribed by the exchange in the settlement schedule.

Inter-depository Delivery

Trades done on a stock exchange may require transfer of securities between depositories. The SEBI (Depositories and Participants) Regulations, 1996 requires depositories to be inter-connected.

Inter-depository delivery of securities is possible only if the security is available for dematerialisation in both the depositories.

For inter-depository debits and credits, instructions have to be given in the inter-depository delivery or receipt forms to the DPs of the seller and the buyer.

Inter-depository transfer instructions are exchanged on-line for each day between the depositories.

12.4 Beneficial Owner Reporting

An investor holding dematerialised shares can conduct transactions such as transfer of shares without having to resort to the Issuer/ R&T agent.

However, information about the change in the holding of beneficial owners of the shares of the company and details of new beneficial owners will have to be periodically provided to the issuer depending upon the agreement between the Issuer and the depository. In case of the entry of a new beneficial owner the information that is provided by the depository are:

- ISIN
- Name(s) of the holder(s)
- Address
- Age
- PAN Number
- Bank account details
- Nominee details, if any
- Details of the DP
- Client account number of the beneficial owner
- Number of shares

The Beneficial Owner Master Register will be updated by the R&T agent based on the above information. For existing beneficial

owners, change in address is communicated to DP .The issuer/R&T agent will need to download the Beneficial Owner Master every time there is a corporate action such as dividend, bonus and the like. The depository will provide a beneficial owner download as on the record date for the corporate action which will have all the following information of the beneficiary owner including:

- ISIN
- Name of beneficial owner(s)
- Address of beneficial owner
- Quantity of shares held in the account
- Details such as lock-in and amount paid-up on the securities

The entitlement of beneficial owners to corporate actions will depend upon the holding as per the download provided.

12.5 Corporate Actions

Apart from the public issue of shares, the depository, issuer, R&T agent, DP and the investor are involved to give effect to other corporate actions such as:

- Bonus
- Rights
- Mergers/Acquisitions

Bonus Issue

The company informs the depository of the record date for the bonus issue. The depository generates a beneficial owner's report as on

this date based on which the R&T agent updates the beneficial owner master and calculates the entitlements for each beneficial owner.

The R&T Agent obtains the download from the depository as of the record date/book closure date and after the Company completes the listing formalities with the Stock Exchanges on the basis of the "In principle approval for listing of the shares" given by the Stock Exchange approach the depository for carrying out a corporate action for crediting the bonus shares into the respective investors account. After the shares are credited, the R&T Agent will send a communication to the investors for the corporate action carried out.

As per the present directions given by SEBI, a company is not permitted more than one ISIN for its equity shares unless the amount called and paid is not the same or the shares have differential voting rights. In other words, all shares under an ISIN shall be pari pasu in all respects.

Rights Issue

When a company is planning a rights issue it has to obtain the beneficial owner download from the depository by giving details of the ISIN for which they want the report and the book closure period/record date.

The R&T agent will calculate the rights allotment of each beneficial owner and send the composite application form to them. The beneficial owners/renouncees will mention in the form whether they want the rights allotted (electronic or physical) and submit it to the collection bank.

The process of allotment, refund and intimation of allotment follows the normal procedure. The depository's name is included in the register of members of the company for the shares allotted to investors in the electronic form.

After verification, the R&T agent sends the information of the rights allotted through a credit corporate action to the depository. The statement gives details of the client account number, DP Id, ISIN and quantity allotted. The depository validates, acknowledges receipt of the statement and downloads the information to the DPs who inform their clients. The R&T Agent also sends an individual communication to the investor.

Mergers and Amalgamations

In a merger of two companies or a takeover of a one company by another, a scheme of amalgamation or takeover is decided which defines the number of shares of one company that will be exchanged for the other or issued in the other company.

The various scenarios are as follows:

- If the shares of both the companies have been included for dematerialisation by the depository then the exchange of shares are done electronically.
- If the shares of the acquiring company alone have been admitted for dematerialisation, the investors of the acquired company will have the option of receiving shares in the electronic form.
- If the shares of the acquired company alone are admitted for dematerialisation, the depository will give a list of

beneficial owners to the acquiring company/R&T agent who are eligible for shares of the company. The physical securities will be sent to the beneficial owners.

