SECURITIES LAWS AND COMPLIANCES
Dec. 2009
PART A

Answer 1 (a) (i)

Ans	False
Reason	Hybrid instruments are those which are created by combining the features of equity with bond, preference, shares have features of both equity and preference share capital, these are hybrid instruments.

Answer 1 (a)(ii)

Ans	False
Reason	Equity linked saving schemes have a lock in period of 3 years under Income-tax Act.

Answer 1 (a)(iii)

Ans	True
Reason	A Depository is an organization like a Central Bank where the securities of a shareholder are held in the electronic form at the request of the shareholder through the medium of a Depository Participant. In both the systems, the transfer of funds or securities happens without the actual handing of funds or securities. Both the Banks and the happens without the actual handling of funds or securities. Both the Banks and the Depository are accountable for the safe keeping of funds and securities respectively.

Answer 1(a)(iv)

Ans	False
Reason	In this system the investors through the member brokers of the exchange are able to buy or sell all 30 scrips of sensex in one go in the proportion of their respective weights in the sensex. The investors can also create their own baskets by deleting certain scripts from 30 scrips in the sensex.

Answer 1(a)(v)

Ans	True
Reason	Hedge funds employ their funds for speculative trading where they buy shares whose prices are likely to rise and sell shares whose prices are likely to dip.

Answer 1(b)

(i) Direct and indirect control of virtually all aspects of securities trading is provided by **Securities Contract (Regulation) Act, 1956**.

(ii) Tracking stock is a type of common stock that 'tracks' depending on **financial performance of a specific business unit or operating division**.

(iii) CAMEL model encompasses **Capital adequacy, Asset quality, Management Earning & Liquidity.**

(iv) As per SEBI regulations, capital adequacy requirement for merchant banker shall be a net-worth of not less than Rs. **5 Crores.**

(v) **Special Margins** are imposed on the scrip which witness abnormal price/volume movements.

Answer 2(a)(i) Corporate Restructuring

Corporate Restructuring is a comprehensive process, by which a company can consolidate its business operations' and strengthen its position for achieving its short-term and long-term corporate objectives. The restructuring could be undertaken by any entity or business unit, whether it is run as a sole proprietorship or partnership or society or in any other form of organization.,

Answer 2(a)(ii) Trade to Trade

If a scrip is shifted on a Trade-to-trade settlement basis, selling/buying of shares in that scrip would result into giving/taking delivery of shares at the gross level and no intra day settlement/netting off/ square off facility would be permitted. The scrips which form part of 'Z group' are compulsorily settled on a trade to trade settlement basis. In addition to that surveillance department transfer various scrips from time to time on a trade to trade basis to contain the excessive volatility and/or abnormal volumes in the scrip.

Answer 2(a)(iii) Margin Trading

In order to enable the investors to take exposure in the market over and above the limit through their own resources, a leveraging mechanism of trading through borrowed funds has been introduced, which is called Margin Trading Facility. Margin Trading was introduced by SEBI to curb speculative dealings in shares leading to volatility in the prices of securities.

Answer 2(a)(iv) Securities Appellate Tribunal

The Central Government may, by notification establish an appellate tribunal known as Securities Appellate Tribunal (SAT) to exercise the jurisdiction, powers and authority conferred on such tribunal under the SEBI Act, .1992. The Central Government has set up a Tribunal at Mumbai. Any person aggrieved by the order to the SEBI may refer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter. The SAT is not bound by the Code of Civil Procedure, 1908 but is guided by the principle of natural justice and has the powers to regulate its own proceedings.

Answer 2(b)(i)

DVP- Delivery Versus Payment.

Answer 2(b)(ii)

EDIFAR - Electronic Data Information Filing and Retrieval.

Answer 2(b)(iii)

OMO - Open Market Operations.

Answer 2(c)

Real Estate Mutual Fund Scheme (REMFS) means a mutual fund scheme that invests directly or indirectly in the real estate assets or other permissible assets in accordance with SEBI (Mutual Fund) Regulations, 1996. Some of the salient features of
REMFS are follows:

(i) Existing Mutual Funds are eligible to launch real estate mutual funds if they have adequate number of experienced key personnel/directors.

(ii) Sponsors seeking to set up new Mutual Funds, for launching only real estate mutual fund schemes, shall be carrying on business in real estate for a period not less than five years.

(iii) Every real estate mutual fund scheme shall be close-ended and its units shall be listed on a recognized stock exchange.

(iv) Net asset value (NAV) of the scheme shall be declared daily.