- If the two companies are to be merged into a new entity and the shares of the new company has been admitted to a depository, the shareholders will have the option of receiving the shares in electronic form. Else the shareholders will be given physical securities based on the record of beneficial owners given by the depository for either or both companies if they were part of the depository.

The R&T agent of the acquiring company/final company will be responsible for undertaking all activities related to the merger/takeover such as:

- Informing the depository about the corporate action and record date
- Obtaining the record of beneficial owners, if applicable.
- Calculating the entitlement according to the scheme of amalgamation/takeover.
- Informing the shareholders and beneficial owners of the details of the scheme of amalgamation/takeover and the option, if available, to receive shares in the electronic form
- Completing the process of allotment of shares in electronic and/or physical form just as it is done for a rights issue of shares, downloading the information to the depository, if shares are being allotted in the electronic form and obtaining the acknowledgement from the depository.

- Including the depository in the register of members for the shares allotted in electronic form and updating the beneficial owners' master.

12.6 Reconciliation

The records of the holdings in a security are maintained by the issuer/R&T agent through the register of members. If the shares are also held in electronic form, then a record of the holdings will also be available with the depository.

The records held with the R&T agent and with the depository are reconciled on a daily basis to check the integrity of the total capital issued by the Company. The reconciliation is an end of day process done on a daily basis.

The depository will ensure that all pending dematerialisation and rematerialisation requests are downloaded and the R&T agent ensures that all pending confirmation for dematerialisation and rematerialisation are completed.

The holding in the register of members along with the pending dematerialisation and rematerialisation requests should be equal to the holding in the depository along with the pending dematerialisation and rematerialisation requests. If there is a discrepancy, the same has to be resolved between the issuer and the depository before any other activity is undertaken. The common reasons for discrepancies are requests which are in transit between the DP and the R&T agent or a communication failure between the depository and the R&T agent.

If the reconciliation cannot be done electronically due to a communication failure, the R&T agent has to send the following information by fax to the depository:

- Opening balances of NSDL's holdings and the pending dematerialisation and re materialization requests.
- Dematerialisation and rematerialisation requests received during the day in physical and electronic form.
- Dematerialisation requests that have been confirmed and credited to the depositories account.
- Dematerialisation requests rejected during the day.
- Closing balance of the holding of the depository.
- The End of Day (EoD) time as per the R&T agent.

Key Concepts

1. Transactions with a depository involve the investor, the DP, the R&T agent and the depository.
2. Dematerialisation and rematerialisation requests are initiated by the investor with the DP. The information and documents are forwarded electronically and physically to the R&T agent and the depository.
3. After cross-checking the same, the R&T completes the request with electronic and physical confirmation to the depository and the DP.
4. For dematerialisation of securities the R&T agent enters the depository as the registered holder and deletes the investor from the records. The physical securities are destroyed.
5. For rematerialisation the name of the depository is removed and the investor entered in the register of members.
6. Debits and credits are made to the beneficiary account of a seller and buyer for market and off-market trades.
7. Market trades are cleared and settled within the mechanism of the stock exchange and within the time specified for the same.
8. Inter-depository transfer of securities is possible only if the securities are available in dematerialised form on both the depositories.
9. The depository provides for a periodical download of the beneficiary holder details to the R&T Agent.
10. The issuer however can seek additional downloads from the depository by making such payment as prescribed by them.

11. Corporate actions require the movement of data between the depository, issuer/R&T and the DP.
12. Reconciliation between the records of the depository and R&T agent is an end-of day function done on a daily basis.

Quick Recap

Fill in the Blanks:

1. On dematerialisation, the name of the _____ is entered in the Register of Members.
2. Rematerialization of securities has to be completed within _____ days.
3. Debits to a beneficiary account can be initiated only on receipt of _____
4. The beneficial owner register is maintained by the _____.

State True or False:

1. The physical securities for dematerialisation along with the DRF are sent to the depository.
2. The Company has to pay stamp duty on shares that are rematerialised.
3. Credits are received automatically to a beneficiary account only if standing instructions are given by the account holder.
4. A clearing member account is the account through which the settlement of off-market trades is done.
5. Every time there is a bonus or rights issue a new ISIN is created by the depository.