(v) Each asset shall be valued by two valuers, who are accredited by a credit rating agency, every 90 days from the date of purchase. 'Lower of the two values shall be taken for the computation of NAV.

(vi) Caps will be imposed on investments in a single city, single project, securities issued by sponsor/associate companies etc.

(vii) A real estate mutual fund scheme shall not undertake lending or housing-finance activities.

(viii) There are specific accountings and valuation norms, pertaining to Real Estate Mutual Fund scheme.

Answer 3(a)(i) Corporate Governance

Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable 'development of all stakeholders.

Good Governance in capital market has always been high on the agenda of SEBI.

Corporate governance is looked upon as a distinctive brand and benchmark in the profile of Corporate Excellence. This is evident from the continuous updation of guidelines, rules and regulations by SEBI for ensuring transparency and accountability.

Answer 3(a)(ii) Financial Disclosure

One of the major responsibilities of the board of directors is to ensure that shareholders and other stakeholders are provided with high-quality disclosures on the financial and operating results of the entity. Almost all corporate governance require the board of directors to provide shareholders and other stakeholders with information on the financial and operating results of a company to enable them to properly understand the nature of its business, its current state of affairs and how it is being developed for the future. The quality of financial disclosure depends significantly on the robustness of the financial reporting standards on the basis of which the financial information is prepared and reported.

Answer 3(a)(iii) Rolling Settlement

Under rolling settlements, unlike the "account period settlements", the trades done on a particular day are settled after a given number of business days instead of settling all trades done during an 'account period' of a week or fortnight. In case of Rolling Settlements, pay-in and pay-out of both funds and securities is completed on the same day. Each trading day is considered as a trading period and trades executed during the day are settled to obtain the net obligations for the day in a rolling settlement.

Answer 3(b) Treasury Bills

Treasury Bills are money market instruments to finance the short term requirements of the Government of India. These are discounted securities and thus pre issued at a discount to face value. The return to the investor is the difference between the maturity value and issue price. In the short term, the lowest risk category instruments are the treasury bills.

Features of Treasury Bills

(a) The treasury bills are issued in the form of promissory note in physical form or ' by credit to Subsidiary General Ledger (SGL) account or Gilt account in dematerialized form.

(b) Bids for Treasury bill are to be made for a minimum amount of RS.25000/- only' and in multiples thereof.

(c) All entities registered in India like Banks, Financial Institutions, Primary Dealers', Firms, Companies, Corporate Bodies, Partnership Firms, Institutions, Mutual Funds, Foreign Institutional Investors, State Governments, Provident Funds Trusts, Research Organizations, Nepal Rashtra bank and even individuals are eligible to bid and purchase Treasury bills.

(d) The treasury bills are repaid at par on the expiry of their tenor at the office of the Reserve Bank of India.

(e) All the treasury Bills are highly liquid instruments available both in the primary and secondary market.

(f) For treasury bills the day count is taken as 365 days for a year.

(g) The yield of a Treasury bill is calculated as per the following formula:

$$Y = \frac{(100 - P) \times 365 \times 100}{P \times D}$$

Answer 3 (c)(i) BOLT

BSE on-line-Trading (BOLT) is the modern trading practice introduced by the Bombay Stock Exchange. Under this arrangement, trading can be carried out by member-brokers and their authorized assistants from their workstations. It provides for a search based trading mechanism whereby two-way quotes are accepted from jobbers and Market Makers and from brokers on' the basis of orders received from investors. The system matches them according to the logic specified in BOLT.

Answer 3(c)(ii) NEAT

'National Exchange for Automated Trading (NEAT) which is the sophisticated fully automated screen based trading system operated by NSE, which is order driven without trading intermediaries to quote buy or sell prices of stock as an inducement. The systems matches the orders received and executed on a price time priority basis systematically. The orders are entered combining time, price and quantity conditions.

Answer 4(a)(i) Naked debentures

Debentures of this kind do not carry any charge on the assets of the com holders of such debentures do not therefore have the right to attach particular property by way of security as to repayment of principal or interest.

Secured debentures

Debentures that are secured by a mortgage of the whole or part of the assets of the company are called mortgage debentures or secured debentures. The rnortgage may be one duly registered in the formal way or one which is secured by the deposit of title deeds in case of urgency.

Answer 4(a)(ii) Industrial Revenue Bonds

Industrial revenue bonds are issued by financial institutions in connection with the development or purchase of industrial facilities. The bond proceeds could be used to purchase or a construct facilities which are subsequently leased or sold to the company.

Commodity Bonds

Commodity bonds are bonds issued to share the risk and profitability of future commodity prices with the investor. For example, petro bonds, silver bonds, gold bonds and coal bonds.