Answers:

Fill in the Blanks:

1- Depository

2- 30

3- Delivery Instruction

4-R&T agent

State True or False

1- False

2-True

3-True

4-False

5-False

13 Investor Interface with the R&T Agent

The R&T agent is the focal point for all service requirements for the investor's holding in securities. If the securities are dematerialised, the depository participant is the contact point for the investor. The common service requests that investors have are:

- Transfer of ownership
- Recording change in address, bank particulars, PoA
- Issue of duplicate shares certificates
- Stop Transfers
- Transmission

Where shares are held in the physical form, the R&T agent is approached for such service requirements. For dematerialised shares, the request has to be submitted to the depository participants along with supporting documents and the request is given effect electronically. For physical shares, any service requirement would mean that the certificates along with supporting documents have to move to and from the R&T agent.

The R&T agent, therefore, needs to put in place an efficient system to receive, verify, acknowledge and dispatch documents. An Inward Register in which details of the documents received are entered is maintained by the R&T agent. The details captured include the mode of receipt (hand delivered, courier, post), the date and time of receipt and the nature of the document. Similarly, for documents going out of the R&T agent's office, an outward register is maintained in which the details are recorded.

13.1 Transfer of Securities

Securities are bought and sold either in the stock markets or on a person to person basis in 'off-market' deals. Whenever a transaction is done, it requires a transfer of ownership from the seller to the buyer. When the transaction is of physical securities, the request for transfer of ownership is sent to the R&T agent.

The procedure to be followed is as follows:

- The security along with a transfer deed duly filled in, signed by the seller and the buyer and stamped is sent to the R&T agent.
- The R&T agent verifies the signature of the transferor with the specimen signature in the records before taking up the documents for further processing.
- The transfer deed attached to the documents have to be scrutinised for the following:
    - Validity of the transfer deed and signature of the prescribed authority.
    - The transfer deed is considered valid if it is presented within one year of the date of presentation to the prescribed authority or commencement of book closure, whichever is later.
    - Details of the securities such as folio number, certificate number, and distinctive numbers are correctly filled in.
    - Consideration amount is filled and the deed is stamped.

- The date of execution of the transfer deed is after the date of presentation and the transfer deed has been correctly witnessed.
- The certificate and transfer deed should comply with SEBI's norms for good delivery.
- The transferor(s) signature tallies with the master.

The documents have to be returned to the transferee if there is any objection within a period of 7 days from receipt of documents. If all the documents are in order, then the transfer should be effected. The register of members should be updated and the details of the transferee should be endorsed on the certificate.

The certificates should be sent to the transferee within a period of 30 days from the date of receipt of documents for transfer.

13.2 Recoding Change in Investor Information

Personal information of the investor such as address and bank details are maintained by the issuer/R&T agent. Any change in the information will have to be intimated and the records modified accordingly.

Change in Address

A request for change of address should be signed by all the holders and attested by the holders' bank. The request for change should be supported by attested copies of proof of identity (driving license, passport, PAN card and the like) and proof of new residence (front

and back pages of the ration card, property agreement, latest electricity/telephone bills, passport and the like).

The R&T agent will verify the signature with the specimen signature, scrutinize the documents and if found in order will update the records with the new information. The intimation of the change will be sent to the new and old address of the investor.

Change in Bank Account

The request for change in bank details must be accompanied by a letter from the banker attesting the security holder's signature and address. After verifying the signature with the specimen, the R&T agent will update the records with the new information and intimate the investor of the same.

Registering a Power of Attorney (PoA)

The R&T agent has to verify the signature of the security holder on receipt of the document. If it tallies, then the details of the holder and the attorney should be recorded in a register maintained for this purpose and allot a serial number. The signature of the attorney should be scanned and maintained. The holder and the attorney should be informed that the PoA has been registered and the serial number allotted.

13.3 Issue of Duplicate Share Certificate

If a share certificate is lost the holder can apply to the R&T agent for a duplicate certificate. The holder must intimate the R&T agent of the loss following which a 'Stop Transfer' will be marked on the lost

securities. The investor is required to file an FIR and furnish the proof to the R&T agent within 15 days

Where securities were lost in transit before transfer of ownership, the transferee is required to provide proof of purchase such as the contract note if the shares were purchased from a stock exchange. If the shares were purchased in an 'off-market' deal, the claimant is required to ask the security holder to apply for a duplicate share certificate and also a fresh transfer deed for transferring the securities.

The claimant has to furnish a bond and surety along with an affidavit notarised by a notary public or first class magistrate. If the value of the security is above a specified limit, the claimant is also required to advertise the loss of security in the gazette and/or in a newspaper.

The R&T agent will verify the documents and send it to the issuer for approval. On receipt of the same, the duplicate certificate will be issued with "Duplicate certificate issued in lieu of certificate no._____" printed on it. The stamp duty, as applicable, has to be paid on it. The process has to be completed within a period of 45 days from receipt of all the documents. The stock exchange where the shares are listed will also be informed of the loss of certificate and issue of duplicate certificates.

13.4 Stop Transfers

A security holder can request the R&T agent to effect a "Stop Transfer" against securities that have been lost. The R&T agent will give effect to this if the request is accompanied by an FIR,

acknowledged copy of police complaint or restraining order from the court.

If these documents are not submitted within 30 days from the date of notice of loss to the R&T agent, the direction to 'stop transfer' will be removed. If the holder of the security requests removal of a 'stop transfer' direction, the R&T agent will give effect to the same after verifying the signature of the holder. The removal of the direction will be communicated to the holder by the R&T agent.

If the R&T agent receives a document for a service request against which a 'stop transfer' direction has been effected, the R&T agent must intimate the holder of the same and process the request only with the holder's approval.

If the documents to support the 'stop transfer' directive have not been received by the R&T agent within a period of 15 days from informing the holder about the receipt of documents, the R&T agent can process the request subject to the documents lodged being in order.

If the supporting documents are received, then the request should not be processed and the photocopy of the original document has to be sent back to the lodger. If documents sent by the R&T agent are not received by the holder, the agent has to intimate the stock exchange of this and effect a 'stop transfer' on the securities.

13.5 Transmission

On the death of a security holder, the surviving holders may apply for a deletion of the name of the deceased holder and transmission of the securities to the surviving holders. The request has to be submitted to the R&T agent along with the share certificates and a certified true copy of the death certificate.

On receipt of the same, the R&T agent will verify the documents, delete the name of the deceased holder and update the register of members and send the certificate to the new first holder. If the deceased security holder had registered a nomination, then the nominee can apply for the transmission of shares to his name. This should be supported by a certified true copy of the death certificate and documents to prove the identity of the nominee.

After verifying the documents, the R&T agent will seek the approval of the issuer before giving effect to the transmission. This involves updating the register of members with the information of the nominee and scanning the signature of the nominee for the records before sending the share certificate to the new holder.

Where a request for transmission is received by the R&T agent for securities where the deceased holder was a single holder, the following steps will be taken by the R&T agent:

- Effect a 'stop transfer' on the security.
- Ask the claimant to submit documents such as probated will, succession certificate and letter of administration from the court to support the claim.

- If the value of the securities is less than a specified value, the claimant may be asked to submit an affidavit, notarised indemnity bond and a 'no-objection' certificate from other heirs, if any.

After verifying the documents and obtaining the approval of the issuer, the R&T agent will remove the 'stop transfer' on the securities, endorse the claimant as the security holder in the certificate, capture the information about the claimant including signature for the records, update the register of members and dispatch the certificate to the new holder.

The R&T agent has to give effect to the transmission within 45 days of receiving all valid documents.

Key Concepts

1. The servicing needs of the investor in terms of transfer, transposition, change of address, bank account and such are taken care of by the R&T agent if the shares are held in physical form.
2. The request along with appropriate documents such as transfer deed, affidavit or power of attorney, letter from the banker should be lodged with the R&T agent.
3. The period within which a request has to be serviced is laid down by SEBI.
4. The R&T agent must put in place an efficient system for managing receipt and dispatch of documents.
5. A transfer request should be accompanied by a valid completed stamped transfer deed.
6. A request for a change in the personal information of the investor recorded with the R&T agent should be accompanied by proof of identity and relevant documents supporting the change.
7. An investor can ask for a 'Stop Transfer' on shares if they are lost. Subsequently, a request for a duplicate share certificate accompanied by necessary documents can be made.
8. A transmission request is made to remove the name of a deceased holder and replace it with the names of the heirs/claimants.