Answer 4(a)(iii) Indexed Rate Notes

In Indexed rate notes, the interest rate fixation is postponed till the actual date of placement, rather than fixing it on the date of the commitment. The interest rate is computed on the date

of take down at the then prevailing private placement rates, using a formula based on the index such as the 182 days treasury bill yield rates.

Extendable Notes

Extendable notes are issued for 10 years with flexibility to the issuer to review the interest rate every two years. The interest rate is adjusted every two years to reflect the then prevailing market conditions by trying the interest rate to a spread over a bond index such as two years treasury notes. However, investors have a put option at par' value every two years i.e. they have the right to sell the bond to the issuer at a fixed rate on the expiry of every two years.

Answer 4(b)

Risks involved in Mutual Funds

(i) Excessive diversification of portfolio, losing focus on the .securities of the key segments.

(ii) Too much concentration on blue-chip securities which are high priced and which do not offer more than average return.

(iii) Necessity to effect high turnover through liquidation of portfolio resulting in large payments of brokerage and commission.

(iv) Poor planning of investment with minimum returns.

(v) Unresearched forecast on income, proms and government policies.

(vi) Fund managers being unaccountable for poor results.

(vii) Failure to identify clearly the risk of the scheme as distinct from risk of the market.

Answer4(c) Dematerialisation

Dernaterlalisation is a process by which the physical share certificate of an investor are taken back by the Company and an equivalent number the account in electronic form at the request of the investor. An investor will have to first open an account with a Depository Participant and then request for the dematerialization of his share certificates through the Depository Participant holdings can be credited into account.

Benefits of Dematerialisation

- Elimination of bad deliveries
- Elimination of all risks associated with physical certificate
- Immediate transfer and registration of securities
- Faster disbursement of non-cash corporate benefits like rights, bonus etc.
- Reduction in handling of huge volumes of paper and periodic status reports.

Answer 5(a) Functions of Price Monitoring

The functioning of the Price Monitoring is broadly divided into following activities:

(i) 'On-line Surveillance System generates the alerts on-line, in real time, based on certain present parameters like price and volume variations in scrips etc.

(ii) Off-line Surveillance System comprises of the various reports based on different parameters and scrutiny thereof.

(iii) Derivative Market Surveillance focus on abnormal fluctuation, Market Movement, Member Concentration and Closing Price Manipulation.

(iv) Investigations conduct in-depth investigations analysis made into trading of the scrips.

(v) Surveillance Actions includes Special Margins, Reduction of Circuit Filters and Circuit Breakers, Trade to trade, Suspension of a scrip, Warning to members, Imposition of penalty/Suspension/Deactivation of terminals.

(vi) Rumor verification and proactive measures.

Answer 5(b)

The Procedure for buy back through purchase in open market at stock exchange is as follows:

(i) In the special resolution or Board resolution passed for buy-back through stock exchange, the maximum price at which the buy-back shall be made should be specified.

(ii) Promoters or persons in control are not permitted to offer their securities.

(iii) The company should appoint a merchant banker and make a public announcement containing necessary disclosures, at least 7 days prior to the commencement of buy-back. A copy of the same should be filed with SEBI within 2 days of such announcement along with the required fees.

(iv) The buy-back shall be made only on stock exchanges having nationwide trading terminals and electronic trading facility.

(v) The buyback of shares shall be made only through order matching mechanism except 'all or none' order matching system.

(vi) The company and the merchant banker. is required to submit the information regarding buy back to the stock exchange on a daily basis and publish the said information in a national daily on a fortnightly basis and every time when an additional five per cent of the buy back has been completed.

(vii) The identity of the Company as a purchaser shall appear on the electronic screen when the order is placed.

Answer 5(c) Norms for registration as Portfolio Managers

The requirements to be satisfied by the applicant for getting the certificate of registration as mentioned in Regulation 6 of SEBI (Portfolio Managers) Regulations, 1993 are as follows:

(a) the applicant IS a body corporate;

(b) the applicant has the necessary infrastructure and fulfills the capital adequacy requirement;

(c) the principal officer of the applicant has the professional qualifications in finance, law, accountancy or business management from an institution recognized by the Government;

(d) the applicant has in its employment minimum of two persons who, between them, have at least five years experience as portfolio manager or stock broker or investment manager or in the areas related to fund management;

(e) The applicant, director and its principal officer or the employees state above is not involved in any litigation connected with the securities market which has an adverse bearing on the business of the applicant and has not at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence;

(f) No previous application for grant of certificate made by any person directly or indirectly connected with the applicant has been rejected by the Board;

(g) No disciplinary action has been taken by the Board against a person directly or indirectly connected with the applicant under the Act or the Rules or the Regulations made there under;

(h) The applicant is a fit and proper person;

(i) Grant of certificate to the applicant is in the interests of investors.