Quick Recap

Fill in the Blanks

1. The date of execution of a transfer deed should be _____ the date of presentation to the prescribed authority.
2. Issue of duplicate certificates in place of lost ones have to be completed within_____ days.
3. In case of loss of certificate subsequent to an off-market deal, the request for issue of duplicate has to be made by the _____.
4. The details of the transferee are endorsed on the _____
5. On registering a PoA, the R&T agent allots a _____.

State True or False

1. In a transfer request the R&T agent will have verify the signature of only the transferor with their existing records.
2. A request for change of address needs to be signed by the first holder only.
3. Transmission of shares is possible only if there are multiple holders.
4. A transfer deed that does not have the consideration amount filled is not considered bad delivery.
5. A nominee can ask for a transmission of shares to his name.

Answers:

Fill in the Blanks:

1- After

2- 45

3-Transferor/Holder

4- Share certificate

5- Serial number

State True or False:

1- True

2-False

3-False

4- False

5-True

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A company issues securities for the first time to different classes of investors in the primary markets. An Initial Public Offer (IPO) or a Follow-on Public Offer (FPO) is an offer of shares to the public at large while a private placement of shares is an offer made to a select group of investors such as financial Institutions, mutual funds, group companies and the like.

The proceeds of shares sold in the primary market go to the company and it increases the share capital of the company. The only exception to this is the offer for sale of shares in the primary market where the proceeds go to the person(s) making the offer and not to the company.

Once the shares are issued, they may be traded among investors. This market for trading in securities that have already been issued is called the secondary market for securities. In the secondary market, the securities are purchased from other investors rather than from the issuer. The proceeds of the transaction go to the selling investor and not to the issuing company.

The need for a secondary market in securities arises because of the important role it plays in the several ways.

Providing a mechanism for price discovery

The investors in a stock would buy and sell the share depending upon their estimation of the value of the stock. The estimation that

the investor makes takes into consideration all the information available which will impact the performance of the company. When many investors evaluate a stock, it is possible to arrive at the appropriate price for the stock.

Providing a mechanism for dissemination of information

Determining the price of a stock would depend on the quality and timeliness of the information that the investor has to evaluate. An efficient secondary market will provide the way for periodic, relevant and timely information to reach the investors.

Providing liquidity

Investors who have bought securities may want to exit the investment. A secondary market provides a way for the investor to find buyers at prices that reflect the valuation of the stock and are acceptable to them. The efficiency of a secondary market lies in enabling this in a cost-effective way.

14.1 Stock Markets

The organised secondary market for securities is called a stock market. The principal stock exchanges in India are the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE).

A stock market will have the following features:

- It will be regulated by the regulator of capital markets in the country. In India the stock exchanges are regulated by SEBI.
- It will provide a platform for trading, clearing and settlement of trades.

The principal features of a stock exchange are:

- Trading Platform – The main stock exchanges in India now facilitates screen based trading from member offices around the country. The trading system provides for anonymous trades and price-time priority in the prices at which trades are done.

  This basically means that trades are executed at the best price (lowest if the investor is buying and highest if the investor is selling) at a given point of time. The system also allows options for the investor to structure the trade in terms of the period of validity of the order, the manner in which the order will be filled and the like.

- Clearing and Settlement System- The stock exchange provides facilities of a clearing corporation whose function it is to identify the net trade obligations of each party and what each party is owed for trades done in terms of securities and funds. The clearing corporation also stands guarantee for the trades done on the exchange.

Trading in dematerialised securities through a depository- Stock exchanges like the NSE and the BSE trade in dematerialised securities. Trading in dematerialised securities has the advantages of:

- Quicker settlement
- Elimination of threat of loss of certificates
- Elimination of bad deliveries through fake certificates, mutilation and the like.

- Ease of transactions such as transfer, nomination
- Lower costs of transactions as stamp duty is not applicable

Stock exchanges enrol and regulate members and institutions which are allowed to participate in the markets. It will set guidelines for the conduct of transactions in securities and the conduct of members through the prescription of bye-laws for membership, capital, and conduct of members.

14.2 Participants in the stock markets

The participants in a stock market process are

- Investors
- Intermediaries
- Companies

Investors

Investors come to the stock exchange to buy and sell securities. SEBI's regulations permit Resident investors, Non-resident Indians, Corporate bodies, Trusts, FIIs who are registered with SEBI, among others, to invest in stock markets in India. Foreign citizens and overseas corporate bodies are prohibited from investing in Indian securities markets.