Answer 6(a)(i) Domestic Custodian Bank

This is a banking company which acts as custodian for the ordinary shares or Foreign Currency Convertible Bonds of an Indian Company, which are issued by it. The domestic custodian bank functions in co-ordination with the depository bank. When the shares are

issued by a company the same are registered in the name of depository physical possession is handed over to the custodian. The beneficial interest in respect of such shares, however, rests with the investors.

Answer 6(a)(ii) Global Depository Receipts

It is a form of depository receipt of certificate created by the Overseas Depository Bank outside India denominated in dollar and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company. In simple words, it is basically a negotiable instrument denominated in US dollars. It is traded in Europe or the US or both. GDR is traded like any other dollar denominated security in the foreign markets.

Answer 6(a)(iii) Overseas Depository Bank

It means a bank authorized by the issuing company to issue Global Depository Receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company. In case of redemption of Global Depository Receipts, Overseas" Depository Bank shall request the Domestic Custodian Bank to get the corresponding nderlying shares released in favour of the non-resident investor, for being sold directly on behalf of the non-resident, or being transferred in the books of account of the issuing company in the name of the non-resident.

Answer 6(b) Conditions for Voluntary Delisting of Securities

(i) Company shall not use the buy-back method to delist its securities.

(ii) The amount of consideration shall be settled in cash. The payment of consideration for delisting of securities shall be paid in cash by the promoter or . acquirer.

(iii) In case of partly paid-up securities, the price determined by the book building process shall be applicable to the extent the call has peen made and paid.

(iv) In the case of infrequently traded securities, the offer price and infrequently traded shares shall be determined in the manner explained under SEBI Takeover Regulations.

(v) The promoter may not accept the securities at the offer price determined by the book building process.

(vi) When a company, which is listed on any stock exchange or stock exchanges other than BSE or NSE (i.e., the stock exchanges having nationwide trading terminals), seeks delisting, an exit offer shall be made to the shareholders.

(vii) Before making application for delisting, the promoters or the acquirers of the company shall make a public announcement.

Answer6(c)

Pre-marketing exercise is a tool through which the syndicate members evaluate the prospects of the issue. This is normally done closer to the issue. The research analysts along with the sales force of the syndicate members meet the prospective investors ring pre-marketing road shows. This enables the syndicate members to understand market and the probable response from the prospective investors. The pre-marketing exercise helps in assessing the depth of investors' interest in the proposed issue, their about the valuation of the share and the geographical locations of the investors are interested in the issue. The response received during pre-marketing provides vital information for taking important decisions relating to timing, pricing and size of the issue. This would also help the syndicate members in evolving strategies for market the issue.

Answer 6(d) Access to External Commercial Borrowings (ECB) under Automatic Route

1. Corporates (registered under the Companies Act except financial intermediaries (such as banks, financial institutions (Fls), 'housing finance companies a NBFCs) are eligible to raise ECB. Individuals, trusts and non-profit organization are not eligible to raise ECB.
2. Non-Government Organizations (NGOs) engaged in micro finance activities are eligible to avail ECB. Such NGO should have a satisfactory borrowing relations' for at least 3 years with a scheduled commercial bank authorized to deal in foreign exchange and require a certificate of due diligence on 'fit and proper' status of the board/committee of management of the borrowing entity from the designated Authorized Dealer (AD) bank.
3. Units in Special Economic Zones (SEZ) are allowed to raise ECB for their own requirement. 'However, they cannot transfer or on-lend ECB funds to sister concerns or any unit in the Domestic Tariff Area. .

Answer 7(a)

Provisions of SESI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003

Regulation 3 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003 prohibits certain dealings in securities and provides that no person shall directly or indirectly:

(i) Buy, sell, or otherwise deal in securities in a fraudulent manner;

(ii) Use or employ, in connection with issue, purchase or sale of any security listed or proposed to be listed in a recognized stock exchange, any manipulative deceptive device or contrivance in contravention of the provisions of the Act or the Rules or the Regulations made there under;

(iv) Employ any device, scheme or artifice to defraud in connection with dealing in or issue of securities which are listed or proposed to be listed on a recognized Stock Exchange;

(iv) Engage in any act, practice and course of business which operates or would operate as fraud or deceit upon any person in connection with any dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange in contravention of the provisions of the Act or the Rules and the Regulations made there under.