Investors cannot directly trade on the stock market. They have to go through intermediaries called brokers. Brokers are members of the stock exchange. The investors have to open a trading account with the broker. They are required to comply with the "Know your

Customer" (KYC) norms. This seeks to establish the identity and bona-fides of the investor.

Investors will also need to open a beneficiary account with a depository participant (DP) to be able to trade in dematerialised securities. This account will hold the shares which the investor will buy and sell.

Once the formality of account opening is done, investors can put through their transactions through their broker's terminal. The trades have to be settled, i.e. securities delivered/received and funds paid out/received, according to the settlement schedule (currently T+2) decided by the exchange. Investors have to give instructions to the DP to transfer securities from their account to that of the broker who is also a clearing member. Or give standing instructions to receive securities if they have bought shares. Similarly, they have to ensure that funds are available in their bank account to settle for shares they have bought.

Brokers

Intermediaries in the secondary market process include brokers and depository participants. Brokers are members of a stock exchange who are alone authorised to put through trades on the stock exchange. Brokers may be individuals or institutions who are registered with SEBI and meet the respective stock exchange's eligibility criteria for becoming a member of the exchange.

The stock exchange will specify minimum eligibility requirements such as base capital to be collected from the member brokers which are in line with SEBI's regulations on the same. The exposure that a

broker can take in the market will be a multiple of the base capital that is deposited with the exchange.

DPs

Depository participants are associates of a depository through whom the investor will hold the beneficiary account of the investors to enable them to trade in dematerialised shares.

The SEBI (Depository and Participants) regulations specify the eligibility requirements for a DP. Banks, financial institutions, brokers, custodians, R&T agents, NBFCs among others are eligible to become DPs. Apart from this, the DPs are required to have minimum net worth as specified by the regulations. This could range from Rs 10 Crore for R&T agents who are DPs to Rs 50 Crore for NBFCs.

The DPs are responsible for executing the investor's directions on delivery and receipt of shares from their beneficiary account to settle the trades done on the secondary markets.

14.3 Listing of Securities

Companies list their shares on the stock exchange and they are bought and sold by investors using the mechanism of the stock exchange. A company has to meet certain eligibility requirements to be able to list its shares on a stock exchange. These include:

- Minimum continuous public holding of 25% of total number of issued shares of every class of security listed. The public shareholding can be 10% for those classes of shares where

there at least 20 lakh shares outstanding and the market capitalisation is at least Rs 100 Crore or where shares have been issued according to Sec 19(2)b of the SCRA.

- The post-issue paid up capital shall not be less than Rs 10 Crore and the market capitalization shall not be less than Rs 25 Crore.
- The company/ promoters have a three year track record.
- The memorandum and articles of association of the company must be approved by the stock exchange and contain the relevant provisions required by the SCR Act.
- The requirements are :
  - Dividends will not be forfeited unless time-barred
  - A common transfer form will be used
  - Transfer of shares will not be denied on account of any obligation of the investor to the issuer
  - That the fully paid-up shares will be free of lien
  - The draft prospectus will be approved by the stock exchange as to its compliance with the Exchange's listing requirements

The Company signs the listing agreement with the stock exchange which lays down the obligation of the company with regard to its investors. The primary requirements in the agreement are:

- The issuer will give the stock exchange due notice of meetings of board of directors where corporate actions such as dividends, bonus, buyback, rights issue and the like is to be considered.

- The proceedings of the meeting will also be intimated to the exchange within 15 minutes of the closure of the meeting.
- The issuer will ensure flow and dissemination of information by providing the exchange copies of the balance sheet, the profit and loss account, all periodic and special reports, minutes of general body meetings and the like.
- The issuer will submit accounts and cash flow statements as required by the accounting standards and disclose all financial transactions with associates.
- Any information that has a bearing on the operations of the company and is price-sensitive will be disclosed to the exchange.
- The issuer will give effect to transfer of shares where all documents and formalities are in order. If there are minor discrepancies, the transfer will be done after getting the approval of the transferor.
- The issuer will undertake to maintain the minimum public share holding as required by the provisions of the SCRA.
- The company will abide with the requirements of corporate governance in terms of:
    - Composition, remuneration, operations and conduct of the board of directors
    - An audit committee that will oversee the financial aspects of the company
    - Overseeing the operations of subsidiary unlisted companies
    - Complete disclosure to the board and the audit committee on all matters that have an implication on the operations and finances of the company

The purpose of the listing agreement is to bind the company to a contract which will take care of the public investor's interest. The company pays an annual listing fee to the exchange to have its shares listed and traded on the exchange.

Key Concepts

1. Shares issued in the primary market, with the exception of an offer for sale, results in an increase in the share capital of the company.
2. The secondary market is the market for trading in shares already issued by the company.
3. Secondary markets provide a facility for better price discovery, dissemination of information and liquidity.
4. An organised secondary market is called a stock exchange and it provides facilities for trading, clearing and settlement.
5. A company has to get itself listed on a stock exchange before its shares can be traded on the stock market.
6. The company has to abide by the clauses of the listing agreement that aims to protect the interests of the investors buying the shares on the secondary market.

Quick Recap

Fill in the Blanks

1. 1.The proceeds of the trades done on the secondary market goes to the _____
2. _____ stands guarantee for trades done on the stock exchange.
3. Stock markets are regulated by _____
4. The trading and settlement cycle is decided by _____
5. The minimum public shareholding requirement is specified by _____

State True or False

1. Investors cannot directly access the stock markets for trading.
2. The KYC norms are optional formalities imposed by some market participants to protect themselves.
3. An investor cannot have a trading and beneficiary depository account with the same broker.
4. The draft prospectus is vetted by the stock exchange where the shares are proposed to be listed to ensure that the listing norms are met.
5. Minimum public shareholding is defined in the interest of liquidity

Answers:

Fill in the blanks:

1- Seller

2-Clearing corporation

3-SEBI

4-Stock exchange

5- SCR Act

State True or False:

1-True

2-False

3-False

4-True

5-True

List of Abbreviations

ADR	American Depository Receipt
AMC	Asset Management Company
ASBA	Application Supported by Blocked Amount
AUM	Assets Under Management
BRLM	Book Running Lead Manager
BSE	Bombay Stock Exchange
CAN	Confirmation of Allotment Notice
CB	Controlling Branch
CBLO	Collateralized Borrowing Lending Obligation
CD	Certificate of Deposit
CoA	Change of Address
CoB	Change of Bank
CP	Commercial Paper
CSDL	Central Securities Depository Limited
DB	Designated Branch
DIS	Delivery Instruction Slip
DP	Depository Participant
DR	Depository Receipt
DRF	Dematerialisation Request Form
DRN	Dematerialisation Request Number
FCCB	Foreign Currency Convertible Bond
FCD	Fully Convertible Debenture
FCNR	Foreign Currency Non Resident
FEMA	Foreign Exchange Management Act
FI	Financial Institution
FII	Foreign Institutional Investor
FPO	Follow-on Public Offer
GDR	Global Depository Receipt
GSO	Green Shoe Option

HNI	High Net worth Individual
IDR	Indian Depository Receipt
IEPF	Investor Education and Protection Fund
IPO	Initial Public Offer
IRDA	Insurance Regulatory Development Authority
ISC	Investor Service Centre
ISIN	International Securities Identification Number
KIM	Key Information Memorandum
KYC	Know Your Customer
MoA	Memorandum of Association
NAV	Net Asset Value
NBFC	Non Banking Finance Company
NFO	New Fund Offer
NSDL	National Securities Depository Limited
NSE	National Stock Exchange
OCB	Overseas Corporate Bodies
PCD	Partially Convertible Debenture
PDC	Post- dated Cheque
PMLA	Prevention of Money Laundering Act
PoA	Power of Attorney
QIB	Qualified Institutional Buyer
QIP	Qualified Institutional Placement
R&T	Registrar and Transfer
RBI	Reserve Bank of India
RoM	Register of Members
RRF	Rematerialisation Request Form
SA	Stabilizing Agent
SCCB	Self Certified Syndicate Bank
SCRA	Securities Contract Regulation Act
SEBI	Securities and Exchange Board of India
SI	Standing Instruction

SO	Structured Obligation
YTM	Yield to Maturity

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