Regulation 4 of the Regulations provides that:

(i) Without prejudice to the provisions of Regulation 3, no person shall indulge in a fraudulent or an unfair trade practice in securities.

(ii) Dealing in securities shall be deemed to be a fraudulent or an unfair trade practice if it involves fraud.

Answer 7(b)

Various common grievances of investors in India are as follows:

(i) In case of any public issue, Interest on delayed refund, Allotment advice, Share certificates and revalidations in case shares are held in physical mode.

(ii) Regarding listed debentures, non-receipt of Interest due, redemption proceeds, Interest on delayed payment.

(iii) Grievance relating to shares or debentures in unlisted companies.

(iv) Grievance relating to Deposits in collective investment schemes like plantations etc. and Units of Mutual Funds; Fixed Deposits in Banks and Finance Companies and Manufacturing companies.

In respect of the grievances of investor, complaints can be lodged with the Registrar of Companies, Ministry of Company Affairs, Stock Exchange or SEBI as the case may be and in certain cases, they can be pursued with the Company Law Board also to obtain remedies and relief. Investor Grievance Centres .have been set-up in .every recognized stock exchange which takes up all complaints regarding the trades effected in the exchange and the relevant member of the exchange. Moreover, two other avenues are always available to the investors to seek redressal of their companies i.e., companies with Consumers Disputes Redressal Forum and Suits in the Court Of Law.

Answer 8(i) Permanent Account Number (PAN)

PAN is the sole identification number for all participants in 'the securities market with an alpha-numeric prefix or suffix to distinguish a particular kind of account.

In order to strengthen the Know Your Client (KYC) norms and identify every participant in the securities market with their respective PAN thereby ensuring sound audit trail of all the transactions. PAN has been made the sole identification number for all participants transacting in the securities market, irrespective of the amount of transaction.

It is mandatory for the transferee(s) to furnish copy of PAN card to the Company/ RTAs for registration of transfer of shares in physical form for securities market transactions and off-market/private transactions involving transfer of shares in physical form of listed companies

Answer 8(ii) Investor Education and Protection Fund (IEPF)

Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001 (IEPF Rules) stipulate the activities related to investors' education, awareness and protection for which the financial sanction can be provided under IEPF.

Activities undertaken by IEPF include: educating and creating awareness among investors through Voluntary associations or organizations registered under IEPF; Educating investors through Media, conducted panel discussions on DO (Delhi, Mumbai, Kolkata, Chennai and Ahmedabad), Telecast of TV Video spots on DO & private channels, print advertisement in national as well as regional newspapers. All these programmes have been undertaken in Hindi, English and Regional languages; Organizing seminars and workshops through associations, registered under IEPF; Financing research projects pertaining to Investor education, awareness and coordinating with institutions engaged in investor education, awareness.

Answer 8(iii) Regulatory Framework of Debt Market in India

Issue and listing of non-convertible debt securities, whether issued to the public or privately placed, are required to be made in accordance with the provisions of the SEBI (Issue and Listing of Debt Securities) Regulations, 2008.

Issue of debt securities that are convertible, either partially or fully or optionally into listed or unlisted equity shall be guided by the disclosure norms applicable to equity or other instruments offered on conversion in terms of SEBI (DIP) Guidelines, 2000 (Now ICDR Regulations).

SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 deals with public offers of securitised debt instruments or to listing of securitized debt instruments issued to public or any person(s), on a recognized stock exchange.

Continuing with rationalization of disclosure norms for listing of debt issuances, SEBI has issued Listing Agreement for debt securities.

Answer 8(iv)

Lock-in-period requirement for promoters' contribution

Any contribution made by promoters ever and above the minimum contribution shall be subject to a lock-in-period of one year in case of all the companies. In case of the existing

listed companies, additional contribution is subject to lock-in-period of one year as per guidelines for Preferential Issue of Capital. Promoters' contribution for meeting shortfall in the firm allotment category shall also be locked-in for a period of one year.

In case of issue of securities by a company listed on a stock exchange for at least three years and having a track record of dividend payment for at least three immediately preceding years promoter's contribution shall not be subject to lock-in-period.

Answer 8(v)

Rights of Securities Holders in case of Compulsory Delisting of Securities

Where the securities of the company are delisted by an exchange, the promoter of company shall be liable to compensate the security-holders of the company by paying them the fair value of the securities held by security-holders and acquiring their securities. However, security holders shall be given an option to remain security-holders with the company. The person appointed by the Stock Exchange out of a panel of experts, which shall also be selected by the Stock Exchange shall determine fair value, having regard to the factors mentioned in the Takeover Regulations.